

28 April 2023

Ronita Ram
A/g Assistant Secretary
Tax Treaties Branch
Corporate and International Tax Division
Treasury
Langton Cres
Parkes ACT 2600

Via email: MNETaxIntegrity@treasury.gov.au

Dear Ms Ram,

Re: Treasury Laws Amendment (Measures for Consultation) Exposure Draft 2023: Deductions for payments relating to intangible assets connected with low corporate tax jurisdictions ('the Exposure Draft')

Medicines Australia leads the research-based medicines industry of Australia. Our members discover, develop and manufacture prescription medicines, biotherapeutic products and vaccines that bring health, social and economic benefits to Australia. Medicines Australia and its members are seeking to continue our collaborative partnership with the Australian Government to ensure that Australia's first-class health care system can continue to deliver lifesaving and life changing medicines to Australian patients.

Medicines Australia welcomes the opportunity to provide a submission in respect of the Exposure Draft. This submission includes broad comments which are relevant to our members. We note that some of our members may make individual submissions with other points relevant to their specific circumstances.

General comments

The Exposure Draft is complex and challenging to administer based on the current drafting and will be unnecessarily difficult for companies to reliably self-assess. The Exposure Draft would be aided by the inclusion of further examples in the explanatory materials to assist taxpayers to understand the anticipated application of the final law, and to assist with the potential compliance burden associated with reaching conclusions on the scope of several new or adapted concepts, including the concept of 'mischaracterisation'.

The final law should better align to the policy intent made by the Government in their election commitment

The Exposure Draft forms part of the Government's election commitment "*Plan to ensure Multinationals Pay Their Fair Share of Tax*"¹. The specific component² within the election commitment is labelled "*Tax havens integrity*".

¹

https://www.aph.gov.au/About_Parliament/Parliamentary_departments/Parliamentary_Budget_Office/General_elections/2022_General_election/2022_Election_commitment_costings

² Component 3

Additionally, a media release prior to the 2022 Election³ states “*multinational companies have been using tax havens and tax avoidance schemes to avoid paying tax in Australia*” and describes the purpose of the proposed measure as “*limiting the ability for multinationals to abuse Australia’s tax treaties when holding intellectual property in tax havens*”.

We consider specific changes should be made to the Exposure Draft to be introduced into Parliament to more closely align to this intent, and we make three recommendations as follows:

RECOMMENDATION: The final law should not apply to genuine commercial arrangements

The Exposure Draft explanatory material states the rule is designed “*to deter SGEs from avoiding income tax...*”⁴ and further states that “*it is not intended for this anti-avoidance rule to inappropriately apply to genuine supply and distribution arrangements between associates, where there is no tax avoidance behaviour*”⁵. These statements appear to be aligned with the statements made in respect of the proposed measure in 2022.

However, there does not appear to be any part of the Exposure Draft which provides a safeguard to satisfy these stated intentions. Such safeguards are provided by way of a purpose test in Australia’s main tax anti-avoidance rules⁶ and a sufficient economic substance test within the Diverted Profits Tax.

The inclusion of a dominant purpose test and/or a substance-based exclusion test would align to other integrity measures and take out of scope genuine supply and distribution arrangements, for example where intangible assets are located in the same jurisdiction as the performance of related significant functions⁷, or where the location of intangible assets aligns to the history and origination of a multinational group.

Such safeguards would also limit the compliance burden of groups who operate genuine supply and distribution arrangements and where officers of Australian companies, who will be required to self-assess, may not have visibility to be able to map and trace payments through the global operating model. We recommend a dominant purpose test and a sufficient economic substance test are included in the final law to incorporate this safeguard.

RECOMMENDATION: The definition of a low corporate tax jurisdiction should be updated

The rate of 15% appears aligned to the Government’s commitment to supporting a 15% minimum tax under the OECD’s Global Two Pillar Plan⁸. However, in using the headline rate of tax in a jurisdiction within the definition of a low corporate tax jurisdiction, the Exposure Draft does not appear to incorporate any tax that will be paid under the Two Pillar Plan (and specifically under Pillar Two which will establish a 15% minimum tax). We recommend the definition is updated to include any tax that is paid in a jurisdiction in reaching the 15% minimum tax threshold under Pillar Two.

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

⁴ Paragraph 1.1 of the exposure draft explanatory materials

⁵ Paragraph 1.47 of the exposure draft explanatory materials.

⁶ The general provisions of Part IVA, the Multinational Anti-Avoidance Law and the Diverted Profits Tax.

⁷ For example Development, Enhancement, Maintenance, Protection and Exploitation or ‘DEMPE’ functions

⁸ Component 1 of the Election Commitment of the ‘Plan to ensure Multinationals pay their fair share of tax’.



We also recommend that the definition of a low corporate tax jurisdiction also incorporates other taxes which might be paid in respect of the income of the recipient including tax paid under controlled foreign company regimes, state or municipal taxes and withholding tax.

Furthermore, we recommend that there is an exclusion to the definition of a low corporate tax jurisdiction for income received by the ultimate parent entity or jurisdiction of the ultimate parent entity where there is also sufficient economic substance in that jurisdiction.

RECOMMENDATION: Incidental use of intangible assets in marketing and promoting tangible goods should not be caught

The Exposure Draft explanatory materials consider the concept of mischaracterisation stating that “*These amendments apply where a contract provides that a payment is made for other things, such as services and tangible goods, and the arrangement also results in the SGE or another entity exploiting, or acquiring a right to exploit, an intangible asset, even at no cost.*”⁹

Concerns related to mischaracterisation were raised in a narrower context by the ATO in Taxpayer Alert 2018/2: *Mischaracterisation of activities or payments in connection with intangible assets*. This Taxpayer Alert was specifically discussed in the Consultation Paper released by Treasury in August 2022¹⁰ in relation to this measure.

The Taxpayer Alert states its concerns as including “*whether intangible assets have been appropriately recognised for Australian tax purposes*”. However, the Taxpayer Alert also states “*This Taxpayer Alert... does not apply to international arrangements which involve an incidental use of an intangible asset... Whether a use is incidental in this sense will depend on an analysis of the true relationship and activities of the parties*”.

We recognise there is no firm threshold between incidental and non-incidental use and each arrangement may need to be considered on its own facts and circumstances. However, we consider it common for intangible assets to be used in the marketing and promoting of tangible products in a highly controlled and restricted manner whereby the value of such rights is generally seen as being of a negligible amount. We recommend the final law incorporates an exclusion for the incidental use (exploitation) of intangible assets. We also recommend several examples are included in the final explanatory memorandum (and in any ATO guidance) on mischaracterisation which will enable our members to better consider the implications of the final law to their arrangements.

Yours sincerely,

Elizabeth de Somer
CEO
Medicines Australia

⁹ Paragraph 1.37 of the exposure draft explanatory materials

¹⁰ <https://treasury.gov.au/sites/default/files/2022-08/c2022-297736-cp.pdf>.