November 1, 2022

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Re: Comment Letter on the Global agreement on corporate taxation: addressing the tax challenges arising from the digitalisation of the economy

The National Foreign Trade Council (the "NFTC") and the Information Technology Industry Council ("ITI") are pleased to provide written comments on the Australian Treasury's consultation paper – *Global agreement on corporate taxation: addressing the tax challenges arising from the digitalisation of the economy* published on October 4, 2022 (the "Consultation Document").

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. ITI is the premier global advocate for technology, representing the world's most innovative companies. We promote public policies and industry standards that advance competition and innovation worldwide.

Our respective 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. The NFTC and ITI appreciate the opportunity to provide written feedback on the Consultation Document, especially on its approach to implementation and welcome continued engagement in the future. We cannot emphasize enough the importance of regularly consulting with the business community to ensure that outcomes are ones with which taxpayers and tax authorities can consistently and easily comply.

This is especially relevant given that negotiations are ongoing for Pillar 1 and the Inclusive Framework ("IF") is actively developing the GloBE Implementation Framework. Not only will there be interactions between the two pillars, but companies will be undertaking significant and

time-consuming system changes to administer these fundamental reforms to the global tax system.

We provide specific feedback on a few of the questions posed in the Consultation Document:

1. What are your views on the challenges facing the international tax system and what role do you see for the two-pillar multilateral solution to the tax challenges arising from digitalisation?

We understand that multilateral challenges need multilateral solutions, and specifically solutions that provide certainty and stability in the international system.

The IF's Pillar 2 rules are designed to operate as a common approach, with each jurisdiction translating these provisions into their respective domestic law. However, the benefits derived from taking a common approach begin to fall apart if jurisdictions adopt conflicting or inconsistent implementing legislation and regulations. Such fragmented implementation will lead to double taxation and needless disputes. Treasury should resist any temptation to 'clarify' the operation of the Model Rules through its own drafting or 'gold plate' the Model Rules. For such reasons, we encourage Treasury to work with its counterparts to ensure that respective implementations are taking into account ongoing analysis of recently published documents (such as the Commentary) and the significant amount of time and resources it will take for companies to design, build, and test internal compliance systems.

The IF intends for Pillar 1 to address the uncertainty and instability caused by the proliferation of digital services taxes and relevant similar measures, which undermine the design of the longstanding international tax system. We strongly encourage the Australian government to refrain from advancing other unilateral tax approaches that would contravene globally accepted tax norms and principles, especially given the breadth of past and ongoing efforts to develop a multilateral approach in the Two-Pillar Solution.

5. What are the major areas of Pillars One and Two that are likely to generate uncertainty for your business? How could that uncertainty be best addressed?

Significant uncertainties exist in the following areas:

Application of UTPR with respect to existing tax treaties

The UTPR as laid out in the Report on Pillar 2 Blueprint required a payment nexus between the disallowed deduction and the taxing right asserted by the taxing jurisdiction. Taxation under the UTPR as envisioned by the Model Rules where there is no payment nexus may conflict with Australia's obligations under existing treaties. Relevant provisions include the business profits clause's (Article 7 of the OECD Model Tax Convention) limiting taxation rights to profits that arise in the jurisdiction; the Associated Enterprises Clause's (Article 9 of the OECD Model Tax Convention) limiting arm's length adjustments between associated enterprises to transactions between the contracting state and the other contracting state; Article 24(5)'s non-discrimination provisions requiring that taxation in one state may not be more burdensome than taxation in

another state (which is particularly relevant where there is not a critical mass adoption, including by the largest economies such as China, the U.S., or India); and Article 23 which seeks to avoid double taxation. With respect to Article 23, inconsistent application of the GloBE rules amongst adopting jurisdictions (particularly as each adopting jurisdiction may overlay domestic law principles into GloBE) will likely lead to double taxation.

It is unclear by what mechanism such disputes would be resolved (MAP, as currently designed, does not address disputes between more than two nations with respect to an item of taxation). The question arises as to whether Australia's existing treaty framework with significant trade partners is sufficient to implement these rules as they are written, or if a multilateral instrument would be required in order to successfully implement the UTPR and any related dispute resolution mechanism.

