Law Council
OF AUSTRALIA

Business Law Section

01 November 2022

First Assistant Secretary
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Treasury
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By email: contact.internationaltax@treasury.gov.au

Dear Sir/Madam

Global agreement on Corporate Taxation: Addressing the Tax Challenges Arising from the Digitalisation of the Economy

1. The Taxation Committee of the Business Law Section of the Law Council of Australia (the **Committee**) welcomes the opportunity to make a submission responding to the *Global Agreement on Corporate Taxation: Addressing the Tax Challenges Arising from the Digitalisation of the Economy* Treasury Consultation Paper (**Treasury Consultation**) issued in October 2022.

The Committee's Approach to the Treasury Consultation

2. The Treasury Consultation, as is explained in the consultation paper, occurs after several years of policy development led by the OECD with critical directions being in part approved by the OECD/G20 Inclusive Framework on BEPS (**Inclusive Framework**), in the so-called 'two-pillar multilateral solution'.

3. The Australian Government has broadly approved the direction to be taken, and Australia is at the stage of consulting on the proposed design of legislation to introduce the proposed policy advanced by the OECD and partly approved by the Inclusive Framework. It is noted that, at this stage, several aspects of the proposed 'two-pillar' solution have not yet been approved by the Inclusive Framework.

4. The Treasury Consultation poses 40 discussion questions in aid of advising the Government on the development of legislation. Our submission seeks to concisely address many of the questions, grouping them into topics or themes. Some questions are not addressed as they fall outside the remit or expertise of the Committee.

5. As a general proposition, given that the taxation of multinational companies is already very complicated, the Committee advocates an approach that is consistent with policy intent yet as simple and certain as possible. This will achieve compliance with minimal cost for those taxpayers and for the ATO to administer

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the law. In our view simplicity and certainty will arise from leveraging existing rules such as the Country by Country reporting (**CbCR**) rules (as a safe harbour), consistency with international rules (such as the Global anti-Base Erosion Model Rules) and domestic tax regimes (such as consolidations, franking and income tax administration). We note that the Consultation does not mention withholding taxes, so we assume the current policy intent is to maintain the status quo.

6. We also note that, whilst our submissions are largely address Pillar 2, many of the themes or positions apply equally to the implementation of Pillar 1.

7. For brevity we will employ terms and abbreviations employed in the Treasury Consultation.

8. The Committee would welcome the opportunity to be consulted on draft legislation on all aspects.

Submissions on Specific Topics/Themes

Legislative and Treaty Implementation (Question 12)

9. For constitutional reasons, a top-up tax will need to be imposed as a separate tax. It would be highly desirable for Treasury to present the proposed approach for consultation.

10. Any interactions with the existing income tax law need to be carefully considered. The Under-Taxed Profits Rule, in contrast to Top-up Tax, may be implemented by a denial of deduction rule or similar, which may be enacted in the existing income tax law.

11. The Committee opposes legislation by cross-reference as has occurred with the multilateral instrument (MLI) modifying tax treaties. This issue would arise if an international set of rules, such as the GloBe Model Rules, were to be introduced into Australian law by cross-reference. The current experience with this approach is that it is unwieldy for taxpayers and advisers to be certain as to what is the correct law. Instead, the Committee submits that the legislation should be free-standing so that all users are certain as to what the law states from the source legislation. Such an approach is not inconsistent with a multilateral convention, and is consistent with maintaining Australian Parliamentary sovereignty over the process of reflecting convention terms in local law.

12. Although the production of synthesised texts by the ATO is a pragmatic response, the warning text employed by the ATO at the start of the synthesised text for each treaty reveals the problem. The ATO warns: “The purpose of this document is to facilitate the understanding of the application of the MLI to the Agreement and it does not constitute a source of law. The authentic legal text of this tax treaty and supplementary instruments Protocol and Second Protocol remain the legal texts applicable.”

International consistency and timing for introduction of Pillar 2 (Questions 9, 17, 18, 19, 21)

13. We note that the OECD/G20 Inclusive Framework Consensus presents Pillar 1 and Pillar 2 as a ‘package’ multilateral solution. However, the work on Pillar 2, specifically the GloBE rules, is further advanced than the work on Pillar 1; and the

GloBE Model Rules have been approved by the Inclusive Framework, unlike the proposed approach to Pillar 1. As far as possible, the Treasury should provide notice, and consult on the implementation of both Pillars in the Consensus package, or provide notice that it is proceeding with one aspect if that is the policy approach.

