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28 April 2023

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

Via email to: MNETaxIntegrity@treasury.gov.au

RE: Denial of Deductions for Intangible-related Payments

Dear Ms. Ram:

The government of Australia (the “Government”), as part of Budget 2022-23, published draft legislation that would place limits on deductions for payments relating to intangible assets connected with low corporate tax jurisdiction (such legislation, the “Exposure Draft”). The Government explained that the Exposure Draft is an anti-avoidance measure and “part of the government’s commitment to ensure that multinational enterprises pay their fair share of tax in Australia” The Government is seeking stakeholders’ views on the Exposure Draft by 28 April 2023. On behalf of Tax Executives Institute, Inc. (“TEI”),¹ I am pleased to respond to the Government’s request for input.

About TEI

TEI was founded in 1944 to serve the needs of in-house tax professionals. Today, the organisation spans the globe with 56 chapters, including membership in Australia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting fair tax policy at all levels of government. Our nearly 6,500 members represent 2,800 of the largest companies in Asia, Europe, and North and South America.

¹ TEI is organized under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. Federal Income Tax under section 501(c)(6) of the Internal Revenue Code of 1986, as amended.

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TEI Comments

General Comments

The Exposure Draft Explanatory Materials explains that the Draft is:

designed to deter [Significant Global Entities (“SGEs”)] from avoiding income tax by structuring their arrangements so that income from exploiting intangible assets is derived in a jurisdiction where no or low corporate tax rates apply, while tax deductions for payments attributable to intangible assets made by the SGE to an associate are claimed in Australia. This rule prevents the SGE from claiming tax deductions for such payments.²

In general, TEI questions how “no or low corporate income tax rate” should be seen in light of the upcoming Pillar 2 rules that will effectively implement a top up tax to a 15% ETR, either by the shareholder of undertaxed entities or by domestic measures in the form of a Qualified Domestic Minimum Top Up Tax. In addition, we note the internationally agreed norm references the “Effective Tax Rate” (as calculated under Pillar 2 rules), whereas the proposed Australian rules target headline corporate income tax rate. TEI urges the Australian government to abide to international agreed rules and concepts to avoid unnecessary risks on double taxation, and high compliance costs for multi-national enterprises (“MNEs”).

The Exposure Draft states that when determining the jurisdictions where “no or low corporate tax rates apply,” the Minister of Finance must make a legislative instrument to designate the foreign country's income tax laws’ status as a “preferential patent box regime.” The Minister may reference the OECD’s base erosion and profit shifting (“BEPS”) project Action 5 on Harmful Tax Practices and peer reviews under that Action when determining whether a country operates a preferential patent box regime, but the OECD’s documentation is not authoritative in the Minister’s determination. The OECD’s BEPS project, and in particular Action 5, was intended to avoid countries enacting unilateral measures when denying deductions for certain intangible payments, and to set forth global standards for the necessary substance requirements for certain patent box regimes. However, Australia now proposes to do what the BEPS project was intended to avoid with the Exposure Draft’s proposed denial of deductions.

More broadly, in TEI’s view Australia should not implement its own version of an STTR (formerly known as the “subject to tax rule”) under Pillar Two of the OECD/Inclusive Framework project on the digitalization of the economy while negotiations over the design of the STTR are still ongoing. TEI recommends Australia postpone implementation of the Exposure Draft until negotiations regarding the STTR’s design under Pillar Two are final. Should Australia decide to introduce the proposed rule nonetheless, including the application of a substance-over-form doctrine, TEI recommends these principles be applied balanced basis. That is, not only to the recharacaterization of (part of) a payment as for the right to exploit an intangible asset, or to a qualifying a patent box regime in a high tax

² Explanatory Materials at paragraph 1.1.

jurisdiction as lacking economic substance as a result, but also in recognition that in where an MNE has sufficient economic substance in a low tax jurisdiction no tax avoidance behavior is present and therefore the payment should be deductible.

Indeed, the current negotiations under Pillar Two, as with BEPS Action 5, are intended to coordinate efforts by the members of the OECD/Inclusive Framework from adopting their own individual – and therefore very likely inconsistent – rules for denying deduction for certain payments (as well as income inclusions for certain other payments). Individual, inconsistent jurisdictional measures increase the risk of double taxation, as a deduction may be denied for a payment even if it is included in income in another jurisdiction. Indeed, unilateral measures raise the possibility of a deduction denial, imposition of a withholding tax, income inclusion in the recipient jurisdiction, and the possibility of taxation of the recipient entity under controlled foreign company rules. For these reasons, TEI again recommends the Government postpone implementation of the Exposure Draft until the OECD/Inclusive Framework negotiations are complete.

Specific Comments

TEI notes it is unclear how the Exposure Draft would apply to contracts that include payments not only for the right to exploit intangibles – which may be subject to a deduction denial – but also payments for other services. For example, a software as a service contract may include not only the use of the software itself, but also the for the helpdesk, telecom services, and data storage. Would taxpayers be able to apportion the payment across all services so only a portion of it would be denied a deduction, or would a deduction be denied for the entire payment if any part of it was for use of an intangible asset? The final rules should state which approach is intended.

Further, in numerous countries the corporate income tax rate is not driven by “solely” the headline rate but also mandatory, applicable-to-all, rates in the form of a solidary, state, communal and municipal rates. There would be a clear overreach in the proposal if the proposal would apply to payment to entities resident in a country where all MNEs are subject to a combined corporate income tax and local tax rate of over 15%. Therefore, TEI recommends that “national level corporate tax” be interpreted to include all mandatory non-sector specific rates.

Finally, the Exposure Draft would deny deductions for an MNE’s intangible related “payments” to affiliated entities located in a country with a preferential patent box regime. There is no definition of “payment” in the Exposure Draft, however. TEI recommends the Government adopt a clearly defined set of payment types to which the deduction denial would apply.

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TEI appreciates the opportunity to comment on the Exposure Draft. Should you have any questions regarding TEI's comments, please do not hesitate to contact Benjamin R, Shreck of TEI's legal staff at bshreck@tei.org or + 1 202 464 8353.

Respectfully submitted,



Wayne G. Monfries
International President
TAX EXECUTIVES INSTITUTE