ITI Promoting Innovation Worldwide

ITI comments on the Australian Treasury's "Multinational tax integrity – denying deductions for payments relating to intangible assets connected with low corporate tax jurisdictions"

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Dear Assistant Secretary Ram:

Thank you for the opportunity to provide feedback on the exposure draft legislation and accompanying explanatory materials related to deductions for payments relating to intangible assets connected with low corporate tax jurisdictions.

ITI[1] appreciates Treasury's efforts to incorporate some feedback from the August 2022 consultation on "Government election commitments: Multinational tax integrity and enhanced tax transparency," such as limiting application to related parties.

However, the exposure draft legislation maintains an overly broad approach that will contribute to double taxation, increased risk of disputes, and significant complexity for taxpayers engaging with the Australian market. The announcements and consultation paper preceding the release of the exposure draft legislation and Explanatory Materials (EM) suggest that the proposed measures were intended to apply to situations where intangible assets were transferred to a low-tax jurisdiction that did not have sufficient substance with a view to generating a net tax savings for a multinational group. This appears consistent with the objective of the proposed measures as outlined in proposed subsection 26-110(1) which refers to significant global entities (SGEs) avoiding tax by structuring their arrangements so that income from the exploitation of intangible assets is derived in a low corporate tax Jurisdiction. As an anti-avoidance rule, it should be made clear that the proposed measures are to be narrowly construed so as not to interrupt ordinary business or commercial dealings. As with

[1] The Information Technology Industry Council (ITI) is the premier global advocate for technology, representing the world's most innovative companies. Founded in 1916, ITI is an international trade association with a team of professionals on four continents. We promote public policies and industry standards that advance competition and innovation worldwide. Our diverse membership and expert staff provide policymakers the broadest perspective and thought leadership from technology, hardware, software, services, and related industries.

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other Australian anti-avoidance rules, there should be a purpose-based carveout along with a substance-based carveout.

There is also reason to question the relevancy of the measure given Australia's anti-avoidance rules and the implementation of the Organisation for Economic Co-operation and Development (OECD)/G20 Inclusive Framework's global minimum tax (Pillar Two GloBE Rules). From ITI's perspective, the global minimum tax addresses Australia's stated objective to "deter SGEs from avoiding corporate income tax" and it is therefore unnecessary and redundant to develop a new anti-avoidance measure that would sit on top of the GloBE Rules and Australia's existing anti-avoidance policies.

Further, the exposure draft legislation does not account for the many ways in which SGEs are already paying tax beyond domestic corporate income tax on payments relating to intangible assets, both in terms of existing tax regimes (e.g., withholding tax, attribution, etc.) and the forthcoming Pillar Two GloBE Rules and Qualified Domestic Minimum Top-Up Tax (QDMTT), and should therefore be eligible to claim income tax deductions. The unusual breadth and lack of clarity around several definitions, such as "intangible assets" and "exploit," also raise uncertainty for taxpayers and open the possibility for conflict with long-standing international tax norms.

Consideration of existing tax regimes

As noted in the introduction, the exposure draft legislation does not acknowledge many existing tax regimes that may apply to payments relating to intangible assets, nor relevant regional, state, or local taxes. If Treasury's objective is to address anti-avoidance behaviour and insufficient tax paid, then the criteria for denying deductions should fully reflect the variety of ways in which taxpayers are paying tax on payments related to intangible assets in order to better target any perceived tax mischief. Similarly, if Australia decides to advance the draft legislation, then the tool should work as a top-up tax that only denies deductions up to the amount to bridge the difference between the low tax rate and the minimum tax rate.

ITI has identified several regimes that revised legislation should take into consideration:

- **GloBE Rules**: Many jurisdictions, including Australia, are working to implement the GloBE Rules, which provide interlocking rules to execute a global minimum effective tax rate of 15%. There is no consideration in the exposure draft legislation for whether the income is being picked up in a third state through an IIR (formerly Income Inclusion Rule) or QDMTT and therefore subject to an effective tax rate of at least 15%. ITI and the National Foreign Trade Council (NFTC) previously identified this concern in a joint response to the September 2022 consultation on "Government election commitments: Multinational tax integrity and enhanced tax transparency." Australia committed to implementing the OECD/G20 Inclusive Framework's GloBE Rules; no government should be taking unilateral action in advance of and/or beyond the multilateral agreement.

- **Withholding tax regimes**: Any withholding taxes levied by Australia should be grossed down to be treated as income tax paid by the recipient in determining the effective tax rate of the recipient to ensure Australia does not double tax the same royalty income (i.e., once by denying a deduction and again by levying withholding tax).

- **Attribution regimes**: The exposure draft legislation similarly does not appear to consider taxes paid under attribution regimes, most notably Controlled Foreign Company (CFC) rules. It would be appropriate to better target the rules to acknowledge such taxes.