14. The Pillar 2 GloBE Implementation Framework is being developed and will be published late this year. Consideration will then need to be given to the design of domestic legislation consistent with the Implementation Framework. That will be a complex process requiring consideration of numerous issues including interactions with existing treaty obligations and the domestic tax regime for both foreign and locally sourced income. Only once those issues have been worked through will corporates be in a position to undertake systemic changes. The time needed for corporates to implement system changes is expected to be at least 18 months. Therefore, an effective start date of 2023 is unlikely to be possible. Revenue authorities also need to put processes and reporting arrangements in place to analyse and share information. This suggests a start date of no earlier than 2024 (aligned to a corporate's financial year commencing in 2024 without straddling periods). Ideally Australia is neither ahead nor behind the pack in the timing of implementation, thereby maximising global consistency and minimising arbitrage opportunities.

15. Noting our observations above, for the implementation of GloBE rules in domestic law, there should be consistency with the GloBE Model Rules, not bespoke Australian rules which differ significantly. We note that hybrid mismatch rules have not achieved global consistency and there is significant Australian complexity as a result.

16. To the extent possible, Australia should enact domestic legislation in terms that reflect the GloBE Model Rules, with any necessary or desirable adjustments for Australian domestic law reasons.

<u>Pillar 2 and Domestic Minimum Tax (**DMT**) (Questions 35–40)</u>

17. Only multinational companies in the scope of Pillar 2 should be subject to a Domestic Minimum Tax. It is assumed that an Australian DMT would be a qualifying domestic minimum top-up tax for the purposes of the GloBE rules.

18. On the principle that income tax paid should give rise to a franking credit, DMT should give rise to franking credits for Australian corporates.

<u>Ordering rules and Safe Harbours – Pillar 1 & 2; Domestic Tax Rules (Questions 11, 12, 29, 30)</u>

19. The Committee favours a safe harbour system that is closely modelled on the existing CbCR regime. Such alignment to the existing regime ensures taxpayers are dealing with a process with which they are already familiar, and they should, by and large, be able to rely on existing calculations.

20. To the extent to which a CbCR safe harbour is available, this may be achieved through:

    - requiring amendments to the CbCR when used for Pillar 2 purposes to more closely align it to the GloBE rules (e.g. to account for timing differences and aligning the definitions of profits and covered taxes); or

    - uplifting the minimum required effective tax rate (ETR) percentage to create a buffer that accounts for those differences.

21. Where offshore jurisdictions apply a qualifying domestic minimum top-up tax, it is preferable that no corresponding GloBE calculation is required in Australia (for an ultimate parent entity) in respect of those jurisdictions.

22. Safe harbours should apply on an ongoing basis and not for a transitional period.

23. Rules prioritising the application of Pillars 1 and 2 will be required even though at present no Australian resident corporate group may fall into Pillar 1. For example, the way in which a Market Jurisdiction Amount A allocation is taken into account in application of the GloBE should be made clear in the rules themselves. As a Market jurisdiction that may have Amount A allocations, the Pillar 1 rules will interact with Australian income tax law through the proposed Marketing and Distribution Profits Safe Harbour. As a Market Jurisdiction, Australia would have an interest in ensuring that this is correctly defined as this Safe Harbour reduces the Amount A allocation. Australia would also need to decide at what rate to tax the Amount A allocation. This requires further consultation. The Pillar 1 rules will also interact with domestic and foreign tax laws through the proposed approach to elimination of double-tax for Amount A. These two elements of the proposed Pillar 1 approach are extraordinarily complex, and would require careful examination of potential interactions with domestic tax law.

Interaction with integrity provisions: CFCs, hybrid mismatches (Questions 31–32)

24. The Committee is generally concerned by the growing complexity of Australian international tax rules, with layer upon layer of integrity measures giving effect to the OECD BEPS program as well as unilateral measures. In these circumstances, it is not possible to comment to any great extent in the absence of draft legislation. As noted, Safe Harbour rules will assist in dealing with cases to which they apply.