Domestic law overlay

While the GloBE Model Rules seem to envision the hierarchy of taxing rights as the QDMTT, the IIR, and then the UTPR, it does not address how disagreements amongst states may function in the event that states do not agree to a specific characterization of a transaction. As states adopt legislation that interacts with domestic principles (e.g., General Anti-Avoidance Rules ("GAARs"), anti-hybrid rules, CFC regimes, etc.), disagreements amongst states on the application of the GloBE rules are not only possible but highly likely, and with no clear method of dispute resolution. To the extent Australia adopts the GloBE rules, careful consideration should be given to ensuring that Australia does not challenge a jurisdiction's primary taxing right under either a QDMTT or IIR by overlaying domestic principles to assert a right under the UTPR. Inconsistent interpretations of GloBE rules amongst implementing states could result in significant instability in the global tax system, and governments' interpretations over time are likely to impact investment decisions. Australia should therefore strongly consider adopting the Model Rules as written without an overlay of other domestic tax concepts (e.g., anti-hybrid, MAAL, GAAR, etc.)

Pillar 2 interaction with GILTI

Recognizing the U.S. Global Intangible Low-Taxed Income regime ("GILTI") as a compliant QDMTT or IIR is critical to prevent uncertainty from a U.S. taxpayer perspective. Without GILTI's deemed compliance, the likelihood of double taxation and other negative impacts significantly increases for U.S. groups with operations in Australia and other adopting jurisdictions. Further, in the event that GILTI is viewed as non-compliant, there remains significant uncertainty around or how the CFC rules would allocate GILTI taxes to CEs, the application of the passive income limitation rules, and the position of GILTI in the hierarchy of taxing rights (i.e., before or after the QDMTT).

6. How do you think Pillars One and Two may impact investment decisions in Australia relative to the rest of the world?

The significant uncertainties surrounding Pillar 2 in particular (as well as lack of global consensus on Pillar 1), could impact investment decisions made in particular countries, particularly around domestic tax incentives (e.g., in the U.S., the R&D tax credit).

Further, inconsistent application of the UTPR, as interpreted under local law principles, could – if interpreted in an aggressive manner – disincentivize businesses from having either property or payroll in a jurisdiction to avoid the potential double taxation resulting from the application of an aggressive interpretation of the UTPR.

9. What challenges do you foresee with the OECD timelines, which have Pillar Two coming into effect in 2023 and Pillar One coming into effect in 2024?

Rushing the implementation of Pillar 2 would result in dramatic uncertainties for multinational companies and tax authorities. To the extent Pillar 2 is adopted, it should be done so no earlier than the delayed timeline of IIR implementation in 2024 and UTPR in 2025 to ensure at least a modicum of coordination between implementing jurisdictions. With the exception of Korea's proposed approach, implementing legislation introduced in other jurisdictions is aligned with the EU's proposed implementation of IIR in 2024 and UTPR in 2025. With respect to Pillar 1, considering the requirement for changes in treaty obligations and the fact that many design issues are still being released for public consultation, we urge Australia and other participating governments to focus on making Pillar 1 administrable and durable as possible, and to ensure a future date for implementation incorporates sufficient time for taxpayers and tax authorities to prepare accordingly.

11. What interaction issues could arise between Pillar One and Pillar Two, and other Australian or foreign tax laws? How should these interactions influence the way Australia implements the two-pillar multilateral agreement?

One requirement for the GloBE Model Rules that is particularly applicable to cross-border transactions is that the tax laws of the jurisdiction in which the acquiring CE is located require the acquiring CE to compute taxable income after the disposition or acquisition using the disposing CE's tax basis in the assets. While this rule appears to have been designed to avoid step up transactions, the rule does not take into account that each implementing jurisdiction has its own way of calculating basis, and that any base differences are likely to result in failing the GloBE reorganization test, even when there is a step down in asset basis (e.g., differences in treatment of goodwill, going concern, or even depreciable assets). Unless there is global consensus on calculating asset basis in cross-border reorganizations, any local country reorganization rule (including Australia's) is likely to be frustrated as a result of this broad rule even in situations where there is no abuse (i.e., no step up in overall asset basis).

Further, Australia's recently issued Budget includes the proposal to deny tax deductions for payments made by SGEs to related parties in relation to intangibles held in jurisdictions with less than a headline tax rate of 15%. By doing so, Australia would be inherently frustrating the Pillar

2 rules and creating double taxation. The proposal also does not appear to take into account the effective tax rate paid in that jurisdiction. Inconsistencies between Australia's approach (statutory tax rate) and the Pillar 2 approach (effective tax rate taking into account all covered taxes) will inherently result in double taxation whereby the additional tax Australia collected on the disallowed deduction would not be allowable as an offset or credit against the jurisdiction receiving the royalty payment (as it would create additional covered tax in Australia, despite being economically equivalent to a WHT on the recipient). We urge Australia to reconsider whether the disallowance of royalty deductions on the basis of statutory rate is appropriate in a world where Pillar 2 is widely adopted.

