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Assistant Secretary
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The Treasury
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Dear Assistant Secretary

Deloitte submissions
Government election commitments: Multinational tax integrity and enhanced tax transparency

We write in response to the Consultation Paper (Paper) issued in August 2022 in relation to Multinational tax integrity and enhanced tax transparency measures.

We have responded in respect of each of the three matters separately:

- Appendix A: MNE interest limitation rules
- Appendix B: Denying MNEs deductions for payments relating to intangibles and royalties paid to low or no tax jurisdictions
- Appendix C: Multinational tax transparency

The first two of these measures have the potential to materially impact the tax positions of existing Australian operations and to increase the cost of future investment in Australian operations.

At a time of increasing cost of funds and ever growing reliance on intellectual property and other intangibles, where Australia has a relatively high rate of corporate income tax and strong existing anti-avoidance laws, these measures are creating uncertainty and potential additional tax costs. These concerns are further exacerbated by the intention to be operative from July next year, leaving limited time for consultation, drafting, Parliamentary debate and implementation.

Further, it appears from the Paper that many of the critical design and policy features on all three issues are yet to be determined. In respect of each of the three matters, the concerns with the current laws should be clearly articulated and the objectives of the response should be identified. This will serve to ensure the most effective consultation process and targeted responses.

We note the comments in the Introduction to the Paper, being that 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." (formatting added)

It is important that the more detailed policy formulation proceed in a way that regularly tests the proposals with these objectives.

We would be happy to further discuss any of these matters, and in the first instance, please contact David Watkins on 0498 344 000.

Yours sincerely

David Watkins
Partner, Tax & Legal

Appendix A

Part 1: MNE interest limitation rules

Introductory comments

Debt funding of Australian business and the associated interest costs are very material amounts and therefore care needs to be taken in adjusting the related tax settings. The tax laws associated with the deductibility of interest underpin existing business and proposed investments in Australia. Any change to these tax settings, especially in a period of increasing cost of funds, creates uncertainty. This is especially so given the changes are to commence in less than a year's time.

We acknowledge the Government's intention to further limit interest deductions and that the EBITDA based model is the OECD recommended approach and a widely adopted approach globally. We also acknowledge the over-riding principle in the Paper that the policy is to "[limit] debt deductions to genuinely commercial amounts".

The key policy and design issues that need to be addressed are

- In recognition of the volatility of earnings and EBITDA, and consistent with common design features in comparable regimes globally
  - Denied interest deductions (interest > 30% of EBITDA) should be available for carry forward
  - Excess capacity (interest < 30% of EBITDA) should be available for carry forward
- Whether there will be any transitional or grandfathering measures for existing funding, or the ability to compute an opening excess capacity balance for years prior to the commencement of the EBITDA based model (understood to be a feature of the proposed Canadian model)
- The relationship between transfer pricing and the EBITDA based model. The current interaction between the thin capitalisation regime and transfer pricing has been largely settled via section 815-140. It is critical that a clear and principled approach is retained
- We note that the Australian model intentionally goes beyond the OECD recommended approach and will retain an arm's length test. We commend this approach that recognises that the arm's length principle is the over-riding principle, and that a fixed ratio is a short cut or a proxy for permitted interest deductions. The Paper states that the policy is to "[limit] debt deductions to genuinely commercial amounts". It is important that the proposed arm's length test retains the capacity to permit interest deductions for "genuinely commercial amounts"
- To the extent that the policy is seeking to address "excess deductions" in an inbound context, the policy settings should be tested to ensure that the outcomes are also appropriate for Australian outbounds
- Preventing inappropriate mismatches and double countings where some or all of the interest expense is in one entity and the related earnings and EBITDA is in another entity. This will require the modification of existing associate rules to the new EBITDA based model

Implementation considerations: adopting an earnings-based 'safe harbour' test

[Q1] We recommend that the fixed ratio rule should rely on tax concepts. This position accords with the OECD's recommended approach, and common approaches globally.

[Q2 & Q4] It is difficult to meaningfully respond to questions such as compliance costs and affected businesses as this will depend upon the status quo under current law (compliance costs and outcome) and under the revised regime, depends upon critical design features, in particular:

- whether there is a carry forward of excess or denied deductions, and
- whether taxpayers are required to increasingly rely upon the worldwide test or the arm's length test.

As a general comment, businesses generally will be at increased risk of interest denials under the fixed ratio approach relative to the current approach, for the reason that the benchmark of earnings / EBITDA is inherently more volatile than a benchmark of assets.

[Q3] The current safe harbour test is widely relied upon for two principal reasons: reduced cost of compliance and high levels of certainty: that is, it is a genuine safe harbour. It will be important the revised approach provides that, at least for the vast majority of taxpayers, a comparable result is achieved as regards both compliance costs and certainty. We note that the Paper at page 6 refers to the "earnings-based 'safe harbour' test", and assume that the rules will be designed to deliver the compliance costs and certainty outcomes of a safe harbour.

[Q5] We do not propose any changes to the current thin capitalisation rules as they relate to ADIs, noting banking entities are subject to prudential regulations and reporting, including requirements to keep capital.