25. We do observe that, provided that the Australian CFC rules work effectively, the occasion for top-up taxes (either on the Australian side or the other jurisdiction) will be minimised. This may produce a bias towards the use of CFCs but that is not necessarily a bad thing from a policy perspective.

26. We consider that Treasury should consider amendment of Part IVA to ensure that the general anti-avoidance rules would apply to cases where the top-up tax is avoided. This would involve amendment of the general rules[1] rather than a new specific anti-avoidance rule. That said, the Committee does not at this time observe a specific opportunity or strategy for avoiding the new rules, but raises the

[1] Sections 177C and 177D *Income Tax Assessment Act 1936* (Cth) (**ITAA36**)

point out of a general awareness that new taxes often inspire thought as to how to avoid them.

Integration with domestic corporate taxation—e.g. franking, consolidations; M&A (Questions 23–25, 33, and 34)

27. Australia's domestic rules for the taxation of companies including the consolidation rules, the franking rules and the various rules affecting M&A should be as far as possible relied upon and not altered in aid of implementing the Government's policy intent.

28. Consolidated group rules including liability for taxes in tax sharing agreements are well established. There may be interactions with consolidation, for example in defining the scope of either Pillar 1 (for Amount A allocation and the Safe Harbour) and Pillar 2 application to corporate groups. Treasury should consult on whether any of the same approaches as in the consolidation rules should be applied. It may not be suitable to apply full tax sharing / joint and several liability for taxes in relation to the GloBE, for example.

29. Caution should be exercised in introducing joint and several liability for DMT across entities within Australia. The rules will need to complement, not complicate, existing tax consolidation rules to the extent possible.

30. With regard to Constituent Entities that have accumulated losses, an issue arises as to whether there should be a top-up tax where there is no economic profit in a jurisdiction. We recommend that Treasury consult on this issue, and whether it is appropriate for the top-up tax to apply in Australia in this situation.

31. On the principle noted earlier, that a DMT is similar to the payment of Australian income tax, top-up tax should give rise to franking credits. This scenario is obviously different from Australia giving a franking credit for tax that is actually paid to a foreign Treasury.

32. If Australia levies a top-up tax, or a DMT that is a qualifying minimum tax under the GloBE rules, this is effectively the collection of more tax on a multinational company where there are subsidiaries or parts of the corporate group operating in Australia. It is not clear why this would qualify as additional 'foreign' tax, rather than additional Australian tax, given that Australia collects it (assuming it is not absorbed by a foreign-qualifying domestic minimum top-up tax, etc). In this case, it would seem to make sense that the payment of top-up tax or a DMT could generate franking credits that are available to support franked dividends from the Ultimate Parent Entity of an Australian corporate to its shareholders in Australia, where paid by the Ultimate Parent Entity, or subsidiary entities in the group (whether or not it is a MEC or consolidated group).

Risks and Behavioural Responses (Questions 4, 7)

33. Question 4 asks about the second round global tax system effects of actions other countries may take that may impact Australian interests.

34. For Pillar 2, if other countries adopt a qualifying domestic minimum top-up tax, this would reduce any top-up tax that Australia may levy under the Income Inclusion Rule or Under Taxed Profits Rule.

35. Aspects of the GloBE have been suggested by some countries to breach double-tax agreements. There is the potential for disputes or disagreement with Australia's treaty partners, whether or not they sign up to Pillar 2, as to whether the rules breach the treaty.

36. Question 7 asks about incentivising behavioural changes or business restructures over the medium to long term. The Committee considers that, given the application of both Pillar 1 and Pillar 2 to multinational companies that satisfy financial accounting requirements to file consolidated financial accounting returns/profits, the rules create an incentive to consider the tax implications and attractions of either divesting assets or subsidiaries or merging/growing the corporate group. We note, for instance, that arbitrage may still exist between Australia's corporate tax rate and Domestic Minimum Tax.

Tax Administration (Questions 26, 27–28)

37. As a general principle, the Committee considers that, because the proposed measures will in substance add to and reinforce the corporate tax base, the tax administration legislative framework should also as far as possible be the same. That is because the adoption of that framework should comply with the relevant limitations on Commonwealth taxing power as well as be processes familiar to the affected parties (both taxpayers and revenue authorities) and therefore more likely to lead to the most efficient administration of those measures.

