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5 September 2022

Assistant Secretary
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam,

MULTINATIONAL TAX INTEGRITY AND ENHANCED TAX TRANSPARENCY – CONSULTATION PAPER - BDO SUBMISSION

BDO refers to the invitation by the Treasury to provide comments on the policy issues and implementation considerations to improve multinational tax integrity, as raised in the **Multinational tax integrity and enhanced tax transparency - Consultation Paper (Consultation Paper).** BDO is pleased to provide feedback and comments on the questions raised in the Consultation Paper and we commend the Government for considering the appropriate legislation changes to deal with the policy issues and implementation considerations of the three main proposals to improve multinational tax integrity and enhanced tax transparency.

BDO supports the Government's efforts to strike an appropriate balance between domestically supporting multilateral efforts to address Multinational Entities' (MNE) profit shifting, and positioning Australia as an attractive destination for necessary foreign capital. To this end and while Australia is still reliant on foreign capital for the development of its domestic economy an appropriate balance must be reached, without running the risk of derailing Australia's economic growth.

One of BDO's primary concerns is that the proposed measures are likely to significantly increase the compliance burden for a wide range of taxpayers - adding to already complex compliance requirements.

BDO suggests therefore that the proposed measures should be specifically targeted so that their application is limited to those taxpayers who have the capacity to manage both the complexity, cost and time required to deal with these new measures.

Our other concerns on the proposals in the Consultation Paper are summarised under the Heading ***BDO General Comments*** below.

In the appendix attached to this letter, we provide comments on most of the consultation questions in the Consultation Paper.

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BDO General Comments

Part 1: MNE interest limitations rules Fixed Ratio Rule

Replacement of the Safe Harbour Debt Test

The Consultation Paper proposes to replace the current Thin Capitalisation safe harbour debt test with an earnings based safe harbour test to limit net interest deductions to a 'fixed ratio' of 30% of Earnings Before Interest, Taxes, Depreciation, and Amortisation (EBITDA), known as the 'fixed ratio rule'.

We acknowledge this approach is in line with the OECD's recommendation under Action 4 of the Base Erosion and Profit Shifting (BEPS) Action Plan. The Consultation Paper indicates the rationale of this approach is that it directly links to the entity's economic activity and taxable income, which can help protect against tax planning practices.

However, it is important to consider the balance between dealing with profit shifting and attracting foreign capital – and whether an Earnings-based safe harbour test properly reflects an entity's economic activity and whether, as a capital importing nation, a move to the fixed ratio rule would adversely impact Australia's access to the capital required to maintain (and grow) our economy.

Balance between dealing with profit shifting and attracting foreign capital

The Australian economy is a net capital importer and we question whether for Australia to follow a trend to an EBITDA model for determining the level of allowable debt would be to ignore the fundamental differences between the Australian economy and the economies of those countries from where Australia sources capital. We note that, although tax policy is just one part of a broader picture, Australia needs to ensure that its tax policy appropriately reflects the unique characteristics of Australia's economy including the Resources industries and requirements to update infrastructure etc.

Tax planning profit shifting practices

The Consultation Paper refers to the 'tax planning practices' that 'thinly capitalise' entities with high debt-to-asset ratios that "use various tax planning strategies to shift profits out of Australia (for example, by maximising debt-deductions via relatively high interest rate loans)". It is assumed that there may also be concerns around the ability to manipulate asset values and classification of debt/equity. However, it is not clear that a move to an earnings based safe harbour rule will eliminate attempts to shift profits out of Australia. Under the fixed ratio rule there is likely to be opportunities to manipulate an entity's earnings to increase the EBITDA and thus increase the amount of allowable debt. However, the Consultation Paper does not provide any empirical basis for either of the claims that:

- Taxpayers are utilising 'relatively high interest rate loans' or manipulating assets; or
- EBITDA is less subject to manipulation than assets.

