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Via Email: MNETaxIntegrity@treasury.gov.au

Dear Assistant Secretary,

The American Chamber of Commerce in Australia (AmCham) writes in response to the release of the Exposure Draft Legislation for the *Multinational tax integrity – denying deductions for payments relating to intangible assets connected with low corporate tax jurisdictions* measure (the 'proposed measure').

This submission does not endorse the need for the rules nor the form of the proposed measures but is concerned with ensuring the proposed measure is appropriately targeted to achieve its originally stated objective by being confined to apply only to tax abusive planning and not to genuine commercial arrangements.

The proposed measure is characterised as an '*anti-avoidance measure*'¹ by the draft Explanatory Materials, and paragraph 26-110(1) of the exposure draft law states that its object is "*to deter significant global entities from avoiding corporate income tax...*"²

The policy announcement which originally raised the proposed measure³ stated that it would be subject to '*consultation to ensure the rules are appropriately targeted at tax minimization and that firms have flexibility around substantiating genuine business transactions.*'

As currently drafted, the proposed measure does not '*...carefully target activities deliberately designed to minimised tax – without creating an extra burden on legitimate business activity.*'⁴ In fact, the proposed measure would apply to legitimate business activities and limit firms' flexibility regarding genuine business transactions.

¹ Exposure Draft Explanatory Materials, Treasury Laws Amendment (Measures for Consultation) Bill 2023: Deductions for Payments Relating to Intangible Assets Connected with Low Corporate Tax Jurisdictions 2023 (Cth), 1.1.

² Exposure Draft Treasury Laws Amendment (Measures for Consultation) Bill 2023: Deductions for payments relating to intangible assets connected with low corporate tax jurisdictions 2023 (Cth), ss26-110(1).

³ Dr Jim Chalmers MP, Stephen Jones MP and Dr Andrew Leigh MP, 'Labor's Plan to Ensure Multinationals Pay Their Fair Share of Tax', (Media Release, Australian Labor Party, 27 April 2022).

⁴ Dr Jim Chalmers MP, Stephen Jones MP and Dr Andrew Leigh MP, 'Labor's Plan to Ensure Multinationals Pay Their Fair Share of Tax', (Media Release, Australian Labor Party, 27 April 2022).

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This misalignment with its publicly stated policy objective is likely to operate as a disincentive to attracting and maintaining direct foreign investment in Australia.

We have not attempted to canvas all potential issues associated with drafting the proposed measure but instead our submission is focused to ensure the proposed measure better achieves its stated objectives.

1. Background

AmCham 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.

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.

For these reasons, AmCham's members consider it pivotal that Australia's taxation settings continue to support foreign investment and the benefits accruing from that investment.

2. Aligning the scope of the proposed measure with its stated purpose

Access to intangible assets is fundamental to the continuing increase in productivity and economic growth in Australia. Australia's fiscal settings generally, and the proposed measure specifically, should not impose barriers to such access which would in turn impede productivity and income growth.

The initial policy announcement for this measure included sensible limitations to ensure that *'firms have flexibility around substantiating genuine business transactions'*⁵ by establishing that the measure should apply only to:

- payments into tax havens and
- payments deliberately designed to minimise tax.

These safeguards would be welcomed in the final legislation as they would assist in ensuring that the proposed measure does not impact genuine business transactions and arrangements which are beyond the stated intent. We refer to our submission of 2 September 2022, and the comments therein, regarding the importance of a tax avoidance purpose and substance based carve-out. These aspects are not reflected in the exposure draft.

⁵ Dr Jim Chalmers MP, Stephen Jones MP and Dr Andrew Leigh MP, 'Labor's Plan to Ensure Multinationals Pay Their Fair Share of Tax', (Media Release, Australian Labor Party, 27 April 2022).

In addition to including a purpose test and a substance based carve out, we would still submit that important refinements can, and must, be made to the proposed measure to ensure that it does not create an extra burden on legitimate businesses.