Fixed ratio rule: implementation considerations

[Q6] A de minimis rule should be maintained of at least $2 million (the existing threshold).

The questions do not specifically address the other exemptions such as the assets threshold (s820-37) and special purpose entities (s820-39). We submit that these rules should remain so that the change to an EBITDA based model is not used as a means of expanding the scope of the interest restriction rules.

[Q7] Whilst some sectors may be more likely to experience earnings volatility, the prospect of volatile earnings should be seen as a risk across almost all sectors. This has been evident in the last few years due to COVID, flood, bushfires, etc.

[Q8] Fixed ratio rule: significant features

The most significant feature of the fixed ratio rule adopted in other jurisdictions that should be implemented is the carry forward of excess (or denied) net interest costs.

We also support the carry forward of unused capacity.

Both of these features recognise the inherent volatility in earnings. We believe this is sound from a policy perspective and has been adopted in the UK and many EU jurisdictions[1].

Some form of transition or grandfathering of existing financing arrangements should be permitted to allow for a transition into the new rules: current projects have been funded and modelled based on existing rules, and refinancing may be time consuming and expensive.

An exclusion from thin capitalisation for third party loans used to fund qualifying long-term public infrastructure projects in Australia should be considered. Currently such projects can typically rely on the ALDT and apply the inward low risk zone in PCG 2020/7 to minimise their documentation requirements. Demonstrating eligibility under a new law would likely be similar to the documentation under the PCG approach but should be built into the legislation. The definition of an 'economic infrastructure facility' adopted for the purposes of the stapled structure reforms provides a concept that could be expanded and leveraged in this context. However, that example also underlines the additional complexity and uncertainty that such definitions can introduce. Accordingly, while an exclusion should be considered, it should not detract from ensuring that the Australian regime provides an ALDT that caters for the particular

[1] We understand that the UK rules permit unlimited forward of denied deductions and 5 year carry forward of excess capacity (also the case in Germany, France, Spain, Italy, amongst others). We understand that Canadian rules to commence in 2023 propose a 20 year carry forward of denied deductions and 3 year carry forward of excess capacity.

characteristics and financing requirements of taxpayers in capital intensive sectors such as infrastructure and property, which will increasingly include projects directed at lowering Australian carbon emissions.

The rules should continue to provide for the existing overseas investor or investment requirement (inward and outward entities), the 90% exemption rule, the insolvency-remote exemption (per s820-39) and the de minimis rule.

The rules should also continue to permit grouping related rules such as the associated entity excess amount and be modified to apply to the fixed ratio rule. This is critical for non-consolidated structures as well as trusts that are not able to form consolidated groups.

Group ratio rule

[Q9, Q10 & Q11] Whilst the OECD approach proposes a worldwide test based on net third party interest / EBITDA, it also contemplates other models (e.g. asset-based, debt / equity).

As a practical matter and to address the needs of the vast majority of taxpayers, we consider that the appropriate design features and drafting priority is on the fixed ratio test and the arm's length test.

As currently designed, our experience is that there are no particular types of entities or businesses that particularly adopt the worldwide test.

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

Introductory comments

As noted in the Paper, "the Government also indicated it would maintain an arm's length test". We assume this test will be based on the ALDT.

Integrity issues: quantum

We note that the over-riding policy objective is stated to be to permit interest deductions for "genuinely commercial amounts". We see this objective to be consistent with the ALDT.

By definition, the ALDT is designed to ensure an entity cannot claim debt deductions in respect of a non-arm's length debt amount; the test prescribes that arm's length terms and conditions of debt are hypothesised to exist in the process of assessing an arm's length amount of debt.

In other words, the arm's length debt amount is determined on an assumption of arm's length terms and conditions of debt (including interest rate) that would reasonably be expected for the notional Australian business (i.e. on a standalone basis) – rather than the actual terms and conditions of the debt held by the taxpayer (and this tested interest rate may be higher given the standalone ALDT construct).

The Paper expresses concerns:

- "consideration should be given to … [a] strengthened [test] to prevent entities from opting into arrangements, that potentially take advantage of greater debt deductions than would be available under the fixed ratio rule"; and
- "using the arm's length test … would nonetheless undermine the Government's policy intent"

This appears to reflect a view that the arm's length test is not consistent with "genuinely commercial amounts".

This tension is encapsulated by the Paper's concluding comments on the issue: "The consideration of any changes to the [ALDT] would seek to **ensure integrity**, while balancing the ability to **determine a genuinely commercial level of debt** for the Australian business".

Integrity issues: rate

The Paper notes that “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”. We query the premise of this statement:

- *Interest paid to an Australian entity:* if a taxpayer pays an above arm’s length interest rate to another taxpayer (related or unrelated) the amount is returned as assessable income in Australia. The NALI rules may be applicable to address a particular integrity concern associated with lower tax rates for MITs.

