July 21, 2023

Committee Secretary
Senate Economic Legislation Committee
Department of the Senate
P.O. Box 6100
Parliament House
CANBERRA ACT 2600
AUSTRALIA

Re: Comment Letter on Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023 [Provisions]

The National Foreign Trade Council (the "NFTC") is pleased to provide written comments on the Australian Government's Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023, published in June 2023 (the "Draft Bill").

The NFTC, organized in 1914, is an association of U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities. Our members value the work of the OECD and the Inclusive Framework in establishing and maintaining international tax norms that provide certainty to enterprises conducting cross-border operations. We understand Australia's stated goals of providing for the disclosure of information about a corporation's subsidiaries in the annual financial reports through a new 'consolidated entity disclosure statement' and separately strengthening the thin cap rules. The Government has issued a "Treasury Laws Amendment (making multi-nationals pay their fair share – integrity and transparency) Bill 2023 Explanatory Memorandum" ("Explanatory Memorandum") addressing Country-by-Country Reporting ("CbCR"). The Draft Bill contains a new reporting requirement aimed to increase transparency in how companies structure their subsidiaries for tax purposes in Schedule 1. Schedule 2 will limit the amount of debt that entitles can deduct for tax purposes and ensure that these debt deductions are directly linked to an entity's economic activity. The NFTC welcomes the opportunity to provide written comments on the Explanatory Memorandum and Draft Bill.

General Comments

NFTC has previously expressed concerns with proposals for publicly available CbCR. The Explanatory Memorandum sets out the Government's preferred option. It indicates that the implementation of public CbCR rules will be deferred by 12 months and that certain changes to the draft legislation will be made, but that further consultation on the public CbCR draft legislation would be beneficial. We welcome another consultation on these rules and appreciate the amendments already agreed.

However, in reviewing the Government's preferred option for public CbCR we still have concerns about the scope, safeguards for data and compliance burden.

Many of the rules provided in Schedule 2 exist elsewhere in Australian law. Nonetheless, if additional protections are pursued in relation to thin capitalization, they need to be refined to ensure that routine transactions are not captured, and that the anti-avoidance rule is appropriately tailored.

Specific Comments

Explanatory. Memorandum – Country-by-Country Reporting

The Government's preferred option set out in the Explanatory Memorandum still goes further than the EU reporting regime. Some information being requested is not currently collected or compiled by multinational enterprises ("MNEs") and would take time and system changes to implement.

Scope

The proposed scope of information requested is still overly broad and is beyond what is included in OECD Confidential CbCR. The scope of CbCR was agreed at the OECD as 'appropriate' to enable tax authorities to make a confidential risk assessment of an MNE's tax affairs. While we understand the need for this data to conduct risk assessments, there seems to be no objective policy goal for publishing that information.

Similarly, the information requested goes beyond that required under the public CbCR EU Directive. Neither the statement on approach to tax included on CbCR filing nor the reconciliation prepared by jurisdiction between income tax accrued and taxes due and paid are requirements in the EU. The lack of consistency with the EU proposal increases the potential for confusion amongst stakeholders and the compliance burden for taxpayers. The EU Directive requires separate disclosure of each EU member state together with those jurisdictions deemed to be non-cooperative tax jurisdictions. Additionally, the EU Directive provides that small local operations of MNEs (i.e., operations where there is minimal impact on the overall tax picture) are excluded to reduce unnecessary compliance costs. Data for the rest of the world is then reported in the aggregate. In line with the EU Directive, the information to be disclosed should be limited to Australian operations with the rest of the world in aggregate. The lack of consistency with the EU proposal increases confusion amongst stakeholders and the compliance burden for taxpayers.

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NFTC recommends providing a materiality threshold in relation to any of the data required to be published. Not only is the lack of a materiality threshold troubling from a compliance burden perspective, but it is not helpful from a stakeholder perspective in interpreting and understanding the published data. The lack of a materiality threshold could also negatively impact foreign direct investment into other countries (if immaterial information from all countries must be disclosed) as well as Australia (if the investment would subject the business to public CbCR). Accordingly, if data on a jurisdictional basis is required, we would propose limiting disclosure to the largest jurisdictions covering in aggregate eighty percent of revenue and employees and including a materiality threshold for Australian operations.