The remainder of this submission is directed towards recommending improvements to the proposed measure to better serve its stated goal and identifying where further explanation or guidance is required to aid in effective administration of, and compliance with, the proposed measure.

2.1. The proposed measure should not apply where the relevant income is either attributed to or derived by the global parent company

Consistent with the stated objective of not affecting genuine business transactions, income derived by the global parent entity of the relevant multinational group (with economic substance that is not a tax resident of a tax haven) should not be able to trigger the application of the proposed measure.

Payments made to an ultimate parent entity are not “*funnel[ed] into tax havens*”⁶ nor is a simple payment to the parent of the group an example of “*avoiding corporate income tax by structuring their arrangements*.”⁷ Where income is included in the tax base of the global parent entity it is clearly not funnelled into tax havens or the product of tax structuring in order to achieve a favourable tax outcome.

This sensible limitation on the scope of the measure could be achieved by amending proposed section 26-110. For example, in the model of s26-110(3), a subsection could be added to section 26-110 to clarify that income derived by the global parent entity of the multinational group (or otherwise included in the tax base of the ultimate parent entity) is disregarded for the purpose of determining whether there has been income derived in a low corporate tax jurisdiction for the purposes of subsection 26-110(2).

2.2. A jurisdiction which has implemented a QDMTT or is subject to an IRR should not be a Low Corporate Tax Jurisdiction

As noted above, Australia has repeatedly expressed its commitment to the OECD’s ‘two-pillar’ solution and is a signatory to the Inclusive Framework which has endorsed this solution.

Within the Pillar Two model rules (and associated administrative guidance), the definition of a Low-Tax Jurisdiction, which is a jurisdiction with an effective tax rate below the 15% minimum rate prescribed by the model rules, is fundamental. Importantly, any QDMTT is taken into account for determining whether a jurisdiction should bear a Top-up Tax.

For the same policy reasons that means a QDMTT is taken into account when determining the tax base of a jurisdiction for the purposes of the Pillar Two rules, Australia should also factor a QDMTT into the determination of whether a jurisdiction is a ‘low corporate tax jurisdiction’ as defined.

If Australia does not take a QDMTT into account, then this measure would likely be seen as a unilateral measure that is fundamentally inconsistent with the Inclusive Framework’s principled solution (arguably akin to a digital services tax which would be contentious given the commitments to Pillar One).

Such a unilateral action would be damaging to Australia’s attractiveness for foreign investment.

Accordingly, we recommend clarifying section 960-258 by adding a subsection stating that a country will not be a low corporate tax jurisdiction to the extent that it has implemented Pillar Two and / or has a Qualifying Domestic Minimum Top-up Tax.

⁶ Dr Jim Chalmers MP, Stephen Jones MP and Dr Andrew Leigh MP, ‘Labor’s Plan to Ensure Multinationals Pay Their Fair Share of Tax’, (Media Release, Australian Labor Party, 27 April 2022).

⁷ Exposure Draft Treasury Laws Amendment (Measures for Consultation) Bill 2023: Deductions for payments relating to intangible assets connected with low corporate tax jurisdictions 2023 (Cth), ss26-110(1).

2.3. Determining the rate of corporate income tax in a jurisdiction should have regard to subnational taxes

The policy objective of the proposed measure is to “prevent large multinationals from securing an unfair tax advantage over other Australian businesses”⁸ and it does so by focusing on whether there is “insufficient tax being paid.”⁹

The level of government that levies the relevant income tax is irrelevant to determining whether a multinational has secured an unfair advantage, or whether sufficient tax is being paid. Subnational taxes are a real cost to multinationals and thus should be taken into account in determining whether a jurisdiction is a low corporate tax jurisdiction.

In this respect, arguably subnational (State, Municipal, Cantonal or Local) may already be included in the relevant statutory text of the proposed measure.

However, paragraph 1.55 of the Explanatory Material suggests that “[o]nly national level corporate tax is relevant for determining whether a foreign country is a low corporate tax jurisdiction.”¹⁰ This creates sufficient uncertainty to warrant a change to the proposed statutory text.

