



Government election commitments: Multinational tax integrity and enhanced tax transparency

Consultation paper

August 2022

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Manager
Media and Speeches Unit
The Treasury
Langton Crescent
Parkes ACT 2600
Email: media@treasury.gov.au

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Consultation Process

Request for feedback and comments

Interested parties are invited to comment on the policy issues and implementation considerations to improve multinational tax integrity, as raised in this paper. While submissions may be lodged electronically or by post, electronic lodgement is preferred.

All information (including name and address details) contained in formal submissions will be made available to the public on the Australian Treasury website, unless it is indicated that you would like all or part of your submission to remain confidential. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain confidential should provide this information marked in a separate document.

A request made under the Freedom of Information Act 1982 for a submission marked 'confidential' to be made available will be determined in accordance with that Act

Closing date for submissions: 2 September 2022

- Email** MNETaxIntegrity@treasury.gov.au
- Mail** Assistant Secretary
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600
- Enquiries** Enquiries can be initially directed to David Hawkins (interest limitation rules, tax transparency commitments) and Ronita Ram (denying deductions for payments relating to intangibles and royalties).
- Phone** David Hawkins 02 6263 1552 (interest limitation rules, tax transparency commitments)

Ronita Ram 02 6263 3168 (denying deductions for payments relating to intangibles and royalties)

The principles outlined in this paper have not received Government approval and are not yet law. As a consequence, this paper is merely a guide as to how the principles might operate.

Strengthening Australia's multinational tax avoidance and tax transparency rules

Introduction

The Government, as part of its election commitment platform, announced a multinational tax integrity package to address the tax avoidance practices of multinational enterprises (MNEs) and improve transparency through better public reporting of MNEs' tax information. These changes form part of the Government's commitment to ensuring that MNEs pay their fair share of tax in Australia to help fund vital services, repair the Budget and level the playing field for Australian businesses.

Tax integrity issues arise due to MNEs adopting increasingly sophisticated tax planning practices. MNEs can take advantage of the differences between jurisdictions' tax systems to minimise their tax paid, typically by moving the incidence of taxation from a high taxation jurisdiction to a low taxation jurisdiction, or by avoiding a taxable presence in high taxation jurisdictions altogether.

Transparency is a key factor underpinning the integrity of the tax system. It can help to deter MNEs from entering arrangements to minimise their tax paid, and helps to build community confidence that MNEs are paying their fair share of tax in Australia.

This paper seeks to consult on the implementation of proposals to:

- amend Australia's existing thin capitalisation rules to limit interest deductions for MNEs in line with the Organisation for Economic Cooperation and Development (OECD)'s recommended approach under Action 4 of the Base Erosion and Profit Shifting (BEPS) program (Part 1);
- introduce a new rule limiting MNEs' ability to claim tax deductions for payments relating to intangibles and royalties that lead to insufficient tax paid (Part 2); and
- ensure enhanced tax transparency by MNEs (Part 3), through measures such as public reporting of certain tax information on a country-by-country basis; mandatory reporting of material tax risks to shareholders; and requiring tenderers for Australian government contracts to disclose their country of tax domicile.

The changes contemplated in this paper seek to target activities deliberately designed to minimise tax, while also considering the need to attract and retain foreign capital and investment in Australia, limit potential additional compliance cost considerations for business, and continue to support genuine commercial activity.

This consultation paper complements the Government's other MNE tax initiatives, including Australia's ongoing participation in negotiations on the OECD 'two-pillar' solution to address the tax challenges of the digitalisation of the economy, which includes a 15 per cent global minimum effective tax rate on the profits of large MNEs.

The Government also announced that it will implement a public registry of beneficial ownership to improve transparency on corporate structures, to show who ultimately owns (or controls) a company or legal vehicle. Further details on the beneficial ownership register will be announced in due course.

Following consideration of responses to this discussion paper, the Government will issue and consult further on exposure draft legislation prior to introducing any legislation into Parliament.

Part 1: MNE interest limitation rules

Introduction and existing framework

The thin capitalisation regime is Australia's current approach to limiting debt deductions. These rules are designed to limit the debt deductions that an entity can claim for tax purposes based on the amount of debt used to finance its operations compared to its level of equity. While the optimal capital structure is dependent on an entity's circumstances (reflecting, among other factors, risk profile and revenue streams), generally, debt financing represents a more tax-efficient method of financing, as an entity can claim tax deductions for interest paid on debt and therefore reduce its taxable profits, relative to equity finance.

The OECD notes that "...the use of third party and related party interest is perhaps one of the most simple of the profit-shifting techniques available in international tax planning. The fluidity and fungibility of money makes it a relatively simple exercise to adjust the mix of debt and equity in a controlled entity".¹

Generally, there are two approaches to limiting MNE interest deductions for tax purposes: either directly, by limiting the amount of interest expenses an entity can claim, or indirectly, by limiting the amount of debt an entity can use to generate allowable interest deductions.

Australia's thin capitalisation regime currently utilises the indirect approach, by restricting the amount of interest deductions a company can have based on its level of assets. These rules are complemented by transfer pricing rules, which can also limit deductions by examining the interest rate on the debt, to ensure entities price their related-party international dealings in line with what is expected from independent parties in the same situation. The OECD earnings-based model adopts the direct approach, by limiting the amount of net interest expense that can be claimed as an interest deduction.

Current thin capitalisation rules

Entities subject to the current thin capitalisation rules are required to calculate their adjusted average debt and compare it to the maximum allowable debt prescribed under Australia's thin capitalisation rules. Currently, the maximum allowable debt is the greatest of:

- the safe harbour debt amount, which is set at 60 per cent of the average value of the entity's Australian assets;
- the arm's-length debt amount, which reflects the amount of debt that could have been borrowed by an independent party carrying on the same operations as the Australian entity; or
- the worldwide gearing debt amount, which allows an entity's Australian operations to be geared up to 100 per cent of the gearing of the worldwide group to which the Australian entity belongs.

The majority of Australian entities subject to the thin capitalisation rules apply the safe harbour test.

Australia's current thin capitalisation rules apply in respect of both Australian and foreign entities that have multinational investments, including:

- Australian entities with overseas operations or investments;

¹ OECD report on *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments Action 4 – 2016 Update*, pg. 19

- foreign controlled Australian entities; and
- foreign entities that claim debt deductions in respect of operations or investments in Australia.

The current thin capitalisation rules do not apply to an entity whose debt deductions, together with those of any associate entities, are \$2 million or less for the income year (among other exclusions).

Implementation considerations

Adopting an earnings-based ‘safe harbour’ test

In 2015, the OECD outlined a framework for a best-practice interest limitation rule, to discourage debt arrangements which are designed to minimise tax. This rule is known as the fixed ratio (earnings-based) rule. The OECD’s recommended approach limits net interest deductions to 30 per cent of Earnings Before Interest, Taxes, Depreciation, and Amortisation (EBITDA) and is intended to be a straightforward rule to apply.

