

Submission to the exposure draft on denying deductions for payments relating to intangible assets connected with low corporate tax jurisdictions

BCA Submission

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Contents

1.	Overview.....	2
2.	Key recommendations.....	2
3.	Additional information	3
3.1	A solution in search of a problem in search of a solution	3
3.2	A broad application antithetical to a modern economy	4
3.3	Other issues.....	5
3.3.1	Low corporate tax jurisdiction	5
3.3.2	Tax preferential patent box regime	5
3.4	Inadequate impact analysis and consultation	5
3.4.1	Inadequate impact analysis	5
3.4.2	Inadequate time for consultation.....	6

1. Overview

The Business Council welcomes the opportunity to provide a submission to the consultation on proposed changes to deny deductions for payments relating to intangible assets connected with low corporate tax jurisdictions.

All companies must meet their tax obligations and where arrangements do not keep pace with community norms, they should be reviewed. Robust tax integrity and transparency measures are an integral complement to more competitive business tax arrangements.

Australia has some of the strongest tax integrity rules in the world, and they have been strengthened over time.¹ Existing integrity measures, institutions and enforcement all contribute towards and complement a high level of compliance with our tax system. The Australian Taxation Office (ATO) is a strong, capable, active and well-resourced administrator, with extensive powers and a strict interest and penalty regime. The ATO workforce focused on large companies is “larger and more skilled than it has ever been”, and it has one-to-one engagement with large companies for assurance over approximately two-thirds of all corporate tax (around \$60 billion).²

The BCA urges the government to follow through with its commitment 12 months ago to introduce a measure to “carefully target activities deliberately designed to minimise tax – without creating an extra burden on legitimate business activity.”³ The proposal as it currently stands does not achieve these objectives. It is still unclear with this proposal what the precise problem to be solved for is or why Australia’s existing integrity rules are inadequate. At the same time, the proposed measure has a potentially wide application that creates enormous uncertainty, significantly higher compliance activity and costs, the potential for double taxation and reduces incentives to invest in Australia.

The tax system must ensure that the Australian economy, which is heavily reliant on trade and foreign investment, remains competitive, strong and continues to grow. A frontier economy is one in which Australian firms and industries are at the global cutting edge of new value creation and productive efficiency. Being at the frontier will lay the groundwork for delivering more productive, higher paying, and more secure jobs. This relies on businesses – and governments – adopting new technologies, new software tools, taking advantage of data, adopting new processes, increasing research and development, and increasing cyber resilience. Simply put, having access to these intangible assets is becoming increasingly important. But Australia is an international laggard when it comes to intangibles investment and the policy environment is becoming increasingly antipathetic to it.

The proposed changes will significantly increase the cost of doing business in Australia, alongside several tax and other related measures. It is therefore critical to maintain a competitive business environment overall, while signalling to investors that Australia is open for business.

2. Key recommendations

1. The proposed integrity measure should not proceed in its current form. A thorough consultation process must clearly identify the problem to be solved, establish why existing laws may not adequately address the problem and identify a targeted solution that continues to support genuine commercial activity.
2. Any anti-avoidance rule should be highly targeted to not adversely impact genuine commercial activity. A purpose- and substance-based test could help achieve this.

¹ Commonwealth of Australia, Treasury, 2018, *The Digital Economy and Australia’s Corporate Tax System*, Treasury Discussion Paper, October.

² <https://www.ato.gov.au/General/Tax-and-Corporate-Australia/We-are-an-active-and-capable-administrator/>

³ <https://jimchalmers.org/latest-news/media-releases/labor-s-plan-to-ensure-multinationals-pay-their-fair-share-of-tax/>

3. Do not proceed with the regulation-making power to prescribe new assets to which the proposed law applies.
4. Any definition of low corporate tax jurisdiction should include subnational corporate taxes and consider all taxes paid on income.
5. Do not proceed with the regulation-making power to prescribe countries as having a preferential patent box regime.
6. Any proposed changes should be subject to a comprehensive assessment that follows best practice principles. This includes the problem to be solved must be well understood, new regulation is subject to cost-benefit analysis, adequate time for consultation, and regulation must achieve objectives at least cost.

3. Additional information

3.1 A solution in search of a problem in search of a solution

The original election commitment 12 months ago was about “limiting the ability for multinationals to abuse Australia’s tax treaties when holding intellectual property in tax havens.”⁴ It was explained the range of announced measures “carefully target activities deliberately designed to minimise tax – without creating an extra burden on legitimate business activity.”⁵

The initial consultation on this proposal then focused on “a new rule limiting MNEs’ [multinational enterprises] ability to claim tax deductions for payments relating to intangibles and royalties, that can lead to insufficient tax paid.”⁶

The latest version of the proposal is targeted at denying tax deductions for Significant Global Entities (SGEs) “structuring their arrangements so that income from exploiting intangible assets is derived in a low corporate tax jurisdiction by an associate of that SGE, while deductions for payments made by the SGE to an associate that are attributable to those or related intangible assets are claimed in Australia.”