Importantly, neither of the two Australian anti-avoidance rules that rely on the level of foreign tax which is imposed exclude subnational foreign taxes:

- The sufficient foreign tax test contained in section 177L of the *Income Tax Assessment Act (ITAA) 1936* refers to ‘foreign income tax’ as defined in section 770-15(2) of the ITAA 1997. This definition includes subnational income taxes; and
- The foreign interposed zero or low rate lender rule contained in Subdivision 832-J explicitly includes municipal and State taxes in working out what is subject to foreign income tax.¹¹ The Explanatory Memorandum to the Bill which clarified this noted that “the hybrid mismatch integrity rule is intended to apply only if a scheme results in the total foreign income tax being imposed on a payment is at a rate of 10 per cent or less.”¹²

It is logically and legislatively inconsistent for the definition of low corporate tax jurisdiction in the proposed measure to exclude subnational foreign income taxes.

Accordingly, the definition of low corporate tax jurisdiction contained in proposed section 960-258 should be amended to include a subsection clarifying that, for the purposes of determining whether the rate of corporate income tax is less than 15%, regard should be had to all forms of foreign income tax.

2.4. Withholding tax and CFC taxation should be included in determining whether the proposed measure should apply

Similar to the comments at 2.3 above, the policy objectives of the proposed measure are best met when the total tax burden is taken into account in determining whether income has been derived in a Low Corporate Tax Jurisdiction.

The drafting to achieve this outcome can also utilise concepts which already exist in the law. For example, section 832-130(5) already contains drafting including CFC taxation in the definition of subject to foreign tax.

⁸ Exposure Draft Explanatory Materials, Treasury Laws Amendment (Measures for Consultation) Bill 2023: Deductions for Payments Relating to Intangible Assets Connected with Low Corporate Tax Jurisdictions 2023 (Cth), 1.2.

⁹ Exposure Draft Explanatory Materials, Treasury Laws Amendment (Measures for Consultation) Bill 2023: Deductions for Payments Relating to Intangible Assets Connected with Low Corporate Tax Jurisdictions 2023 (Cth), 1.16.

¹⁰ Exposure Draft Explanatory Materials, Treasury Laws Amendment (Measures for Consultation) Bill 2023: Deductions for Payments Relating to Intangible Assets Connected with Low Corporate Tax Jurisdictions 2023 (Cth), 1.55.

¹¹ Subsection 832-725(1A) of the ITAA 1997.

¹² Explanatory Memorandum, Treasury Laws Amendment (2020 Measures No. 2) Bill 2020 (Cth), 1.89.

The scope of the proposed measure could be appropriately targeted by adding the subject to foreign income tax test (at a rate of 15%) as an alternative to the Low Corporate Tax Jurisdiction. For example, language similar to section 832-725(1)(g)(i) could be added as an alternative test in section 26-110(2)(c) – so that the proposed measure would only apply where there is income derived in a Low Corporate Tax Jurisdiction, that is subject to foreign income tax at a rate of 15% or less.

Similarly, any Australian royalty withholding tax should be taken into account in determining whether a foreign country is a low corporate tax jurisdiction. The draft legislation does not currently take withholding tax into account, which would mean that any royalty paid to a non-resident that is subject to Australian withholding tax (at 30% for payments to non-treaty countries) could still give rise to a denial of deduction for the payment, notwithstanding that corporate tax has been paid at up to 30% in Australia.

Such an approach would ensure the proposed measure is appropriately targeted to achieve its stated objectives.

2.5. Differences in tax base should not cause a jurisdiction to be deemed to be a Low Corporate Tax Jurisdiction

Paragraph 960-258(2)(d) creates considerable uncertainty in the practical application of the section 960-258 definition.

