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Friday, 2 September 2022

Assistant Secretary
Corporate and International Tax Division
The Treasury
*Via email: MNETaxIntegrity@treasury.gov.au*

Dear Assistant Secretary,

The American Chamber of Commerce in Australia (AmCham) is writing in response to the Consultation Paper – *Government election commitments: Multinational tax integrity and enhanced tax transparency* released to the public for consultation and comment on Friday, 5th August 2022.

AmCham notes the introductory comments at page 4 of the Paper, that the changes contemplated:

> *…seek to target activities deliberately designed to minimise tax, while also considering the need to attract and retain foreign capital and investment in Australia, limit potential additional compliance cost considerations for business, and continue to support genuine commercial activity.*

AmCham is concerned that the proposals are largely unnecessary given the raft of existing measures available to the Australian Taxation Office (ATO) to combat and discourage multinational tax avoidance practices and as such they could operate as a disincentive to attracting much needed direct foreign investment into Australia. While not wholly endorsing the need for the measures described in the proposal, our submissions seek to strike a balance between the competing policy objectives set out above.

**Background**

The Chamber was founded in 1961 by Australian and American businesses to encourage the two-way flow of trade and investment between Australia and the United States, and to assist its members in furthering business contacts with other nations. AmCham is Australia's largest and most active international chamber of commerce, representing some of America's most significant companies operating in the Indo-Pacific region, as well as start-ups and SMEs. In pursuing its purpose, the Chamber has found itself not only representing the United States' business view, but also speaking increasingly for a broad range of members involved in the Australian business community.

The US-Australia alliance is underpinned by core common values including the rule of law, transparency, hard work and fair play.

AmCham National Partners

AmCham Premium Members

The relationship has provided an immense benefit to Australia – including new jobs, higher wages, elevated productivity, market access, capabilities, intelligence, interoperability, research and development, trade and investment, cultural ideas, and exchanges of people.

The current two-way trade and investment relationship between our countries is valued at almost $2 trillion. US trade and investment in Australia in 2019 accounted for $131 billion or 7% of Australia's GDP, roughly equivalent to the mining sector. Over a quarter of all foreign investment in Australia comes from the United States, making it the biggest investor in our country. There are 323,000 Australians working for 1,100 US majority owned companies in Australia on a median salary above $100,000. US companies also spend $1.2 billion a year here on research and development.

**Introduction**

The Consultation Paper sets out three broad proposals on which public comment is sought:

Part 1: Multinational (MNE) interest limitation rules

Part 2: Denying MNEs deductions for payments relating to intangibles and royalties paid to low or no tax jurisdictions

Part 3: Multinational tax transparency

AmCham welcomes the opportunity to provide comment on each of these proposals on behalf of its members. Our key observations and recommendations are set out below.

**Part 1: MNE Interest Limitation Rules**

We support the Government's intentions to adopt the Organisation for Economic Co-operation and Development's (OECD) recommended approach for debt deductions as described in the Base Erosion and Profit Shifting (BEPS) Action 4 Report which also recognises that achieving an effective solution to BEPS concerns must be balanced by the need for an approach that is reasonably straightforward for groups and tax authorities to apply. We set out below our recommendations in relation to key design elements of revised thin capitalisation rules.

The Government's stated policy intention[1] is clear:

- *"From 1 July 2023 we will adopt the OECD's recommended approach for debt deductions within the allowed range to limit net interest expense to 30 per cent of profits, measured using taxable earnings before interest, taxes, depreciation and amortisation.*
- *We will ensure we are targeting tax minimisation and firms may be able to make further deductions if they can substantiate those under the arm's length test or worldwide gearing ratio test."*

In summary, the Government's stated policy intention is to replace the existing balance sheet safe harbour with an earnings-based fixed ratio safe harbour.

The fixed ratio safe harbour[2] must provide for the carry forward of disallowed interest expense and unused interest capacity in accordance with the OECD's recommended approach. Such an approach is adopted in many other countries. We would suggest an ongoing carry-forward of disallowed interest expense (consistent with the carry-forward of tax losses and deferred deductions under the hybrid mismatch rules) and a five-year carry-forward of unused interest capacity.

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[1] *Labor's Plan to Ensure Multinationals Pay their Fair Share of Tax*, Media Release, 27 April 2022

[2] Described as the "earnings-based 'safe harbour' test" in the *Consultation Paper*

This feature of the fixed ratio safe harbor is critical to reduce the impact of earnings volatility and ensure that long-term investments and start-ups are not unfairly disadvantaged by a change from a balance sheet to earnings-based approach.

In accordance with the OECD's recommended approach and the Government's stated policy, a group ratio rule would recognise that some groups are highly leveraged with third party debt for non-tax reasons. In our view, it would be logical that this test would allow an entity with a fixed ratio above the 30% safe harbour to deduct interest up to the level of net interest/EBITDA ratio of its worldwide group (with a 10% uplift buffer) and this would replace the existing debt-to-equity worldwide gearing test.

