Multinational Tax Integrity and Tax Transparency Discussion paper

KPMG Submission

KPMG Australia

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Executive Summary

As a leading professional services firm, KPMG Australia (KPMG) is committed to meeting the requirements of all our stakeholders – not only the organisations we audit and advise, but also employees, governments, regulators and the wider community. We welcome the opportunity to provide a submission on the *'Government Election Commitments: Multinational Tax Integrity and Tax Transparency'* Consultation Paper (the Paper) released by Treasury on 5 August 2022.

In relation to the proposed interest limitation rule, it is critical that sufficient consideration is given to its design features. Most importantly, a fixed ratio rule must include the ability to carry forward denied interest deductions. This is consistent with the approach adopted by most countries who have a fixed ratio rule and would address the potential detrimental impact to taxpayers with volatility in earnings, those investing in the development of pre-revenue assets and those in capital-intensive industries.

We also encourage the retention of the arm's length debt test in its current form. This is an appropriate complement to a fixed ratio rule and would maintain Australia's competitiveness and ability to attract foreign capital. It would also retain flexibility in the system to recognise that certain industries/sectors may be adversely impacted by the fixed ratio rule, including real estate and infrastructure.

Before the introduction of any measure regarding payments for intangibles, the need for this measure should be reassessed, particularly in light of Australia's commitments as a member of the Inclusive Framework (IF) in relation to Pillar Two of BEPS 2.0. Members of the IF have agreed that the primary right to impose "top up tax" should go to the jurisdiction of the ultimate parent entity of the recipient. The only exception to this is the "subject to tax rule", which would generally require tax treaty changes.

Therefore, the international community could regard any new measure seeking to assert primary taxing rights over low-taxed income as a unilateral measure going outside the internationally agreed approach. If there were to be any new measure on payments for intangibles, it should only apply to arrangements whose principal purpose was to reduce tax. Any threshold for "insufficient foreign tax" should be no higher than 9 percent, being the benchmark for the BEPS 2.0 Pillar 2 "subject to tax rule".

Finally, any new tax transparency measure should comprise a standardised, clear framework which uses information that MNEs are already required to compile, is useful for key stakeholders, and is not open to misinterpretation. There should be an introductory transition period during which adoption would be voluntary.

KPMG looks forward to continued engagement with the Australian Government as it develops its final policy approach over the coming months.

Regards,

Alia Lum
Partner
Tax Policy & Regulatory Engagement Lead

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Background

About KPMG

KPMG Australia (KPMG) is a member of a global organisation of independent professional firms, providing a full range of services to organisations across a wide range of industries, governments and not-for-profit sectors. In Australia, KPMG has a long tradition of professionalism and integrity combined with our dynamic approach to advising clients in digital-driven world.

KPMG International Tax practice

KPMG's International Tax practice works with multinational organisations to provide commercially focused advice on cross-border tax matters. We help companies manage the complexities of meeting their tax obligations relating to multiple tax systems and supranational regulation around the world.

We partner with our clients to advise on and manage the tax implications relating to their cross-border arrangements, structures and transactions. We also help businesses manage the tax impact and drive efficiency relating to complex events, including cross-border mergers and acquisitions, divestments, international expansion, cross-border financing, and business change. By drawing not only on our network of tax professionals around the world, but also on our specialists in other areas of taxation, we provide a complete, multi-disciplined perspective to any tax challenge.

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Section 1: KPMG recommendations

Part 1: MNE interest limitation rules

Recommendation 1:

The new "safe harbour" rule should include features that would allow an entity to (i) carry forward denied interest deductions (most importantly) and (ii) carry forward unused deduction capacity to use in future years. This would allow entities with volatile earnings to avoid the compliance costs and risks associated with other relief options.

Recommendation 2:

KPMG is supportive of the retention of the ALDT as an appropriate complement to a fixed ratio rule. While the satisfaction of the ALDT requires increased compliance costs for taxpayers and the ATO, it is necessary for taxpayers in sectors which naturally support higher levels of debt financing and higher EBITDA to interest coverage ratios (e.g. real estate, infrastructure, financial services) to access this test in its current form. Retaining the ALDT will maintain Australia's competitiveness and ability to attract foreign capital, particularly given Australia's economy is heavily reliant on capital-intensive industries when compared to many other developed countries.

Recommendation 3:

There remains a very short timeframe for implementation of the new "safe harbour" and related measures by 1 July 2023. We encourage the retention of as many features of the existing thin capitalisation rules as possible to minimise any unintended consequences. In addition, the legislation on MNE interest limitation should include a government commitment to conduct a post-implementation consultation within six months with the objective of identifying and remedying any unintended consequences.

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

Recommendation 4:

Prior to the introduction of any measure there should be further consideration of how such a measure fits with Australia's commitments as a member of the OECD Inclusive Framework (IF) in relation to the Pillar 2 global minimum tax rules. The IF members have agreed that the primary method of addressing profit shifting to low-tax jurisdictions should be the imposition of additional tax on the ultimate parent entity of the recipient. The only exception to this is the "subject to tax rule" which generally requires tax treaty changes to implement.

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With Australia expected to adopt the Pillar 2 measures, any new measure seeking to assert primary taxing rights over low taxed income could be seen by the international community as a unilateral measure going outside the internationally agreed approach. The need for any new measure should be reassessed in light of Pillar 2 and the various integrity mechanisms Australia already has in place to prevent BEPS behaviours. If it is found there is a need for further integrity measures, the basis for this need should be clearly articulated and carefully designed to deal with any identified gap and not go beyond this in a way that may inadvertently impact ordinary commercial arrangements or arrangements where the compliance burden is disproportionate to the revenue risk.

Recommendation 5:

Any new legislation should include a “principal purpose” test. This should ensure the measure appropriately operates to target only those MNEs with BEPS motives, while reducing the potentially detrimental impact to foreign investment and cost to Australian consumers.

Recommendation 6:

Where a measure of “insufficient foreign tax” becomes relevant, this should be set as anything below 9 percent, which is the rate below which the IF members have agreed that the “subject to tax rule” can be incorporated into bilateral tax treaties. In the alternative, the threshold should be 10 percent, as used in the integrity rule in Subdivision 832-J ITAA 97.

Recommendation 7:

There should not be any new legislation on the identification or definition of an “embedded royalty”. The current legislative provisions, combined with OECD guidance, already provide the ATO with sufficient ability to identify and calculate the value of the royalty component of a bundled payment.

