



NESTLÉ S.A.

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Multinational Tax Integrity – denying deductions for payments relating to intangible assets connected with low corporate tax jurisdictions: Consultation response by Nestlé S.A

1 Introduction

We welcome the opportunity to provide comments on the Government's *Exposure Draft - Treasury Laws Amendment (Measures For Consultation) Bill 2023: Deductions For Payments Relating To Intangible Assets Connected With Low Corporate Tax Jurisdictions* which was released on 31 March 2023.

Nestlé ("Nestlé Group" or "the Group") is extremely concerned that this proposed legislation may significantly and unfairly penalise the Group merely because it has been headquartered in Switzerland since its creation more than 150 years ago. We understand that the intent of the proposed legislation is to prevent the avoidance of tax through structured arrangements that do not have appropriate substance. We certainly understand potential legislation attempting to prevent abusive situations, however we would like to believe that it would not be the intent of the Government to target genuine business arrangements from Switzerland-headquartered MNEs, such as Nestlé.

We set out below the consequences to Nestlé of the proposed legislation in order to assist Treasury in understanding the potential detrimental impacts and unintended consequences that this proposed legislation could have. We first provide an overview of the Nestlé Group in Switzerland, then describe the substance and genuine commercial nature of the operating arrangements between Australia and Switzerland, as well as the impact this proposed legislation could have, before finally setting out our specific concerns and recommendations on the proposed legislation.

2 Nestlé Group

Founded in 1866 in Switzerland, Nestlé has become the world's leading nutrition, health and wellness company. Nestlé's product portfolio includes baby food, bottled water, cereals, chocolate and confectionery, coffee, culinary, chilled and frozen food, dairy products, drinks, food service, healthcare nutrition, ice cream, pet care products, vitamins, and weight management products. The Group is the largest industrial company in Switzerland with annual sales of over CHF 94.4 billion in 188 countries and around 275'000 employees. The Group operates 344 factories in 77 countries.

With more than 2,000 brands, Nestlé is known almost everywhere and has a reputable brand for products that are used by millions every day. Nestlé brands are underpinned by significant investment in innovation which helps to keep the organization as a market leader. As the owner of Nestlé's intangible assets for more than 100 years, the head office in Switzerland is responsible for development, enhancement, maintenance, protection, and exploitation of the Group's intellectual property ("IP"). It also incurs all expenses and costs related to that IP.



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Nestlé employs 4,100 research and development (“R&D”) employees globally (with about 1,760 located in Switzerland). The annual R&D investment for the Nestlé Group for 2022 was CHF 1.7 billion (with 64% of the spend directly incurred in Switzerland).

Besides brands, patents, and R&D, the head office over the years has accumulated a wealth of proprietary knowledge, know-how, and expertise. Moreover, the head office is responsible for gathering, developing, and making available to Nestlé affiliates around the world all the technical and commercial know-how and expertise required for managing and developing their businesses.

3 Nestlé Australia

The Nestlé Group established its presence in Australia more than 100 years ago with the opening of its first Australian sales branch in Sydney in 1905. By 1906, Australia had become the second largest export market for Nestlé and was served by a network of sales agents. On 30 June 1921, Nestlé Australia Limited (“NAL”) was incorporated as the operating entity for the Nestlé Group in Australia. In 1999, NAL’s head office became headquarters for the Oceania Region, which includes Nestlé operations in Australia, New Zealand, and the Pacific Islands. The total number of employees of NAL as of FY2021 was approximately 3,800.

NAL manufactures products for distribution in Australia, as well as for its overseas affiliates, from its 6 manufacturing facilities in the Australian states of Queensland (Gympie), New South Wales (Smithtown and Blayney) and Victoria (Wahgunyah, Broadford and Campbellfield). NAL also purchases products manufactured by its overseas affiliates, which it then distributes within Australia. NAL’s sales in FY2021 were AUD 2.344 billion, including export sales to affiliates.

4 Nestlé Australia’s royalty arrangement with Nestlé Switzerland

NAL (as every other Nestlé affiliate around the world) pays a royalty to Nestlé in Switzerland for the use of its IP. As part of Nestlé’s commitment to tax transparency, Nestlé has initiated a global Advance Pricing Arrangement (“APA”) program and engaged in discussions and concluded many bi-lateral APAs (“BAPAs”) with various tax authorities around the world, regarding the appropriate amount of payments for licensing the Group’s IP. In Australia, Nestlé has been working proactively and transparently with the Australian Taxation Office (“ATO”) since 2018 to negotiate a BAPA with the Swiss Tax Authority to agree on the appropriate royalty payment to Switzerland for use of the Group’s IP. This BAPA is in the final stages of being negotiated between the two tax authorities.