We submit that if 1 July 2023 is the committed earliest start date for the measure, that it applies to income years which commence after 1 July 2023. Having the measures start at the commencement of a new tax year will make it easier for taxpayers to manage and apply the new rules for the full income year.

In accordance with the Government's stated policy intention, the arm's length debt test should be preserved. In our view, no adjustments to the arm's length debt test are required and this is consistent with the recommendations of the Board of Taxation's review[3] and subsequent helpful ATO guidance[4]. This aspect could be monitored by the ATO to ensure that the Government's policy intent is not undermined, and any such issues brought to the attention of the Board of Taxation for review.

**Part 2: Denying MNEs deductions for payments relating to intangibles and royalties paid to low or no tax jurisdictions**

Our concerns with the proposals in Part 2 include:

**1. The measures are being proposed in an environment where the existing law already covers the mischief discussed in the Paper.**

The Consultation Paper acknowledges that there are a range of existing measures available to the ATO to counter any perceived mischief relating to structures where intangible assets are held in low tax jurisdictions. We note the following:

a. numerous disputes are currently being progressed through the Courts regarding international tax issues, (including the tax treatment of cross-border payments) which involve the application of the existing measures referred to above;
b. multiple draft rulings have been issued by the ATO regarding the characterisation of cross-border payments, including royalties, that need to be finalised; and
c. we are waiting for the domestic implementation of various international tax legislative changes, including BEPS 2.0 Pillar 1 and Pillar 2 (and we would expect that Pillar 2 in particular could solve many of the issues associated with this Consultation Paper)

We consider it is premature to be considering the additional of yet another measure to the long list of unimplemented or recently enacted tax reforms. We note that the precise scope (and interrelationship) of the many existing provisions is not currently settled. We consider there is a material risk that this new legislation will be merely duplicating one or more of the numerous existing or proposed measures in the Australian tax system which would stifle foreign investment and potentially hamper technological advancement in Australia.

[3] *Board of Taxation, Review of the Thin Capitalisation Arm's Length Debt Test* (2014)
[4] *Taxation Ruling TR 2020/4* and *Practical Compliance Guideline PCG 2020/7*

Within a tax framework that includes a General Anti-Avoidance Rule, a Multinational Anti-Avoidance Law, a specific Diverted Profits Tax, OECD compliant Transfer Pricing rules under both domestic law and in tax treaties, broad Control Foreign Corporations (CFC) rules, broad reporting (including Country by Country (CBC)) obligations), a comprehensive treaty network and anti-hybrid regime which is based on (but expands beyond) OECD recommendations, the additional work being done by the ATO regarding the tax treatment of cross-border payments related to intellectual property and proposed initiatives regarding Pillar 1 and Pillar 2, we query whether there is any real benefit of this additional proposed anti avoidance legislation.

We submit that the window for multinational taxpayers to access the mischief considered in this Paper has already been well and truly shut by the efforts of the ATO, Government law changes and the OECD Action Plan on BEPS.

In our view, the need for such rules is not strongly made, with the focus on perceived integrity issues in the existing law not fully explained. Given the range of measures available to the ATO including those referred to above, it is not readily apparent where the 'gaps' in the ATO's wide ranging powers exist.

As discussed further below, the Consultation Paper does not provide sufficient consideration of measures to avoid duplication, conflict or inconsistency between the proposed rule, existing Australian tax laws and new provisions under consideration developed by the ATO or in the OECD BEPS process. Therefore, while the Consultation Paper concludes that *"Australia's tax framework needs a specific measure targeting integrity issues associated with intangibles and royalties",* we see no basis on which this statement is supportable in the current domestic and global tax environment.

**2. We consider it is fundamentally important to include a tax avoidance purpose with a substance based carve-out as threshold requirements necessary to implement this proposed anti-avoidance rule.**

Both the mischief and the Tax Alerts referred to in the Paper (TA 2018/2 and TA 2020/1), involve transactions motivated by tax avoidance which lack economic substance. The legislative fix should similarly refer to the mischief. Comparisons with our Division 815 *Income Tax Assessment Act 1997* (ITAA 1997) transfer pricing rules are misplaced, noting the objective nature of these rules and their international application. If a tax avoidance purpose is not included as a pre-condition, then a denial of a tax deduction could potentially apply to transactions inappropriately. If the measures are to genuinely achieve their stated objective of targeting activities that are *"deliberately designed to minimise tax"* and at the same time respect and continue to support genuine commercial activity, then a workable tax avoidance purpose test, backed up by a substance based carve-out, would in our view be an essential feature of the rules.