It is BDO's experience that there are many clients who may currently be able to obtain a higher allowable debt level by applying the Arm's Length Debt Test (ALDT) but instead choose ***not*** to apply that test because of the complexity and cost of work required to justify the ALDT approach. This indicates that there may only be a small number of entities engaging in theses 'tax planning practices' and care needs to be taken not to impose more complex compliance costs on taxpayers that are not looking to undertake such 'tax planning practices'.

Volatility and Uncertainty of the EBITDA Approach

We acknowledge and appreciate that the Government's proposal to move to a fixed ratio rule of 30% of EBITDA is at the top end of the 10%-30% interest ratio 'corridor' that is set down by the OECD in BEPS Action Item 4. However, the introduction of the 30% EBITDA limitation will *create volatility and less certainty* in the ability to claim interest deductions because it will vary with revenue levels.

There are many industries where revenue is subject to high fluctuations. This is particularly relevant for industries that can be severely affected by external factors such as the weather, international commodity pricing, economic conditions (local or international) etc.

The capital structure of an entity is not always readily adjusted (especially larger entities that have both internal and external debt along with equity). Interest denial arising from short term volatility in earnings cannot always be readily remedied through a change in capital structure. This contrasts with the current safe harbour debt amount approach where short term earnings volatility of itself does not readily translate into a reduction of asset values – and therefore interest deductions.

The migration from an assets-based model to an earnings-based model will generally see capital intensive companies lose out; whereas cashflow rich/asset light entities will gain. Is this the intention of the proposed fixed ratio rule?

In addition, volatility affects the Beta in any business case analysis and is likely to have the effect of reducing foreign investment into Australia. This is particularly important for a country like Australia that is a net importer of capital

It is also a concern that the level of an entity's earnings does not necessarily directly relate to the appropriateness of the debt level for a particular enterprise; whereas it is arguable that the level of the entity's asset values is a more stable indicator of the appropriateness of the debt level, as is the case with the current safe harbour debt test.

There is also a concern that the replacement of the current safe harbour debt test with the 30% EBITDA test will replace one complex set of rules with another complex set of rules that may be less suitable for determining the appropriate debt levels of an MNE.

The 30% EBITDA test may not provide any fewer opportunities to shift profits out of Australia and it reduces the certainty with which overseas entities can invest in Australia. Therefore, if the Government's concern is that the current safe harbour debt test is too generous, an alternative is to *lower the current 60% safe harbour debt threshold instead of using the 30% of EBITDA test is available*

The effect on the Resources Sector

The Australian Bureau of Statistics recently reported that in FY22 Australia's resources set a new export revenue record totalling $413 billion contributing 69% of Australia's total export revenue. Given the importance of the resources sector to Australia's economy and the fact Australia is a net capital importing country, with many resources projects requiring foreign investment, this should be a primary consideration in any proposed changes to the thin capitalisation rules.

Profitability in the resources sector is often cyclical, impacted by commodity prices as well as exploration and development costs and labour costs because many projects require significant exploration investment before they are developed. If a thin capitalisation safe harbour test based on EBITDA was applied and the current approach of permanently denying excess interest was retained, given the many factors that can impact profitability and therefore the deductibility of debt under a fixed ratio EBITDA test, *this would give rise to significant uncertainty when deciding whether to invest in Australian resource projects*. Therefore, a fixed ratio EBITDA test may be less fit for purpose for Australia than for the majority of OECD countries.

The effect on Start-up Businesses

There is also a concern that moving to a 30% of EBITDA net interest limitation will act as a disincentive for investment for early-stage businesses, most of which have little or no revenue and fixed or higher start-up costs. This is because they may have little to no EBITDA and would therefore be required to use the arm's length debt test to support reasonable debt funding, which is likely to entail higher compliance costs.

At a time when Governments are looking to accelerate the adoption of new technologies and encourage innovation through start-ups, the proposal to move to a "fixed ratio" model appears counter-intuitive.