Part 3: Multinational tax transparency

Recommendation 8:

Any mandating of additional tax transparency public reporting should initially be limited to larger MNEs that already undertake some form of country-by-country reporting, with a transition period in which the reporting is voluntary. It should be a standardised, clear framework which uses information that MNEs are already required to compile, is useful for key stakeholders, and is not open to misinterpretation.

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Recommendation 9:

On tax risk reporting to shareholders, given the reporting already required under Australian accounting standards, there should be further consultation about what information would genuinely be useful to shareholders. Disclosure of self-assessed risk ratings in relation to ATO guidance materials could be significantly misleading for members of the public who are not familiar with those guidance documents.

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Section 2: Response to Consultation Questions

Part 1: MNE interest limitation rules

Adopting an earnings-based 'safe harbour' test

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?*

A fixed ratio rule should be based on figures from the income tax return (tax-EBITDA). Using figures from the taxpayer's income tax return should result in lower compliance costs for taxpayers and lower administration costs for the ATO.

This aligns with the OECD's recommended best practice approach which suggests fixed ratio rules should use EBITDA based on tax numbers.[1] The OECD notes this is the preferred approach, as linking interest deductions to an entity's taxable income makes the rule reasonably robust against planning, and it is easy to apply and audit. It also reduces the risk an entity with negative EBITDA would have to pay tax as a result of an interest disallowance.[2]

The fixed ratio rule should also apply to each taxpayer individually, again to simplify compliance and manage costs. The taxpayer and ATO could carry out the calculations using information from one tax return, rather than being required to take the average across multiple returns.

There should also be consideration of what adjustments should be made to figures from the tax return to produce fair and reasonable outcomes. These include:

Item	Comment
Earnings	The deduction available for prior year losses should be reversed in the calculation of tax-EBITDA. For those taxpayers with Australian "associates", it would be reasonable for the fixed ratio rule to incorporate an associated entity "push up" feature for the associate's excess "tax-EBITDA capacity".[3] The current safe harbour test includes such a mechanism (e.g., section 820-920 ITAA 97) and provides for an equitable outcome.
Interest	The OECD best practice approach limits net interest expense. That is, interest expense less interest income. There needs to

[1] Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2016 Update, pp 23.

[2] Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2016 Update, pp 88.

[3] For example, where Entity A borrows in order to contribute equity to associate Entity B. Entity B has excess tax-EBITDA capacity and is not part of Entity A's tax consolidated group.

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Item	Comment
	be a definition of interest income that complements debt deductions for these purposes. The OECD best practice approach also incorporates interest and payments economically equivalent to interest. This broader definition includes amounts (such as FX and hedging) that are currently excluded from the definition of debt deduction. Consideration should be given to whether these amounts economically equivalent to interest should be brought within scope. Consideration should be given to the treatment of both portfolio and non-portfolio dividend income (and any associated franking credits). The inclusion of non-portfolio dividends may result in the ability to have debt at various levels in an economic group. Different considerations arise for portfolio dividends. Consideration should also be given to the treatment of foreign income on which a foreign tax credit has been claimed, given a taxpayer is required to gross-up its foreign income for the foreign tax paid. To ensure that the net interest expense calculation does not differentiate between direct interest revenue and indirect interest revenue derived via trusts and other structures (e.g. regulated entities such as insurance companies), a taxpayer's share of the gross interest revenue of an underlying trust (or joint venture) should be included in the calculation of net interest expense. The fixed ratio rule should be capable of adaptation so as to produce fair and reasonable results for trusts and partnerships and in relation to unincorporated joint ventures.
Depreciation and amortisation	This should include all amounts deductible under Divisions 40 and 43 ITAA 97.

Another reason for using tax-EBITDA is that it would generally align more with the entity's ability to service debt than the accounting figures would. Accounting standards may require that the latter reflect non-cash items such as unrealised gains and losses, for example.

If there is to be a group fixed ratio rule, this should by contrast rely on accounting concepts. Firstly, in the context of identifying the accounting group and secondly when determining the group ratio. Using the accounting figures would result in lower compliance costs for taxpayers, when compared to having to apply tax law adjustments

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to the multinational accounting figures. This will create some complexity in how the group ratio based on accounting concepts translates to the domestic tax EBITDA calculation, however this should be less complex than undertaking a global tax-based calculation.

2 Will the move to a fixed ratio based on earnings impose additional compliance costs on taxpayers? Can these costs be quantified?

There would be a one-off cost to taxpayers in adjusting their tax compliance processes to comply with the new rule. The use of figures from the income tax return would significantly reduce the compliance costs, compared with using accounting numbers. This is because, particularly in the context of tax consolidated groups, there are often no financial statements that include only the taxpayer.

The nature of the calculations required to pass up tax-EBITDA capacity from subsidiary entities (including trusts and JVs) would also impact on the transition/compliance costs.

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)?

Currently, many taxpayers’ level of debt falls within the safe harbour and so this represents the most straightforward method to justify interest deductions.

Principally, other taxpayers would use the safe harbour test after carrying out a cost versus benefit analysis.

A taxpayer would only accept incurring the additional administration, external costs and likely additional ATO scrutiny associated with one of the other tests if it considered that it would be able to justify an increase in the allowable deduction that more than offsets those additional drawbacks.

It follows that if the fixed ratio rules restrict or will further restrict interest deductions above current levels, it is more likely that taxpayers will move away from the fixed ratio rule.

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?

There are three categories of entity that will be impacted by the introduction of an earnings-based rule. The first are those entities with significant variability from year to year in their tax-EBITDA. The second are those who invest in assets with a lead time to deriving assessable income or where assessable income is expected to increase over time. Finally, there are those entities who operate in capital intensive industries that historically carry higher levels of debt.

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Earnings volatility

The OECD has recognised the issue of earnings volatility and has recommended jurisdictions consider allowing interest deductions denied under the fixed ratio rule to be claimed in a future year(s) where an entity has interest deductions that are less than 30 percent of tax-EBITDA.

The OECD also suggests that jurisdictions allow the carry forward to future years of unused tax-EBITDA capacity (i.e., where 30 percent of tax-EBITDA exceeds the interest expense incurred).

The effect of these carry forwards is that over time, if an entity has incurred interest expenses of 30 percent of the cumulative tax-EBITDA, or greater, it is able over that period to deduct interest equal to 30 percent of that cumulative tax-EBITDA. It would have the same interest deductions as if it had achieved that cumulative tax-EBITDA in equal annual amounts.

