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September 2, 2022

VIA E-MAIL

Assistant Secretary
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600
MNETaxIntegrity@treasury.gov.au
Attention: Ronita Ram

Re: Comments on Multinational tax integrity and enhanced tax transparency Consultation paper

Dear Sir / Madam,

The Silicon Valley Tax Directors Group (SVTDG) welcomes the opportunity to provide comments to the Australian Treasury in relation to Multinational tax integrity and enhanced tax transparency: Consultation paper (August 2022) (Consultation Paper).

The SVTDG represents U.S. high technology companies with a significant presence in Silicon Valley that are dependent on R&D and worldwide sales to remain competitive. The SVTDG promotes sound, long-term tax policies that allow the U.S. high tech technology industry to continue to be innovative and successful in the global marketplace. SVTDG members are listed in the Appendix 1 to this letter.

Please feel free to contact me at johnsonr@cisco.com if you have any questions or comments regarding this submission. We would be pleased to discuss in further detail any of the points raised in our submission.

Sincerely,

/s/ Robert F. Johnson
Co-Chair, Silicon Valley Tax Directors Group

COMMENTS ON MULTINATIONAL TAX INTEGRITY AND ENHANCED TAX TRANSPARENCY CONSULTATION PAPER

This letter provides comments on Part 2 of the Consultation Paper regarding the proposal to limit the ability of Multinational Enterprises (**MNEs**) to claim tax deductions for payments relating to intangibles and royalties that lead to insufficient tax paid. This letter also comments on the Part 3 proposal to mandate public reporting of tax information on a CbC basis.

We request this submission be kept confidential and not published on Treasury's website. We welcome the opportunity to engage further with Treasury on our submission.

1. Executive summary

- Integrity measures should be appropriately targeted and not overly broad. Australia has several pre-existing anti-abuse measures (including to capture arrangements to avoid royalty withholding tax). We respectfully submit that the proposal in the Consultation Paper is overly broad and complex. Moreover, Australia's existing anti-avoidance measures are more appropriate to capture any concerns regarding the mischaracterization of outbound payments.
- Concerns about the proper characterization of commercial transactions as licenses or other transactions, and the proper determination of compensation for DEMPE functions performed in Australia, can be reviewed through the normal audit processes, including the application of existing anti-abuse rule rules. We do not see the utility of further legislation on those points.
- We strongly disagree with any proposal to separate "embedded royalties" from commercial transactions that do not involve as the main purpose of the transaction the transfer of rights to use intellectual property (**IP**) in Australia. Many items sold in commerce through an ordinary distribution function are valuable in part due to their intangible value. However, it is highly unusual for jurisdictions to not treat those transactions according to their commercial nature as a sale of goods or services. A well-designed tax law should follow commercial realities. We are not aware of any other jurisdiction in the world which endeavors to unbundle or disaggregate the "embedded royalty" element of a good or service. A "look through" approach in this context is extremely impractical, particularly if an entity in Australia is required to have visibility into the entire supply chain offshore to make the assessment.
- The proposal to tax payments made outside Australia exceeds the generally accepted limits on extraterritorial taxation. As a general proposition in international law, income taxation presupposes a genuine link between the transaction and the taxing state. No such connection exists in the Consultation Paper's proposal which effectively taxes revenue derived from IP in transactions entirely located outside of Australia.
- The proposal to deny a deduction to an Australian company on the basis it is contracting with a foreign company imposes a competitive disadvantage on the foreign company. This would be discriminatory and disincentivizes Australian companies doing business with foreign businesses. This may also give rise to potentially retaliatory measures from Australia's trading partners.
- The "embedded royalty", deduction denial and extraterritorial taxation proposals all may be incompatible with Australia's tax treaty obligations.

- The "insufficient tax" proposals are redundant to the work nearing completion under Pillar 2.
- None of the referenced international regimes provides an appropriate comparison to the proposed measure. The international comparisons mentioned are either being replaced with Pillar 2, have no embedded royalty element and/or very different in design and scope to the proposal in the Consultation Paper. Therefore the proposed measure cannot be justified as comparable to the international comparisons mentioned in the Consultation Paper. Adopting a measure that denies deductions arising to Australian companies despite the payment being subject to a sufficient rate of tax (under the OECD's Pillar 2) will go directly against the stated goal of the OECD under Pillar 1 and 2 to stabilize the international tax framework and end the proliferation of unilateral measures.
- Any measure should apply to all taxpayers irrespective of size on the basis of the principle of equality. It would be discriminatory if a measure described in the Consultation Paper only applied to a certain category of taxpayers such as Significant Global Entities (**SGEs**).
- In respect of Part 3, we submit that introducing a public CbC reporting obligation would not only be a departure by the Australian government from the clear position it adopted at the OECD, but also a departure from a key cornerstone of the Australian (and international) tax system and one which would create competitive distortions.