Carry Forward of Denied Interest Deductions

To alleviate some of the detrimental effects of the proposed 30% of EBITDA test on low revenue businesses and capital-intensive businesses, *the Government should allow the denied interest deductions to be carried forward*. BDO submits that the Fixed Ratio Rule should allow a carry-forward of denied interest deductions i.e. only temporary denial, then profit fluctuations need not be as punitive, as any period of larger profits could allow for recoupment of prior denied deductions during a down cycle. This is particularly important for start-ups that are likely to have no or low revenue as early-stage businesses.

The OECD BEPS action 4 gives support to allowing for excess deductions be carried forward where the EBITDA fixed ratio rule is implemented. However, this has not been mentioned in the Consultation Paper.

Associate Entity Rule

There is no mention in the Consultation Paper about whether the 'associate entity' rules would apply to the 30% of EBITDA test. It is suggested that there should be a consideration of *the associate entity rules to apply to allow upstream entities* to utilise the excess debt capacity of downstream entities.

Interaction between Transfer Pricing and Thin Capitalisation

The purpose of the thin capitalisation rules is to control gearing levels, but then relies on Transfer Pricing to control the level of interest charged. However, the Transfer Pricing rules can have an effect on the gearing levels. This leads to a confusing interaction between these provisions, all trying to answer the same question/control the same risk to revenue. It is suggested *the Government consider further aligning the Transfer Pricing and Thin Capitalisation treatment of debt deductions*.

Part 2: Denying MNE deductions for payments relating to intangibles and royalties

It is acknowledged that there are some inappropriate arrangements to avoid royalty withholding tax being implemented by some MNEs and we commend the Government for considering ways to discourage such arrangements. However, the proposed introduction of anti-royalty/intangible abuse provisions needs to be carefully considered. Dealing with embedded royalties requires a surgical precision rarely found in legislative provisions. It should be recognised that the Government has already introduced some appropriate legislative tools and is considering further OECD recommendations to deal with these concerns. Any additional legislative intervention should only be applied specifically to address the material undermining of the revenue and be narrowly targeted at the entities/industries involved in the relevant abuse.

Merely adding more anti-abuse provisions does not lead to greater compliance and could come at the expense of investor confidence and cause unproductive compliance costs.

This proposal in the Consultation Paper can be seen as part of the global concern regarding how to identify, value and tax "hard to value intangibles". However, this issue is being dealt with already via the OECD BEPS action items, including:

1 (Digital Economy – Now known as BEPS2.0),

2 (Hybrid Mismatch),

3 (CFC),

5 (Harmful Tax Practices e.g. patent boxes),

6 (GAAR including DPT) and

8 to 10 (Hard to value intangibles)].

It is suggested that instead of introducing a new complex rule for royalties, the government should specifically focus on BEPS 2.0 (Pillars I and II), which has aims to address circumstances where assets/transactions, including IP, have been inappropriately transferred/mispriced. Introducing local legislation will risk contradiction to the globally agreed standard, which will further increase the risk of double taxation and increased cost of offshore investment into Australia.

Conclusion

BDO suggests there exists an opportunity here for the Australian Government to tackle Multinational Tax Integrity and Enhanced Tax Transparency concerns in a nuanced way that acknowledges Australia's uniqueness from other OECD economies and does not create more complex compliance requirements.

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

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APPENDIX

BDO Submission to the Treasury
Multinational tax integrity and enhanced tax transparency – Consultation Paper

BDO has considered the **Multinational tax integrity and enhanced tax transparency - Consultation Paper (Consultation Paper)** which addresses what the Federal Government perceives as the tax avoidance practices of multinational enterprises (MNEs), along with improving transparency through better tax information reporting for MNEs to help deter MNEs from entering arrangements to minimise their tax paid through increased transparency. We provide the following comments on the questions raised in the Consultation Paper.

Part 1: MNE interest limitations rules

Fixed Ratio Rule - 30% of EBITDA
Implementation considerations

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?**

The use of either tax or accounting figures for the fixed ratio rule both have their own particular limitations and advantages as outlined below.