The Government has committed to adapting Australia’s interest limitation rules to align with the OECD recommended approach.

The policy intent of a fixed ratio rule based on earnings is to ensure that an entity’s interest deductions are directly linked to its economic activity and the entity’s taxable income, which can help protect against tax planning practices. Compared to the current assets-based safe harbour, the OECD-recommended approach recognises that ‘thinly capitalised’ entities with high debt-to-asset ratios can still use various tax planning strategies to shift profits out of Australia (for example, by maximising debt-deductions via relatively high interest rate loans).

Tax EBITDA is a common commercial concept. Using this concept to define earnings intends to better reflect an entity’s capacity to meet its interest payment obligations (compared to the EBIT alternative, for instance) by adding back ‘non-cash’ items of an entity’s income statement (depreciation of fixed assets and amortisation of intangible assets).

The fixed ratio rule would replace the current asset-based safe harbour test, which can be viewed as a shortcut method for claiming ‘reasonable levels’ of debt deductions. The current safe harbour test is relatively compliance-light and is used by most taxpayers subject to the current thin capitalisation rules.

The Government recognises that entities can be highly geared on commercial (arm’s length) terms allowing them to claim higher levels of deductions, provided these can be substantiated. The interaction of the fixed ratio rule with an arm’s length test and worldwide gearing test is outlined further below.

It is proposed that the fixed ratio rule will target ‘general entities’ as defined in the current thin capitalisation legislation. Financial entities and authorised deposit-taking institutions would, in the interim, continue to be subject to the existing thin capitalisation rules. In this regard, the OECD acknowledges that the fixed ratio rule is unlikely to be effective for these types of entities –partly because they are net lenders and are subject to regulatory capital rules. As such, they can be excluded from the fixed ratio rule.

Questions

1. Considering the policy intent of limiting debt deductions to genuinely commercial amounts, should the fixed ratio rule rely on accounting or tax figures? On what basis do you say this?
2. Will the move to a fixed ratio based on earnings impose additional compliance costs on taxpayers? Can these costs be quantified?
3. What factors influence an entity's current decision to use the safe harbour test (as opposed to the arm's length debt test or the worldwide gearing test)?
4. Are there specific types of entities currently using the safe harbour test that would be affected by the introduction of a fixed ratio (earnings based) rule? If so, how would they be affected?
5. Should there be any changes to the existing thin capitalisation rules applicable to financial entities and authorised deposit-taking institutions?

Fixed ratio rule: implementation considerations

The OECD's framework provides countries with some flexibility in implementing the EBITDA fixed ratio rule.

The following considerations will inform the basis of the final design of the fixed ratio rule:

- A potential *de minimis* monetary threshold based on net interest expense of the local group, to remove low risk entities from the interest limitation rule.
- Additional flexibility for highly leveraged entities/groups (i.e. the arm's length debt test or a specific group ratio rule, including considerations around third party interest expense calculations).
- The treatment of assets/projects that provide net public benefits or are considered nationally significant (leveraging existing legislative concepts).

The Government will draw on approaches adopted by comparable international jurisdictions (for instance, the United Kingdom, Canada, France, Germany and the United States) in implementing the fixed ratio rule.

Questions

6. Would the existing \$2 million de minimis threshold be an appropriate threshold for the fixed ratio rule, to exclude low-risk entities?
7. Are there specific sectors more likely to experience earnings volatility that may cause entities to explore using one of the alternative tests instead (e.g. arm's length test)?
8. What features of fixed ratio (earnings-based) rules in other jurisdictions are most significant (relevant) for implementing a fixed ratio rule in the Australian context?

Group ratio rule

The OECD recommends that countries adopting a fixed ratio rule also consider an earnings-based group ratio rule. The group ratio rule can be as a separate additional provision or part of the fixed ratio rule. The intent of a group ratio rule is to directly limit the net interest expense (in line with the core fixed ratio rule) while providing some flexibility for highly leveraged groups (i.e. those with a net third party interest/ EBITDA ratio above the 30 per cent benchmark fixed ratio) to deduct a higher net interest expense than what would be permitted under the fixed ratio rule. The OECD permits an uplift of up to 10 per cent to the group's net third party interest expense, to ensure this additional feature continues to provide a robust response to BEPS.

Australia's current thin capitalisation rules provide for a group ratio rule in the form of a worldwide gearing test, which is based on a debt-to-equity ratio. While this test is not commonly applied (compared to the current safe harbour test or arm's length debt test), it still gives rise to a threshold question of what role (if any) a debt-to-equity gearing test would serve if a fixed ratio rule (combined with a group ratio rule) was adopted. That is, is it appropriate to have two 'competing' group tests?

Questions

9. If the Government adopts an earnings-based group ratio rule to complement the fixed ratio rule, should the existing worldwide gearing test (based on a debt-to-equity ratio) be repealed? If not, why?
10. How should net third-party interest expense be calculated in applying the group ratio rule (as part of the fixed ratio rule) e.g. what accounting values should be used?
11. What types of entities currently use the existing worldwide group test?

Fixed ratio rule: the role of arm's length debt test

In announcing a commitment to move to a fixed ratio rule, the Government also indicated it would maintain an arm's length test.

Currently, the arm's length amount of debt of the Australian entity is determined in a way prescribed by legislation. It requires considering the Australian entity as a stand-alone business and multiple

factors are then considered to determine what the Australian business *would* and *could* borrow from an independent commercial lender.

In considering the implementation approach to the fixed ratio rule, consideration should also be given to how the current arm's length test might be strengthened to prevent entities from opting into arrangements, that potentially take advantage of greater debt deductions than would be available under the fixed ratio rule. In this regard, the OECD guidance notes that "after introducing the best practice approach, a country may also continue to apply an arm's length test, withholding tax on interest, or rules to disallow a percentage of an entity's total interest expense, so long as these do not reduce the effectiveness of the best practice in tackling base erosion and profit shifting".²

Compliance issues

Entities applying the current arm's length debt test are required to substantiate their claims. As the rules operate to allow an entity to determine whether it is appropriately capitalised, there is a general acceptance that entities should undertake rigorous compliance.

The ATO has published guidance (Practical Compliance Guideline PCG 2020/7) explaining the compliance approach they will take to administering the arm's length debt test. Arrangements are placed in 'risk-zones', with resources allocated based on where the taxpayer sits in the risk spectrum.

While this guidance is helpful in assisting taxpayers to comply with the rules, taxpayers continue to report complexity and high compliance costs involved in applying the arm's length debt test. Similarly, the ATO also incurs a high compliance and administration costs.

Integrity issues

While the arm's length debt amount is determined according to prescribed criteria, it is not a bright-line test and it can be difficult to establish the genuine commercial quantum of debt allowable under the rules. This issue generally arises from related party borrowings (as opposed to third-party debt). Even with strong transfer pricing rules, issues can still arise in complying with, and administering, the test (i.e., the extent of 'implicit credit support' and the effect that has on an interest rate, the concept of 'notional' or 'hypothesised' entities, and information asymmetries generally).