2. Part 2: Detailed discussion

A. Existing and emerging laws already target integrity issues identified in the Consultation Paper

Treasury notes that the proposed measures "seek to target activities deliberately designed to minimize tax, while also considering the need to attract and retain foreign capital and investment in Australia, limit the potential compliance cost considerations for business, and continue to support genuine commercial activity."[1]

We submit there are robust, targeted and pre-existing provisions in Australian taxation law to combat activities designed to minimize tax including through any intentional mischaracterization of payments.[2] The general anti-avoidance provisions in Part IVA of the Income Tax Assessment Act 1936 (**ITAA**) can cancel tax benefits in a range of circumstances, including in circumstances where there has been a structure devised for the sole or dominant purpose of avoiding royalty withholding tax. Similarly, the Diverted Profits Tax (**DPT**) in Part IVA serves as a measure to ensure MNCs are complying with Australia's taxation laws.

Further, Australia's existing robust transfer pricing rules operate to ensure that the amount deducted by the Australian entity under the arrangement meets arm's length requirements, and that the functions performed, assets used and risks assumed by the Australian entity in connection with the arrangement are appropriately compensated in accordance with the arm's length requirements of the transfer pricing provisions in the taxation law.

The Consultation Paper proposes that "Australia's tax framework needs a specific measure targeting integrity issues associated with intangibles and royalties". The Consultation Paper does not, however, satisfactorily identify why existing measures are not sufficient.

[1] Consultation Paper, page 4.
[2] Examples: Diverted Profits Tax (**DPT**), Multinational Anti-Avoidance Law (**MAAL**), the General Anti-Avoidance Rule (**GAAR**) and Australia's endorsement of the BEPS project.

In addition to existing measures, we note that Australia, as a member of the Inclusive Framework, has publicly committed to the OECD Pillar 2 proposal, which we consider will directly address Treasury's concerns regarding MNEs shifting "profits to low or no tax jurisdiction arrangements involving intangibles". Accordingly, there would seem to be no reason to adopt the additional measures proposed in the Consultation paper if Australia intends to adopt the Pillar 2 common standards.

An important attribute of the Pillar 2 project is that it will produce uniform rules around the world. Adopting common standards is preferable to pursing unilateral measures, as unilateral measures have contributed significantly to the destabilization of the international tax framework.

The Pillar 2 project directly addresses the issues raised in the Consultation Paper relating to payments that lead to insufficient tax paid. In particular, Pillar 2 contains a number of separate but interacting measures including the Global Anti-Base Erosion (**GloBE**) rule which itself comprises the Income Inclusion Rule and Undertaxed Profits Rule. The GloBE rules will ensure that all in-scope groups have a minimum 15% effective tax rate in each jurisdiction in which they operate.[3] Indeed, Treasury has proposed in the Consultation Paper that the 15% effective tax rate calculated under the GloBE rules could be used as the test to determine whether "insufficient tax" has been paid.

The Pillar 2 rules also contain a Subject to tax rule (**STTR**). This rule is specifically designed to target related party payments including royalties, payments for the use of or right to use intangibles in combination with services, and payments for intermediary services when the value primarily derives from the use of an intangible asset where the payment is subject to low nominal rates of taxation in the payee jurisdiction.

Accordingly, unlike the GloBE rules, the STTR applies on a payment-by-payment basis and is triggered where the full amount of the payment is not subject to a sufficient nominal rate of taxation (with the precise rate to be determined). We would also note that the STTR applies to all payments irrespective of the size of the group.

We consider that adopting a unilateral measure that denies deductions arising to Australian companies despite the payment being subject to a sufficient rate of tax (under a combination of the GloBE rule and STTR) is unnecessary in light of the Pillar 2 rules and would go directly against the stated goal of the OECD under Pillar 1 and 2 of "reforming the international tax system to address the tax challenges arising from the digitalisation of the economy, restore stability to the international tax framework **and prevent further uncoordinated unilateral tax measures**" (emphasis added).[4]

As a result, enacting such a unilateral measure would mean that Australia would not only be out of step with other Inclusive Framework countries but it would also encourage other jurisdictions to take similar unilateral or retaliatory measures, thereby undermining the work of the Inclusive Framework undertaken to stabilize the international tax framework. Moreover, introducing another measure targeting structures (either already readily dealt with under existing law and/or to be captured under the OECD's Two Pillar solution) will give rise to increased complexity, compliance cost, uncertainty for business and potentially discourage investment into Australia.