Advantages of using the tax figures instead of accounting figures for the EBITDA include:

- Accounting makes no distinction between NANE/exempt income and taxable income and would not align with the entity's tax position;
- Accounting impairment could cause interest denied where there could still be strong cash profits and underlying unaffected taxable income;
- Adjustments resulting from Revenue Recognition standards such as AASB116 for leases could inappropriately affect the EBITDA calculation;
- Using the accounting figures the EBITDA calculation would be open to change by the accounting standard makers without the opportunity for input from Treasury or the Parliament to review.
- The use of Tax EBITDA would be relatively compliance neutral as many companies have forward looking tax provisions or could readily adopt such approaches to allow for greater visibility

Advantages of using the accounting figures instead of the tax figures for the EBITDA include:

- At the time of preparing the Thin Capitalisation calculations for the income tax return, the accounting figures are more certain than the tax figures because the accounting figures have been finalised and audited;
- The Tax figures could subsequently be altered as a result of an amended assessment, which could require a recalculation of the Tax EBDTIA and therefore may require a retrospective denial of more interest deductions (even if the amended assessment had nothing to do with the thin capitalisation calculations);

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- The intent of the thin capitalisation rules is to align the amount of allowable debt to the realistic commercial position of the entity and the accounting figures will give a more accurate picture of the commercial position of the entity than would its tax figures.
- The tax figures are subject to various tax adjustments such as for non-assessable non-exempt income etc that would inappropriately affect the amount of the entity's earnings base for a Tax EBITDA.
- The Tax EBITDA would need to be adjusted to remove tax distortions such as franking credits, but they would be probably straightforward.

These various advantages and disadvantages of using either a tax or accounting EBITDA further highlights the problems of using a fixed ratio rule instead of the current safe harbour debt test.

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

As with any change to laws or regulations there will be additional compliance costs associated with taxpayers and their advisers understanding the new rules and putting in place procedures and methodologies to calculate and monitor the new requirements. Disregarding these initial compliance costs, the move to fixed ratio based on earnings **may or may not** impose additional compliance costs on taxpayers depending on the taxpayer's circumstances and the details of the proposed changes. If complexities in calculating the entity's position under the proposed fixed ratio rule are similar to the complexities in calculating the position under the current safe harbour debt test it may not impose additional compliance costs. However, if as suspected there will be fewer taxpayers who qualify to deduct all their interest under the proposed fixed ratio rule, they will have to consider using the arm's length debt test (ALDT) or the worldwide gearing test (WGT). *Unless these tests are simplified, this will impose an additional compliance burden and additional costs on these taxpayers.*

Without further details of the proposed fixed ratio based on earnings, it would be difficult to quantify the costs involved.

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)?

The factors that would influence an entity's current decision to use the safe harbour test (as opposed to the ALDT or WGT) is the relative simplicity and ease of use as compared to the ALDT and WGT. It is also generally a stable calculation that allows for proper pre-planning by international investors. However if, as suspected, there will be fewer taxpayers who qualify to deduct all their interest under the proposed fixed ratio rule, this will be a factor that could influence many more taxpayers considering the use of the ALDT or WGT.

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?**

Yes, specific types of entities that are currently using the safe harbour debt test that would be affected by the introduction of the fixed ratio (earnings based) rule are:

- early-stage businesses with no or low revenue;
- taxpayers with volatile or variable revenue streams;
- other entities operating on a relatively low revenue basis compared to its asset values and debt/equity requirements;
- Entities within the resources sector; and
- Capital asset intensive industries with long pay-back periods of stable returns (such as infrastructure projects) will be particularly affected

Specifically, BDO is concerned that the introduction of a fixed ratio rule will act as a disincentive for investment, particularly for early-stage businesses with no or low revenue and fixed or higher start-up costs as they may have little to no EBITDA, whether based on income tax or accounting concepts, and therefore be required to use the ALDT to support reasonable debt funding. This may place more costs on such entities because, as the Consultation Paper itself acknowledges, the ALDT is neither a certain nor a cheap exercise.