If an above-arm's length-interest rate is still being paid on a quantum of debt allowed under the thin capitalisation rules, the higher rate undermines the policy intent of limiting Australian debt deductions to a commercially justifiable amount. This gives rise to questions about whether the existing legislative architecture for the arm's length debt test is still appropriate.

Behavioural response

The integrity and compliance issues outlined above are relevant to the extent the introduction of a fixed ratio rule would encourage entities to begin using the arm's length test. Entities might seek to justify a higher quantum of debt, or higher interest deductions than would be allowed under the fixed ratio rule by moving to the arm's length test. While this sort of behavioural response would be dependent on the core design features of the fixed ratio rule (canvassed above), it would nonetheless undermine the Government's policy intent (while also imposing increased administrative burdens on the ATO).

² OECD report on *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments Action 4 – 2016 Update*, pg. 19

The consideration of any changes to the arm's length debt test would seek to ensure integrity, while balancing the ability to determine a genuinely commercial level of debt for the Australian business.

Questions

12. Would introducing a fixed ratio rule encourage entities not currently using the arm's length debt test to shift to an arm's length test? If so, why? Are there specific sectors where this type of behavioural response is likely to be more evident?
13. For entities currently using the arm's length debt test, would replacing the current 'standalone entity' rule to require consideration of the entity being a member of a worldwide group reduce compliance costs? If not, why?
14. To what extent does the current arm's length debt test permit BEPS practices to occur? What changes should be made to ensure that an arm's length test complements the fixed ratio rule?
15. How should the different integrity concerns posed by external (third-party) debt and related-party debt be reflected in any changes to the arm's length debt test?
16. Would differentiating between external (third-party) debt and related-party debt simplify the operation of the test?
17. Would additional limitations be required to prevent any unintended consequences, such as 'debt dumping' or other debt-creation integrity concerns?
18. Are there any other changes (policy or administrative) that could be made to the arm's length debt test, to keep in line with the Government's commitment to limit interest deductions? If so, what would be a reasonable transition period to introduce these changes?

Part 2: Denying MNEs deductions for payments relating to intangibles and royalties paid to low or no tax jurisdictions

Introduction

MNEs can shift profits to low or no tax jurisdictions using arrangements involving intangibles to avoid paying tax in Australia. The fast growth of the digital economy has exacerbated these practices, with an increasing number of MNEs structuring their ownership of intangibles through low tax jurisdictions, giving rise to integrity risks to Australia's tax base.

The Government has announced it will introduce a new rule limiting MNEs' ability to claim tax deductions for payments relating to intangibles and royalties, that can lead to insufficient tax paid. The proposed measure is consistent with actions taken by other jurisdictions to address profit-shifting issues related to intangibles and royalties.

Current rules

Royalties are broadly defined for the purposes of Australia's tax law both in section 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936) and in Australia's bilateral tax treaties.

Examples of royalties as defined in the ITAA 1936 include amounts paid or credited as consideration for:

- the use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trademark, or other like property or right;
- the use of, or the right to use, any industrial, commercial or scientific equipment; and
- the supply of scientific, technical, industrial or commercial knowledge or information.

Royalties are also defined in Australia's bilateral tax treaties in broadly similar terms to the domestic definition. Individual treaties may vary given they are the product of bilateral negotiations.

In broad terms, royalties paid to foreign residents are deductible by the Australian resident payer (reducing taxable income), and subject to a final withholding tax in the hands of the foreign recipient. Where the recipient is a resident of a jurisdiction that has a tax treaty with Australia, the withholding rate is lowered by the treaty (see Appendix 1). If there is no tax treaty, the withholding rate is 30 per cent.

Existing rules in Australia's tax integrity framework may apply where taxpayers seek to reduce their tax liabilities in connection with transactions involving intangibles and royalties. These include:

- the transfer pricing rules, which require cross-border transactions to be arm's length;
- the general anti-avoidance provisions in Part IVA of the ITAA 1936, which cancel tax benefits in a range of circumstances;

- the principal purpose tests (or other similar rules) in Australia’s bilateral tax treaties, which disallow treaty benefits where obtaining that benefit was a principal purpose of the arrangement; and
- the controlled foreign company rules, which attribute certain income parked offshore back to Australia.

Integrity issues

In the context of the highly globalised and digitalised modern economy, digital businesses and more traditional businesses rely heavily on and value highly their intangibles. Examples of intangibles includes brand names, patented inventions, trade secrets and algorithms.

Intangibles are highly mobile and can be located anywhere in the world. MNEs may undertake significant economic activity developing, enhancing, maintaining and exploiting an intangible in a particular jurisdiction. However, it is relatively easy for those MNEs to enter into arrangements involving their intangibles to shift profits from higher tax jurisdictions to low or no tax jurisdictions. Various jurisdictions have also introduced preferential tax regimes for intangibles (such as ‘Patent Box Regimes’). While OECD BEPS Action 5 introduced new rules to constrain eligibility requirements for a patent box, including a requirement for sufficient economic substance in the jurisdiction with the intangible, some patent boxes may be non-compliant or low-or not taxed, thus encouraging aggressive tax planning. MNEs may also secure further advantages when they shift profits to a low or no-tax jurisdiction that do not effectively exchange tax information with other jurisdictions, provide minimal transparency of tax affairs, or have less stringent tax administrations or poor taxpayer compliance.

The increasing digitalisation and globalisation of the economy has exacerbated these issues. The high value of intangibles in knowledge-based economies, the ease of relocating them, and the increased tax competition between jurisdictions have made it harder to address the challenge of ensuring an appropriate amount of tax associated with intangibles is paid in Australia.

The ATO has raised integrity issues regarding international related-party arrangements involving the migration of intangibles and mischaracterisation of Australian activities connected with the development, enhancement, maintenance, protection and exploitation (DEMPE) functions of intangibles in Taxpayer Alert TA 2020/1.³ Specific concern was raised in relation to arrangements where intangibles and/or associated rights are migrated to international related parties as part of non-arm’s length arrangements and/or in a manner intended to avoid Australian tax.

Taxpayers have also entered into arrangements to mischaracterise payments and/or activities or conditions connected with intangibles of a foreign entity to avoid Australian tax. This has been raised by the ATO in Taxpayer Alert TA 2018/2⁴. These arrangements concern a royalty element of a payment which may be bundled into the price of tangible goods and/or services and is not separately recognised as a royalty although it has the characteristics of one (i.e. an ‘embedded royalty’). Moreover, that royalty element may be paid by a person without a taxable presence in Australia.

Through arrangements involving intangibles and royalties, taxpayers may seek to reduce Australian tax by avoiding royalty withholding tax, claiming increased tax deductions, or reducing income recognised

³ Australian Taxation Office Taxpayer Alert TA 2020/1, *‘Non-arm’s length arrangements and schemes connected with the development, enhancement, maintenance, protection and exploitation of intangible assets’*

⁴ Australian Taxation Office Taxpayer Alert TA 2018/2, *‘Mischaracterisation of activities or payments in connection with intangible assets’*

in Australia. The attempted reduction of Australian tax, together with low or no foreign tax, is intended to produce advantageous overall tax outcomes.