[3] We note that groups will be within the scope of Pillar 2 if their global annual gross revenues meet or exceed €750m, which closely aligns with the revenue threshold for SGEs.

[4] Page 10, "*Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*", 14 October 2020.

Treasury has suggested that the proposed new measures are necessary because it "is relatively easy for … MNEs to enter into arrangements involving their intangibles to shift profits from higher tax jurisdictions to low or no tax jurisdictions." We respectfully disagree that it is "easy" for IP to be shifted out of high tax jurisdictions, as such transfers would usually be subject to an exit tax based on the fair market value at the time.[5] In addition, in order for intangible profits to be treated as arising to a low tax jurisdiction, it is generally necessary to have appropriate DEMPE functions located there.[6]

B. Deficiencies in theories re mischaracterization of royalties and embedded royalties

The Consultation Paper raises for discussion whether tax integrity issues exist in certain aspects of the characterization of payments and intra-group value chains, in particular (i) mischaracterization of payments, and (ii) outbound payments from Australia containing an "embedded royalty". We have addressed each in turn below.

(i) Mischaracterization of outbound payments

Accurately characterizing a payment is a question of applying the facts of the transaction to the relevant law. All aspects of the amounts reported by taxpayer's on tax returns are, of course, subject to review by the ATO on audit. On audit, the ATO may review whether the legal distinction between a royalty and another type of commercial transaction causes the character of the payment to be a royalty or not. Further, the ATO has the ability during the audit process to apply Australia's various anti-avoidance rules in Part IVA to structures with the requisite purpose to obtain a tax benefit (including the underpayment of royalty withholding tax). We therefore consider that an additional specific measure dealing with alleged mischaracterization is not needed.

The Consultation Paper raised a separate concern that in some cases where intangibles may be held by an entity outside Australia, an entity inside Australia may undertake significant DEMPE activities with respect to that intangible, but may not be "appropriately remunerated" for that activity. If there is a lack of reward for DEMPE functions in Australia, we respectfully submit that Australia's robust transfer pricing regime would apply to ensure that the return to Australia is at arms' length. The taxpayer's transfer pricing documentation will provide a description of the functions, assets and risks performed by the Australian taxpayer for ATO review. Again, it is hard to see what further legislation would be useful or appropriate on that point.

(ii) Embedded royalties

We understand that the Consultation Paper suggests that a transaction which for commercial purposes may be something other than a license for the right to exploit intangible property may be segregated, for Australian tax purposes only, into a component that is a payment for a right to exploit intangible property and the remainder which is for something else, and the former then would be taxed as a royalty. This proposal is not an accepted norm of international tax law or practice.

There is no doubt that many items sold in commerce are valuable in part due to their intangible value such as branded luxury goods, computer chips with embedded software design features, and even consumer items such as cans of soup bearing a famous trademark. Services also can carry value in the market due to the intangibles used by the service provider to render the service. However, we are not

[5] See for example the exit taxation rules in the EU's Anti-Tax Avoidance Directive (ATAD) directive 2016/1164. We submit that the vast majority of high-tax jurisdictions would have broadly comparable rules.

[6] Part B of Chapter VI, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, January 2022.

aware of any jurisdiction which does not treat those transactions according to their commercial nature as a sale of goods or services.

The relevant question for purposes of characterizing the transaction for tax purposes is: "what is the Australian purchaser paying the offshore party for"? If the purchaser is paying to acquire the luxury goods item, the computer chip, the can of soup, or the high value service, then the payment should be characterized in its entirety as for that article of commerce and/or service, not for any rights to use IP in Australia. This is the generally accepted approach internationally. We refer to the OECD commentary on Article 12 relating to payments by distributors:

"Payments that are solely made in consideration for obtaining the exclusive distribution rights of a product or service in a given territory do not constitute royalties as they are not made in consideration for the use of, or the right to use, an element of property included in the definition.

"…the resident distributor does not pay for the right to use the trade name or trade mark under which the [products] are sold; he merely obtains the exclusive right to sell in his State of residence [products] that he will buy from the manufacturer"

If an Australian company is required to unbundle a payment with reference to the particular IP components used in creating the article offshore, then there is no conceptual line to be drawn between different types of intangibles. Payments for goods or services that have value due to the use by the supplier of patents, trademark, knowhow, copyright or any other intangible item would be subject to unbundling and separate taxation. This would be impossibly complex and over expansive to unbundle payments for all types of goods and services that carry value due to IP elements created and used offshore. We consider this would also be unworkable and impossible to administer.