We are also concerned that currently the thin capitalisation regime results in a permanent disallowance of interest deduction and this will be exacerbated with the introduction of the 30% EBITDA test, *unless the taxpayers are able to carry forward denied deductions*.

The introduction of a fixed ratio rule will also significantly impact entities in Australia's important resources sector. Profitability in the resources sector is often cyclical, impacted by commodity prices as well as exploration and development costs and labour costs such that many projects require significant exploration investment before they are developed. Where a thin capitalisation safe harbour test based on EBITDA was applied, given the many factors that can impact profitability and therefore the deductibility of debt under a fixed ratio EDBITA test, *this would give rise to significant uncertainty when deciding whether to invest in Australian resource projects*. Therefore, a fixed ratio EBITDA test may be less fit for purpose for Australia than for the majority of OECD countries.

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

We agree with the comments in the Consultation Paper that financial entities and ADIs should still be able to apply the existing thin capitalisation rules. As explained in the Consultation Paper, these entities are 'net lenders' and are already subject to regulatory capital rules, therefore it would not be appropriate to apply the fixed ratio rule.

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

We consider that the existing total debt deductions of $2 million de minimis threshold is not a high enough threshold for the fixed ratio rule to exclude low-risk entities and should be increased, we suggest to at least $10 million and indexed periodically going forward. The current $2 million de minimis threshold has not been increased since 1 July 2014 (i.e. 8 years ago) when the threshold was increased from $250,000 before 1 July 2014.

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)?

Yes, the specific sectors more likely to experience risk of earnings volatility to the market that may cause these entities to explore using one of the alternative tests instead, such as the ALDT could be:

- The resources sector
- Other Capital intensive industries
- Primary producers;
- Tourism
- Other sectors subject to earnings fluctuations

See comments in Question 4 above regarding the resources sector.

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?

Many other jurisdictions that have or are considering introducing a fixed ratio rule have allowed the ability to carry forward denied interest deductions. It is recommended that the Government consider allowing the carry forward of denied deduction for the Australian rules. This would assist in alleviating the problems with volatile revenue streams as discussed above.

The ability to carry forward denied deductions is also supported by the OECD in its final report.

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 Consultation Paper is insufficiently precise for us to comment sensibly, and we will wait to see further proposals.

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?**

No BDO comment.

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

No BDO Comment.

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 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?**

Yes, entities that can't meet the fixed ratio rule will consider using the ALDT so they can claim interest deductions on borrowed funds.

This type of response is likely to be more evident in sectors where there are:

- Commercial reasons where certain industries are more highly geared (e.g., regulated infrastructure, motor dealerships, property developers, etc);
- early-stage businesses with little or no revenue;
- taxpayers with volatile or variable revenue streams;
- other entities operating on a relatively low revenue basis compared to its asset values and debt/equity requirements; and
- Capital asset intensive industries with long pay-back periods of stable returns (such as infrastructure projects)

For example, with an ever-growing proportion of economically critical infrastructure assets in the hands of Pension Funds, there will be a need to access measures other than a fixed ratio of EBITDA. For those entities, the ALDT remains important. Alternatively, a safe harbour based on asset values for specific industries could be used.

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 approach may reduce the level of complexity and subjectivity of the ALDT and thereby should reduce compliance costs. This is because it can be complex and hypothetically challenging to determine the characteristics of a standalone entity and there may be an element of subjectivity in doing so.

Further, this change would better align the approach to the ALDT with the Australian Tax Office's (ATO) broader views regarding implicit parental support, as the two technical approaches are currently inconsistent. It would also more appropriately reflect commercial reality and how the transfer pricing regime seeks to set gearing levels and price debt.

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?