Australia's existing integrity rules, including the transfer pricing rules and general anti-avoidance provisions go some way in tackling these issues. However, Australia's tax framework needs a specific measure targeting integrity issues associated with intangibles and royalties.

Policy design issues

Taxpayers in scope

The business models of large MNEs are typically reliant on intangibles. Their cross-border nature, combined with their significant resources, means MNEs are more likely to have the incentives and ability to enter arrangements to reduce profits that would otherwise be taxable in Australia.

Australia has introduced the concept of 'significant global entity' (SGE) to identify the population of large MNEs, defined under Subdivision 960-U of the *Income Tax Assessment Act 1997* (ITAA 1997). An SGE includes a Global Parent Entity (GPE)⁵ or a member of a group of consolidated entities for accounting purposes as a single group, where either the GPE or the group's annual global income⁶ is equal to or exceeds A\$1 billion. It can be headquartered in Australia or overseas, with or without local operations.

SGEs are in scope of a number of existing measures in Australia's legislative framework addressing profit-shifting issues. Examples include the MAAL and the DPT⁷ of Part IVA of the ITAA 1936, the country-by-country reporting requirements (CbC reporting), and increased administrative and other penalties.

Though SGEs are generally corporate entities, since 2019, the broader concept of SGE can include high wealth individuals⁸, partnerships, trusts, those considered to be non-material to a group, as well as certain investment entities (and those that they control), including in circumstances where consolidated financial statements have not been prepared.

Despite SGEs being generally within the main scope of Australia's tax integrity framework, different measures may apply to only certain types of SGEs. For example, individuals are not subject to CbC reporting, even if they qualify as an SGE. Also, not all tax integrity provisions have their application restricted to SGEs (Part IVA of the ITAA 1936, for example, applies to all taxpayers).

5 For further information on the concept GPEs, see <https://www.ato.gov.au/business/public-business-and-international/significant-global-entities/#Significantglobalentitydefinition>.

6 The annual global income is the total of income that goes to the determination of profit or loss in accordance with Accounting Standard AASB 101 as shown on the global financial statements, or that would have been shown had such statements been prepared. While the definition of income also encompasses other comprehensive income, annual global income does not include other comprehensive income, as it does not go to the determination of profit or loss. For further information on annual global income, see <https://www.ato.gov.au/business/public-business-and-international/significant-global-entities/#Significantglobalentitydefinition>

7 The DPT aims to ensure that tax paid by significant global entities (SGEs) reflects their activities in Australia and prevent the diversion of profits offshore.

8 It is noted, however, that even though high-wealth individuals may be classified as SGEs, CbC reporting obligations do not apply to individuals, per sections 815-375 and 815-380 of the ITAA 1997.

Questions

1. Do you consider this policy should apply to SGEs, or should the measure be broader than SGEs, and why?
2. Do you consider this policy should apply to only corporate SGEs, and why?

Payments relating to intangibles and royalties in scope of this measure

Generally, the royalty definition in section 6(1) of the ITAA 1936, or in the respective royalty article (generally Article 12) in each of Australia's tax treaties, will be applied to payments of royalties made by a person with a taxable presence in Australia. Although the definition of a royalty in Australia's bilateral tax treaties is broadly similar to the domestic definition, the definition is exhaustive and may vary between individual treaties. Where a payment falls within the respective royalty definition and the royalty has been sourced in Australia, Australia can apply royalty withholding tax.

Arrangements can be entered to avoid the application of the royalty definition in addition to reducing the taxable profit from activities involving intangibles in Australia, as identified by the ATO under TA 2018/2 and TA 2020/1. Under these arrangements, taxpayers deduct these payments irrespective of whether they recognise the payment as a royalty or not. These arrangements result in a reduction in taxable profit, regardless of whether the payment is also mischaracterised as something other than a royalty.

In TA 2018/2, the ATO raises concerns with the potential existence of royalty payments embedded ('embedded royalties') in the consideration paid for tangible goods or services. The arrangements that give rise to embedded royalties are generally characterised by taxpayers entering transactions involving the supply of goods and services where a royalty element is present, however not explicitly recognised or remunerated in the supply contract. For example, they may be referred to as 'management fees'.

Under such arrangements, the person with a taxable presence in Australia may not be considered to have incurred a royalty. Consequently, Australian royalty withholding tax obligations may be avoided. Embedded royalty arrangements are complex and may present a high level of obfuscation.

In addition, where the royalty is incurred outside Australia and higher up the intra-group value chain and charged to Australia as part of the purchase price of tangible goods and/or services, such royalties may not be considered to be sourced in Australia. In such a situation, it may instead be more appropriate for these payments to be within the Australian tax net, given they were undertaken to avoid the application of Australian royalty withholding tax.

Issues with the characterisation of payments and determining the extent of intra-group value chains means addressing embedded royalty arrangements is challenging. However, not covering embedded royalty arrangements would pose an integrity risk to Australia's tax base. Similar risks with embedded royalties have been recognised in recently introduced policies in other jurisdictions, such as the United Kingdom's 'Offshore Receipts in respect of Intangible Property' (ORIP). Like the United Kingdom, Australia could consider ensuring this commitment covers any amount in respect of rights over intangibles which enable, facilitate, or promote Australian sales (in relation to services, goods, or other property) directly or indirectly.

Further integrity risks associated with intangibles are outlined in TA 2020/1. The ATO raises concerns with intangibles either being relocated to, or held by, a foreign entity. Although significant activities

connected with the DEMPE of the intangible may be undertaken by an entity in Australia, Australia is not appropriately remunerated. In these situations, the Australian taxable profits have been reduced due to reduced worldwide income being derived from the exploitation of intangibles in Australia as the intangible is not in Australia. Australian taxable profits for the economic activity in Australia associated with the intangible may be reduced as the economic activity in Australia is not appropriately recognised. As such arrangements also present risks to Australia's tax base, the current balance of Australia's rules will need to be assessed as to whether they appropriately deal with such arrangements.

Questions

3. Do you consider the policy should seek to cover both royalties and embedded royalties?
4. Do you consider there are practical challenges in identifying embedded royalties, and if so, what are they?
5. Do you consider the policy should seek to address reduced Australian profits which has resulted due to migrated intangibles and DEMPE functions?
6. Do you consider any other payments (not related to intangibles or royalties) should also be covered by this policy?

Application to related and unrelated parties

As outlined in the examples provided in TA 2018/2 and TA 2020/1, profit-shifting arrangements involving intangibles are generally conducted between related entities. However, nothing prevents unrelated entities from acting in concert to achieve a tax benefit.