For example, the commercial reality of an Australian distributor of bulk cans of soup is that it is paying for goods to on-sell (not for the use of the brand), even though the payment received by the soup manufacturer offshore indeed represents in part a return to the supplier on its investment in its brand. It would be highly difficult in any principled and uncontroversial way to unbundle and value any part relating to the IP which could be embedded in the good. Would the Australian distributor be required to look through the global supply chain and identify the percentage of a deduction it would be denied relating to an offshore royalty? It is self-evident that overwhelming compliance issues would arise if any transaction in the world among an Australian party and a foreign non-resident party - related or unrelated - could be subject to the "embedded royalty" rule if a "royalty" element must be unbundled. Again, this approach could also have the unintended consequence of discouraging Australian businesses from buying from foreign suppliers and is therefore discriminatory.

C. Proposals exceed accepted limits on extraterritorial taxation

Denying a deduction for an outbound payment where there is a royalty incurred outside Australia and higher up in the intra-group value chain (where there is no use of, or right to use any IP in Australia by the payer), or imposing a withholding tax obligation on a nonresident person with respect to that payment, is inconsistent with long standing international tax principles discouraging extraterritorial taxation. We have outlined our reasoning below and also provided examples demonstrating that the proposal is practically complex.

(i) No genuine connection exists between Australia and the offshore transaction

As a generally accepted proposition in international tax law, there needs to be a genuine connection between a taxing state and the transaction in order for the state to exercise taxing jurisdiction. The proposal outlined in the Consultation Paper is extraterritorial by seeking to tax the use of IP outside of

Australia and would be contrary to the position of Australia's large trading partners. The proposal in the Consultation Paper would clearly be out of step with this accepted international practice and could give rise to retaliatory measures.

For example, the United States (US) Restatement (Fourth) of Foreign Relations Law states that customary public international law governing jurisdiction to prescribe requires "a genuine connection between the subject of the regulation and the state seeking to regulate". In assessing the geographic scope of federal law, US courts generally apply three principles of interpretation: (i) a presumption against extraterritoriality based on "the comity of nations"; (ii) the principle that in interpreting the geographical scope of federal law, US courts should avoid unreasonable interference with the sovereign authority of other states; and (iii) the principle of avoiding conflicts with customary international law. As a result, U.S. courts will interpret federal statutory provisions to apply only within the territorial jurisdiction of the United States unless there is a clear indication of Congressional intent to the contrary.

We note the comment on p. 14 of the Consultation Paper speculating that where a royalty is incurred "higher up the intra-group value chain", it may be appropriate to bring those payments "within the Australian tax net". The Consultation Paper is not clear as to what mechanism is proposed to impose tax on those payments, but the fact that the UK ORIP is referenced indicates a proposal to impose tax directly on a nonresident, either by a direct charge such as ORIP or perhaps on a royalty withholding tax basis.

In either case, that tax would be a clear effort to exercise extraterritorial jurisdiction over taxpayers not subject to the jurisdiction of Australian courts. As noted above, international tax law places strict limits on the power of states to impose tax extraterritorially.

Any extraterritorial tax of the sort proposed in the Consultation Paper will lead to unrelieved double taxation. Given that the proposed tax would exceed the accepted boundaries of taxing jurisdiction under international practice, it is unlikely that any other country would regard the tax as a legitimate exercise of primary taxing rights over those items of income. In that case, the affected states which have legitimate claims to those items of income in their tax base would not grant double tax relief either through exemption or foreign tax credit.

(ii) Impracticalities of extraterritorial withholding tax

Any proposal to impose a withholding tax on a completely extraterritorial basis should not be pursued due to the inequities it will create among taxpayers. In principle, this theory could apply to any transaction among related or unrelated parties anywhere in the world throughout the value chain which ultimately results in the import of a good or service into Australia. That will create impossible compliance burdens on taxpayers and disrupt normal commercial transactions taking place entirely outside Australia.

It is not conceivable that this sort of extraterritorial taxation could become an international norm. That alone is a sufficient reason for the government to not pursue the proposed extraterritorial tax.

D. Creates discrimination against non-Australian suppliers

We are concerned that the proposed measure is directly discriminatory to foreign suppliers and is contrary to the principle of equality. In this regard, the general principle of equality requires that taxpayers be equal before the law and is accepted to be a main frame of reference for a legislator. The tax law should not treat substantially equal situations unequally.

It is clear that as a result of the Consultation Paper's proposal, Australian businesses would have a disincentive to contract with foreign businesses. Australia's treaty and trade partners would therefore likely have issues with the proposal and as a result, there is a risk Australia could face retaliatory measures. Additionally, inequities could also result in the administration of the proposal on the basis that a tax administration could not fairly administer the law to all potentially in scope transactions given the breadth and extraterritoriality of the proposal.