The proposal in the Consultation Paper appears to be based on an assumption that royalty and intangible related charges are levied by foreign owners of intangible assets in order to obtain an Australian tax benefit. This assumption ignores the fact that an Australian entity making such payments is likely to be but one subsidiary in a multinational network that are making similarly structured and priced payments in order to be compliant with the arm's length principles applying in the jurisdiction of the IP owner. In many cases the IP owner will be in a country that has a double tax agreement with Australia. Again, absent a tax-avoidance purpose test in the new rules, such taxpayers would face double taxation with the one-sided denial of a tax deduction in Australia while at the same time being unable to simply turn off the payment of the royalty to the IP owner as doing so could be in breach of transfer pricing rules in the IP owner country including those of our major trading partners such as the United States.

**3. The insufficient foreign tax measure is inconsistent with the global tax discussions that are ongoing.**

While a list of options is set out in the Consultation Paper, their relevance to the proposed measure is not clear. In light of the focused anti-avoidance rule in Division 832 *ITAA 1997*, we consider that a defined list of low tax jurisdictions, and/or a rule that only applies where the headline corporate tax rate in the foreign country is less than 10%, are the better tests in an Australian context.

It would also be sensible to allow any payments to a jurisdiction with which Australia has an active double tax treaty to be excluded from such measures that would otherwise deny tax deductibility. It would provide certainty for treaty partners with which Australia already has longstanding relationships. It is important to principles of free trade as well as respect for Australia's international obligations and agreements, that Australia should not undermine its regard for each of its treaty partners as being a valid taxing jurisdiction. It should also go without saying that if Australia, through its pre-treaty process of national interest analysis, did not regard a foreign jurisdiction as having a sufficiently rigorous, transparent, and comparable tax system to that of Australia, the Government would not have concluded a double tax agreement with such a jurisdiction.

**4. The Consultation Paper is not a product of existing OECD guidance and is inconsistent with the Australian Labor Party's previous recommendations.**

While the Paper refers to four other regimes - being the US, UK, the Netherlands, and Germany - those regimes differ significantly from the proposals in the Consultation Paper and are much more narrowly defined. The Consultation Paper is not a product of any new OECD proposals. Rather, the Consultation Paper, if enacted as currently drafted, will result in Australia's tax legislation being out of step with international (including OECD) standards and its trading partners.

More broadly, it is difficult to see how the taxation of implicit royalties within a broader supply chain could be consistent with international tax principles and tax treaty obligations. As an example, if a supply chain operating through (say) three countries were to each impose a similar royalty withholding tax of (say) 10%, would this result in a total withholding of 30%? Which country's withholding would take priority? How would the respective foreign tax credit rules operate? This would seem to go back to a requirement that a withholding tax can only be imposed on the actual royalty otherwise double taxation would be a likely consequence and ultimately have a negative impact on trade flows.

We also note that the Consultation Paper differs from pre-election tax policy measures announced by the Australian Labor Party. Noting the current state of flux in Australian tax law and the stated policy objectives underpinning the measures described in this Consultation Paper, we query whether it is beneficial to the Australian economy and reflects an appropriate message from the Australian Government regarding foreign investment into Australia.

As an interim measure, appreciating our opening comments regarding the backlog of current measures, we would recommend referring this issue to the Board of Taxation as an intermediate step to stress test the need for reform and consider the best potential mechanism for implementation of any reform going forward.

If, after further evaluation, the Government decides to pursue this additional integrity measure, we recommend that it is narrowly focused and clearly defined, to ensure that any new measure does not adversely impact legitimate commercial arrangements.

**Part 3: Multinational tax transparency**

*a) Public reporting of tax information on a country-by-country (CBC) basis*

AmCham welcomes the discussion on tax transparency and recognises the importance of public confidence in the integrity of the tax system. As acknowledged in the Consultation Paper, there have already been a broad range of tax transparency and other BEPS related initiatives at the global level and domestically. Looking forward, the scope for MNE tax avoidance and consequential harm to public confidence will be further limited by the Pillar 1 and Pillar 2 reforms of the OECD. Any reforms should be evaluated from a forward-looking perspective that takes into account these developments.

In considering any reforms, it is important to recognise the growing complexity and potential for inconsistency from different thresholds and definitions in existing and proposed future mandatory regimes, including the OECD's CBC reporting regime, Australia's domestic implementation of those rules (and other measures) under the Significant Global Entity (SGE) threshold and proposals under Pillar 2. For example, the SGE definition can apply to a single entity without a foreign group member or permanent establishment, whereas the proposed threshold under Pillar 2 requires a MNE Group to include at least one other entity or permanent establishment in another foreign jurisdiction, in addition to meeting the requisite revenue thresholds.

The increasing weight of global and domestic measures pose significant risks to Australian businesses if local rules are not aligned with our major trading partners, particularly if this creates an uneven playing field for the disclosure of information that may be commercially sensitive, as well as imposing additional compliance costs relative to other countries.