KPMG urges the government to introduce both these carry-forward opportunities in Australia as elements of the fixed interest ratio regime. This would be consistent with the approach adopted by most other countries that have a fixed ratio regime and provides a more equitable outcome for taxpayers in industries with a more volatile earnings profile.[4]

Earnings profile

A second category of taxpayer that could be impacted by a fixed ratio rule is a taxpayer that is investing in the development of an asset that will not produce revenue for some years to come. This category could include a start-up entity with interest expenses above the de minimis threshold, or a development subsidiary of an established group in the construction, infrastructure or extractive sectors.

These entities would be disadvantaged by a fixed ratio rule unless there was the ability to carry forward denied interest deductions until there was sufficient tax-EBITDA capacity to use them. The alternative of applying the ALDT would result in much greater compliance and administrative costs for both the taxpayer and the ATO.

Structural debt levels

The third category of entities that may experience an adverse impact from the introduction of the fixed interest ratio is made up of entities in sectors that are relatively capital-intensive. These sectors include real estate, infrastructure, mining, and oil/gas extraction.

Denial or deferral of the benefit of a component of the interest deductions would adversely impact the profile of investment returns on Australian projects and deter foreign investment. This adverse impact would likely be compounded by the increased interest rate environment which is expected to persist for the foreseeable future.

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[4] Approximately, 35 countries have a fixed ratio rule, and of these, 27 countries allow some form of a carry forward and/or carry back mechanism (OECD Corporate Tax Statistics: Third Edition, 29 July 2021).

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As is suggested by the Parliamentary Budget Office's estimates, there are many taxpayers who are geared to no more than 60 percent of Australian assets whose current interest deductions would exceed 30 percent of tax-EBITDA (noting no carry forward opportunities were assumed in the estimates).

5 Should there be any changes to the existing thin capitalisation rules applicable to financial entities and authorised deposit-taking institutions?

No. The fixed ratio rule would not be appropriate for financial entities or ADIs. Consistent with observations made by the OECD[5] in relation to banking and insurance groups, this sector is unique in that it holds financial assets and liabilities as an integral part of the main business and the purpose of interest expense is different to other sectors. In addition, this sector is subject to strict regulations in relation to capital structure.

These entities should continue to be subject to the existing safe harbour debt tests for financial entities and ADIs, noting that the existing safe harbour capital limit was increased to an appropriate level of 6 percent of risk weighted Australian assets for income years commencing from 1 July 2014.

In relation to insurers, APRA regulated insurers are not included in the definition of "financial entities" under the existing thin capitalisation rules. As such, the existing rules applicable to financial entities and ADIs do not apply to insurers.[6]

Given the characteristics of the insurance sector, as outlined above in the context of the OECD's observations on banking and insurance groups, we recommend that APRA regulated insurers are also excluded from the scope of the fixed ratio rule and continue to be subject to the existing thin capitalisation rules.

Fixed ratio rule: implementation considerations

6 Would the existing $2 million de minimis threshold be an appropriate threshold for the fixed ratio rule, to exclude low-risk entities?

The government should increase the de minimis threshold, which has been at $2 million since 1 July 2014. It had previously been $250,000 from 2001 to 2014.

As a comparison point, the UK de minimis threshold is GBP 2 million (around A$ 3.6 million).

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[5] Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2016 Update: Inclusive Framework on BEPS.

[6] Noting that, in practice, insurers would generally satisfy the safe harbour debt test, because they are subject to prudential regulations that impose minimum equity capital and restrict lending capability or debt funding in equity investments.

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The government should retain the exemption in Section 820-37 of the ITAA97 for entities whose average Australian asset value is 90 percent or more of their average total asset value. Entities with this asset profile would have relatively little scope for activities that would result in tax base erosion or profit shifting.

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)?

Recent years have shown that earnings can be volatile across all sectors due to external factors such as weather events and public health incidents which are largely beyond the taxpayer's control. However, from our experience, agribusiness, insurance, transport, hospitality and tourism are examples of particularly volatile sectors.

The primary production and construction sectors form a relatively large proportion of Australia's economy when compared to other highly developed countries. These sectors are also inherently cyclical and would be more suited to a safe harbour that relied on balance sheet information rather than tax-EBITDA.

There are other categories of taxpayers that do not necessarily experience earnings volatility but nevertheless may explore using one of the alternative tests. These include taxpayers that are investing in the development of assets that will not produce revenue for some years to come, and taxpayers in capital-intensive sectors. There should be consideration of whether it is in Australia's best interests for certain sectors that are relatively capital-intensive (including renewable energy, green hydrogen installations, for example) to have no option but to undertake the additional administration of justifying their interest deductions using the ALDT.

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?

Germany, Japan, the US and UK, in common with the majority of other countries that have adopted a fixed ratio rule, have also implemented some form of carry-forward rule along the lines of those supported by the OECD.

KPMG strongly supports the adoption of carry-forward rules (in relation to both denied deductions and unused tax-EBITDA capacity) in Australia. It would be fair and reasonable for the carry-forward rules to apply without time limits, given that the purpose of these rules would be to put taxpayers with uneven tax-EBITDA and those with relatively steady tax-EBITDA in the same position in terms of their interest deductions.

In particular, the carry forward of denied interest deductions would be very important in supporting new capital investment into Australia.

If there were to be limitations on carry-forward capability, one option would be to apply the continuity of ownership / business continuity tests, as is the case for tax losses.

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Alternatively, there could be consideration of imposing a time limit of say five years in relation to the carry forward of excess tax-EBITDA capacity (this time limit would align with the UK approach).

The UK has a public benefit infrastructure exemption for qualifying infrastructure activities provided to public bodies. Australia should consider this to help mitigate adverse impacts in relation to the highly geared nature of the infrastructure sector.

We suggest that the legislation relating to this exemption be drafted broadly, in order for there to be a nimble response to emerging infrastructure needs such as digital infrastructure. The Paper notes "nationally significant" projects as a possible limitation. While this concept already exists in Australian legislation[7], this is too restrictive a limitation based on our experience with the stapled structure rules and the breadth of infrastructure that would be reliant on such an exemption.

The US also has exceptions from its interest limitation rules for real estate, regulated utilities and infrastructure on the basis of their debt levels which are justifiably relatively high.

Group ratio rule

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?

The current worldwide gearing test should be retained as an option for taxpayers alongside the earnings-based group ratio. The worldwide gearing ratio is an appropriate measure of an Australian taxpayer entity's commercial borrowing capacity. The taxpayers which currently apply it should be able to continue to do so and not have to incur the additional compliance costs that would come with carrying out a new analysis for the earnings-based group ratio.

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?