The suggestion that the proposals might apply only to SGEs would create a different type of discrimination. The tax law on characterization, deductions, tax obligations and similar fundamental points of the taxation architecture should apply to all taxpayers equally.

E. Issues exist re compatibility with treaty obligations

We suggest that several of the proposals may raise issues under Australia's tax treaties. The assertion by ATO that a payment to an entity resident in a treaty state that a payment is partially a royalty and partially something else implicates the application of Articles 7 and 12 of the treaty. That interpretative issue clearly is subject to agreement between the contracting states. We expect that the proposed view in the Consultation Paper will not be a common view. We do not expect the US IRS, for example, to endorse the "embedded royalty" concept for payments to US residents.

We also urge the Australian government to consider the treaty implications of the proposal to allocate the offshore tax base to Australia by denying all or part of a deduction for certain cross-border payments. Since the purpose of that deduction disallowance transparently would be to bring the offshore transaction into scope of Australian tax, that enforcement mechanism might implicate Art. 5 on the basis of direct taxation without a permanent establishment, and Art. 9 on the basis of an effort to allocate additional taxable profit to Australia in excess of that arising from arm's length pricing with the Australian entity.

We were gratified to see no mention in the Consultation Paper that the government may propose to address those conflicts by overriding Australia's tax treaties. Absent an override, we understand that all existing treaties will control over domestic legislation.

F. Observations on insufficient tax proposals

A focus of the Consultation Paper concerns arrangements relating to intangibles and royalties paid to low or no tax jurisdictions or that lead to insufficient tax being paid. As noted above, the Pillar 2 project addresses the same issues. Accordingly, the proposals in the Consultation Paper are redundant to the work already nearing completion on Pillar 2.

Nevertheless, we can offer the following observations on the options to define "insufficient tax" or "low or no tax jurisdictions" on page 16 of the Consultation Paper.

Global Anti-Base Erosion Rules minimum tax rate: The Consultation Paper suggests that "payments made to entities in jurisdictions determined under the GloBE rules to have an effective tax rate of less than 15 per cent would be in scope".

Using the GloBE minimum tax rate of 15% has some logic given that the purpose of the GloBE rules is to ensure groups have sufficient effective tax rates in each jurisdiction in which they operate which is similar to Treasury's stated purpose for the proposed measure in the Consultation Paper. Under the common standards of Pillar 2, states will claim taxation rights over profits earned by low-tax entities, defined as entities with taxes paid at less than 15% of book profits. If Australia adopts Pillar 2, the proposed rule set out in the Consultation Paper would almost never apply, which again demonstrates why the Pillar 2 proposal should appropriately address Treasury's concern regarding arrangements involving intangibles in low or no tax jurisdictions.

In addition, we consider that, even if another measure of "insufficient tax" is selected, the proposed measure must take into account any top-up taxes paid under Pillar 2 to ensure that the Pillar 2 measure is not undermined. Accordingly, the following issues will need to be addressed:

a) Pillar 2 comprises a series of separate but interrelated rules and therefore the proposed measure would need to ensure it had regard to the effect of the Income Inclusion Rule (which may result in a third jurisdiction subjecting the profits in the payee's jurisdiction to a top-up tax if the payee's effective tax rate were less than 15%), the Undertaxed Payment Rule, and the STTR when determining if a payee is not subject to a sufficient level of tax;

b) The proposed measure would also need to have regard to the fact that the GloBE rules operate on a jurisdictional (rather than entity-by-entity) basis; and

c) The GloBE rules calculate the effective tax rate for group entities in a jurisdiction by reference to the group's financial accounting statements which are prepared after the end of a financial year. Accordingly, the Australian company paying the royalty will not know at the time whether the payee (and entities related to the payee in the same jurisdiction) will have a sufficient effective tax rate until the Pillar 2 return has been finalised and lodged, which may be well after the due date for the Australian company's tax return. An Australian payor will not have access to this information if the payee is an unrelated party.

Sufficient foreign tax test: Australia's standard corporate tax rate for SGEs is 30% and under the proposed sufficient foreign tax test, payments made to jurisdictions with a corporate tax rate of less than 24% would be within scope. The OECD statistics note that some of Australia's key trading partners have corporate tax rates of less than 24%. For example[7]:

- United States 21%
- United Kingdom 19%[8]
- Japan 23.2%

We are concerned that the proposed sufficient foreign tax test would affect Australia's relationship with these trading partners and in particular, discourage companies from doing business in Australia. The sufficient foreign tax test is also used in the DPT provisions, however certain arrangements supported by sufficient economic substance are generally not within the DPT. No such "sufficient economic substance" carve out appears to be within the proposal contemplated by the Consultation Paper.