Consistent with the exclusion from scope of the draft rules for partnerships and trusts with individual partners and trusts, the draft legislation should be modified to exclude from its scope a constitutional corporation or other entity that is treated as fiscally transparent for tax purposes in its country of organization unless each of the owners is a constitutional corporation that is not treated as fiscally transparent for tax purposes in its country of organization.

The revised proposal requires a tax rate reconciliation by jurisdiction. This is not something that companies ordinarily prepare on a jurisdictional basis and it's not clear what additional value this will bring to stakeholders. We would suggest limiting the tax rate reconciliation requirement to Australian operations only.

Lack of Safeguards for Commercially Sensitive Data

NFTC is very concerned about the lack of safeguards to protect against the disclosure of commercially sensitive data regarding business operations. While there is a reference to allowing exemptions, there is no clarity on what might qualify for an exemption, and it appears to be at the discretion of the Commissioner. Such disclosures could harm the competitive position of businesses, eventually resulting in market distortions, particularly when compared to competitors not subject to disclosure (e.g., competitors with no operations in Australia).

As a result of the requirement to publish jurisdiction by jurisdiction information, this distortion could occur in any market in the world (not just Australia) in which one business is required to publish as a result of the Australian legislation and a competitor is not. By not providing an exemption from the publication of commercially sensitive data and requiring disclosure of data for all jurisdictions (not just Australia), these requirements create a direct and significant disincentive for growing businesses to commence operations in Australia. This concern is particularly acute due to the lack of a materiality threshold for the publication of jurisdiction-by-jurisdiction data. Accordingly, information regarding a jurisdiction could reflect start-up operations, or business costs with a single customer, or a single contract, any of which could be commercially sensitive.

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There is no safeguard exempting the publication of data that is otherwise publicly available (e.g., through a public stock exchange filing). It is also concerning that the proposal seems to create a "workaround" to the confidentiality requirements agreed to by Australia and other governments which ratified the Multilateral Instrument negotiated as part of the OECD BEPS project. Requiring companies to participate in the elimination of the confidentiality protections afforded by that instrument is a violation of those agreements. Furthermore, the Australian Treasury ("ATO") already has CbCR and other taxpayer data and is best placed to audit compliance with the law. Publishing this data risks undermining public trust in the ATO's ability to execute its statutory obligations if those efforts are publicly questioned or second guessed by stakeholders relying solely on the public CbCR data.

The EU Directive permits reporting groups to withhold reporting of commercially sensitive information. Consistent with the EU Directive, the draft legislation should be modified to permit reporting groups to withhold reporting of commercially sensitive information. At a minimum, we recommend that Australia adopt a safe harbor allowing MNEs to defer publication of confidential and commercially sensitive data for five years, in line with the public CbCR EU Directive.

By not providing an exemption from publication of commercially sensitive data and requiring disclosure of data for all jurisdictions (not just Australia), these requirements create a direct and significant disincentive for growing businesses to commence operations in Australia.

Compliance Burden

The proposals are still extremely broad and will impose a disproportionate administrative burden on taxpayers. Such disclosure increases the compliance burden at a time when large MNEs are already facing the complex implementation of Pillar Two, and work is ongoing with respect to Pillar One. The information requested goes far beyond that included in OECD Confidential CbCR under BEPS Action 13. As a result, many in-scope businesses will not have this data readily available. Much of the information required is not something that many companies ordinarily prepare or retain today. For example, as noted above, the requirement to prepare a tax rate reconciliation on a jurisdictional basis (section 6 (i)) will require jurisdictional consolidations and tax rate reconciliations to be prepared. For a large group, collecting this data and preparing these reconciliations for every jurisdiction in which they operate will impose significant and disproportionate administrative and resource challenges.

We note that there does not appear to be a materiality threshold in relation to any of the data required to be published. As such, for large MNEs operating globally, the level of information required is extremely burdensome and, in some cases, it may not be possible to comply. Indeed, it is unclear what purpose is served by requiring the publication of such data for jurisdictions in which the MNE has no material operations or income.

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Schedule 2 - Thin Capitalization

The Draft Legislation in Schedule 2 and the Explanatory Memorandum suggest that the new debt creation rules are only intended to apply to artificial interest-bearing debt created within a multinational group that lacks genuine commercial justification. As drafted, Schedule 2 is much broader than the intended goal.