To ensure integrity risks are appropriately captured, it may be necessary to apply the measure to arrangements that involve both related and unrelated entities. This would also more effectively build upon, and be consistent with, other aspects of Australia's tax law framework. For example, the transfer pricing rules of Subdivision 815-B of the ITAA 1997 apply to both related and unrelated entities that enter non-arm's length cross-border arrangements. This is necessary to ensure that, irrespective of the relationship between the parties, where non-arm's length conditions operate in connection with cross-border arrangements, amounts are appropriately brought to tax in Australia. Furthermore, Subdivision 815-B does not require a tax avoidance motive.

Question

7. Do you consider the policy should apply to both related and unrelated entities?

Insufficient tax

The measure focuses on arrangements involving payments relating to intangibles and royalties to low or no tax jurisdictions or that lead to insufficient tax being paid.

There are various factors that could be considered in defining ‘insufficient tax’ or ‘low or no tax jurisdictions’, such as the options set out below.

- 1) **Hybrid mismatch targeted integrity rule:** Payments made to jurisdictions where they are taxed at a rate of 10 per cent or less would be in scope. This is consistent with the hybrid mismatch targeted integrity rule in Subdivision 832-J of the ITAA 1997⁹, which seeks to prevent offshore MNEs from otherwise circumventing the hybrid mismatch rules by routing investment or financing into Australia via an entity located in jurisdictions with a tax rate of 10 per cent or less.
- 2) **Global Anti-Base Erosion Rules (GloBE) minimum tax rate:** Payments made to entities in jurisdictions determined under the GloBE rules to have an effective tax rate of less than 15 per cent would be in scope. This is consistent with the GloBE minimum tax rate as part of the GloBE (Pillar Two) Model Rules. Under the GloBE rules, the tax base for the effective tax rate calculation is based on financial accounting statements, rather than tax filings, and the covered taxes are broadly the same as the tax liability recorded in the income tax return.
- 3) **Sufficient foreign tax test:** Payments made to jurisdictions with a corporate tax rate of less than 24 per cent would be in scope. This is consistent with the ‘sufficient foreign tax test’ outlined under section 177L of the ITAA 1936. Under this test, the measure would not apply if the increase in foreign tax resulting from the offshore income diversion is at least 80 per cent of the reduced Australian tax liability. Jurisdictions with a corporate tax rate below 24 per cent would not be considered to pass this exception, as the company tax rate for SGEs is 30 per cent.
- 4) **Intellectual property tax-preferential regime:** Payments made to jurisdictions with an intellectual property (IP) tax-preferential regime (commonly referred to as ‘Patent Box Regimes’) would be in scope. However, this option may restrict the proposed measure to IP only rather than the broader application to payments relating to intangibles and royalties.
- 5) **Low or nominal tax jurisdiction lists:** Payments made to jurisdictions listed on low or nominal tax jurisdiction lists published by international organisations would be in scope. However, this option is not preferred as there is no global consensus on the status of these lists. Developing Australia’s own bespoke list of low tax jurisdictions for this measure (as opposed to leveraging an existing mechanism) could increase the likelihood of retaliatory responses from listed jurisdictions.

Questions

8. What are your views in relation to the options outlined above?

International comparisons

Several other jurisdictions have implemented measures to address payments relating to intangibles and royalties. An overview of other jurisdictions’ measures is below:

⁹ The hybrid mismatch targeted integrity rule intends to deter the use of certain hybrid arrangements that exploit differences in the tax treatment under the income tax laws of two or more countries.

Jurisdiction	Measure	Overview
United States (US)	Global Intangible Low Taxed Income (GILTI)	<p>Applies tax on a US resident's controlled foreign company foreign income (returns above 10 per cent from tangible assets and all income from intangible assets). excluded income includes:</p> <ul style="list-style-type: none"> income from US sources that are effectively connected to the conduct of a trade or business in the US high taxed foreign income (if the effective rate of the foreign income tax exceeds 90 per cent of the maximum US corporate rate). <p>A partial deduction for the amount of GILTI included in income may be claimed.</p> <p>The GILTI applied from tax years beginning after 31 December 2017. The US has announced changes to the GILTI.</p>
	Base Erosion Anti-abuse tax (BEAT)	<p>Applies an alternative minimum tax to the difference in the calculation between an entity's US corporate tax liability and an alternative calculation at the BEAT rate after cross-border related party payments are added back, if the BEAT calculation is higher than the entity's US corporate tax liability. The BEAT applies to a US corporation that has an average annual gross receipt of at least US\$500 million for a three-year period, and where a certain threshold of 'base erosion payments' are made.</p> <p>The BEAT applied from tax years beginning after 31 December 2017. The US has announced the BEAT will be replaced with the Pillar Two UTPR from 2024.</p>
United Kingdom	Offshore Receipts in respect of intangible property (ORIP)	<p>Applies a 20 per cent charge (in accordance with the UK corporate tax rate) to an entity that is not resident of the UK or a country with which the UK has an applicable tax treaty, on income (regardless of whether they are related parties) that:</p> <ul style="list-style-type: none"> The entity receives in a low tax jurisdiction (considered to be a jurisdiction with a rate of less than approximately 10 per cent); and Is in respect of intangible property due to the sale of goods or services in the UK (for example, an embedded royalty). <p>Exemptions from the ORIP charge include:</p> <ul style="list-style-type: none"> Turnover of £10 million or less. Where all, or substantially all, of the business activity in relation to the intangible property has always been undertaken in the territory of residence (but only if the intangible property has not been transferred from a related person, has not been derived from anything transferred from a related person or is not derived from intangible property held by a related person).

Jurisdiction	Measure	Overview
		<ul style="list-style-type: none"> Where the foreign tax is at least 50 per cent of the ORIP tax charge. <p>Measure applied from 6 April 2019.</p>
Netherlands	Withholding tax	<p>A withholding tax equivalent to the highest Dutch corporate tax rate is applied in respect of royalty payments made to a related company in a low tax jurisdiction (jurisdictions with a tax rate of less than 9 per cent or are on the EU list of non-cooperative jurisdictions for tax purposes) and in abusive situations.</p> <p>Measure applied from 1 January 2021.</p>
Germany	Royalty barrier rule	<p>Applies to limit deductibility of royalty payments between related parties where the payments are preferentially taxed at the recipient level at an effective tax rate below 25 per cent and where the preferential regime applying is not compliant with the nexus approach under OECD BEPS Action 5.</p> <p>Measure applied from 1 January 2018.</p>

Question

9. What are your views on the effectiveness or behavioural impacts of other jurisdictions' measures, particularly if Australia were to adopt any similar design features from these measures in the Australian context?
10. What are your views on the compliance or administrative experiences with other jurisdictions' measures, particularly if Australia were to adopt any similar design features from these measures in the Australian context?

Part 3: Multinational tax transparency

Introduction

This section addresses the tax transparency (improved public reporting) elements of the Government's MNE tax integrity package. Specifically, the commitments relating to:

- the public reporting of tax information on a country-by-country basis,
- mandatory reporting of material tax risk to shareholders, and
- requiring tenderers for Australian government contracts to disclose their country of tax domicile.