5 Impact of the proposed legislation

If the proposed new rules were to apply to Nestlé in their current form (of which there is much uncertainty given the current drafting – see below comments in **Section 6**), there would be a 100% denial of deductions for NAL’s payment to Nestlé in Switzerland for its IP, despite the fact that this payment relates to a substantive arrangement between NAL and the Nestlé Group’s Switzerland-based IP, at an amount which will be agreed under a BAPA.

We have estimated that the effective tax rate in Australia will be over 50% as a result of the proposed disallowance. Given the commerciality of its arrangements, this significantly detrimental impact to Nestlé seems to be an extraordinarily unfair and unintended consequence of proposed legislation that is designed to target tax-avoidance arrangements.

6 Nestlé's specific concerns and recommendations for amendments to the Exposure Draft

We set out below our specific concerns and recommendations in respect of the Exposure Draft:

1. It is currently unclear whether the corporate income tax ("CIT") rate utilized in determining a low-tax jurisdiction would include cantonal and communal taxes ("ICC"), even though these are recognised as income taxes in the Swiss/Australia double tax treaty and under IFRS/Swiss GAAP. If these taxes are included, then Nestlé's CIT rate would be higher than 15% as shown below.

Current gross CIT in Switzerland is computed as follows:

IFD rate (Federal income tax)	8.5%
ICC (Cantonal and Communal) income rate in the Canton of Vaud	<u>7.53%</u>
Total CIT	16.03%

Recommendation: It is only fair that cantonal and communal taxes should be included as CIT in order to align with the treatment in the Swiss/Australia double tax treaty, IFRS/Swiss GAAP and Pillar 2 (which also recognises CIT to include ICC).

2. There is no exclusion for payments made to parent jurisdictions, which is inconsistent with other integrity measures in Australia, such as the financing integrity rule (subdivision 832-J in the hybrid legislation). This is also inconsistent with the ATO's loan PCG (PCG 2017/4), whereby it is noted in the low tax risk criteria in the motivational section that where the lender is the parent (even if in a low tax jurisdiction), no points should be given.

Recommendation: A parent jurisdiction (operational headquarters) exclusion should be included in the proposed legislation, as its absence could result in an extremely unfair outcome for genuinely headquartered MNEs just because of their country of incorporation.

3. The proposed legislation takes no account of interactions with Pillar 2 and, thus, is out of step with global measures to tackle base erosion and profit shifting and ensure a minimum 15% effective tax rate. This is inconsistent with the Australian Government's strong support of the BEPS 2.0 measures for a globally consistent and coherent tax framework. Further, the Switzerland Government has also publicly stated they intend to adopt the Pillar 2 framework from 1 January 2024, subject to a constitutional vote. Absent addressing this, the outcome of the proposed legislation would result in double tax outcomes. This is further exacerbated with the mismatch on the proposed start date for the proposed legislation (1 July 2023) vs Pillar 2 (1 January 2024).

Recommendation: There should be provision in the proposed legislation to ensure that any Pillar 2 taxes are taken into account (e.g., in determining the CIT rate) to avoid double taxation as well as to conform the enactment dates.

4. There is no carve out for substance or purpose (even though this is an integrity measure) – which is inconsistent with other integrity measures in Australia's tax laws such as Part IVA, Multinational Anti-Avoidance Law or Diverted Profits Tax. As demonstrated above, Nestlé has significant substance in Switzerland and there is no tax avoidance purpose.

Recommendation: A substance or purpose test should be included in the proposed legislation to prevent detrimental impacts in situations such as ours.

5. There is no carve out for payments that have been agreed with the ATO as arm's length and/or that have been recognized as providing an appropriate tax outcome under the transfer pricing rules



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under a BAPA/tax treaty in force. As noted above, we are close to completing a BAPA with ATO and the Swiss Tax Authority regarding the appropriate royalty payment to Switzerland for use of the Group's IP.

Recommendation: Arrangements that are under a BAPA should be excluded from the proposed legislation.

6. There is no account taken of Australian withholding tax in the determination of low-tax jurisdiction, which again would result in double taxation where there is no credit available.

Recommendation: Withholding tax should be considered in arriving at the CIT rate.

7. There is no concept of proportionality in the denial of the deductions to differentiate between payments to nil-tax countries vs countries that may be marginally below 15%.

Recommendation: It would be more fair to include a proportionality provision such that only the difference between the CIT and 15% would be denied.

We thank you for your consideration of our submission and welcome the opportunity to discuss with you (in a virtual meeting) the proposed legislation and what we believe are its negative, unintended consequences to Nestlé. We also refer you to the submission made by Swiss Holdings, which represents the interests of 62 Swiss-based MNEs, including Nestlé.

Yours sincerely,

Nestlé S.A.

A handwritten signature in blue ink, appearing to read "James Parent".

James Parent
Senior Vice President
Nestlé Group Head of Tax

CC:

Ms Diane Brown, Deputy Secretary, Revenue, Small Business and Housing Group
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