- *Interest paid to a non-resident entity:* the transfer pricing rules (Subdivision 815-B) apply to substitute arm’s length conditions if a transfer pricing benefit arises. The pricing (rate) may be arrived at after taking into account a different debt quantum, but the actual debt quantum continues to be taken to exist (per an application of section 815-140) in most circumstances.
  - The operation of the law (or the ATO’s current interpretation and administration) results in an application of the transfer pricing rules (say, reduction in interest rate on debt) that then operates for the purpose of the remainder of the Act, including thin capitalisation and the ALDT.
  - Accordingly, the interest rate should be an arm’s length rate for transfer pricing purposes (broadly reflective of the circumstance where the taxpayer is taken to be a member of a global group, rather than an orphan). Given the ALDT hypothetical construct (the notional Australian business) is broadly a standalone concept it will generally be the case that the hypothesised terms and conditions required to be determined to assess the ALDA will not require a lower interest rate than arrived at under Subdivision 815-B.
  - As such, the rules typically interact in a way that is favourabe to revenue in that the hypothesised interest rate used for assessing the ALDA may in fact be higher than the actual interest rate required under the TP rules.

In our view integrity concerns arise in connection with the practical challenges of an application of the ALDT rather than the test in and of itself, which is economically sound and based on an objective standard. We do not dispute that there is often uncertainty in establishing an arm’s length amount of debt, however this is not dissimilar from the lack of bright line associated with a range of tax issues (i.e. transfer pricing, non-arm’s length income rules, anti-avoidance rules such as section 45B and the GAAR, the capital / revenue distinction).

Given the ALDT only permits a commerically justifiable amount of debt and the stated commitment to retaining an arm’s length test and a commitment to “genuinely commercial amounts”, to the extent taxpayers adopt the ALDT following the introduction of a fixed ratio rule, we would maintain this is not an integrity concern unless the ALDT is misapplied.

Compliance issues

In practice the introduction of PCG risk zones has reduced the ALDT compliance burden in some instances as documentation detail has been substantially reduced. In our experience this is particularly the case for an inward entity that only holds third party debt (or back to back debt) (as per the inward low risk zone in paragraph 30 of PCG 2020/7). To provide greater certainty to taxpayers, consideration could be given to codifying aspects of the PCG risk zones particularly as they relate to lowering the documentation burden for taxpayers in the low risk zones.

We note that section 820-980 requires documentation that addresses the legislative test but this is not necessarily lengthy or overly detailed documentation if the application of the ALDT is not complicated.

Whereas for taxpayers that present a more complex fact pattern, the requirement to undertake rigorous analysis is appropriate to substantiate an application of the test. Typically this is because of related party debt (in both an inward and outward context, although more commonly in an inward context) and / or debt held by the outward entity that is borrowed on the basis of the entity's global business.

Summary

We submit that the commitment to an arm's length test is consistent with interest deductions based on "a genuinely commercial level of debt" and arm's length interest rates. The threshold issue is a commitment to a genuine arm's length test. Practical and administration issues ought to be addressed thereafter, and not as a means of constraining the arm's length test.

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?

Question 12

Entities in the start-up and investment phase (including construction and development phase) who are pre-revenue will be denied interest deductions under the fixed ratio rule (ameliorated to an extent by the introduction of design features such as carry forward rules in the fixed ratio rule). However the use of ALDT, with interest effectively converted to carry forward tax losses, may be advantageous as in the early stage of income production those losses, plus current year deductions, may be available to offset assessable income rather than being capped under the fixed ratio rule.

Often SPV infrastructure and property sector entities already use the ALDT. Start-up investment activity outside these sectors is not likely to have significant debt and may not be well suited to the ALDT on a go-forward basis.

We would not necessarily envisage entities operating in sectors with volatility of earnings to be significant users of the ALDT (i.e. given that certainty of earnings is a clear indicia of the capacity to support higher debt levels) unless the fixed ratio rule is introduced without the capacity to carry forward unused deductions.

Question 13

We understand this question to be referencing the varying hypothetical constructs required in assessing an application of the transfer pricing rules in Subdivision 815-B compared to the ALDT.

Acknowledging there are essentially two distinct legislative tests that must be independently assessed, we view the policy setting, whilst creating a compliance burden, to be sound and appropriate from an integrity perspective.

The current factual assumptions for ALDT include that the taxpayer is taken to be a notional standalone entity (i.e. without the benefit of any guarantee, security or other credit support provided by an associate or the use of foreign assets). Broadly speaking, if instead the taxpayer was taken to be a member of a global group, then this would likely reduce compliance effort for those funded (at least partially) by cross-border related party debt. This is because such a hypothetical scenario for ALDT would more closely align to the generally accepted transfer pricing construct.

However, this could permit a higher quantum of permissible debt deductions under the ALDT in certain circumstances:

- An Australian subsidiary of a global group could effectively obtain third party debt in Australia supported by the global group's balance sheet (via implicit and / or explicit credit support).
- An Australian HQ entity could borrow third party debt that is supported by the Australian *and* foreign business of the taxpayer.

These scenarios appear to undermine the policy intent of the ALDT designed to ensure the debt of the *Australian business* is arm's length. To an extent it could also serve to undermine the level playing field for competitors in the same industry operating in Australia (regardless of the global footprint of the taxpayer's group).