The section also canvasses the merits of mandating the voluntary Tax Transparency Code (the Code) and including the government's transparency commitments for MNEs as part of revisions to the Code.

Policy context

Transparency is a key factor underpinning the integrity of the tax system. Following the 2008 Global Financial Crisis, revelations of aggressive tax planning by MNEs led to concerns about whether MNEs were paying their 'fair share' of tax in the jurisdictions where they operated.

These concerns informed the OECD's BEPS Project, which includes improved transparency as one of its three key pillars. The widespread adoption of the BEPS recommendations, in particular action item 13 on Country-by-Country (CbC) reporting, is seen as a significant step to reduce the information asymmetry that exists between large MNE taxpayers and the regulators.

In Australia, the Commissioner of Taxation has a wide range of powers to obtain tax related information from taxpayers (but until a problem is identified, the Commissioner may have no basis to act). The automatic generation and exchange of BEPS CbC reports between jurisdictions address the information asymmetry inherent between MNEs and tax authorities.

An essential feature of BEPS CbC reporting is that it is confidential between the MNEs and tax authorities. This condition was necessary to obtain its adoption by the OECD and is also seen as the foundation of a collaborative relationship between tax authorities and taxpayers, who would otherwise be more circumspect in the information they would be willing to provide.

Public tax transparency has an important role in ensuring MNEs pay their fair share of tax. Along with the benefits of extra scrutiny, public tax transparency helps build trust in the tax system. It undermines the self-assessment nature of our tax system if there is a perception that MNEs are not paying their fair share.

The community is increasingly seeking more openness from business (and governments), to assist the public's understanding of MNEs' tax compliance and to better inform their assessment of MNEs contributions to the community (in terms of tax paid) relative to their activities in the economy. Essentially, this understanding reflects the social contract notion and the idea that the tax burden should be shared equitably; that is, MNEs should pay a fair share of tax. Public transparency allows civil society and the public to scrutinise the corporate behaviour of MNEs and judge whether it meets public expectations.

There is, however, an in-built tension between the push for improved access to corporations' tax-related information and taxpayer privacy and confidentiality. This tension gives rise to trade-offs and

the need to balance the ‘public good’ element of improved transparency with the protection of MNEs’ commercially sensitive information. Additionally, increased tax transparency should not detract from entities’ investment intentions or impose unnecessary compliance burdens as to be counterproductive.

Recent global developments reflect a shifting attitude towards MNEs voluntarily sharing more information about their tax affairs, moving away from strict taxpayer confidentiality. The European Union’s recent public CbC reporting Directive and the emergence of the Global Reporting Initiative’s Tax Standard are examples of schemes that enhance corporate tax transparency.

The options outlined in this discussion paper are informed by these recent international developments.

Ultimately, the Government’s intent is to introduce targeted and balanced tax transparency initiatives directed at MNEs. As part of the broader regulatory mix, these measures are intended to moderate corporate tax-aggressiveness. The ideal is that the more information and data insights the wider community has on MNE structures and their cross-border activity, the more informed the debate will be about what level of tax should be paid by MNEs. In turn, enhanced public scrutiny aims to seed fundamental behavioural change in how MNEs view their tax obligations, including in relation to their tax governance practices and their decision-making around aggressive tax planning strategies.

Tax transparency reporting: the current approach in Australia

Australia’s current approach to tax transparency has played a limited role in informing the public debate in relation to the tax affairs of large MNEs, leading to claims that the current transparency reporting framework is deficient. Issues of this sort have informed the Government’s improved transparency commitments.

Australia has adopted the OECD BEPS Action 13 (CbC reporting) initiative which requires CbC reporting entities¹⁰ or a significant global entity, to lodge a CbC Report, Master file and Local file with the ATO. This data is subject to strict confidentiality restricting what can be published. While the CbC data assists the ATO with their compliance activities, the lack of public transparency has not addressed the increased community demand for enhanced corporate tax disclosures.

Australia also has a voluntary Tax Transparency Code. The Code was developed by the Board of Taxation, at the request of the then Government, and was subsequently endorsed as part of the 2016-17 Budget. The Code is intended to encourage greater transparency by the corporate sector and enhance the community’s understanding of the corporate sector’s compliance with Australia’s tax laws. However, the voluntary nature of the Code has given rise to relatively low take-up by companies (which is even more pronounced for foreign companies). A further criticism is that the disclosures provided under the Code are not verifiable. The lack of verifiable data has not helped to address the growing distrust among ordinary members of the community who, as a demographic, are less willing to accept assurances that large corporations are honouring their tax obligations in line with societal expectations.

The final element of Australia’s tax transparency framework is the Corporate Tax Transparency report, published by the ATO. The information in this report is sourced from tax return information and excludes various tax return label items, including tax losses information, from being disclosed. The exclusion of label items can hinder the general community’s understanding of the tax affairs of

¹⁰ A CbC reporting entity is defined in Subdivision 815-E of the *Income Tax Assessment Act 1997*. Further information on CbC reporting can be found at: www.ato.gov.au/business/international-tax-for-business/in-detail/transfer-pricing/country-by-country-reporting/

corporate tax entities, including MNEs, as the report does not provide a complete picture of an entity's tax position. For instance, the valid role that tax losses play in determining an entity's tax position. Further, non-corporate entity structures (such as large privately-held groups) are not included in the Corporate Tax Transparency report.

Questions

1. Are there any specific features you would introduce to improve how MNEs publicly report tax information?

Public reporting of tax information on a country-by-country basis

The Government has announced the introduction of measures requiring the public release of high-level data on the amounts of tax large MNEs pay in the jurisdictions they operate, as well as on the number of employees these jurisdictions.

These types of disclosures are commonly referred to as country-by-country or CbC reporting. The policy objective of public CbC reporting is to improve community awareness around the arrangements of large MNEs operating within Australia by highlighting the amount of tax these entities pay. The enhanced scrutiny of MNEs tax information levels the (information) playing field, which, in turn, can assist in better informing the public debate on MNE tax compliance.

Questions

2. How should large MNEs be defined for the purpose of enhanced public reporting of tax information? Would the Significant Global Entity definition be appropriate to use?
3. Would you support an incremental (phased in) approach to mandatory tax transparency reporting for a broader range of entities, starting with large MNEs?

Confidential country-by-country reporting (OECD standard)

Currently, MNEs which are CbC reporting entities are required to report CbC information to tax authorities (including the ATO) on a confidential basis (in accordance with Australia's commitments under Action 13 of the OECD's BEPS Action Plan). The ATO uses the CbC data to inform its risk and compliance work.

CbC disclosures under this OECD regime are subject to strict confidentiality. As mentioned above, this confidentiality has been a key feature to encourage taxpayer compliance with increased reporting requirements. Jurisdictions which fail to meet the confidentiality standards will fail a Peer Review and could face the potential exclusion from future reporting exchanges.