It would be a considerable compliance task to take the expenses that were classified as third-party interest and borrowing costs in the accounts of a large global group and adjust those expenses so that they aligned with Australian concepts of what is an allowable deduction.

The group ratio rule should be based solely on expenses that are classified as third-party interest expenses or borrowing costs in the audited accounts of the ultimate parent

[7] Definition of "nationally significant infrastructure" in Section 3, *Instructure Australia Act 2008* Cth.

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entity, where acceptable accounting standards apply to those accounts. This is consistent with the approach adopted by the UK.

11 What types of entities currently use the existing worldwide group test?

In our experience the worldwide gearing test is rarely used.

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

12 Would introducing a fixed ratio rule encourage entities not currently using the arm's length debt test (ALDT) 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?

Where the fixed ratio rule would significantly reduce the allowable interest deductions compared with the outcome under the current "safe harbour", this may change the outcome of the cost versus benefit analysis that we refer to at Question 3.

Where an entity considers that the benefit of undertaking the extra work to justify deductions under the ALDT will be greater, it is more likely to be prepared to undertake that work.

Entities that may shift to an ALDT are those in industries where naturally high levels of gearing are commonplace, for example, industries where participants enjoy a relatively high degree of certainty over future cash flows. A 30 percent cap of tax-EBITDA corresponds to an EBITDA "interest cover" ratio (i.e. EBITDA to interest) of around 3.3 times. This is not particularly high; there are industries for which an interest cover ratio of substantially less than 3.3 times is entirely normal, even where arm's length / third party debt comprises the entirety of the entity's capital structure, for example, infrastructure, regulated utilities or leasing/REITs.

A high-level search using the Refinitiv™ Loan Connector database reveals 101 tranches on Australian financing deals which had/have an interest cover loan covenant of less than 3.3 times, further signalling that independent lending institutions are entirely comfortable with debt levels that go beyond what a 30 percent of tax-EBITDA fixed ratio rule would otherwise permit.

Given Australia's reliance on inbound capital and foreign investment, together with the ongoing energy transition and need for significant investment in infrastructure (e.g., renewable energy, transmission and energy storage), the behavioural response of shifting to the ALDT should be both expected and encouraged in terms of such projects (i.e. in order to maintain our competitiveness and ability to attract foreign capital to these projects).

If the fixed ratio rule included an ability to carry forward denied deductions and also to carry forward unused tax-EBITDA capacity, this would reduce the number of taxpayers that would seek to use the ALDT as an alternative to the fixed ratio rule (with the added

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benefits of reduce associated compliance costs and providing investors greater certainty).

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?

This may reduce compliance costs for entities with inbound related party loans.

When applying the ALDT, the "standalone entity" rule requires the entity's position as a member of a global group to be disregarded. This impacts on how "arm's length" terms and conditions are identified for related party loans for purposes of the ALDT.

Where the same related party loans are also subject to Australia's transfer pricing provisions, a separate analysis is required to identify "arm's length" conditions consistently with the requirements of the Australian transfer pricing provisions. The transfer pricing analysis usually requires that the entity's position as a member of a global group should be taken into account.

Replacing the current standalone entity rule to require consideration of the entity being a member of a worldwide group may standardise the analysis required across transfer pricing and the ALDT for the identification of related party loans.

However, this change may have unintended consequences which could increase the quantum of debt supportable under the ALDT for certain groups. For example, if an entity is a member of a highly rated group and benefits from strong implicit or explicit support from that group, that entity could conceivably gear itself to levels well beyond what would make commercial sense for a standalone entity (e.g. up to 100 percent debt with little to no equity), whilst still receiving a strong investment-grade credit rating on account of the support it receives from affiliates. The fact that its debt would be viewed favourably by reason of that support obviously does not mean that its capital structure is a commercial one. Presently, such an outcome is protected against by the factual assumption in subsection 820-105(2)(e) and subsection 820-215(2)(e) ITAA97.

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?

KPMG is supportive of the retention of the ALDT in its current form, as an appropriate complement to a fixed ratio rule.

Whilst the ALDT may not be straight forward to apply, it is (and should continue to be) relied upon by taxpayers with specific needs, primary those categories of taxpayers outlined in Questions 4 and 7 above. Retaining the ALDT will maintain Australia's competitiveness and ability to attract foreign capital. Australia's economy is heavily reliant on capital intensive industries when compared to many other developed countries.

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The ALDT provides taxpayers with the opportunity to demonstrate that, given their circumstances including industry and economic factors, their debt levels (and interest deductions) are commercial and not excessive.

The OECD paper on BEPS Action 4 does infer that BEPS practices could potentially still occur under an ALDT. However, we would expect that in the great majority of cases where the ATO accepts a taxpayer's ALDT amount under current rules, this is aligned with no BEPS practices being evident. The ATO currently requires an entity to provide extensive evidence to justify the calculation of its allowable deductions.

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?

Where third-party debt was accepted as arm's length by its nature (in the absence of any evidence of support to the borrower from a related party), this could limit the detailed analysis required under the ALDT to the amount of any additional related-party debt. Where the amount of any additional related-party debt is minimal, this should not be cause for detailed additional analysis. One way to deal with this might be to permit a certain limited amount of related-party debt in addition to the external arm's length debt burden.

The above approach would simplify compliance for taxpayers and review processes for the ATO.

17 Would additional limitations be required to prevent any unintended consequences, such as 'debt dumping' or other debt-creation integrity concerns?

Debt levels that have met an arm's length test should not generally give rise to integrity concerns. To the extent a borrowing is not supported by a commercial purpose, Part IVA could apply to address 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?

The plan to amend the safe harbour was announced prior to 1 July 2022 and is intended to take effect for income years commencing on or after 1 July 2023. Given the likely short time frame for policy development on this measure, we encourage the government to retain as many features of the existing thin capitalisation rules as possible to minimise these unintended consequences.

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Where the government makes any changes to the thin capitalisation rules that are not yet announced, these should not become effective until at least one complete financial year has elapsed following the communication of the measure to the community (i.e., 1 July 2023 would be too soon for any further changes not yet announced to take effect).

Further, the MNE interest limitation legislation should include a government commitment to conduct a post-implementation consultation within six months with the objective of identifying and remedying any unintended consequences.

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

Overarching comments

We acknowledge the government is seeking a new rule which would deny MNEs' tax deductions for payments relating to intangibles and royalties where insufficient tax has been paid (being either Australian withholding tax or foreign income tax). However, the government has also expressed its commitment to BEPS 2.0, which will address the tax challenges arising from the digitalisation of the economy, and in doing so, target the specific risks to revenue identified in the Paper as well as a broad range of other arrangements which result in insufficient tax being borne by MNEs. Given the commitment to BEPS 2.0, Australia should continue to pursue changes to the taxation laws governing MNEs in a globally co-ordinated manner.