Question 14

It is unclear as to the exact premise of this question as it depends upon a view of the term "BEPS practices". As noted above, we view the ALDT to be consistent with interest deductions for "genuinely commercial amounts", and hence not a "BEPS practice" or BEPS concern.

Broadly speaking it is not an application of the ALDT in and of itself so much as a misapplication of the test that gives rise to profit shifting concerns. As noted above, the notional Australian business construct created by the factual assumptions in the ALDT operate to alleviate many of the BEPS and integrity concerns that would otherwise arise in the absence of that construct.

That said, it is understood that historically the majority of debt deductions claimed under the ALDT are in connection with third party debt rather than related party debt.

Furthermore, Australia has comprehensive integrity rules (including transfer pricing and other anti-avoidance measures) and a robust legislative framework presently in existence. Our recommendation is that attention should be focused on compliance and administration of the ALDT, rather than legislative change of, in our view, an inherently sound tax policy.

There are no changes we would recommend to complement the fixed ratio rule.

Questions 15 & 16

As noted, the integrity concern in an ALDT context largely depends upon whether the taxpayer is an inward or outward entity. At a most basic level and as noted above, an outward entity may be using overseas assets to support third party debt deductions in Australia and an inward entity may be using related party debt to push more debt deductions into their Australian business. As such, the concern does not necessarily align with whether the debt is third party or related party debt.

Only permitting an application of the ALDT to third party debt would be a blunt tool to address the integrity concern that related party debt may present.

This would cause additional administrative effort for inbound multinationals who often borrow through a centralised finance entity to simplify their financing and obtain the lowest cost of funds. Having to go to external lenders to borrow directly into the Australian subsidiary does not necessarily change the debt deductions but introduces further administration for potentially no change in tax outcome.

An alternative would be for the Australian business to have to rely on the WWG test so that the debt in Australia is compared to the global group but this doesn't adequately account for diverse business operations and / or geographic differences (say, an infrastructure asset in a less developed jurisdiction compared to an OECD country) and the ALDT permits a more nuanced and appropriate commercial outcome.

For completeness, the need to identify the notional Australian business should remain regardless of any change in the application of the ALDT to third party debt.

Question 17

The ALDT properly applied shouldn't permit excess debt to be dumped as the test requires an amount of debt that *would reasonably be expected*. By definition, the amount of debt is not excessive for the Australian business. From a policy perspective an entity should be permitted to operate in Australia with a level of debt that is arm's length and should not be competitively disadvantaged by having to retain a different capital structure because regearing is restricted or even prohibited. Commercial and financial decisions pertaining to capital structure and financial risk are not driven exclusively by tax outcomes and there are robust anti-avoidance rules presently in place in Australia.

Question 18

The administration of the ALDT could be improved by additional resourcing and consistency of approach by the ATO.

Whilst acknowledging the regulators approach will necessarily evolve, concerns arise as administration practices change and taxpayers in the same industry do not necessarily arrive at a similar outcome following ATO review. This may introduce comparative advantage / disadvantage into sectors in circumstances where economic returns are typically quite stable.

The protracted time frame for review and audit resolution (at times extending over many years) is a considerable concern at present. Whilst up-front, contemporaneous review of positions might be time intensive, in the long run it could prove to introduce overall efficiency and savings, along with much needed certainty and consistency.

The ALDT could be limited to particular industries or sectors but that switches the administration to the definitional aspects of the test – how broadly is 'infrastructure' defined and which class of entities are included?, who is an entity in the 'property' sector? The current users of ALDT are diverse and not as heavily concentrated to the obvious industries but perhaps an improved administration of the rules would see a grouping back to the more obvious industries (i.e infrastructure and property).

We note the Board of Taxation in their 2014 report specifically rejected the idea that eligibility should be limited for certain taxpayers.

Trying to impose a particular preferred ALDT methodology is not appropriate or feasible as the test requires a high degree of judgement to be exercised and an appropriate application of the test will vary depending upon the taxpayer's facts and circumstances. We note the ATO did not go down the path of trying to dictate a mechanical application of the rules and the BoT also acknowledged that was not appropriate in its 2014 report.

Appendix B

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

Introductory comments

Whilst the precise scope of the royalty measures in the Paper is unclear, it has moved significantly beyond the scope of the April 2022 announcement, which was targeted to arrangements involving tax havens, abuse of tax treaties, treaty shopping and funnelling of payments together with a carveout for an absence of a tax avoidance purpose. A feature of the announcement was a low taxed recipient.

The measure in the Paper is much broader. In addition to seeking to target certain arrangements that may involve payments to low or no tax jurisdictions (referred to below as insufficient arrangements), the policy is also addressing the following concerns:

- embedded royalty arrangements in connection with intangible assets, per TA 2018/2 (referred to below as embedded royalty arrangements); and
- non arm's length arrangements having regard to the functions performed, assets used, and risks assumed by various entities, per TA 2020/1 (referred to below as mischaracterisation of DEMPE arrangements).