Public country-by-country reporting (EU standard)

Recently, there have been developments internationally that will require large MNEs to publicly report CbC information. Specifically, the EU has introduced the obligation for MNEs to produce a CbC report on an annual basis detailing certain tax information (see box below).

The Directive¹¹ came into force on 21 December 2021, and EU member-states have 18 months (i.e. until 22 June 2023) to transpose the directive into their national laws. The Directive applies to MNEs with consolidated revenue exceeding EUR 750 million that are active in more than one EU member state. This could include Australian headquartered MNEs that meet these qualifying requirements.

EU public CbC reporting requirements

The EU has introduced an obligation for MNEs to produce a CbC report on an annual basis detailing:

- the name of the ultimate parent;
- the currency used for the presentation of the report;
- a brief description of the nature of company's activities;
- the number of employees on a full-time equivalent basis;
- revenues;
- profit or loss before income tax;
- accumulated income tax;
- income tax accrued;
- income tax paid on a cash basis; and
- accumulated earnings.

The EU's move to mandate public CbC reporting reflects shifting public expectations on MNE tax transparency. The *Senate Economic References Committee's Inquiry on Corporate Tax Avoidance* has previously recommended that the Australian government publish excerpts from the CbC reports, using the EU's standards as a guide¹².

¹¹ DIRECTIVE (EU) 2021/2101 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 24 November 2021 amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches - <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=OJ:L:2021:429:FULL&from=EN>

¹² See: Corporate Tax Avoidance report Part 1, Rec 6 -

https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Corporate_Tax_Avoidance/Report_part_1 and Part 3, Rec 7 -

https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Corporatetax45th/Report

Questions

4. Should Australia mandate improved tax transparency regime in line with the EU's approach to public CbC reporting? If so, why?
 - a. What sorts of entities (based on revenue or entity structure) should this mandate apply to?
 - b. Please provide details of any compliance costs associated with adopting the EU's approach to public CbC reporting.
5. If the EU CbC approach was mandated in Australia, are there additional tax disclosures that MNEs should be required to report, such as related party expenses, intangible assets, deferred tax and effective tax rate (ETR) per jurisdiction?

Global Reporting Initiative – Tax Standard

The Global Reporting Initiative (GRI) is a non-government international standards organisation (standard-setting body) designed to assist entities with sustainability reporting. It is a voluntary transparency regime which provides a global standard for corporate governance, including improved public reporting on tax.¹³

On 1 January 2021, the GRI's new tax Standard – GRI 207: Tax 2019 – took effect. Some members within the international tax community have positioned the GRI 207 as the first global reporting standard supporting public disclosure of corporations' business activities and tax payments on a CbC basis.

From a tax perspective, the GRI Tax Standard is designed specifically to improve tax transparency through quantitative and qualitative disclosures as it relates to the tax affairs of large MNEs (see box below). However, the GRI tax standard can be used by entities of all sizes.

While the GRI is voluntary, the information reported is similar to the data points listed in the OECD CbC regime. Proponents of the GRI tax standard claim that the GRI reporting data is more accessible for the public compared to the OECD's CbC regime (which is regarded by some as 'unreadable' and 'not for the public'). The assertion is that the raw CbC data released into the public domain, or anonymised aggregated CbC figures would be too difficult to analyse. For this reason, some tax advisors and corporate executives anticipate the GRI reporting standard will gain increasing prevalence in the annual reports of both public and privately held corporations.

¹³ See: <https://www.globalreporting.org/standards/standards-development/topic-standard-project-for-tax/>

GRI tax standard: CbC reporting requirements

The GRI Tax Standard requires the public disclosure of company business activities and tax payments on a country-by-country basis.

The GRI tax standard can be used by entities of all sizes. Entities are required to report the following CbC information:

- a) All tax jurisdictions where entities are resident for tax purposes.
- b) For each tax jurisdiction reported under (a):
 - i. names of the resident entities
 - ii. primary activities of the organisation
 - iii. number of employees, and the basis of calculation of this number
 - iv. revenues from third-party sales
 - v. revenues from intra-group transactions with other tax jurisdictions
 - vi. profit/loss before tax
 - vii. tangible assets other than cash and cash equivalents
 - viii. corporate income tax paid on a cash basis
 - ix. corporate income tax accrued on profit/loss
 - x. reasons for the difference between corporate income tax accrued on profit/loss and the tax due if the statutory tax rate is applied to profit/loss before tax

In addition, the GRI tax standard requires reporting on “Management approach to disclosures” which includes:

- Approach to tax
- Tax governance, control, and risk management
- Stakeholder engagement and management of concerns related to tax.

Questions

6. Should the GRI tax standard be used as a basis for Australia to mandate MNE public CbC reporting? If so, why?
 - a. What sorts of entities (based on revenue or entity structure) should this mandate apply to?
 - b. Please provide details of any compliance costs associated with adopting the GRI tax standard approach to public CbC reporting.
7. If the GRI standard was used as a basis for mandating CbC reporting in Australia, are there additional tax disclosures that MNEs should be required to report, such as related party expenses, intangible assets, deferred tax and effective tax rate (ETR) per jurisdiction?

(Voluntary) Tax Transparency Code

The Tax Transparency Code is a set of principles and ‘minimum standards’ to guide disclosure of tax information by businesses. The Code, developed by the Board of Taxation, is intended:

- to encourage large and medium-sized businesses to publicly disclose their tax affairs to highlight those that are paying their fair share and to encourage all businesses not to engage in aggressive tax avoidance; and
- for large businesses to take the lead, to become more transparent and help educate the public about their compliance with Australia’s tax laws.

At the time of this paper, there are approximately 203 signatories to the Code, and of these, around 198 have published at least one report in accordance with the Code. However, generally there has been low uptake of the Code, particularly by Australian subsidiaries of foreign companies.

However, if the Code was mandated, the approach would retain existing qualitative and quantitative disclosures required under the Code, while applying a higher threshold for CbC reporting from large MNEs (they should already have this data due to their OECD CbC reporting requirements).

Questions

8. Would legislating the Tax Transparency Code to include CbC reporting provide a suitable basis for a mandatory transparency reporting framework? If so, why?
 - a. What sorts of entities (based on revenue or entity structure) should this mandate apply to?
 - b. Please provide details of any compliance costs associated with adopting the Tax Transparency Code for public CbC reporting.
9. If the Tax Transparency Code was used as a basis for mandating CbC reporting in Australia, are there additional tax disclosures that MNEs should be required to report, such as related party expenses, intangible assets, deferred tax and effective tax rate (ETR) per jurisdiction?

Standardised public CbC reporting

One of the challenges of shifting to greater tax transparency is to limit unintended consequences, such that the initiatives become counterproductive (e.g. allowing MNEs to report selective information or using different formats) detracting from accountability and public scrutiny/analysis. This needs to be balanced against imposing unnecessary compliance costs.