The rules will apply even where the amount of debt borrowed by an Australian taxpayer is an arm's length amount and the rate of interest charged on the debt is an arm's length rate, i.e., the measures will apply to completely commercial arrangements. Thus, debt deductions will be denied where:

- an Australian taxpayer borrows debt (related party or unrelated third party) to acquire an asset (e.g., property plant & equipment, trading stock, contracts, contractual rights such as the rights as a lessee) from a related party (onshore or offshore); or
- an Australian taxpayer borrows related party debt (onshore or offshore) to fund any payment or distribution made to a related party (onshore or offshore). The relevant payments to the related party may be made before, at or after the time when the Australian taxpayer borrows the debt.

Anti-Avoidance

The anti-avoidance provision with a low "principal purpose" threshold can apply where the Commissioner is satisfied that a scheme was entered into to avoid the debt creation rules. On one reading, that provision could apply where an Australian taxpayer raised equity to fund payments to related parties but used debt to fund the purchase of inventory from third parties. In that case, *prima facie*, the debt would not be caught by the debt creation rule as it was used to fund a payment to a third party for the purchase of an asset from that third party. However, the Commissioner could argue that the reason the funding mix was structured this way was to avoid the application of the debt creation rules, which would then put us back into the debt creation rules. Ultimately, the bill provides no safe harbor or pathway for taxpayers subject to the bill to provide their debt is truly commercial in nature and not a debt deduction creation scheme; as written, it is not a defense to say that the amount of debt borrowed by the Australia taxpayer is arm's length or the rate of interest on the debt is arm's length.

Application to intercompany loans

If the bill is enacted as currently drafted, Australian companies that engage in standard intercompany borrowings from corporate in-house banks to short-term or long-term fund their operations as a matter of ordinary and routine practice would be denied interest deductions to the extent that any of those borrowings were used to make the following payments to other group companies: purchase of business assets as part of a restructure; purchase of hard assets for an operations expansion; purchase of inventory, intercompany payments of license fees, royalties, or service fees, intercompany lease rental payments, etc. Further, interest on Australian borrowings is generally subject to a withholding tax rate, even after the application of the relief

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provided in the U.S.-Australia treaty, which ensures a portion of the interest payment is paid to Australia.

Impact

These measures put foreign multinationals at a competitive disadvantage to Australia parented MNCs. It is a completely legitimate commercial structure for foreign multinationals to have offshore finance companies that are able to raise lower cost debt for the entire group which is able to be loaned to Australian subs at lower interest rates. While there may be incrementally more tax collected as a result of these new rules, the net investment in the country will decrease as MNC's factor in an increased cost of using debt to their investment cost. These same restrictions do not apply to the Australian parent of Australian based MNCs which is able to use the larger size of the entire group to borrow more cheaply from third parties to fund the acquisition of trading stock from third parties.

These measures effectively force MNCs to fund their Australian subsidiaries entirely with equity. Equity may be a more expensive form of financing than debt, as available funds may not be at the parent level and parents would need to borrow to equity fund or limit their investment instead of accessing available cash elsewhere that may be lent. The measures are effectively making an already expensive country to do business in even more expensive.

A myriad of Australian rules already exist that are designed to ensure that MNCs do not artificially load debt into their Australian subsidiaries (e.g., transfer pricing, thin capitalization, specific and general anti-avoidance rules). While the Draft Legislation suggests that the debt creation rules are designed to capture artificial or non-commercial arrangements, query whether those such arrangements would actually exist given the breadth of measures already in place. It would be more accurate to say that the proposed debt creation rules will impact legitimate commercial borrowing, effectively forcing foreign MNCs to fund their Australian subs with potentially more expensive equity.

Conclusion

NFTC has previously expressed its concerns with publicly available CbCR data and appreciates the revisions being contemplated. Notwithstanding our previously expressed concerns, if Australia chooses to pursue public CbCR as suggested by the Explanatory Memorandum, we recommend a more limited and proportional approach to disclosure that closely aligns with international standards, including the EU's Public CbCR Directive. We recommend that the materiality thresholds be adopted and safeguards against commercially sensitive data be adopted. We still recommend that the commencement date be aligned with the EU Public CbCR Directive. The thin capitalization rules are redundant with protections that already exist in Australian law. As drafted, the rules apply to routine transactions and impact the competitiveness of foreign multinational companies in relation to companies based in Australia. We urge Parliament to limit the scope of Schedule 2. NFTC appreciates the opportunity to provide comments and looks forward to continuing opportunities for constructive engagement.

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