It is not clear whether the proposed measure is intended to apply only to an embedded royalty arrangement **or** a mischaracterisation of DEMPE arrangement which **also** features insufficient tax, or whether the proposed measure targets the above as **three separate concerns**:

- Embedded royalty arrangements, irrespective of whether there is insufficient tax;
- Mischaracterisation of DEMPE arrangements, irrespective of whether there is insufficient tax;
- Insufficient tax arrangements, irrespective of whether that involves an embedded royalty arrangement or a mischaracterisation of DEMPE arrangement

If the latter is the intended scope, this goes well beyond the original announcement and the current description of the measure as "<u>Denying MNEs deductions</u> for payments relating to intangibles and royalties <u>paid to low or no tax jurisdictions</u>".

Further, the Paper makes no mention of a carveout for an absence of a tax avoidance purpose, as per the April 2022 announcement.

In addition, there is no discussion of the interaction of this policy with the withholding regime, so prima facie, it appears that there could be a denial of a deduction together with the continued imposition of withholding tax. Indeed, the situation could arise where an in scope royalty is denied deductibility by this measure (effectively a 30% tax), and in addition, the ATO may assert that relevant treaty benefits are not available (resulting in a rate of 30% instead of the regular treaty rate: effectively a 60% tax).

Given the broad and unclear scope, we read the Paper to potentially mean under the policy: an arm's length amount paid to an unrelated party for commercially valuable intangible rights used in the Australian business where the royalty is insufficiently taxed to the unrelated payee, will be treated as non-deductible and remain subject to withholding tax at the appropriate rate. This is an excessive and inappropriate response.

A policy which disallows, in entirety or in part, genuine deductions for royalties paid to obtain valuable intangible rights will significantly disrupt commercial practices, potentially increasing costs to Australian taxpayers of acquiring such rights and limiting the use of world leading technologies in Australia.

In our view, there are many and numerous powerful provisions currently in effect to address the arrangements of concern. The Paper at pages 11-12 notes a number of existing rules. To this we would add the Diverted Profits Tax which is not specifically mentioned: the DPT is especially powerful as it takes into account a purpose of reducing foreign tax. A matter is currently before the Federal Court which will examine many of these provisions including the DPT, and we submit that any further action in this regard should be deferred until that matter is resolved.

We also note the beneficial ownership test in tax treaties, and existing section 26-25 which already denies a deduction for a royalty where there is a failure to withhold or remit. In addition, it is expected that Pillar 2 will be introduced to establish a 15% minimum tax. It is unclear how any additional rule will interact with the existing regimes.

We submit that no further action is required with respect to embedded royalty arrangements or mischaracterisation of DEMPE arrangements. There are already many powerful provisions in the tax legislation and imminent judicial consideration of these provisions.

That said, there may be a narrow case of egregious insufficient tax arrangements, which if demonstrated to be beyond the scope of the existing provisions, the appropriate response could be to deny the deduction. For example, such a provision could address an arrangement involving:

- A SGE;
- Making a payment to a related entity;
- Where the related entity is in a treaty country (and the withholding tax is therefore reduced);
- The tax imposed on the income-side is "low" in circumstances involving a harmful tax practice. For example, a payment to a non-harmful patent box regime with appropriate substance (consistent with the DEMPE), etc should not relevantly be in scope.

This is more aligned with our understanding of the April 2022 announcement.

With respect, it is submitted that further consultation is required to identify the specific areas of concern and ensure that the response is targeted to those concerns.

Taxpayers in scope

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?**

It is not clear what is meant by the term "corporate SGE", however we assume it is referring to "CbC reporting entities".

The policy should be targeted and only apply to SGEs. Alternatively, the measure could apply only to CbC reporting entities: the extensive reporting obligations that attach to CBC reporting entities should assist to address the practical challenges of identifying payments of concern. Expanding the policy to all entities, without a materiality threshold, will unnecessarily burden taxpayers with further complexity and compliance costs.

Payments relating to intangibles and royalty in scope

3. **Do you consider the policy should seek to cover both royalties and embedded royalties?**

The policy should only cover royalties, which is relevantly taken to refer to amounts within para (a) of the s6(1) definition of royalty (being payments "for the use of, or the right to use, any copyright, patent, design or model, plan, secret formula or process, trade mark or other like property or right").

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There is no formal meaning of 'embedded royalties'[2] but in any event, a so-called embedded royalty is a royalty, albeit that it may not be obviously identified as a royalty. The embedded royalty concern can currently be addressed under existing law.

A policy which created a concept of embedded royalty, which goes beyond the existing definition of royalty (per para (a) of the s6(1) definition), would likely not be in scope of the definition of royalty in our tax treaties in any case.

4. Do you consider there are practical challenges in identifying embedded royalties, and if so, what are they?

We acknowledge that there are practical, commercial and legal challenges with respect to so-called embedded royalties.

5. Do you consider the policy should seek to address reduced Australian profits which has resulted due to migrated intangibles and DEMPE functions?

We assume that this question is asking whether the policy should address the concerns raised by the ATO in TA 2020/1.

We consider that there are many and various existing measures that address the concerns raised by the ATO in TA 2020/1. To create additional measures would add unwarranted conflict with existing provisions.