Australia’s existing tax integrity laws are some of the most stringent in the developed world. They are regularly under review and have been comprehensively amended over the past few years, while new laws have also been introduced. These include:

- our robust transfer pricing rules which apply to the prices charged on transactions between related companies, including for the sale/purchase of goods and services
- a comprehensive foreign income anti-deferral regime that ensures that tax is paid in Australia on income that is not comparably taxed overseas
- extensive specific and general anti-avoidance rules which target arrangements where the principal purpose is to obtain a tax benefit
- robust thin capitalisation laws that ensure multinationals do not allocate an excessive amount of debt to their Australian operations
- the Multinational Anti-Avoidance Law was introduced to address concerns around artificial and contrived arrangements used to avoid the attribution of profits to a permanent establishment in Australia
- the Diverted Profits Tax was introduced to prevent the diversion of profits offshore through contrived arrangements.

⁴ <https://jimchalmers.org/latest-news/media-releases/labor-s-plan-to-ensure-multinationals-pay-their-fair-share-of-tax/>

⁵ Ibid.

⁶ The Australian Government the Treasury, 2022, *Government election commitments: Multinational tax integrity and enhanced tax transparency*, Consultation paper, August.

It continues to be the case that a clear problem that requires a specific measure to address it has not been defined. This should include an explanation as to how and why any outlined problem is not already addressed by Australia's existing integrity rules. At the same time, the government has flagged a desire to be an early adopter of Pillar Two from the OECD's Two-Pillar Solution, which includes a 15 per cent minimum effective rate through introduction of a Qualified Domestic Minimum Top-up Tax.⁷ It is unclear how the proposed law will interact with Pillar Two, or its purpose given this context.

Recommendation 1

The proposed integrity measure should not proceed in its current form. A thorough consultation process must clearly identify the problem to be solved, establish why existing laws may not adequately address the problem and identify a targeted solution that continues to support genuine commercial activity.

3.2 A broad application antithetical to a modern economy

Both the draft Explanatory Memorandum and a review of the draft legislation are clear – the proposal will have a broad application. It does not meet the original commitment to “carefully target activities deliberately designed to minimise tax – without creating an extra burden on legitimate business activity.”⁸ The example in Paragraph 1.47 of the draft Explanatory Memorandum outlines a case where the proposal should not apply – but even in such an example there is uncertainty as it notes the proposal is “unlikely” to apply.

The draft legislation applies to certain transactions but gives no regard for the purpose or substance of these transactions – or how existing tax integrity rules may deal with any concerns. The result is a measure with potentially wide application. This creates enormous uncertainty, significant compliance costs, the potential for double taxation and reduces incentives to invest in Australia. These issues are further compounded by the potentially limitless scope of the measure through the regulation-making power to prescribe new assets under which it applies.

Investment in intangibles has increased dramatically in Australia over the past 60 years, growing from 3 per cent to 18 per cent of total business investment. But Australia is an OECD laggard by most metrics when it comes to investment in intangibles, implying we are underperforming in a relative sense. Relative to the OECD we have the second lowest share of intangibles investment as a share of total investment and the fourth slowest real growth rate in intangibles investment over the past decade.

This measure should be viewed alongside the ongoing stasis around the proposed patent box regime and the decision to not proceed with allowing taxpayers to self-assess the effective life of intangible depreciating assets.⁹ Combined, they demonstrate antipathy to the investment needed for a modern economy and could limit Australia from accessing modern technology and assets as global companies would be disincentivised from sharing intellectual property with their Australian subsidiaries to avoid payments from Australia and limit the application of these proposed rules. Priority funding areas under the National Reconstruction Fund, including renewables and low emissions technologies, medical science, transport, agriculture, resources and defence, all depend on both tangible and intangible investment

Recommendation 2

Any anti-avoidance rule should be highly targeted to not adversely impact genuine commercial activity. A purpose- or substance-based test could help achieve this.

Recommendation 3

Do not proceed with the regulation-making power to prescribe new assets to which the proposed law applies.

⁷ <https://ministers.treasury.gov.au/ministers/andrew-leigh-2022/transcripts/interview-tom-connell-newsday-sky-news>

⁸ <https://jimchalmers.org/latest-news/media-releases/labor-s-plan-to-ensure-multinationals-pay-their-fair-share-of-tax/>

⁹ Budget October 2022-23, Budget Measures, Budget Paper No. 2

3.3 Other issues

3.3.1 Low corporate tax jurisdiction

The definition of the new concept 'low corporate tax jurisdiction' is critical to this proposal. However, the application in practice gives rise to several issues:

- The focus on the national level corporate tax rate ignores the fact corporate taxes also apply at the subnational level, for example in around a quarter of OECD countries. They result in a doubling of the corporate tax rate in Switzerland and almost doubling in Germany and Canada. This can result in perverse outcomes such as a scenario where a country reduced its national corporate rate below 15 per cent while subnational rates were increased such that there is no change in the combined effective tax rate. They would now fall within scope of the law, despite no change in tax paid.
- Where different rates of income tax apply to different types of income, only the lowest tax rate is considered. It is unclear why this would be the case – particularly if the lowest tax rate does not apply in practice – given the purpose of this measure is that of an anti-avoidance rule. Furthermore, where a tax preferential patent box regime is determined, the entire country is deemed a low corporate tax jurisdiction rather than the relevant income.

