

The Secretary
Senate Economics Legislation Committee
Parliament House
Canberra
Lodged electronically

19 July 2024

Dear Sir / Ms,

Re: Inquiry into Taxation (Multinational—Global and Domestic Minimum Tax) Imposition Bill 2024 and related bills

Thank you for your invitation to make a submission to the Committee on the package of Bills intended to enact the 15% global minimum tax in Australian law and introduced into the House of Representatives on 4 July 2024:

- the *Taxation (Multinational – Global and Domestic Minimum Tax) Bill 2024*,
- the *Taxation (Multinational – Global and Domestic Minimum Tax) Imposition Bill 2024*, and
- the *Treasury Laws Amendment (Multinational – Global and Domestic Minimum Tax) (Consequential) Bill 2024*

along with the accompanying Explanatory Memorandum for the Bills.

We note that some of the Explanatory Memorandum addresses both Pillars of the OECD's 'Two Pillar Solution'; our submission addresses only Pillar Two – the part of the 'Two Pillar Solution' being enacted by the package of Bills.

1. Policy underpinnings

Ordinarily, a submission such as this might consider the policy objectives underlying the package of Bills. We note that a sizeable portion of the Explanatory Memorandum [*Attachment 2: Impact Analysis*] does just this, to support the conclusion that 'the best option for Australia is to proceed towards implementing the Two Pillar Solution' (p. 103).

On the other hand, the ALP took to the last election an express policy to implement 'the OECD's Two-Pillar Solution for a global 15 per cent minimum tax ...' and the inherent value in respecting election commitments would seem to render any debate about the merits of the project for Australia unnecessary. But we think it important to note, an election commitment might no longer be a sufficient justification if subsequent events have overtaken the policy meaning it is now misguided or needs to be qualified.

In this respect, we note that Attachment 2 does not address recent and potential developments in the US and in particular, the likely fate of the Two Pillar Solution were members of the Republican party to control either house of the US Congress after November 2024. The US has always been sceptical about the OECD's base erosion and profit-shifting projects. The US did not sign the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* in 2017, and in December 2019, US Secretary Treasury Mnuchin tried (unsuccessfully) to sabotage the Two Pillar Solution. Currently, some Republican members of Congress are pursuing a 2-pronged attack to stymie the Two Pillar Solution. The first line of attack promises to impose retaliatory taxes against the US subsidiaries of companies from any country which enlivens parts of the Two Pillar Solution (either Amount A of Pillar One, or the



Under Taxed Profits Rule in Pillar Two), and two Bills have been tabled in the US House of Representatives to do this: the *Defending American Jobs and Investment Act* (May 2023) and the *Unfair Tax Prevention Act* (July 2023). A second line of attack threatens to 'defund the OECD.' While this might be dismissed as US political theatre, it does attest to a degree of inability or unwillingness on the part of the US to implement the OECD's agenda, including the Two Pillar Solution. There is already evidence to contradict the assumption in the Explanatory Memorandum that, 'the remaining OECD Inclusive Framework members would continue to work towards implementation of Pillar Two' (page 121).

We consider it very unlikely, therefore, the US will implement the Two Pillar Solution itself. That alone is not fatal to the endeavour as the design of the GloBE regime has been deliberately constructed to make it 'fire-proof' against just this kind of US intransigence. For example –

- the liability for tax under the IIR can devolve to lower-tier entities in other countries if the US will not impose a qualifying IIR on the US parent;
- the *raison d'être* of the UTPR is to collect tax from group members in other countries if the US will not eliminate its preferences or impose a qualifying DMT on the US parent; and
- if the US does not require the local parent to supply a GloBE information return or the US will not share it, responsibility for collecting that information devolves to group members in other countries.

But part of the US political establishment has already announced an intention to go further and actively sabotage the efforts of those countries which act to implement parts of the Two Pillar Solution. It can do this by unilateral domestic retaliatory actions, and there is no way to fire-proof the GloBE regime from these measures. Instead, there will have to be protracted and expensive disputes under income tax treaties, investment treaties and trade treaties trying to undo US sabotage.

Consequently, there is a valid question to be asked about the merits of pursuing this policy in 2024: is it still the best option for Australia to proceed towards implementing the Two Pillar Solution given that the US is threatening to retaliate against Australian-owned companies in the US if Australia does this, and there is a reasonable prospect that these threats will be implemented?

2. Execution of the policy

Next, a submission such as this might then consider the way in which the policy is being expressed in statutory form.