Although not asked, we also are of the view that the policy should not address the concerns raised by the ATO in TA 2018/2. We understand that the Commissioner is currently in the Federal Court challenging an arrangement under the DPT which, resembles an arrangement described in TA 2018/2. We submit that the litigation should be completed prior to introducing additional measures (if any) to target the same concern.

6. Do you consider any other payments (not related to intangibles or royalties) should also be covered by this policy?

We consider that the policy should be limited to amounts which are within para (a) of the s6(1) definition of royalty.

Application to related and unrelated parties

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

If an additional measure is to be introduced over and above existing measures which is premised upon an understanding of the tax affairs of the payee / recipient, it should be targeted at related party dealings only. For example, the hybrid mismatch targeted integrity rule with respect to interest applies to payments within a "Division 832 control group".

Insufficient tax

8. What are your views in relation to the [insufficient tax] options outlined above?

We consider that the relevant test of insufficient tax should be circumstances involving a harmful tax practice. For example, a payment to a non-harmful patent box regime with appropriate substance (consistent with the DEMPE), etc should not relevantly be insufficient taxation.

[2] TA 2018/2 did not use the term "embedded royalty", however Minutes of the Energy and Resources Working Group minutes 17 October 2019 (refer https://www.ato.gov.au/General/Consultation/In-detail/Stakeholder-relationship-groups-minutes/Energy-and-Resources-Working-Group/Energy-and-Resources-Working-Group-minutes-17-October-2019/) contain an example of the ATO referring to the term embedded royalty: "TA 2018/2 was released which is focused on embedded royalty arrangements, where an Australian entity pays for a tangible asset which includes the right to use intangible assets with the payment of a royalty."

Appendix C

Part 3: Multinational tax transparency

Introductory comments

Deloitte recognises and supports the critical importance of strong community confidence in the Australian tax system and in the roles performed by the various key participants in that system. We acknowledge that an appropriate level of tax transparency plays a role in maintaining and enhancing that confidence, although any changes must identify the particular objective and consider both the perceived benefits and the expected costs.

Business affairs, and hence tax matters, inevitably involve commercially confidential and sensitive information, particularly where large multinationals (MNEs) are operating globally. Successful taxpayer engagement relies heavily on taxpayers trusting that such information when provided to the tax administrator is kept in strict confidence and is not made more widely available. The law has recognised the importance of this concept. There is a balance to be struck between an appropriate level of tax transparency and the maintenance of taxpayer confidentiality.

Given the importance of taxpayer confidentiality that is recognised in the tax laws and in the dealings between taxpayers and tax authorities, care must be taken not to undermine that principle by requiring information that the ATO cannot provide to instead be provided by the taxpayer.

It is not certain that more and more taxpayer led transparency and disclosure will of itself achieve optimal community confidence, especially given the complexity of the subject matter and the pre-conceptions in the community, which are regularly reinforced by media and politicians.

Improving community confidence in the Australian tax system requires a range of responses by various parties. We acknowledge the increased transparency of the ATO in recent years, one example of which is the tax gap information, which covers various taxes including "large corporate groups, income tax". Both in dollar terms and percentage terms, there are numerous gaps which are considerably larger than the gap associated with large corporate groups, income tax. It is submitted that, separate to taxpayer led transparency, much could be done to address community concerns about tax paid and not paid if the wider narrative was aligned with this tax gap data.

We submit that the particular objectives associated with increased tax transparency need to be identified and the responses targeted towards those objectives, rather than simply seeking more tax transparency.

Our over-riding comment in respect of increased tax transparency is that any Australian requirements need to be harmonised with the key similar requirements around the world. We acknowledge that there is no global standard as of today, although this is likely to emerge. It is unhelpful if the Australian requirements are out of line with other regimes in terms of compliance costs and the level of information.

Other high-level comments are that any Australian tax transparency requirements are:

- Consideration needs to be given to the appropriate type of disclosure of Australian tax matters versus non-Australian tax matters;
- Consideration needs to be given to the way in which appropriate disclosures be tailored depending on whether the taxpayer group is principally domestic, principally outbound or principally inbound;
- We are strongly opposed to any public disclosure requirement being linked to any ATO risk management tools such as practical compliance guidelines or tax alerts.

Tax transparency reporting: the current approach in Australia

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

In the context of further, or different, measures in respect of taxpayer led public reporting of tax information, we encourage Treasury to take into consideration the following principles:

- any new measures should consolidate the broader set of Australian tax transparency requirements into a single coherent regime;
- the regime should be simple and efficient to comply with, preferably based on reporting that is already required to be made by MNEs;
- the regime should align with the predominant measures in place in other jurisdictions to the extent possible, so as to mitigate the work, complexity and cost associated with complying with varying regimes across jurisdictions; and
- the regime should not require further or additional information to that required to be disclosed in other jurisdictions;
- The cost benefit analysis of increased transparency should be well understood given the increased compliance burden it will place on taxpayers doing business in Australia; and
- A post implementation review should be undertaken to assess costs and benefits and alignment with global practices.