A plausible, but not preferred, interpretation of this paragraph could suggest that an amount which Australia would consider to be income, but which is not relevantly included in a jurisdiction's tax base, could cause a jurisdiction to be considered a Low Corporate Tax Jurisdiction.

Such a reading could cause absurd consequences. For example, jurisdictions such as New Zealand which does not tax capital gains, or the United States which does not tax certain tax-exempt government bonds could be considered Low Corporate Tax Jurisdictions under such a reading of paragraph 960-258(2)(d).

For this reason, we submit that the application of paragraph 960-258(2)(d) should be clarified – ideally by amendment to the statutory text, or at the least through appropriate guidance in the explanatory memorandum.

2.6. Treaty jurisdictions should not be considered to be Low Corporate Tax Jurisdictions

This Government has recognized that “[t]ax treaties improve tax system integrity through the establishment of a bilateral framework of cooperation on the prevention of tax evasion, the collection of tax debts and rules to address tax avoidance”¹³ and that they provide businesses with “greater tax certainty which will encourage increased economic integration.”¹⁴

Denying deductions where there are payments made to, or income derived by, a jurisdiction with which Australia has a tax treaty runs counter to these objectives. Accordingly, we recommend that the definition of Low Corporate Tax Jurisdiction be amended to clarify that a jurisdiction with which Australia has a tax treaty would not be a Low Corporate Tax Jurisdiction.

This would be consistent with the scope of regimes which Treasury noted as being potentially comparable to the proposed measure, such as the Offshore Receipts in respect of Intangible Property (ORIP) rules imposed by the United Kingdom.

¹³ Dr Andrew Leigh MP, Assistant Minister for Competition, Charities and Treasury, ‘Tax treaty network expansion’, (Media Release, Australian Government, 16 November 2022), <<https://ministers.treasury.gov.au/ministers/andrew-leigh-2022/media-releases/tax-treaty-network-expansion>>.

¹⁴ Dr Andrew Leigh MP, Assistant Minister for Competition, Charities and Treasury, ‘Tax treaty network expansion’, (Media Release, Australian Government, 16 November 2022), <<https://ministers.treasury.gov.au/ministers/andrew-leigh-2022/media-releases/tax-treaty-network-expansion>>.

2.7. Limitation of deduction denial to the lesser of the extent to which the payment relates to the right to exploit an intangible asset or the amount of income derived in the Low Corporate Tax Jurisdiction

This point is made for the avoidance of doubt as it appears abundantly clear that this should be the appropriate policy outcome.

However, for completeness, we note that there is uncertainty created by the statutory text of the proposed measure whereby the apportionment language contained in s26-110(2) (which limits the deduction denial to the extent to which the payment relates to the right to exploit the intangible assets), does not also apply to section 26-110(2)(c)'s reference to the derivation of income in the Low Corporate Tax Jurisdiction.

This could arguably lead to a manifestly absurd outcome where \$1 of income derived in a Low Corporate Tax Jurisdiction could cause the entirety of a payment to be rendered non-deductible.

Additionally, the draft legislation contains a 'cliff-edge' effect whereby the entire amount of a deduction will be denied to the extent that income is derived in a low corporate tax jurisdiction (assuming the above issue is addressed), irrespective of the rate of tax in that foreign jurisdiction. For example, a payment to Ireland may be subject to corporate tax at its headline rate of 12.5%, yet the entire payment would be denied a deduction in Australia. This is out of step with the agreed framework under Pillar Two, which includes top-up tax to the extent of the difference in foreign tax below a 15% rate. Australia risks becoming an outlier compared to agreed global norms for addressing a minimum tax level and we recommend the proposed measure is changed to only deny a deduction to the extent of the difference in tax rate below 15%, e.g. 16.67% of the abovementioned payment to Ireland would be denied a deduction (calculated at $[15\% - 12.5\%] / 15\%$).

3. Areas requiring more clarity

As noted above, the purpose of this submission is to ensure that the proposed measure appropriately satisfies its stated objectives. Accordingly, we do not propose to discuss every potential issue.