But again, there seems little point:

- most of the detail for implementing the GloBE measures will be contained in the Rules – see, all the items in the Explanatory Memorandum *Attachment 1: Conversion Table* marked as 'Deferred to the Rules'. A preliminary draft of those Rules has been released for public comment, but we note it appears the Rules have not been referred to the Committee by the Senate, and
- more importantly, it is clearly necessary that Australia's legislation conform sufficiently to the OECD's Model Rules that our IIR is a '**qualifying** IIR' and our DMT is a '**qualifying** DMT.' It seems likely the response to suggestions for improvements to the current Bills will be met with the response, 'we can't do that because that's not what the Model Rules say.' Treasury will likely have very little appetite for making modifications to the drafting, a position which is unhappy, but not unreasonable.



3. Matters where there is domestic autonomy

Consequently, this submission will address the few matters in the package of Bills which are entirely at the discretion of the Australian legislature – the items in the Explanatory Memorandum *Attachment 1: Conversion Table* marked as ‘No equivalent’. Most of these measures appear in the *Treasury Laws Amendment (Multinational – Global and Domestic Minimum Tax) (Consequential) Bill 2024* as they are consequential amendments to existing Australian tax laws.

3.1 GloBE tax ‘is not really tax ...’

Items 3-5 and 17-26 of *Treasury Laws Amendment (Multinational – Global and Domestic Minimum Tax) (Consequential) Bill 2024* all reflect an unstated predisposition to treat tax paid under the GloBE rules as not being ‘real’ tax.

This is unprincipled. Australia’s tax system should be even-handed. It should make no difference if a company has paid \$100 corporate tax and \$0 of GloBE taxes *versus* \$0 corporate tax and \$100 of GloBE taxes. In both cases, the company has paid \$100; the rest is mere labelling. And it really shouldn’t affect Australian law where the \$100 GloBE tax conforms to the OECD Model Rules – the foreign country is acting appropriately to do so, and we should respect its efforts, not undermine them.

Item 25 is a good example of this view. It proposes amendments to the hybrid mismatch rules in Div 832, ITAA 1997. Those rules are, in most cases, enlivened by a ‘deduction non-inclusion mismatch’ – an amount is allowable as a deduction to an Australian payer, but the amount is not subject to tax in a foreign country (or Australia) in the hands of the recipient (or its parent company). The regime thus depends on the question: is someone going to be taxed on this payment, given that we are allowing a deduction for it?

Item 25 says, the amount will not be ‘subject to tax’ if the tax being imposed is, a ‘foreign GloBE tax or other foreign minimum tax.’ ‘Foreign GloBE tax’ will be defined in s. 995-1 ITAA 1997 to include a ‘foreign DMT’ which is defined in turn in s. 770-150 to mean a ‘Qualified Domestic Minimum Top-up Tax’ – that is, a domestic top-up tax regime which conforms to the OECD Model Rules.

So the deduction of the Australian payer is in jeopardy if the foreign country chooses to collect \$100 tax under its GloBE tax instead of \$100 under its corporate tax.

Items 3 and 4 display the same view. An Australian company with a subsidiary offshore is liable to pay Australian tax on the (unremitted) profits of the subsidiary where those profits are not subject to (sufficient) tax offshore. If the profits of the foreign subsidiary are subject to (probably, modest) tax offshore, the Australian parent can claim a tax offset for that (modest) tax against the Australian tax it owes. So, the classification of a foreign tax as ‘real’ tax matters in two places: both in deciding whether the foreign subsidiary has actually paid tax (so that the parent is probably immune from immediate attribution); and in deciding whether the parent will get a tax offset for whatever tax the foreign subsidiary has paid.

Items 3 and 4 insist that, ‘foreign GloBE tax [is] not ... foreign tax’. So if the subsidiary has paid \$100 of foreign domestic minimum tax Australian law will not respect that; Australia will say the foreign subsidiary has actually paid nothing.

3.2 Joint and several liability of group members

Item 35 will insert Div 128 into Schedule 1 of the Tax Administration Act. Proposed s. 128-5 provides, ‘if an amount is payable under the *Minimum Tax law by a *Group Entity ... that Group Entity and each other Group Entity ... are jointly and severally liable to pay the amount.’

Proposed s. 128-10 imposes similar joint and several liability in the case of a GloBE Joint Venture – the label used to describe an entity in which an MNE Group holds at least 50%. In the case of a GloBE Joint Venture, the joint and several liability extends to the GloBE



Joint Venture and to any Group Entity that holds an interest in the GloBE Joint Venture. In other words, if 2 groups each have a 50% stake in a company, then every other company in both groups is liable for the GloBE tax debts of the jointly held company and its subsidiaries.