- **Bilateral tax treaties**: Australia has agreed to income tax treaties (double tax agreements) with more than 40 jurisdictions, including trade and investment partners such as the United States, Ireland, Singapore, and Switzerland. The exposure draft legislation does not account for Australia's commitments under those treaties and would undoubtedly result in double taxation.

Definitions

ITI notes with concern that key definitions in the exposure draft legislation are broad and ambiguous and will yield greater complexity and uncertainty for taxpayers engaging with the Australian market.

- "**Exploit**" refers not only to "the use, marketing, selling and distributing the intangible asset," but also "a supply, receipt, or forbearance in respect of the asset," "further exploiting another asset that is a right in respect of, or an interest in, the asset," or even "anything else in the respect of the asset." The addition of "anything prescribed by the regulations for the purposes of this paragraph" further underscores concern about the breadth of this definition and the implications for taxpayers seeking to comply. The Treasury states the broad definition is intentional; ITI urges further clarification to improve the administrability of the rules. Otherwise, there is real risk that the provisions could apply to the ordinary business and commercial dealings of taxpayers where use of an intangible by a related payee is not the substance of an arrangement. A closer connection between the payment from Australia and income derived should be required: simply because Australia makes a payment to Country A and Country A makes a payment to Country B should not make the latter payment connected to Australia.

- "**Intangible asset**" is broad in definition and could apply to many transactions that are not considered as royalties under international tax norms. Paragraph 1.44 of the Explanatory Materials (EM) even notes that the listed assets do not necessarily align with "the ordinary meaning of 'intangible asset.'" The additional rulemaking power to expand the definition of "intangible asset" implies that even more payments may come into scope, further increasing the uncertainty for taxpayers. At a minimum, the definition should be revised to explicitly exclude embedded royalties.

- "**Low corporate tax jurisdiction**" should be more appropriately defined as follows:

    - The draft legislation should be amended to clarify that a jurisdiction should not be considered a low corporate tax jurisdiction to the extent it has a QDMTT or has otherwise adopted the GloBE Rules.
    - The draft legislation should be amended to clarify that subnational taxes (including state, cantonal, and local) taxes, if they are in essence a corporate income tax, should be aggregated for the purposes of determining the relevant corporate tax rate.
    - The draft legislation should be amended to take into account circumstances where there is no lowly taxed income because the income is taxed in another jurisdiction (e.g., under CFC provisions).

- The draft legislation or EM should further clarify that having different rates of income tax should only be relevant for calculating the tax rate for that particular source of income. A jurisdiction should not be deemed as a low tax jurisdiction only because one class of income may be exempt or subject to a low tax rate in the jurisdiction.
- To ensure the measures do not apply to ordinary commercial dealings, income derived by entities in the same jurisdiction as the ultimate parent entity should not be considered as a trigger for the application of the measures, particularly when substantial DEMPE functions are located in the ultimate parent entity jurisdiction, or the ultimate parent entity jurisdiction has CFC-like rules.
- As in the United Kingdom Offshore Receipts in respect of Intangible Property (ORIP) rules, there should be a carveout for payments with a resident in a jurisdiction with which Australia has concluded a double tax agreement that includes a non-discrimination article.
- The draft legislation should clarify that differences in tax base should not cause a jurisdiction to be a low corporate tax jurisdiction.

Other issues

Apportionment. Paragraph 1.37 of the EM provides that a taxpayer may apportion a payment in the event a deduction is denied for a payment to exploit an intangible asset. Bifurcating payments into IP and non-IP will undoubtedly lead to more disputes and divert significant resources on behalf of the taxpayer and the tax administration.

Purpose test. Any anti-avoidance measure should include a purpose test, so it does not inadvertently capture bona fide commercial arrangements or structures that have economic substance. This approach would be consistent with Australia's other anti-avoidance rules.

Shortfall penalty provision. Given the ambiguity in these rules, there should not be penalties asserted, particularly if taxpayers are undergoing an Australian Taxation Office (ATO) risk review. We also note that the EM proposes a shortfall penalty provision to penalise SGEs that attempt to avoid income tax, including withholding tax, but the exposure draft legislation does not consider withholding tax for the purpose of denying deductions.

Restructuring. The EM should clarify that restructuring is permissible and that alternative arrangements can satisfy the objective. This approach would be consistent with the EM for Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Bill 2018 (hybrid mismatch rules).

Effective date. ITI encourages postponing enactment of the legislation to better understand how the amendments would interact with implementation of the GloBE Rules and indeed whether the amendments are required at all. If it is determined that there is material benefit to Australia in enacting the proposed amendments, consideration will need to be given to allowing more time for taxpayers to prepare for compliance once Treasury has finalized the rules.

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