However, for completeness, we note that the proposed measure contains many concepts of uncertain application, including but not limited to:

- the concept of apportionment contained in the phrase '*to the extent that the payment is attributable to a right to exploit an intangible asset*'¹⁵
- what constitutes a '*related arrangement*'¹⁶
- the definition of '*income*' for the purposes of paragraph 26-110(c)
- the meaning of what constitutes '*exploiting the intangible asset*'¹⁷
- the meaning of intangible asset¹⁸
- aspects of the definition of low corporate tax jurisdiction including subparagraphs (2)(a) – (e) and
- examples of arrangements to which the rules would not apply (i.e. examples where an Australian entity would not have the right to exploit intangible assets)
- an Australian subsidiary of a multinational group involved in advance manufacturing may export rights to use IP, possibly more than it imports due to the amount of R&D and other activities performed in Australia. We expect the Government would want to encourage this type of activity in Australia. However, it could be penalised unfairly by these rules. As with the new proposed thin capitalisation rules, we would recommend managing this issue by limiting the scope of these rules to net offshore payments to exploit an intangible asset (such that it can only apply to a net importer of IP).

¹⁵ Exposure Draft Treasury Laws Amendment (Measures for Consultation) Bill 2023: Deductions for payments relating to intangible assets connected with low corporate tax jurisdictions 2023 (Cth), s26-110(2).

¹⁶ Exposure Draft Treasury Laws Amendment (Measures for Consultation) Bill 2023: Deductions for payments relating to intangible assets connected with low corporate tax jurisdictions 2023 (Cth), s26-110(2)(b).

¹⁷ Exposure Draft Treasury Laws Amendment (Measures for Consultation) Bill 2023: Deductions for payments relating to intangible assets connected with low corporate tax jurisdictions 2023 (Cth), s26-110(2)(c)(iv) and s26-110(9).

¹⁸ Exposure Draft Treasury Laws Amendment (Measures for Consultation) Bill 2023: Deductions for payments relating to intangible assets connected with low corporate tax jurisdictions 2023 (Cth), s26-110(5)

This clarification could be through amendments to the proposed statutory text or through additional explanatory materials.

4. Sensible tax administration and public guidance

The potentially broad ambit of the proposed measure, and the uncertainty that could result from that breadth, highlights the importance of sensible and timely public guidance as to the administration of this measure.

Similar to the diverted profits tax and the hybrid mismatch legislation, we would appreciate sensible and timely guidance from the Australian Taxation Office (ATO) in respect of the proposed measure, including in the form of Law Companion Rulings and Practical Compliance Guidelines. This guidance should include explanations of the areas outlined at (3) above.

5. Restructuring and penalties

The proposed measure could deny deductions for payments which may already be subject to royalty withholding tax (a final tax). The cumulative impact of a deduction denial and royalty withholding tax resulting in double taxation that would render operating in Australia uneconomic.

Accordingly, it is reasonable to expect that taxpayers may restructure their operations to mitigate against this punitive outcome. A behavioural response from taxpayers to move out of structures to which an anti-avoidance rule may apply is an intended and positive outcome.

Therefore, it would be useful to include guidance consistent with that provided in respect of the hybrid mismatch rules,¹⁹ that such a behavioural response is consistent with the objectives of this legislation, and the ATO should provide guidance regarding the potential application of the general anti-avoidance rule to such restructures also.

The Exposure Draft Explanatory Material also requests stakeholder views in respect of the potential drafting of such a penalty provision. In this respect, we submit that Australia's penalty provisions for SGEs are already amongst the most punitive in the world. Moreover, section 284-145(1)(b)(i) already ensures that scheme penalties apply where there is a sole or dominant purpose of getting a scheme benefit, meaning that no additional penalty regime should be required to address the stated concerns.

6. Conclusion

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

Kind regards,



April Palmerlee
Chief Executive Officer
AP: ao

¹⁹ Revised Explanatory Memorandum, Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Bill 2018, 1.20.