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By email: MNETaxIntegrity@treasury.gov.au

28 April 2023

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

Dear Madam/Sir,

BDO SUBMISSION - DENYING DEDUCTIONS FOR PAYMENTS RELATING TO INTANGIBLE ASSETS CONNECTED WITH LOW CORPORATE TAX JURISDICTIONS

BDO refers to the invitation by Treasury to provide comments on the Government's **Exposure Draft - Treasury Laws Amendment (Measures for Consultation) Bill 2023: Deductions for payments relating to intangible assets connected with low corporate tax jurisdictions (Exposure Draft legislation).**

BDO is pleased to provide comments on the Exposure Draft legislation in relation to deductions for payments relating to intangible assets connected with low corporate tax jurisdictions. In summary, our main concerns regarding the Exposure Draft legislation are:

- The definition of 'low or no tax jurisdiction' needs to be changed because, as it currently stands, it would include any high tax jurisdictions that provide tax exemptions for particular income classes whether or not they are not associated to income from intangible assets, see more details in the appendix below.
- The lack of a requirement to directly trace indirect payments will result in SGEs having to look at all payments to other group members to consider whether there is a connection with any payments that the other group member makes to an associate in a nil or low tax jurisdiction that may be attributable to the use or exploitation of an intangible asset. This will be a very difficult and costly process for the SGE.
- Regarding mischaracterised payments that may result in the partial non-deductibility of the payment where there are other payments that are not directly related to the access of the intangible assets but there may be some attribution to the exploitation of an intangible asset, there is no guidance on how to apportion the non-deductible portion of the payment.
- The proposal to impose a specific shortfall penalty for this measure should be reconsidered. We do not consider a specific shortfall penalty is necessary for this measure as the deduction denial is a sufficient penalty.

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- There should be consideration of the interaction of these measures with the Pillar Two - 15% minimum tax proposal if it is legislated in Australia.

BDO’s detailed comments in this regard are in the attached appendix.

Should you have any questions or wish to discuss any of the comments made in our submission, please do not hesitate to contact me on 02 9240 9736 or lance.cunningham@bdo.com.au.

Yours sincerely

Lance Cunningham

Lance Cunningham

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APPENDIX

BDO Submission to Treasury
Exposure Draft - Treasury Laws Amendment (Measures for Consultation) Bill 2023: Deductions for payments relating to intangible assets connected with low corporate tax jurisdictions.

BDO has considered the Exposure Draft - Treasury Laws Amendment (Measures for Consultation) Bill 2023: Deductions for payments relating to intangible assets connected with low corporate tax jurisdictions (Exposure Draft legislation) which sets out the Government's proposed anti-avoidance measure to prevent large multinationals from claiming tax deductions for payments relating to intangibles connected with low corporate tax jurisdictions. We provide the following comments on the issues of concern in the Exposure Draft legislation.

Definition of low or no tax jurisdiction

The definition of low or no tax jurisdiction in section 960-258 needs to be changed as it currently could result in high taxing countries being defined as low or no tax jurisdictions. It currently requires you to conduct an analysis of the tax rate applying to each type of income in a particular jurisdiction. In particular, subsection 960-258(2)(e) provides that where there are different income tax rates applying to different types of income, have regard only to the lowest rate to determine the corporate income tax under the laws of that foreign country. In determining whether there are different rates of tax subsection 960-258(2)(a) says you disregard deductions, offsets, tax credits, intra-group dividends and treaty exemptions. In addition, subsection 960-258(2)(d) deems a nil income tax rate where any amount of income is not subject to income tax. This appears to mean that if there is any exempt or otherwise non-assessable income received by the relevant entity the relevant tax rate for the corporate income tax under the laws of that foreign country will be taken to be nil.

This does not appear to be the intended result of the proposed law. In fact, under that test, if Australia were a foreign country, under this definition it would be considered a low or nil tax jurisdiction in relation to many Australian entities due to exemption or non-assessability for particular classes of income such as:

- the section 23AH non-assessable foreign branch profits of non-treaty countries; or
- the exemption for government support payments regarding Covid-19; or
- Subdivision 768A non assessable foreign non-portfolio dividends.

This could occur despite the other income of the entity being taxed at the 30% or 25% tax rate

It is likely that many other high taxing countries will also be captured for similar reasons.

In addition, the exemption/non-assessability in question does not have to relate to the income for which the test is relevant. The definition is general. So even where the intangible related revenue is taxed at a high rate, the jurisdiction could still be low tax and bring the new section 26-110 into play.