In joining the BEPS 2.0 Inclusive Framework and specifically Pillar Two, Australia has agreed to several key principles, in particular the following:

- That 15 percent is an acceptable minimum effective tax rate to apply to MNE profits on a jurisdictionally blended basis;
- The primary taxing right for any "top up tax" sits with either the low-taxed entity's jurisdiction of residence (through a QDMTT), or with the jurisdiction of residence of the low-taxed entity's parent entity (through an IIR);
- In relation to a MNE group with a foreign ultimate parent, Australia obtains only a residual taxing right (through a UTPR)) to tax the profits of an offshore low-taxed entity; and
- The STTR provides a treaty-based avenue for source countries, primarily aimed at those with lower administrative capacities than developed countries such as Australia, to protect their tax base through a top-up tax on certain payments (likely to include royalties) that are taxed at a rate of less than 9 percent.

As such, the new rule proposed in this Paper, being a kind of unilateral UTPR or STTR, appears to go against the international framework agreement Australia has reached with other jurisdictions as to how to sufficiently tax MNE profits which might otherwise incur "insufficient tax".

While the Paper notes jurisdictions with potentially similar rules (UK, US, Netherlands, Germany), these rules were all initiated prior to the IF's BEPS 2.0 Statement of October 2021. Hence, there is a risk that any new Australian rule would be out-of-step with the IF agreement and would risk facing retaliatory measures from other countries if it is seen to be undermining the allocation of taxing rights under the Pillar 2 measures.

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Pending implementation of BEPS 2.0 in Australia, the existing legislative framework governing payments relating to intangibles and royalties is adequate and summarised at a high-level below:

1. Royalties paid to residents of non-treaty countries	Subject to royalty WHT at a rate of 30 percent under domestic law.
2. Royalties paid to residents of treaty countries:	
a. Where the relevant treaty includes a PPT or LOB article (noting most of Australia's treaties fall within this category)	Subject to a reduced royalty WHT rate, unless the PPT satisfied (if so, the standard rate of 30 percent would apply). Domestic integrity rules also apply, particularly the DPT for SGEs.
b. Where the relevant treaty does not include a PPT or LOB	Subject to a reduced royalty WHT rate. Represents only a limited number of treaties, and domestic integrity rules apply, particularly the DPT for SGEs.
3. Non-royalty payments for intangibles	Australia's existing rules could tax these payments as Australian-sourced income of offshore entities resident in non-treaty countries, or as income attributable to Australian PEs of offshore entities resident in treaty countries. Any extension of this scope would be at odds with existing OECD concepts and would come with a risk of uncertainty as to how to characterise such payments, relieve double taxation and resolve tax disputes.

In addition to the above measures, Australia's transfer pricing rules operate by applying the arm's length principle to ensure tax is based on profits reflecting the economic activity attributable to Australia. The OECD's transfer pricing guidance arising from BEPS Actions 8 – 10 included specific updates to the chapter addressing intangibles, and Division 815 of the ITAA97 specifies that it is to be interpreted to achieve consistency with this guidance.

ATO public advice and guidance (e.g., Draft Practical Compliance Guideline PCG 2021/D4) also provide direction to taxpayers on how to ensure intangibles arrangements are compliant with tax laws including transfer pricing provisions.

The current laws, together with the ATO's public guidance, provides the Commissioner with sufficient ability to target and address any BEPS activities of an MNE group.

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Where any new rule operates to deny deductions (or apply tax) for arrangements which have no BEPS motive, there is a real risk of decline in foreign investment, given the potential impact to an investor's return on investment calculation, and an increase in cost to Australian businesses and customers, given this higher cost of doing business (real or perceived) would likely be passed on to consumers.

With Australia expected to adopt the Pillar 2 measures, any new measure seeking to assert primary taxing rights over low taxed income could be seen by the international community as a unilateral measure going outside the internationally agreed approach. The need for any new measure should be reassessed in light of Pillar 2 and the various integrity mechanisms Australia already has in place to prevent BEPS behaviours. If it is found there is a need for further integrity measures, the basis for this need should be clearly articulated and carefully designed to deal any identified gap and not go beyond this in a way that may inadvertently impact ordinary commercial arrangements.

Therefore, it is important that any new rule includes a PPT, to restrict its application to circumstances where an MNE seeks to obtain a tax benefit from the arrangement. The inclusion of a PPT would also make it clear that the new rule was an integrity measure, which could provide support for the basis of interactions with Australia's tax treaties and make it less likely to be viewed as undermining the BEPS 2.0 process. This is particularly important if the measure is not designed in a way that fits within the Pillar 2 framework (in particular, alignment with the STTR).

We have provided our general observations in relation to the consultation questions below.

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?

Where Australia is seeking to target those MNEs with the greatest resources, on the basis that these entities are more likely to engage in the BEPS activities identified in the Paper, it would be preferable that any new measure use the concept of an "MNE Group" pursuant to the GloBE rules. While this would be a new concept in Australia, therefore bringing with it an additional compliance cost, this would be one-off and provide future alignment when taxpayers come to apply the GloBE rules both in Australia and globally.

An alternative approach would be to use the SGE concept. While the SGE definition does not exclusively capture MNEs, larger taxpayers understand the SGE definition and have applied this definition for several years.

Consideration should also be given to a low turnover exclusion, such as the $25 million income test in the DPT (Section 177K of the ITAA97), to ease the compliance burden for certain low-risk entities.

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Payments relating to intangibles and royalties in scope of this measure

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?

We consider that genuine royalties should be appropriately taxed in Australia. However, any new measure should not go beyond this, for example, by denying a tax deduction in Australia for a payment, merely on the basis that some component of the payment may potentially be an embedded royalty. While we agree there are practical challenges in identifying embedded royalties, the matter of how to characterise a payment (or a part of a payment) should not be addressed through additional legislative parameters relating to intangibles or royalties.

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

No, this is adequately addressed by the existing legislative framework, in particular transfer pricing rules. The transfer pricing rules require that they be interpreted to achieve consistency with the OECD's Actions 8 – 10 guidance.

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

No, the taxation of other payments is being addressed via Australia's commitment to BEPS 2.0.

Application to related and unrelated parties

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

Any new rule should apply to arrangements between related entities only. Scoping in arrangements between unrelated entities would place inappropriate burdens on Australian businesses, particularly in relation to obtaining and substantiating foreign taxation treatment.