Intellectual property tax-preferential regime: We submit it would not be sensible or in the spirit of reciprocity to deny deductions for payments made to jurisdictions with a patent box regime (e.g. some of which are Australia's key trading partners, such as the U.K.) when Australia itself has proposed a patent box regime domestically. Countries adopt patent box regimes as instruments of domestic economic development policy. A tax targeted on those payments may be seen by the governments which had instituted the patent box regime as an encroachment on their sovereignty to set their own industrial policy. In any event, the work dealing with combatting harmful tax practices from the BEPS

[7] OECD statistics: https://stats.oecd.org/Index.aspx?DataSetCode=CTS_CIT

[8] We note that the UK has legislated to increase its corporate tax rate to 25% from 1 April 2023.

project has produced useful improvements to patent box regimes to more closely connect the tax relief to actual economic activity conducted in the source state.

Low or nominal tax jurisdiction lists: We agree that developing a bespoke list could increase the likelihood of retaliatory responses.

We note that the proposals to unilaterally impose a royalty withholding tax on all or part of a payment or to deny a deduction almost inevitably will result in double taxation at very high effective rates.

By way of example, assume an Australian company made an intercompany payment of $100 to an Irish trading company and that the recipient had a relatively healthy operating margin of 10%. The Irish corporation tax on the $10 of profit would be $1.25 per the 12.5% corporation tax applicable to trading profits. Under the proposals in the Consultation paper, Australia may subject up to the full $100 to 10% withholding tax. Even if the Irish Revenue agreed with the ATO's assertion of the proper character of the revenue and allowed a credit, the credit would only be for $1.25. As a result, the effective rate of tax on the Irish company's Australian-derived profits would be 100% ($10 of tax paid on $10 of profit). If the Irish Revenue disagreed with the ATO's interpretation of the Australia - Ireland tax treaty, the effective rate would exceed 100%.

The effective rate also would be extremely high due to double taxation if the proposal were applied to disallow a deduction by the Australian payor. In that case, the effective tax paid in Australia would be 30% at the SGE rate, with no double tax relief in Ireland. In that case, the effective tax rate on $10 of profits would be 42.5% ($4.25 of tax on $10 of profit).

This outcome is clearly disproportionate when compared to the proposed "insufficient tax" thresholds set out in the Consultation paper which range from tax rates of 10% - 24%. The bluntness of this instrument also is shown by the fact that the deduction denial under the Consultation paper proposal is not impacted by either the value of the royalty (which may be immaterial) or by whether the payment recipient has substantial operations and DEMPE functions in its home state.

Finally, we note that after the reforms to the international tax system arising from the BEPS project, it is now increasingly uncommon for multinational groups to include in their structures entities that are subject to low or very low rates of tax, in particular any such entities that do not actually perform significant DEMPE functions. Accordingly, we believe that today there is a much smaller incidence of the types of cases that the Consultation Paper seeks to address than may be assumed by the drafters of the Consultation Paper.

G. International measures referred to in Consultation Paper do not support the proposals

The Consultation Paper notes that the Government's proposal to limit MNEs' ability to claim tax deductions for payments relating to intangibles and royalties are "consistent with actions taken by other jurisdictions to address profit-shifting issues related to intangibles and royalties." Specifically, the Consultation Paper makes reference to the US Global Low Taxed Income (**GILTI**) regime, the US Base Erosion Anti-abuse Tax (**BEAT**), the UK's Offshore Receipts in respect of Intangible Property (**ORIP**) rules, the Netherlands withholding tax as applied to payments made to related parties in a low tax jurisdiction, and the German royalty barrier rule.

We do not believe that any of those measures suggest that the proposals made in the Consultation paper are consistent with generally prevailing international practice.

(i) US GILTI regime

The U.S. GILTI regime is an expansion of the U.S. controlled foreign corporation rules to impose current taxation in the U.S. of the earnings of subsidiaries of U.S. MNCs. This tax is universally accepted as an appropriate exercise of taxation rights over the tax base of the jurisdiction of residence of the ultimate parent entity. In contrast, the proposals in the Consultation paper reflect the opposite result, as denying a deduction in Australia or imposing a direct tax on a nonresident not a member of a group headquartered in the taxing state seeks to impose Australian tax on items of income which properly are part of the tax base of a foreign jurisdiction.