In addition, in developing increased tax transparency proposals, this needs to be considered in respect of various categories of taxpayers:

A. Australian parented groups with wholly or predominantly Australian operations (domestic)
B. Australian parented groups with significant offshore operations (outbound)
C. Foreign parented groups with significant offshore operations, and which also have Australian operations (inbound)

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

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?**

We consider that any increased tax transparency measures should be applicable (at least initially) only to CBC reporting entities and not other entities. This targets the measures at those entities currently undertaking CbC reporting, being broadly those the largest entities, and the largest taxpayers and prevents the associated compliance costs from affecting wider sectors of the business community.

It may also be appropriate to include a de minimis exception for those that have a minimal Australian presence, or that do not have material international cross border related party dealings.

As the introduction of any measures that involve additional or varied compliance obligations requires a period of time to understand and apply, we consider that it is appropriate to provide a suitable transitional introductory period.

Public country-by-country reporting (EU standard)

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? lease 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?**

It is submitted that any public CbC transparency reporting regime adopted in Australia should, to the extent possible, be consistent with the manner and form of the prevailing regime of public CbC reporting globally, as it develops. This global model may be principally based on EU proposals, GRI or other that may emerge. At this stage, we have not analysed these various models in detail. We recommend that Treasury undertake further analysis of the developing global model(s) prior to determining a recommended approach for Australia.

At this early stage, the EU's approach to public CbC reporting outlined in the European Union (**EU**) Directive 2021/2101 appears to be the prevailing tax public reporting regime globally. We note that the EU developments have been underway for a number of years (draft EU legislation on public CbC reporting was issued on 12 April 2016), indicating the challenges in mandating disclosure requirements even on a regional basis, let alone a global one. In line with the broader principle of aligning any proposed Australian tax transparency mandatory reporting regime with the prevailing global approach, Australia should monitor international developments in tax transparency reporting, including implementation of the EU model, so as to provide Treasury with a greater level of information as to likely measures to be adopted by other significant jurisdictions (if any).

If the EU model is used by Treasury as a framework for a future working model, which we consider to be the preferred option, there should also be consideration given to the type and extent of disclosures in that model which may or may not be suitable in the Australian tax context. The EU framework is adapted from the initial OECD public consultation discussion draft of 2014. We submit that it is necessary for Treasury to consider the extent and type of public data which would appropriately facilitate tax transparency in the Australian context and balance the legitimate competing interests.

Finally, we note that the EU directive broadly applies to reporting activities within the EU member states (as well as designated 'EU blacklist' and 'EU greylist' countries). Each EU member state is required to legislate the EU directive and thus provide a local jurisdictional basis for enforcement. It is unclear how or whether an Australian regime could obligate large MNEs to publicly disclose sensitive information about extra-territorial activities (e.g., CbC information relating to other jurisdictions).

Further detail about the scope of the proposed measures would be required to determine the associated additional compliance costs imposed on taxpayers.

Global Reporting Initiative – Tax Standard

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?**

It is submitted that any public CbC transparency reporting regime adopted in Australia should, to the extent possible, be consistent with the manner and form of the prevailing regime of public CbC reporting globally, as it develops. This global model may be principally based on EU proposals, GRI or other that may emerge. At this stage, we have not analysed these various models in detail. We recommend that

Treasury undertake further analysis of the developing global model(s) prior to determining a recommended approach for Australia.

Treasury should consider the practical implications of adopting the GRI by balancing the consequences of mandating further reporting requirements with the desire for increased transparency. Some of the practical considerations include:

- the extent to which it is necessary for the taxpayer to make a detailed disclosure on how tax strategy is linked to sustainable development and business development;
- how the measures marry existing tax public policy, advocacy and engagement of external stakeholders;
- disclosures around intra-group transactions and debt. More clarity may be required around the definition of an "intra-group transaction", and whether there is consistency with OECD standards; and
- disclosures around tangible assets (other than cash or cash equivalents), potentially requiring greater clarity around the definition of tangible asset and consistency with OECD standards.

Mandating the GRI Tax Standard would result in a more detailed country-by-country reporting standard, further increasing the complexity and resources required from taxpayers. It would also require more guidance from Treasury and the ATO to clarify certain definitional aspects as described above as well as maintaining pace with international developments. Whilst overlap exists with OECD CbC standards, the GRI Tax Standards require greater detail than the OECD standards. This includes the use of consolidated numbers at each country level as well as the need to distinguish between corporate income tax accrued and tax due if the statutory rate is applied to profit/loss before tax.

Importantly, it may be necessary for large MNEs with significant global operations to prepare separate reports to comply with GRI 207 (and specifically, GRI 207-4) and OECD CbC reporting. This would be an additional layer of compliance burden.

Given the GRI Tax Standards are relatively new, there has been insufficient time to evaluate the standards in a practical setting, and the respective costs and benefits. To reduce the potential compliance burden, it is recommended that Treasury focus its public disclosure efforts to SGEs with a significant multinational presence and significant international related party dealings, as outlined above.

We encourage Treasury to ensure that any new measures do not overlap or require the duplication of reported data currently disclosed by taxpayers in various forms to the ATO, to markets in annual reports and other disclosures, or through other measures.

(Voluntary) Tax Transparency Code

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?**

For the reasons outlined above, we encourage Treasury to adopt a single, unified tax transparency regime that aligns with the prevailing global approach and existing required reporting requirements.