For comparison purposes, while the hybrid mismatch rules in Division 832 of the ITAA97 can apply to payments between unrelated parties, this is limited to payments that form part of "structured arrangements". The definition of a structured arrangement broadly requires that either the hybrid mismatch is priced into the scheme or that a reasonable conclusion would be that the hybrid mismatch is a design feature

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of the scheme. As such, any consideration of extending this rule to unrelated parties should be limited by the structured arrangement concept.

Insufficient tax

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

A payment taxed at 9 percent or less, including Australian WHT, is an appropriate determination of "insufficient tax". This is consistent with the multilateral agreement reached in relation to the STTR component of Pillar Two.[8]

An alternative may be a rate of 10 percent or less, consistent with the hybrid mismatch integrity rule in Subdivision 832-J of the ITAA97. Importantly, the hybrid mismatch integrity rule extends the definition of foreign income tax to include foreign municipal and state taxes. A similar concept should be considered here, but with the inclusion of a recognition of payment of Australian WHT, in order to target payments where the aggregate Australian and foreign tax imposed is below acceptable limits.

In relation to option 4), KPMG is supportive of preferential tax regimes which adhere to the OECD's recommendations arising from Action 5 - Harmful tax practices and consider this would be an inappropriate way to define "insufficient tax" or "low or no tax jurisdictions".

The Forum on Harmful Tax Practices has undertaken peer reviews of preferential tax regimes, and its most recent report of July 2022[9] outlines the cumulative results of these reviews. Significant progress has been made over recent years, such that only a limited number of regimes do not meet Action 5 requirements.[10] Given preferential tax regimes around the world are at present overwhelmingly compliant with Action 5, we consider it inappropriate for any new rule to target the use of these preferential tax regimes.

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[8] It is proposed that the STTR will be triggered where a covered payment is subject to a nominal tax rate in the payee jurisdiction that is below the agreed minimum 9 percent rate, after adjusting for certain permanent changes in the tax base. A similar concept could be included in any new measure.

[9] Harmful Tax Practices 2018 Progress Report on Preferential Regimes July 2022.

[10] Of the 319 peer tested regimes, 1 is considered harmful, 5 are potentially harmful, 8 are potentially harmful but not actually harmful, 4 are under review, and 16 are in the process of being eliminated / amended (New results show progress continues in combatting harmful tax practices).

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International comparisons

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?*

Jurisdiction	Measure	KPMG comments
US	GILTI and BEAT	The GILTI and BEAT rules are broader regimes and hence not directly relevant as a comparison for present purposes. The Biden administration has also proposed a repeal of BEAT and amendments to GILTI. Given Australia is committed to implementing Pillar Two, an additional measure reflecting elements of GILTI and/or BEAT would create duplication and uncertainty and hence should not be pursued.
UK	ORIP	Given Australia's existing legislative framework, particularly our tax treaties and royalty WHT rules under domestic law, if Australia was to adopt a version of the ORIP, its scope may be as follows: — Income of offshore entities, who are not tax residents of treaty countries; — Where income is received in respect of IP due to the sale of goods or services in Australia (but excluding royalties paid or credited by Australian tax residents); — Where the income is not subject to a sufficient rate of foreign tax (the UK applies a rate of at least 10 percent); and — With an exemption where the IP is held in the jurisdiction where all of the related business activity that generates profits in relation to that IP takes place. Our experience is that MNEs do not typically hold IP in non-treaty countries where the income received in respect of the IP might be within the scope of an Australian version of the ORIP as outlined above. In addition, the administration of such a regime would be difficult, given the ORIP applies a tax on non-residents on an

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Jurisdiction	Measure	KPMG comments
		assessment basis (i.e. without the administrative convenience of WHT).
Netherlands	WHT	Australia has existing measures (primarily, WHT at a rate of 30 percent for royalties paid or credited to residents of non-treaty countries, or where the PPT operates to deny reduced royalty WHT for residents of treaty countries) which broadly achieve the aims of the Netherlands measure.
Germany	Royalty barrier rule	As noted in our response to Q8, given preferential tax regimes are now overwhelmingly compliant with OECD requirements, it is not appropriate to specifically target these regimes with a new measure.

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Part 3: Multinational tax transparency

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?

Any new requirements in Australia for MNEs to publicly report tax information should comprise a standardised, clear framework which uses information that MNEs are already required to compile, keeps additional administration costs within reasonable limits, and promotes the publication of genuinely useful information which is at low risk of misinterpretation.

The establishment of a globally consistent disclosure framework could be effective in achieving the above objectives. If the IASB and ISSB were to implement reporting options for enhancing global tax transparency, they would represent such a consistent disclosure framework.

Pending any standards being developed at the IASB / ISSB level and coming into effect, it would make sense for any mandatory tax transparency reporting in Australia to be based on information that MNEs are already compiling. An example of this would be CbC information that MNEs report to taxation authorities following OECD guidelines or under GRI-207 for those who already voluntarily report under this standard.

We recommend that there should be an introductory transition period during which adoption of any additional public reporting standards is voluntary. The largest MNEs are already undertaking significant steps on tax transparency and such a period would allow for the establishment of best practice templates before any requirements became mandatory.

There should also be consideration of how any additional transparency requirements would remain relevant, useful and easy to interpret correctly, once the BEPS 2.0 measures have commenced operation.

The members of the IF (including Australia) have agreed that on a jurisdiction-by-jurisdiction basis an effective tax rate of 15 percent or more is acceptable. However, the mechanisms by which this is imposed will not always result in the tax authority in that jurisdiction collecting the "top-up tax". For example, where a jurisdiction's headline tax rate is below the 15 percent minimum, other jurisdictions may collect the top-up tax by applying the IIR or the UTPR.

Consequently, CbC information detailing only taxes paid in each jurisdiction may not provide an accurate picture of the outcomes from an MNE's activities in a lower-tax jurisdiction.

If CbC information is made public, we also encourage an optional additional filing to be made to accompany the report which can explain the numbers and put them in the context of the organisation's broader tax contribution. Absent this, there is potential for the CbC data could be misinterpreted.

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Any transparency measures should also have regard to reasonable commercial confidentiality concerns that MNE groups may have, for example in relation to the development of new products and entry into new markets.

We also recommend that regulators in different countries seek to align data reporting formats to enable key stakeholders to compare tax information and reduce the risk of misinterpretation. This can be achieved by an agreed approach to standardising templates for MNEs to follow and having data in a format that is machine readable. Many MNEs are also embracing automation of tax data and it is important the data collected can be in a format that can assist with the transition from manual to automated tax reporting.