38. More specifically:

    a. Outbound and inbound taxpayers subject to Pillars 1 and 2 should self-assess their tax liability in the first instance following mechanisms as occurs for income tax of companies rather than the Commissioner making a determination as a pre-condition of assessment. Obviously, if the company fails to self-assess its liability, the Commissioner would be able to take appropriate assessing action similar to the position at present.

    b. Self-assessment would then be subject to audit and review activity and powers, including the powers if necessary to compel the production of documents and witnesses. The current tax law also provides for offshore information notices. The Treasury should consider data needs for proper administration of new rules introduced in this process, while keeping compliance costs to a minimum.

    c. Post-assessment adjustments should be able to be made to a taxpayer's top-up tax position occasioned by, for example, materially amended assessments. These changes may involve substantial increases in income tax with a correlative impact on top-up tax required. Some amendment to the period of review rules[2] may be required.

    d. Any amended assessments would then be subject to the current objection and review processes,[3] including Court proceedings or settlements of disputes.

[2] Section 170 ITAA36.
[3] Under Part IVC *Taxation Administration Act 1953* (Cth)

e. The above measures are required in order for the taxes to be contestable, as required by the Commonwealth Constitution.

39. These comments arise in the context of the limits on the Commonwealth's taxing power.[4] Those limits include that the tax must be imposed by reference to some ascertainable criteria, which have a sufficiently general application.[5] A tax must not involve the imposition of liability in an arbitrary or capricious manner. A tax must be contestable, and it must be amenable to judicial review when the circumstances of the taxpayer do not attract a legal liability to pay the tax. As was stated in *W R Carpenter Holdings Pty Ltd v Federal Commissioner of Taxation* (2008) 237 CLR 198, 204 [9] (Gleeson CJ, Gummow, Kirby, Hayne, Heydon, Crennan and Kiefel JJ):

> *…, for an impost to satisfy the description of taxation in s 51(ii) of the Constitution it must be possible to distinguish it from an arbitrary exaction. Secondly, it must be possible to point to the criteria by which the Parliament imposes liability to pay the tax; but this does not deny that the incidence of a tax may be made dependent upon the formation of an opinion by the Commissioner. Thirdly, the application of the criteria of liability must not involve the imposition of liability in an arbitrary or capricious manner; that is to say, the law must not purport to deny to the taxpayer "all right to resist an assessment by proving in the courts that the criteria of liability were not satisfied in his case".*

40. The adoption of the current administration regime should lead to compliance with these principles. Any system of agreement between tax administrators from different countries or subsequent arbitration will ultimately need to comply with the Commonwealth's taxing powers under the Commonwealth Constitution.

41. In addition:

    a. the top-up taxes should be defined to be a "tax-related liability" and collectable in the same way as income tax; and

    b. given that we advocate the adoption of the current regime, we currently see no case for new statutory powers to be given to the Commissioner.

42. In terms of administration more generally, there should be consistency where possible across jurisdictions where possible. Specifically:

    a. The GloBE information report (GIR) should be kept as simple as possible, consistent with global standards.

    b. In the event of DMT, separate returns should be minimised given the additional GIR, and preferably combined. Also the GIR needs to be a document that is adopted by all countries applying Pillar 2, and should be in a standardised agreed format.

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[4] See generally, The Hon Justice M Gordon, "The Commonwealth's Taxing Power and Its Limits – Are we there yet?" (2013) 36 Melbourne University Law Review 1037

[5] Citing *Federal Deputy Commissioner of Taxation v Truhold Benefit Pty Ltd* (1985) 158 CLR 678, 684 (Gibbs CJ, Mason, Wilson, Deane, and Dawson JJ). See also *Giris Pty Ltd v Federal Commissioner of Taxation* (1969) 119 CLR 365, 372–3 (Barwick CJ), 379 (Kitto J), 380–1 (Menzies J), 383–5 (Windeyer J).

Conclusion and further contact

43. The Committee would be pleased to discuss any aspect of this submission.

44. Please contact the chair of the Committee, Angela Lee, at angela.lee@vicbar.com.au, if you would like to do so.

Yours faithfully

Philip Argy
Chairman
Business Law Section