Australian MNE tax information is currently not easily accessible as reported information is published in different places – the ATO website, data.gov.au and companies' websites. This means that the public is required to navigate between different information sources to understand an entity's tax position. In addition, the information within these published reports and the income years to which they apply can differ, which makes analysis and capacity to draw comparisons difficult. This is a longstanding issue – the 2010 Henry Review identified this as an issue, recommending that tax information be collected according to consistent and transparent classifications and concepts, and made freely available for analysis and research.

Ensuring that data reporting is standardised, publicly accessible and readable will support quantitative benchmarking of an entity's behaviour using consistent information, such that increased tax transparency from MNEs limits aggressive tax planning.

Other countries' approaches to public reporting can be informative in this regard. For example, environmental hazard reporting in the US mandates disclosure by companies in a standardised format of certain toxic chemicals released into the environment. The US Environmental Protection Agency administers a 'Toxics Release Inventory' – an online database accessible to the public – that serves as a market-based incentive to change corporate behaviour in line with minimum regulatory (and community) standards.

While some companies already voluntarily disclose tax information on a CbC basis (some even do project-by-project basis) via their taxes paid reports (prepared in accordance with the voluntary Tax Transparency Code and other transparency regime the entity is exposed to), ensuring a consistent standard will be important for achieving the Government's policy intent.

Questions

10. How should entities be required to publicly report their CbC information? Would publication in their annual report be adequate? Should this CbC data be verifiable (via independent audit, certification letter from CFO, reconcilable with financial accounts etc)?
11. What role should Government play in reviewing, publishing and aggregated analysis of country-by-country data?
12. What is the most appropriate way to ensure consistent (standard) reporting by MNEs of their public CbC information?
13. Should the data be reported in a standardised template? What should this be?
14. When should mandatory tax transparency reports fall due? For example, should they occur at the same time as annual reports are produced, tax returns lodged, or be staggered to spread compliance burdens?
15. Are there any transitional arrangements that would need to be considered prior to commencement of a legislated reporting requirement? What would these be?

Mandatory reporting of material tax risk to shareholders

The Government announced that it will require companies to disclose to shareholders “material tax risk” to assist shareholders to better understand their investments and any tax structuring arrangements of the company they are investing in.

In highlighting the concept of material tax risk, the Government announcement included, as an example, reference to the proposed global minimum of 15 per cent being progressed through the G20/OECD Two-Pillar solution. However, there are other taxpayer arrangements that might be preferable to disclose to shareholders instead, such as whether an entity has self-assessed as a ‘high-risk’ taxpayer in line with certain ATO Practical Compliance Guidelines.

This section seeks to explore the advantages and disadvantages of these approaches.

Tax haven exposure

While there are moves to introduce a global 15 per cent minimum tax, there is currently no globally accepted definition of a tax haven or a globally accepted list of economies that are tax havens. References to tax havens are commonly understood to mean economies with no or low rates of tax that lack transparency and do not share information with other jurisdictions. In recent years, there has been a move towards focusing on ‘effective exchange of information’ and ‘transparency’.

This raises potential definitional issues. For instance, determining what constitutes a ‘tax haven’ under this transparency initiative, might ultimately be different to the Government’s separate MNE tax integrity measure to deny tax deductions for payments for the use of intellectual property when they are paid to a jurisdiction where they don’t pay sufficient tax.

Similarly, doing business in a jurisdiction with a tax rate above 15 per cent would not necessarily capture any special regimes/rulings that may be available to certain companies. This raises issues about whether it would be more appropriate to determine if an entity’s ‘effective tax rate’ is below the global minimum, rather than merely doing business in that jurisdiction.

Other forms of high-risk tax arrangements

An alternative approach to ensuring that companies make investors aware of high-risk tax practices, could be to require listed entities disclosing to the share market if they self-identify as a high-risk taxpayer, in line with certain key Practical Compliance Guidelines.

For instance, entities are already required to self-identify as high risk under PCG 2017/4 in relation to related party debt funding.¹⁴ Extending this self-reporting mechanism (for certain high tax risk arrangements) to include share market disclosures could be a more principled approach to achieving the objective of making investors aware of high-risk tax practices.

Questions

16. How should entities disclose to shareholders whether they have a material tax risk?
17. What would be an appropriate channel for entities to disclose if they are doing business in a low-tax jurisdiction?
 - a. Are disclosures of this nature already released by organisations?
 - b. Could existing mechanisms be utilised for disclosures of this nature?
18. What types of high-risk tax arrangements should be disclosed to shareholders? Alternatively, are the existing definitions or PCG guidance that should be used to declare higher tax risk arrangements?
19. Should a threshold apply to entities mandatorily reporting tax haven exposure to shareholders? If so, what would be an appropriate threshold and why?
20. What due diligence should companies undertake to ensure the disclosure is accurate?

Requiring government tenderers to disclose their country of tax domicile

The Government announced that it will require all firms tendering for Australian Government contracts worth more than \$AUD 200,000 (inclusive of GST) to state their country of domicile for tax purposes.

This commitment would only apply in the instances where an MNE is tendering for contracts offered by the Australian Government (i.e. would not apply to contracts offered by the States and Territories).

This information would complement the existing details tenderers are already required to provide, when applying for Government contracts/tenders. For example, businesses tendering for Government procurements through open tenders with contracts that have an estimated total value of over \$4 million (including GST) must obtain a Statement of Tax Record to evidence satisfactory engagement with the tax system.

¹⁴ See: <https://www.ato.gov.au/law/view/document?DocID=COG/PCG20174/NAT/ATO/00001>

Questions

21. In considering a disclosure requirement, should the entity's tax residency status be used as the definition of 'tax domicile'?
22. Are there any unintended consequences that may arise from this new information requirement? If yes, what are they?
23. How should this commitment be implemented?
24. Should entities disclosing this information be subject to any verification process, having regard for compliance costs (for both taxpayers and government)?
25. Are there any general compliance cost considerations the Government should take into account in requiring Government tenderers to disclose their country of tax domicile?

Appendix 1 – Royalty withholding tax rates in Australia’s bilateral tax treaties

Jurisdiction	Royalties Withholding Tax Rate (outgoing) %	Jurisdiction	Royalties Withholding Tax Rate (outgoing) %
Argentina	15	Mexico	10
Austria	10	Netherlands	10
Belgium	10	New Zealand	5
Canada	10	Norway	5
Chile	10	Papua New Guinea	10
China	10	Philippines	25
Czech Republic	10	Poland	10
Denmark	10	Romania	10
Fiji	15	Russia	10
Finland	5	Singapore	10
France	5	Slovakia	10
Germany	5	South Africa	5
Hungary	10	Spain	10
India	15	Sri Lanka	10
Indonesia	15	Sweden	10
Ireland	10	Switzerland	5
Israel	5	Taiwan	12.5
Italy	10	Thailand	15
Japan	5	Turkey	10
Kiribati	15	United Kingdom	5
Korea (Republic of)	15	United States of America	5
Malaysia	15	Vietnam	10
Malta	10		