There are specific considerations on tax transparency for investment funds, insurers and institutional investors. Various low-tax jurisdictions are commonly used by investment funds for the purposes of capital pooling and achieving tax-neutral fund holding structures. This is not directed towards, nor does it achieve, tax avoidance, given income and gains which are generated in the jurisdictions where the portfolio investment entities are located would typically be subject to tax in those countries.

The prominence of tax neutrality for investment fund entities has been recognised by the OECD, most recently via the treatment of Investment Funds, Real Estate Investment Vehicles and Pension Funds as excluded entities for the purpose of the GloBE rules.

Similarly, there are compelling commercial reasons for insurance companies to establish operations in low-tax jurisdictions (e.g. Bermuda), including accessing global reinsurance markets and global regulatory regimes. Operations in these jurisdictions do not necessarily result in tax avoidance in the insurance industry as Australia's CFC rules and offshore reinsurance tax framework (Division 15 ITAA36) operate to tax reinsurance profits referrable to Australian risks in Australia.

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?***

If there were to be a definition of a large MNE for this purpose, we recommend it should be based on the OECD definitions and thresholds for CbC reporting. The benefit of this alignment is that MNEs would see that if they were covered by CbC obligations then they would also be covered by the Australian requirements.

Any subsequent extension of the MNEs covered by mandatory reporting should have regard to the additional administrative burden that would be placed on smaller MNEs for whom CbC reporting is not required. There should be consideration of whether existing financial statement disclosures (which would include the MNE's global effective tax

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rate), ATO reporting of corporate tax information and any existing voluntary tax disclosures MNEs make, would be sufficient information for the public to obtain an understanding of the MNE's approach to tax risk and governance.

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?***
   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?***

There would be several issues to consider if Australia were to adopt a mandatory tax transparency regime that was similar to the EU's approach to public CbC reporting. These include:

— The EU's approach to public CbC reporting is intended to apply from financial years beginning on or after 22 June 2024 and hence there would be little experience to draw upon to assess whether the EU's approach to CbC has produced the intended outcomes.

— The EU CbC applies to a MNE group or standalone entity with:

   o At least EUR 750 million total consolidated group revenue in each of the last two consecutive financial years (this is different to the non-public CbC where the reporting obligation is triggered the first year after the threshold is met); and
   o Either the ultimate parent or a member of the group is an entity or branch in the EU member state.

— For non-EU headquartered groups (including Australian headquartered MNE groups), the legislation is relevant if they exceed the revenue threshold and have an EU presence. This includes either medium-sized or large subsidiaries (as defined in Directive 2013/34/EU) or branches (referred to as 'undertakings') that meet the net turnover thresholds.

— An in-scope organisation is required to report specified data for the whole group; separately for each EU Member State; separately for each country that is on the EU list of non-cooperative jurisdictions, or that has been on the "grey list" for two consecutive years; and aggregated information for its operations in the rest of the world. This is a different basis of preparation to the OECD CbC rules which require CbC aggregate data for each tax jurisdiction.

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— If Australia adopted the EU CbC public reporting approach, then tax data to be disclosed could be Australia and the rest of the world. There is a question as to whether the "rest of the world" aggregation of tax data would achieve the policy purpose of any mandatory CbC reporting.

— If Australia was to adopt the EU CbC approach, there should be consideration of how it would apply to inbound foreign-owned groups (including with standalone Australian entities, tax consolidated or MEC groups). If an Australian entity were responsible for the reporting, it may face difficulty in obtaining all the group-wide information, particularly where it is not wholly owned. This aspect requires careful consideration.

— If foreign-owned Australian groups were required to report tax information on a global group basis, recognition should be given to acceptance of similar tax transparency frameworks adopted by the group, such as the UK *Payments to Government Regulations 2014* and EU Directive 2013/36/EU.

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?

Australian headquartered outbound MNEs who are already applying GRI 207 should have the choice to use this as a basis for mandatory tax transparency reporting if they prefer.

Some Australian headquartered MNE groups already adopt GRI 207-4 (CbC reporting) on a voluntary basis. For example, certain industry bodies have performance expectations of their members to comply with the GRI requirements. These groups already have established systems in place to comply with GRI 207-4 for public reporting purposes. It would make sense for these groups to be able to satisfy any mandatory reporting by using their GRI 207-4 reporting if they so choose.

We have some concerns on how a GRI 207 approach could be applied to foreign-owned groups in Australia and particularly where there is a MEC group with multiple entry points into Australia and controlled by different foreign entities. An Australian entity that was required to report group-wide information might not have ready access to all the necessary data.

A solution in some cases could be that if the ultimate parent of the MNE group has voluntarily complied with GRI 207 (or an equivalent standard) then this report should be

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acceptable for the purposes of meeting any Australian mandatory reporting requirements.

Currently, the GRI 207 Tax Standard is a voluntary public disclosure for an organisation of any size, type, sector or geographic location that identifies it as material to report on its impacts related to taxes, in accordance with the GRI standards.

If Australia was to use GRI 207 as a basis to mandate MNE public CbC reporting, the government would need to define what is "material" for mandatory public tax reporting purposes.

There are other groups that may not disclose the GRI 207-4 information requirements but produce OECD CbC reports that are not published. To align the OECD CbC data to GRI 207-4 would require some additional work as there are some differences between the two standards.

For those that do not produce any CbC data, there would be increased compliance costs for entities to produce this data and information. Careful consideration needs to be given to bringing in entities not currently producing CbC information and the need to balance the usefulness of this information with increased compliance costs.

Under GRI 207, deferred taxes are not required to be disclosed on a CbC basis (see GRI 207-4 paragraph 2.2.2.) If additional deferred taxes information were required to be disclosed for the jurisdiction, then the usefulness of this additional information versus compliance costs would need to be considered.

(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?***

The current TTC includes both minimum standards and best practice recommendations that some MNEs have already been complying with on a voluntary basis. There are aspects of the TTC which are an additional administrative burden (e.g. requirements to prepare reconciliations of accounting profit to tax expense and to income tax paid or income tax payable).

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If the TTC were mandated in its current form, then only the minimum standards should be within scope of the mandatory approach and it should be limited to the Australian operations of an MNE. Any additional disclosures should be optional.

If CbC reporting was to be included within the TTC, consideration should be given to a standardised, clear framework that leverages from existing CbC reporting frameworks and standards that large MNEs already comply with to ensure there is not an increase in the compliance burden. Consideration should also be given to ensuring that the information to be reported is genuinely useful and at low risk of misinterpretation.