(ii) US BEAT

The U.S. BEAT has no embedded royalty element. As the Consultation paper notes, it will be replaced once the Pillar 2 regime has been adopted.

(iii) UK ORIP

The ORIP is an expressly extraterritorial tax, and as such we do not believe should be regarded as a model to be emulated. The ORIP legislation itself acknowledges that the nonresident taxpayer normally would be beyond the jurisdictional reach of UK courts. To overcome those limits of accepted international tax law, the UK statute expressly authorizes the tax to be collected from an entirely different taxpayer, namely any member of the foreign MNC group which is resident in the UK. We do not consider that collecting the tax from a different taxpayer should be regarded as an accepted workaround of the normal territorial jurisdictional limits of international tax law.

The ORIP statue does, however, generally respect that the tax imposed by ORIP would be contrary to the UK tax treaties. Accordingly, the statute carves out transactions with taxpayers resident in treaty countries. At a very minimum, any tax Australia may consider under the proposals set out in the Consultation Paper should not apply with respect to payments to any taxpayer resident in a treaty state.

(iv) Netherlands withholding tax

The Netherlands withholding tax example is clearly distinguishable on the basis that those rules do not disregard the commercial reality of transactions and do not look through to the global supply chain. Moreover, the Netherlands withholding tax example only applies in abusive situations (not in ordinary commercial arrangements). Finally, it was introduced in order to comply with the EU Anti-tax Avoidance Directive relating to combatting particular abusive situations. As noted above, Australian law already includes very robust transfer pricing, GAAR, DPT and MAAL provisions. As such, we respectfully consider that existing rules are adequate to cover the situations addressed by the EU ATAD.

(v) German royalty barrier

The German royalty barrier rules also do not provide support for the proposals in the Consultation Paper. Those rules do not disregard the commercial reality of transactions and do not look through to the global supply chain. As the Consultation Paper notes, the German royalty barrier rule is clearly focused on non-compliant preferential regimes under OECD BEPS Action 5.

3. Part 3: Multinational tax transparency

The SVTDG recognizes the importance of public confidence in the integrity of the tax system but also recognizes the need for taxpayer confidentiality. As Treasury highlights in the Consultation Paper, the 'public good' element of improved tax transparency must be balanced with the protection of MNEs' commercially sensitive information, the increased compliance burdens, and the broader impact on the relationship between taxpayers and the revenue authority. With respect, we submit that the downsides of publicly disclosing CbC reporting data far outweigh any potential benefits.

The fundamental importance of maintaining the confidentiality of taxpayers' information is widely recognised. Indeed, the Consultation Paper itself notes that confidentiality of CbC data was a "key" and "essential" feature of the regime which was necessary to obtain consensus agreement to CbC reporting under Action 13 at the level of the OECD. Stepping back from that commitment now would be a serious deviation from the assumptions underlying Action 13.

CbC disclosures under this OECD regime are subject to strict confidentiality and for good reason. The fundamental importance of confidentiality of taxpayer information has repeatedly been acknowledged by the OECD. For example, the OECD has called confidentiality of taxpayer information a "fundamental cornerstone of tax systems".[9] Similarly, Maria José Garde, the OECD's Chair of the Global Forum on Transparency and the Exchange of Information for Tax Purposes, wrote in 2020 that:

> '**Information confidentiality and security is essential to the relationship between tax administrations and taxpayers around the world**. **It also underpins the exchange of information in tax matters between governments**, one of the pillars of the international taxation system and the multilateral efforts to combat tax evasion and avoidance**.** The international community would not have endorsed the Standard for Automatic Exchange of Financial Account Information in Tax Matters, leading to unprecedented global improvement in tax compliance, without its extensive confidentiality and information security management (ISM) requirements' (emphasis added).[10]

Introducing a public CbC reporting obligation would not only be a departure by the Australian government from the clear position it adopted at the OECD, but also a departure from a key cornerstone of the Australian (and international) tax system. The Consultation Paper acknowledges that pursuing public disclosure of CbC reporting data could invite retaliatory measures such as failing Peer Review and exclusion from future reporting exchanges. Additionally, any reporting obligation which requires taxpayers exceeding a certain threshold to publicly disclose commercially sensitive information, whilst affording confidentiality to other competitors falling below the threshold, is discriminatory and will clearly distort competitive dynamics.

In this respect, existing threshold classifications such as SGE or Country by Country Entity (CbC Entity) are not appropriate threshold tests when it comes to public interest and transparency in Australia. In particular, the SGE definition can capture entities which have minimal Australian operations, merely because that entity happens to be a small subsidiary of a large global MNE. Subjecting MNEs with minimal Australian operations to additional public reporting will not assist in the objectives of transparency, whilst creating a disproportionate compliance obligation for such taxpayers.