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It would be better if there was a link between the headline rate on the relevant type of income (or the actual tax paid) and the definition as a low tax jurisdiction. In other words, the test for a low tax jurisdiction would be income type dependent.

If the above issue is not addressed in the final legislation, there should be a purposive element introduced to the provisions so that unreasonable results do not arise.

Indirect payments

The exposure draft legislation provides that where an SGE makes a payment to an associate that is attributable to a right or permission to exploit an intangible asset and, as a result of the arrangement or a related arrangement, income from the exploitation of those or related intangible assets is *directly or indirectly* derived by an associate of the SGE in a low corporate tax jurisdiction, the SGE will not be entitled to deduct an amount for that payment.

However, the Exposure Draft Explanatory Memorandum (EDEM) at 1.34 states “where income is derived indirectly, strict tracing through the flow of funds is not required … it is sufficient if the payment exists between each entity”. The lack of strict tracing will mean the SGE will have to consider every payment it makes to any other member of the group and then each payment any of these other members of the group make to any group members in a nil or low tax jurisdiction, to then consider whether any of these payments are attributable to the relevant intangible asset.

This requirement will substantially increase the compliance burden on SGEs.

Mischaracterisation of payments – how to apportion the deductibility

The EDEM states at 1.37 and 1.38 that the proposed amendments apply:

> *” … where a contract provides that a payment is made for other things, such as services or tangible goods, and the arrangement also results in the SGE or another entity exploiting, or acquiring a right to exploit an intangible asset, even at no cost.*
>
> *In these cases, a deduction that is denied for a payment attributable to the right to exploit an intangible asset may be apportioned. Where such an acquisition results from the arrangement that provides for the payment (regardless of whether it is stated in the written contract that the payment is for services or tangible goods), a deduction for the payment will be denied to the extent that the payment is attributable to the right to exploit the intangible asset”*

We understand this to mean that the proposed new provision will apply ‘to the extent’ the payment is ‘attributable to a right or ability to exploit an intangible asset’. However, the explanatory material indicates that strict tracing is not required and where the Australian entity has access to use an intangible asset owned by an associate without being required to pay for that access, the existence of payments between entities that are associates for another purpose (for example, for services provided), is enough to deny a portion of the deduction for that payment.

BDO is concerned that where other payments that are not directly related to the access to the intangible assets, the apportionment of the non-deductible portion may be difficult to appropriately calculate. There is also no guidance in the EDEM on how this apportionment is to be conducted. We submit that before these measures are legislated, the government provide guidance on how to conduct such apportionment.

Shortfall penalties

At paragraph 1.40, the Exposure Draft Explanatory Memorandum states that:

> *'To complement this anti-avoidance rule, a shortfall penalty provision is being considered as a punitive measure to penalise SGEs who mischaracterise such payments in an attempt to avoid income tax, including withholding tax. We are seeking stakeholder views on how to ensure that this proposed penalty provision is appropriately targeted.'*

BDO considers that the proposal to impose a specific shortfall penalty for this measure should be reconsidered. We do not consider a specific shortfall penalty is necessary for this measure as the deduction denial is a sufficient penalty.

Interaction with Global agreement on corporate taxation consultation paper

We refer to the **Global Agreement on Corporate Taxation – Consultation Paper (Consultation Paper)** on the "Two Pillar Solution" developed by the OECD. The consultation paper addresses the tax challenges arising from the digitalisation of the economy to help ensure MNEs pay their fair share of tax in jurisdictions in which they operate, and particularly includes a global 15% minimum corporate tax rate. These measures are expected to be introduced into Parliament following the Treasury consultation process.

We refer specifically to Pillar Two of the proposed reforms which seeks to put a floor on the 'race to the bottom' on corporate tax rates by establishing a global minimum corporate tax rate of 15 per cent. By way of comment, we note that, if Pillar Two is enacted as currently proposed, consideration should be given to its interaction with or to take account of its impact on the proposed denial of deductions for payments relating to intangibles connected with low corporate tax jurisdictions.

We consider that if Pillar Two were to apply, it would ultimately tax payments relating to the exploitation of intangibles derived by associates in low tax jurisdictions. If there are no amendments to the proposed section 26-110 to take account of Pillar Two, the denial of deductions under section 26-110 would effectively result in double taxation on the amount disallowed.