The ALDT was introduced to provide a mechanism for taxpayers to justify a commercially realistic level of debt and when properly applied should not permit "BEPS practices" to occur. In our view the ALDT itself is not the problem, it is the inconsistent application and ATO review of the ALDT that leads to suboptimal outcomes.

We consider that having the ADLT is good economic policy to incentivise investment by providing certainty over returns and managing double tax risks. As the ADLT is designed to provide a commercially realistic analogy to an entities arm's length debt capabilities, it should be seen as a supplement to the effort to prevent BEPS practices. Any changes to the ALDT should ensure this analogy is maintained and strengthened.

One of the downsides to the ALDT is that it includes (by its very nature) elements of subjectivity – and therefore leaves outcomes subject to litigation. *One of the advantages of a safe-harbour approach is that it is more clearly based on objective measures – and therefore removes subjectivity.*

In addition, there are a number of inherent tensions and trade-offs with regard to the ALDT. On one view, in the case of MNE groups with little to no external debt, it allows for profit shifting. The same could be said for capital sourced from pension funds, which seek to deploy a component of their capital in the form of debt. But in each case, the purity of the tax policy response needs to be weighed against the economic benefits derived domestically from each of those capital flows. However, *we have to consider the investment strategies of Australia's super funds regarding their foreign invested capital* (i.e. they too employ part of their capital as debt in foreign projects and not just by way of equity contributions) and considering the retirement and superannuation investment policy considerations and benefits that flow to Australia both directly and indirectly.

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?

If the entity's debt is external third-party debt, generally there would be less integrity concerns than if the entity's debt was related-party debt. Therefore, where the entity has third-party debt, it should make it easier for them to pass the ALDT and any other integrity concerns should be dealt with by Part IVA of Income Tax assessment Act 1936 (ITAA 1936).

That said, if the entity's debt is related party debt, providing the ALDT is appropriate, then it should not be the role of the Treasury or the ATO to differentiate between the two apart from in a risk assessment context.

16. Would differentiating between external (third-party) debt and related-party debt simplify the operation of the test?

The ATO's 'white zone' already exists to provide an opportunity for taxpayers who have substantially third-party debt to obtain ATO review and approval of their circumstances. This is a good solution that does not require any changes, as the opportunity is already there for taxpayers with those characteristics to achieve a low-risk outcome.

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

Debt dumping and debt creation are adequately covered in Australia by the existing Transfer pricing rules, ATO guidance and Part IVA.

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 ATO could consider adding ALDT related disclosures to the International Dealings Schedule (IDS) to allow the ATO to better target its resources.

An option the Government could consider is a cap on interest deductibility being the "lower of" the ALDT or worldwide debt gearing amount. However, care would be needed in using this "lower of" approach as it would effectively limit inbound investment to Australia, particularly in economically critical activity, such as the development of economic infrastructure. In a forecasted period of already increasing capital costs, this could be detrimental to the economy as a whole.

Alternatively, we would recommend that the approach to the ALDT should be simplified, moving more toward the pure application of the arm's length principle, thus making Australia a more competitive investment opportunity in the global market.

Regarding a reasonable transition period to introduce these changes, tax changes that effect capitalisation arrangements can take a long time to change, if they can be changed at all. Therefore, any transitional period should be for a number of years, rather than the start of the next income year after the announcement/enactment.

Part 2: Denying MNE deductions for payments relating to intangibles and royalties

Policy design issues

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

   BDO considers this policy should only apply to larger entities and the use of the SGE definition is probably appropriate.

2. **Do you consider this policy should apply to only corporate SGEs, and why?**

   No BDO Comment.

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

   BDO considers the policy should only apply to embedded royalties where sellers inflate the cost of tangible goods or services to include the 'embedded royalty' component to avoid royalty withholding tax. Clearly, there are some inappropriate 'embedded royalty' arrangements that warrant further scrutiny and BDO commends the Government for considering the appropriate legislation changes to deal with them.