More generally, publicizing information even for just one jurisdiction could be commercially damaging for companies broadly as competitors could learn competitively significant information as to how the reporting group is operating in a major jurisdiction.

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[9] https://www.oecd.org/tax/transparency/documents/global-forum-keeping-it-safe.pdf, (Keeping it Safe Report 2012)

[10] OECD, Confidentiality and Information Security Management Toolkit, 2020, p 3 https://www.oecd.org/tax/transparency/documents/confidentiality-ism-toolkit_en.pdf

At a more practical level, we consider public CbC reporting will seriously undermine existing collaborative relationships between the ATO and taxpayers; indeed the Consultation Paper itself recognizes that this is a real risk and that that publicly disclosing the information will result in taxpayers being "more circumspect in the information they would be willing to provide." The Consultation Paper does not explain how the Government would maintain the confidence of taxpayers nor the existing collaborative dealings with taxpayers given such a departure from international norms and the clear OECD position.

Existing tools such as the voluntary Tax Transparency Code, Corporate Tax Transparency report and Australia's robust public financial reporting requirements provide a large amount of information to the public, whilst preserving confidentiality between taxpayers and the ATO. We respectfully submit that the current model strikes the right balance in preserving confidentiality and providing the public with access to information.

Given that the benefits of public CbC reporting data are unclear and currently untested whilst the downsides of mandating this approach are clear, we strongly urge the Government against public CbC reporting.

In any event, if the Government moves forward with this proposal, implementation timelines should be after the implementation of the EU Directive to allow groups to react to those new requirements, and the Australian rules should be consistent with the EU ones.

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Appendix -- SVTDG Members

10x Genomics, Inc.
Accenture
Activision Blizzard, Inc.
Adobe Inc.
Advanced Micro Devices, Inc.
Agilent Technologies, Inc.
Airbnb, Inc.
Align Technology, Inc.
Alphabet Inc.
Amazon.com, Inc.
Ancestry.com
Apple Inc.
Applied Materials
Aptiv PLC
Arista Networks Inc.
Asana, Inc.
Atlassian Corp PLC
Autodesk, Inc.
Blackhawk Network, Inc.
BMC Software, Inc.
Broadcom Inc.
Cadence Design Systems, Inc.
Chegg, Inc.
Cisco Systems, Inc.
Citrix
Confluent
CooperCompanies
CrowdStrike Holdings, Inc.
Dell Technologies
Dolby Laboratories, Inc.
DoorDash
Dropbox, Inc.
Dynatrace
eBay Inc.
Electronic Arts
Expedia Group, Inc.
Facebook, Inc.
Flex Ltd.
Forte Labs, Inc.
Genentech Inc.
Genesys
Getaround
Gigamon Inc.
Gilead Sciences, Inc.
GitLab Inc.
Global Blood Therapeutics, Inc.
GlobalLogic
GoPro, Inc.
Hewlett Packard Enterprise
HP Inc.
Indeed
Informatica
Ingram Micro, Inc.
Instacart
Intel Corporation
Intuit Inc.
Intuitive Surgical, Inc.
Jazz Pharmaceuticals
Keysight Technologies, Inc.
KLA Corporation
Lam Research Corporation
Liftoff Mobile, Inc.
LiveRamp, Inc.
Mandiant Inc.
Marvell Technology Group Ltd.
Match Group
Microsoft Corporation
Momentive.ai
Netflix, Inc.
Netskope
NortonLifeLock, Inc.
Nutanix Inc.
NVIDIA Corporation
Okta
onsemi
Oracle Corporation

Palo Alto Networks
PayPal Holdings Inc
Pinterest
Protocol Labs
Pure Storage, Inc.
Qualcomm, Inc.
Reddit Inc.
RingCentral
Robinhood
Rubrik Inc.
salesforce.com
Seagate Technology
Semtech Corporation
SentinelOne
ServiceNow
Snap Inc.
Snowflake Inc.
Sophos
Splunk, Inc.
Stripe, Inc.
Synopsys, Inc.
Tesla, Inc.
The Walt Disney Company
Trimble
Twilio Inc.
Twitter, Inc.
Uber Technologies
UiPath
Unity Technologies
Upstart
Velodyne LiDAR, Inc
Verifone
Veritas Technologies
Visa Inc.
VMware, Inc.
Western Digital
WideOrbit
Workday Inc
Yelp Inc.
Zillow Group, Inc
Zoom Video Communications, Inc.
Zoominfo Technologies Inc.