Recommendation 4

Any definition of low corporate tax jurisdiction should include subnational corporate taxes and consider all taxes paid on relevant income.

3.3.2 Tax preferential patent box regime

The OECD periodically, and comprehensively, reviews preferential tax regimes (including patent box regimes) to determine if sufficient economic substance exists. These were recently updated in January this year, and the OECD does not list any harmful regimes at this time.¹⁰ The proposed changes provide the Minister with a regulation-making power to list countries as being a low corporate tax jurisdiction.

It is unclear why Australia would undertake a unilateral process for determining which countries have tax preferential tax regimes. Nor is it clear Australian officials would be better equipped or resourced than the OECD to undertake this analysis. A reference to the *OECD Forum on harmful tax practices* should be sufficient to achieve the policy intent of quickly responding to any concerns about changes to, or the introduction of, new patent box regimes around the world.

Recommendation 5

Do not proceed with the regulation-making power to prescribe countries as having a preferential patent box regime.

3.4 Inadequate impact analysis and consultation

3.4.1 Inadequate impact analysis

There is no evidence that the proposed changes have been put through a comprehensive policy development or assessment process that follows best practice principles. This includes clarity around how many companies are expected to be impacted by the proposal. The Office of Impact Analysis notes new policies should include:

- clearly identifying and defining the problem to be solved
- clearly identifying a legitimate reason for government action

¹⁰ <https://www.oecd.org/tax/beps/harmful-tax-practices-consolidated-peer-review-results-on-preferential-regimes.pdf>

- identifying a range of genuine policy options
- identifying the net benefits of each option
- explaining the purpose and objectives of consultation
- indicating the preferred option
- discussing what success looks like and how it will be achieved.¹¹

In this context it is also unclear how the law will interact with Pillar Two from the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting. This is particularly concerning given the desire for Australia to be an early adopter of Pillar Two.¹² No regard is given for countries that plan to implement a 15 per cent minimum effective rate through introduction of a Qualified Domestic Minimum Top-up Tax. For example, Ireland has committed to implementing it but appears it will continue to have a 12.5 per cent national corporate tax rate.¹³

3.4.2 Inadequate time for consultation

The consultation period for the proposed measure is unreasonably short given the proposal is due to commence in two months. The draft legislation is out for less than 30 days of consultation, across a period that includes Easter and ANZAC Day public holidays. The BCA notes that the Best Practice Consultation Guidance Note issued by the Department of Prime Minister and Cabinet recommends a minimum consultation period of 30 days.¹⁴ The Note also maintains that longer consultation periods may be necessary when they fall around holiday periods.

The 1 July 2023 start date for the measure may be too soon given the myriad of outstanding issues, complexity, need to update existing systems and processes, limited time for consultation and implementation, and concurrent multinational tax reforms. It is also warranted given the original announcement committed to “ensuring there is the right amount of time to consult with industry on the implementation of these rules”.¹⁵

Inadequate consultation periods and impact analyses have been seen across a number of recent consultations, particularly those dealing with sensitive and complex proposals with high political salience. This is likely to produce sub-optimal policymaking, with increased risk of unintended consequences. The BCA continues to monitor Treasury’s overall adherence to principles of best practice consultation.

Recommendation 6

Any proposed changes should be subject to a comprehensive assessment that follows best practice principles. This includes the problem to be solved must be well understood, new regulation is subject to cost-benefit analysis, adequate time for consultation, and regulation must achieve objectives at least cost.

¹¹ <https://oia.pmc.gov.au/resources/guidance-impact-analysis/7-impact-analysis-questions>

¹² <https://ministers.treasury.gov.au/ministers/andrew-leigh-2022/transcripts/interview-tom-connell-newsday-sky-news>

¹³ <https://www.gov.ie/en/press-release/f344f-minister-mcgrath-launches-next-phase-of-consultation-on-eu-minimum-tax-directive/>

¹⁴ Best Practice Consultation Guidance Note, Department of Prime Minister and Cabinet, March 2020.

¹⁵ <https://oia.pmc.gov.au/sites/default/files/2021-09/best-practice-consult.pdf>

¹⁵ <https://jimchalmers.org/latest-news/media-releases/labor-s-plan-to-ensure-multinationals-pay-their-fair-share-of-tax/>

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