AmCham agrees with the principles outlined in the Consultation Paper that any Australian reform should be targeted and balanced. In doing so, any reforms should:

- recognise that fundamental behavioural change has already occurred and is continuing following the implementation of the OECD BEPS initiatives and in response to public scrutiny;
- draw on the experience and lessons learnt by our major trading partners in implementing mandatory existing and incoming MNE transparency regimes, e.g. EU public CBC reporting is the result of extensive consultation on MNE activity;
- afford taxpayers an opportunity to contextualise and explain the information provided to ensure that the disclosures facilitate meaningful public information and reduce the chances for misinterpretation; and
- be aligned with existing and incoming MNE transparency regimes across our major trading partners to ensure consistency of reporting globally, reduce compliance burden and avoid the abovementioned risks.

The decision to impose new public disclosure rules should not be made before weighing the disadvantages to Australian businesses relative to competitors in countries without comparable obligations. Many of our neighbours in the Asia-Pacific do not and are not proposing the same extent of disclosure rules, meaning Australian businesses face a competitive disadvantage where their data is freely available. Sophisticated businesses in other countries will have a greater ability to understand and utilise sensitive data on Australian businesses than the general public, so the potential harm to competitiveness may be greater than the benefit to the Australian public.

We would also like to query whether the proposed public release of high-level data on the amounts of tax that large MNEs pay in the jurisdictions they operate and the number of employees in those jurisdictions would apply to inbound MNEs, Australian outbound MNEs, or both? For inbound MNEs, this information is already available to the ATO through international counterparts via information exchange. It would be a large compliance burden for entities to collect this information and complete compliance would practicably be very difficult, if not impossible.

In light of the above, if the Government pursues a new mandatory public disclosure regime, careful consideration should be given to whether this achieves the purpose of greater public understanding. For example, data in existing CBC reporting is very difficult to interpret without relevant expertise, being coded in particular ways that is useful for the ATO but would not be easily understood by the public. This would give rise to a significant risk of misinterpretation without conveying the true narrative. Notably, this debate is not about granting new powers to the ATO as it already has broad powers to act on information in CBC reports, so the ability of the ATO to identify and act on potential concerns from CBC reports is not in question. Hence, the question is what is the most effective way to achieve greater public understanding without placing undue compliance costs on businesses?

Alternatives could include:

- Increasing the range of information disclosed by the ATO in its Corporate Tax Transparency report, although consultation would be needed on what items could be disclosed without the commercial sensitivities noted above. Taxpayers would also need the opportunity to include written commentary (prior to publication of the data) to provide appropriate context.
- Publication of existing CBC reports / EU public CBC rules given they also reflect existing or impending required compliance reporting[5]. If this approach is followed, it should be implemented using the same reporting criteria and format but with the option to include written commentary at the choice of the disclosing entity.

Whichever route is taken, it must avoid Australia becoming an outlier in terms of both compliance cost and (disproportionate) disclosures that may harm the relative competitiveness of investing and doing business in Australia. Mandating disclosure regimes that are not required elsewhere could be harmful to Australia in both aspects.

*b) Mandatory reporting of material tax risk to shareholders*

We note that the Consultation Paper does not provide any clear guidance as to what is meant by "*material tax risk*".

It is not clear whether this proposed measure is intended to go beyond existing local and international accounting standards which require the disclosure of uncertain tax positions. Any materiality thresholds should be consistent with accounting standards otherwise there may be duplication and potential cause for confusion.

It is not appropriate to rely on administrative guidance from the ATO to identify what is a material tax risk. Such guidance only reflects the administrator's view, is usually untested by the courts and is frequently subject to reasonable dispute with taxpayers. ATO guidance usually lags the introduction of new law and may not cover all relevant aspects of the law, resulting in a period of uncertainty for taxpayers where they need to determine their position(s) without any indication of the ATO's view.

Further, ATO Practical Compliance Guidelines (PCG), rulings and other guidance are highly technical and lengthy. The general public would find it extremely difficult to understand a company's disclosures without also reading the relevant ATO guidance. Given the general public are not tax experts it is unrealistic to expect they would understand the ATO guidance and context when applied to a taxpayer, e.g. a taxpayer may be rated high risk under the ATO's self-assessment frameworks for inbound distribution (PCG 2019/1) or for cross-border related party debt (PCG 2017/4) but their arrangements may still be reasonable and compliant in light of their particular circumstances (which is acknowledged in each PCG). Accordingly, we strongly recommend against defining materiality by reference to ATO public guidance (or rulings).

Thank you for your consideration, and for this opportunity to submit AmCham's views to this Consultation Paper. We welcome any queries you have regarding our submission and any opportunities to further engage in the consultation process.

Kind regards,

April Palmerlee
Chief Executive

[5] EU public CBC rules will be mandatory for groups with a relevant EU presence.