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

   Yes, we consider there are significant practical challenges in identifying embedded royalties. There are administrative and procedural problems relating to what are embedded royalties and what is their value. The process will also need to be straightforward for ease of implementation and to reduce compliance costs. Dealing with embedded royalties requires a surgical precision rarely found in legislative provisions. The identification of what are and are not 'inappropriate embedded royalties' may be difficult to legislate. It will also be difficult to identify what part of the cost of a product or service is an embedded royalty, particularly when acquired at arm's length prices as is required under the current transfer pricing rules.

   We also consider that taxpayer compliance and ATO administration costs associated with this measure could be significant. This could have considerable flow-on effects if the seller is subject to increased Australian tax on a cost that presumably is otherwise arm's length.

   Merely adding more anti-abuse provisions does not lead to greater compliance and could come at the expense of investor confidence and further unproductive compliance costs and add to subjectivity.

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

   We consider these issues are adequately dealt with under the existing transfer pricing rules, CFC provisions, Part IVA, Diverted profits tax and the BEPS action items [notably Items 1 (Digital Economy – Now known as BEPS2.0), 2 (Hybrid Mismatch), 3 (CFC), 5 (Harmful Tax Practices e.g. patent boxes), 6 (GAAR including DPT) and 8 to 10 (Hard to value intangibles)].

   It is suggested instead of introducing a new complex rule for royalties *the government should focus on BEPS 2.0 (Pillars I and II)* which has aims to address circumstances where assets/transactions, including IP, have been inappropriately transferred/mispriced. Introducing local legislation will risk contradiction to the globally agreed standard, which will further increase the risk of double taxation and increased cost of offshore investment into Australia.

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

   We consider the policy should apply narrowly to situations where intangibles are being used to avoid tax such as via embedded royalties.

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

   BDO considers that the policy should generally apply to embedded royalty arrangements with related parties. While it is possible that a third-party supplier may be including embedded royalties in the cost of goods or services, it would be difficult for the recipient to apply such a rule to transactions with unrelated parties as the recipient would have very limited ability to obtain information from the third-party supplier to determine whether there is an embedded royalty. The Government would have to provide very clear and precise legislation on how the third-party recipient of such goods or services could determine whether there were embedded royalties.

Insufficient tax

8. **What are your views in relation to the options outlined above? (Page 16 of the Consultation Paper)**

   - We consider the appropriate level of ‘low tax’ should follow either the 10% hybrid mismatch integrity rule or the 15% rate as proposed in the Global Anti-Base Erosion Rules (GloBE) for the OECD Pillar Two minimum tax rate.

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?**

   No BDO comment.

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?**

    No BDO Comment.

Part 3: Multinational tax transparency

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

   There are already stringent requirements for the disclosure of tax risk to shareholders, under the financial reporting standards and for Australian Stock Exchange (ASX) listed companies under the listing rules. The ATO already requires most larger companies to lodge Reportable Tax Position (RTP) schedules with income tax returns, and any cross-border structuring or restructuring generally requires Foreign Investment Review Board (FIRB) approval. The mandatory reporting of material tax risks would require a clear and precise definition of what constitutes a 'material risk'.

   Rather than introducing another set of rules around tax risk reporting, we suggest that any further tax risk reporting should only apply to entities that are not already subject to the current tax risk reporting rules.

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?**

   BDO considers the current SGEs definition should be used.

3. **Would you support an incremental (phased in) approach to mandatory tax transparency reporting for a broader range of entities, starting with large MNEs?**

   BDO would support an incremental phased in approach to mandatory tax transparency reporting starting with larger SGE's e.g. those with over $5 billion aggregate turnover with the threshold reducing over time to be no less that the $1billion SGE threshold.

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**

    Generally, we consider that Australia should mandate improved tax transparency in line with the OECD as the basis for a uniform approach and not just follow other specific jurisdictions such as the EU.

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?**

    Same as in Question 4

Questions 6 to 15

No BDO comments for these questions

Requiring Government Tenderers to disclose their country of tax domicile

Questions 21-25 -

No BDO comments for these questions