According to the Explanatory Memorandum these provisions are necessary to ensure an MNE Group cannot, 'locate its assets in jurisdictions beyond the reach of the Commissioner ...' but this measure is probably unnecessary given that 147 jurisdictions, including Australia, have signed *Convention on Mutual Administrative Assistance in Tax Matters*. The Convention applies to any 'taxes on income and profits' and extends to assistance in the collection of tax debts. In other words, hiding assets in some foreign country is not a plausible escape route; Australia can ask 147 other countries to collect Australian tax debts for it.

More generally, when a joint and several liability rule was initially proposed for Australia's consolidation regime, it was quickly appreciated that such a rule is just impractical – anyone wanting to buy a small subsidiary from a consolidated group will need to do due diligence on the income tax debts of the entire group. The same problem is apparent here: non-one can be confident when buying a subsidiary that they aren't also buying a GloBE tax liability quite disproportionate to the size of the target. The proposed joint and several liability rules here are even more prejudicial because they apply amongst non-wholly owned entities, raising the risk that minority shareholders in one entity are subject to losses attributable to the tax affairs of the majority shareholder or other entities over which they have no control.

Similar issues arise for lenders in a range of circumstances where the lender has recourse to some, but not all, members of a group, or to only a specific asset pool or stream of cashflows. This is common in project financing structures (for example, used in funding the development of renewable energy projects), and for the securitisation industry which is predicated on securitisation trusts being 'tax neutral'. In each of these circumstances having a borrower potentially exposed to joint and several liability for tax liabilities unrelated to their operations will be very material.

The preferable solution is to leave the liability for unpaid GloBE with each entity and allow the Convention to address the ATO's concern about enforcement. But if joint and several liability is to remain, a solution similar to that found in Div 721 ITAA 1997 to allow a 'clear exit' for entities leaving corporate groups will have to be enacted, and measures will also be needed to protect the interests of minority shareholders and other stakeholders in non-wholly owned entities. Consideration will also need to be given to measures to avoid materially negative impacts on the viability of important financing structures, such as carving out securitisation vehicles which qualify for the thin capitalisation exemption in s. 820-39 for insolvency-remote special purpose entities. They were carved out from the recent thin capitalisation changes, including the new debt deduction creation rule, and should be excluded here. These issues will not be unique to Australia and time should be taken to consider how they are addressed in other comparable advanced economies.

3.3 The integrity rule in Div 832-J

The ALP also took to the last election an express policy to limit, 'the ability for multinationals to abuse Australia's tax treaties when holding intellectual property in tax havens.' The abuse being addressed in the original proposal was a deduction being claimed in Australia at 30% and insufficient tax being paid in the recipient country because of its low tax rate. The remedy was to deny the deduction for the payment to the Australian payer. That proposal was re-stated in the October 2022 Budget and Treasury conducted consultations on the design of the measure. However, in the May 2024 Budget (*Budget Paper No 2*, p. 11) the government announced it would, 'discontinue the measure Denying deductions for payments relating to intangibles held in low- or no-tax jurisdictions announced in the 2022–23 October Budget **as the integrity issues will now**



HERBERT
SMITH
FREEHILLS

3. Matters where there is domestic autonomy

be addressed through the Global Minimum Tax and Domestic Minimum Tax being implemented by the Government.'

The government should take the opportunity of the GloBE regime to repeal Div 832-J ITAA 1997. The abuse addressed in that regime is a deduction at 30% being claimed in Australia for interest expense, and tax at 10% or less being imposed on the interest income in the recipient country. The remedy was to deny the deduction for the interest payment to the Australian payer. In other words, it is the same issue.

The GloBE regime is sufficient to obviate the need for the intellectual property regime; it is also sufficient to obviate the need for the interest regime.

* * * * *

Please feel free to contact the authors if any of this is unclear or requires further elaboration.

Yours sincerely

Graeme Cooper
Consultant
Herbert Smith Freehills

[Redacted signature]
[Redacted contact information]

Ryan Leslie
Partner
Herbert Smith Freehills

[Redacted signature]
[Redacted contact information]

Herbert Smith Freehills LLP and its subsidiaries and Herbert Smith Freehills, an Australian Partnership ABN 98 773 882 646, are separate member firms of the international legal practice known as Herbert Smith Freehills.