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)?

Given the potential volume of CbC data to be reported, large MNE groups should be able to (continue) to report CbC information in a separate report. Mandating the embedding of the CbC report in the annual report could result in the CbC report needing to be audited for compliance with the accounting and corporate law requirements.

We suggest if Australia were to adopt public CbC reporting, the CbC report should be able to be published in a separate report or as part of a taxes paid report, which incorporates a description of the basis of preparation and level of external review.

If organisations wanted to disclose CbC data in the annual report, then they could have the option to do so.

11 What role should Government play in reviewing, publishing and aggregated analysis of country-by-country data?

A depository of mandatorily reported tax information is available to the public in the UK and Canada. These enable all information to be available in the one spot for the public inspection. A similar approach could be adopted in Australia on the lines of the current central database of voluntary TTC reports at data.gov.au.

12 What is the most appropriate way to ensure consistent (standard) reporting by MNEs of their public CbC information?

As mentioned above, for Australia to align with global standards, to ensure that there is a consistent basis for companies to disclose tax information, thereby minimising compliance costs and facilitating comparison between countries.

13 Should the data be reported in a standardised template? What should this be?

A pro forma template would support consistency of presentation of information reported by large MNEs. For example, there are templates provided in the Draft

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Appendix to the TTC which are helpful for organisations preparing a reconciliation of tax and accounting data.

Any template should incorporate scope for reporting MNEs to include narrative in addition to figures.

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?

The GRI 207-4 report permits prior year CbC data to be reported as it acknowledges that the consolidated financial statements for the most recently completed financial year may not yet be available.

Mandating CbC reports to be produced at the same time as financial reports or tax returns would impose an excessive burden on organisations seeking to meet current obligations.

15 Are there any transitional arrangements that would need to be considered prior to commencement of a legislated reporting requirement? What would these be?

For groups not already reporting tax information in their taxes paid reports, there would need to be some lead time to transition to any proposed mandatory tax transparency requirements, given the potential work involved in preparing CbC reporting data.

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?

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Australian accounting standard AASB12 already requires an entity to disclose information that enables the reader to understand the composition of the consolidated group. AASB12 is aligned with International Financial Reporting Standard IFRS12.

In our experience, a large MNE group typically applies the standards in such a way that it discloses the country of incorporation of its controlled subsidiaries.

If a reporting entity were to be required to highlight jurisdictions of incorporation that were "tax havens" then there would be a need to define this term to ensure consistency of reporting. In the context of the Pillar 2 measures that have been agreed between the IF members and are now available to be legislated, this definition could become redundant for entities covered by Pillar 2.

AASB 101 also requires the reporting entity to disclose the judgments it has made on the areas of uncertainty that most significantly affect the financial position of the group. Therefore, where there is a material uncertainty in relation to the group's tax liabilities, the entity is required to disclose the judgment it has made in how to reflect the matter in the financial statements.

Given the reporting already required under Australian accounting standards, there should be further consultation about what information would genuinely be useful to shareholders.

KPMG does not support the mandatory disclosure of situations where a taxpayer's position would obtain a high-risk rating based on an ATO PCG.

The PCGs merely provide public administration guidance which convey the ATO's assessment of relative levels of compliance risk in relation to certain arrangements, and the ATO's consequential resource allocation intentions. They are not public rulings, not legally binding, and are not prepared for the primary purpose of expressing a view on the application of the tax law.[11]

As such, a high-risk rating under a PCG self-assessment matrix would not necessarily reflect all the relevant factors in a specific taxpayer's circumstances and should not be taken of itself to be an indicator of high-risk behaviour in relation to the entity's tax affairs.

In any event, PCGs generally cover complex areas of the tax law about which reasonable minds may differ and a self-assessed high-risk rating gives the public no firm indication that the taxpayer's application of the law would not be sustained. This tax law complexity also means that the public, who generally do not have tax technical expertise, would have difficultly interpreting and understanding the relevant PCG. Consequently, disclosure of such information could be misleading to the public.

[11] PCG 2016/1 Practical compliance guidelines: purpose, nature and role in ATO's public advice and guidance.

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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?

Any requirement in this regard should be based on a tax concept that already exists and which tenderers could reasonably be expected to be familiar with based on existing tax filing obligations.

Therefore, where the tenderer is an Australian resident for tax purposes the disclosure should be based on this. Where the tenderer is a tax-transparent entity (a partnership or trust, for example) any disclosure should be based on the tax residence of the majority of partners or of the trustee, respectively.

Where the tenderer is not an Australian resident for tax purposes, the disclosure requirement becomes more problematic, as not every jurisdiction has a concept of tax residence or tax domicile. Further, some tenderers may have tax-transparent status in the jurisdiction in which they are based.

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Glossary

The following abbreviations have been used in this document:

AASB	Australian Accounting Standards Board
ADI	Authorised deposit-taking institution
ALDT	Arm's length debt test
APRA	Authorised Prudential Regulation Authority
ATO	Australian Taxation Office
BEAT	Base Erosion Anti-abuse tax
BEPS	Base Erosion and Profit Shifting
BEPS 2.0	OECD's Two-Pillar Solution
CbC	Country-by-country
CFC	Controlled foreign company
DEMPE	Development, Enhancement, Maintenance, Protection and Exploitation
DPT	Diverted profits tax
EU	European Union
EBITDA	Earnings before interest, taxes, depreciation, and amortisation
FX	Foreign exchange
GILTI	Global Intangible Low Taxed Income
GloBE	Global Anti-Base Erosion
GRI	Global Reporting Initiative
IASB	International Accounting Standards Board
IF	Inclusive Framework
IIR	Income inclusion rule
IP	Intellectual property
ISSB	International Sustainability Standards Board
ITAA36	*Income Tax Assessment Act 1936*
ITAA97	*Income Tax Assessment Act 1997*
JV	Joint venture
LOB	Limitation on Benefits
MEC	Multiple entry consolidated
MNE	Multinational enterprise
OECD	Organisation for Economic Co-operation and Development
ORIP	Offshore Receipts in respect of Intangible Property
PCG	Practical compliance guideline
PE	Permanent establishment
PPT	Principal purpose test
QDMTT	Qualified Domestic Minimum Top-Up Tax
REIT	Real estate investment trust
SGE	Significant global entity
STTR	Subject to tax rule
TTC	Tax Transparency Code
WHT	Withholding tax
UK	United Kingdom
US	United States
UTPR	Undertaxed payments rule

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