The voluntary tax transparency code requires a stand-alone report to be prepared on an annual basis. Much of this information is already disclosed to market in other reporting forms and / or to the ATO.

The annual preparation of a tax transparency report adds to the cumulative compliance burden placed on taxpayers. Unlike other proposed disclosure measures (i.e., public CbC reporting), taxpayers are generally less able to leverage other reporting requirements, or reporting requirements in other jurisdictions, because the tax transparency report is an Australian initiative.

For these reasons we encourage Treasury to consider leveraging existing reporting requirements to achieve the desired tax transparency outcomes. Should the measures ultimately differ from the tax transparency code, compliance with the code should remain voluntary.

Standardised public CbC reporting

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?**

In connection with any taxpayer led public reporting of CbC information, the questions at 10-13 should be resolved in a manner consistent with global practices, as they develop from time to time.

Consideration could be given in the future to the Government or the ATO reviewing, publishing and aggregating this information, but at this stage, it is too early to say whether this is meaningful and helpful. Any such Government led disclosures need to maintain taxpayer confidentiality and should comply with the OECD requirements in respect of CbC report confidentiality.

Due dates for any further compliance burden that is placed on taxpayers should fall due after the preparation of annual reports and the lodgement of income tax returns. This would permit flexibility for taxpayer tax functions to allocate its resources as well as focus on other regulatory requirements associated with corporate reporting under the *Corporations Act 2001*.

As the introduction of any measures that involve additional or varied compliance obligations requires a period of time to understand and apply, we consider that it is appropriate to provide a suitable transitional introductory period.

Mandatory reporting of material tax risk to shareholders

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?**

Deloitte.

Taxpayers who prepare financial accounts in accordance with AASB (IFRIC 23) and US GAAP (FIN 48 / ASC 740) are currently broadly required to analyse and disclose uncertain tax positions or disclose income tax risks in their financial reports.

It is submitted that the concepts contained in the relevant reporting standards encompass the intended concept of 'material tax risk', and thus this element is satisfactorily disclosed to the market in audited financial statements. It is further noted that 'material tax risks' that are self-assessed by taxpayers are also currently required to be disclosed to the ATO as part of the Reportable Tax Position Schedule.

We are strongly of the view that there should not be any disclosure regime linked to practical compliance guidelines or other ATO products: these are administrative tools and are not sources of law. An arrangement may fall into a high-risk category for various reasons (e.g., quantum) and yet be entirely in accordance with prevailing tax laws. Tax administration practices and methods change over time, and it is inappropriate to peg mandatory disclosure requirements to current tax administration practices.

The earliest that any public disclosure could be contemplated in response to any ATO actions is at the time of the issue of an assessment / amended assessment. If it is considered that there are material assessments / amended assessments that ought to be publicly reported and are not, any change in this regard should be done in conjunction with a review of the existing financial reporting requirements.

The detail contained in the Paper is insufficient to consider the scope or impact of any proposed mandatory disclosure requirements in respect of 'tax haven exposure'. Any such definition should have regard to the actual treatment of an entity's presence in a jurisdiction rather than, for example, merely the generally applicable headline tax rate. An overly simplistic approach might be counterproductive to the intended outcome of promoting community confidence in the tax system, where legitimate business activities in a jurisdiction that is defined as a 'tax haven' may be incorrectly assumed by sections of the community to be driven by tax considerations.

We encourage Treasury to consult further once greater detail about any proposed measures is available.

Requiring government tenderers to disclose their country of tax domicile

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?**

The April 2022 announcement stated the policy "will level the playing field by … requiring those that gain government contracts to pay their fair share of tax". It thus appears that the objective of is that tenderers should "pay their fair share of tax".

The concept of 'tax domicile' is not clearly defined or understood as an Australian tax concept. The tax residency of an entity is a more suitable concept. In the great majority of cases, the tax residency of an entity will be quite straightforward, however there will be more complex cases involving dual residency or a foreign law that does not have a comparable concept of tax residency.

In any event, the tax residency of an entity of itself tells very little about the Australian or foreign tax that will be paid on income from government contracts, so we query whether this measure will achieve the stated objective. Equally, we acknowledge that in the context of contractual negotiations, a party is entitled to ask for such information and there is no reason why the tax residency of an entity should not be disclosed.

If this were to be introduced and led to a bias against tenderers who were not Australian residents, this could have the unintended effect that the most capable service provider was not awarded the contract.

It is suggested that any required disclosure of tax residency could be incorporated as part of the existing Statement of Tax record (STR) process already in place under the March 2019 Procurement connected policy guidelines: Black economy – increasing the integrity of government procurement, applicable for procurements valued over $4 million (including GST).

Where known to the ATO, the STR could state whether the tenderer is an Australian resident. No further verification should be required as this reflects tax statements that the tenderer is already making to the ATO and it is submitted that there are sufficient integrity controls in place.

In the case where the ATO cannot state whether the tenderer is an Australian resident (i.e., partnership, new entity or foreign entity), the tenderer could state its tax residency (if applicable) and any other relevant considerations.