Finally, Australia must be cautious in overlaying its own domestic GAAR or other recharacterization provisions on top of the Pillar 2 rules when applying the UTPR, as it will result in needless disputes with no clear dispute resolution mechanism.

14. Do you have any suggestions relating to implementation of Pillar Two that could help minimize your compliance costs?

Consistency with the GloBE Model Rules

The most important factor in minimizing compliance costs is to refrain from any deviation with the GloBE Model Rules. The summary of impacts previewed future evaluation of what is likely to be an increase in the compliance and administration burden on those businesses affected as a result of Pillar 2. The compliance costs and complexities will likely increase if Australia imposes an effective date of the GloBE Model Rules before there is clear guidance from the International Accounting Standards Board and the United States Financial Accounting Standards Board. Such accounting guidance is critical for the accurate reporting of financials for multinational enterprises, but also for tax provision reporting, which could occur quarterly or monthly before a final tax return is filed. We are concerned that the administrative burden will be significant, including for groups who owe nothing additional as a result.

Harmonized implementation date

A harmonized implementation date with sufficient transition time will also be critical to minimizing compliance costs for taxpayers and tax authorities. Tax authorities and business cannot begin to plan, design, test, and implement the requisite costly and time-intensive IT system changes for tax and financial reporting until they know what the rules are. Existing ambiguities in the rules mean that it is not possible to commence work to design the necessary modifications, so a future effective date should provide adequate time to complete this work. Beyond immediate compliance concerns, MNEs would need to have the changes in place shortly after the commencement date to reflect the impact of the new rules in their impact analysis for external reporting purposes. Thus, as governments look to implementation, we recommend delaying the currently anticipated implementation date of January 1, 2024, as the lack of certainty and finality around these rules do not provide adequate time for MNEs to build the

infrastructure needed for such reporting and tax authorities to process such information.

Safe harbours

Development of broad, simple, and administrable safe harbours is vital to the administrability of the GloBE rules and to the ability of MNEs to manage the overwhelming complexity and additional compliance posed by the rules. The delay in releasing the safe harbours may significantly impede the ability of MNEs to implement the systems and process changes necessary to meet the accelerated implementation and compliance timeline.

To reduce complexity, we suggest the establishment of safe harbours that would exempt certain jurisdictions from performing GloBE calculations if it is clear the ETR will be above the global minimum rate of 15 percent. It would provide significant simplification if companies were excused from performing the extensive documentation requirements for profits from jurisdictions that are clearly above the minimum ETR. As a complement, administrative guidance could be used to identify jurisdictions in which the tax rates are above the minimum rate and it is clear that the minimum ETR is achieved.

Economic analysis

We strongly encourage conducting analysis on the impacts and welcome the opportunity to support Treasury's efforts in that respect. In our respective responses to the Secretariat's December 2020 consultation on the Blueprints, we expressed concerns about the effectiveness of the OECD's Economic Impact Assessment because it relied on 2016 data that does not account for the implementation of BEPS reforms, nor the changes implemented as part of the 2017 U.S. tax reform. The recent introduction of a qualified minimum domestic top-up tax and other design points further demonstrate the need for an updated impact assessment. Treasury should therefore conduct an impact assessment incorporating data that reflects adoption of these reforms and design decisions. Using empirical data would make for a particularly robust assessment.

16. If any of your related companies is a resident in a jurisdiction that does adopt the Global anti-Base Erosion (GloBE) Model Rules, do you consider that your compliance burden will be largely the same whether or not Australia adopts these rules?

The additional compliance burden will be largely related to how the GloBE rules are implemented in each jurisdiction. If Australia and the other resident jurisdiction both implement the Model Rules, we would expect that this would minimize the additional burden. However, if either jurisdiction deviates from the Model Rules or requires additional information or filings, the burden will increase. Should jurisdictions in which an MNE operates implement diverging interpretations of GloBE Model Rules, the burden would potentially be unmanageable. Thus, if Australia adopts the Model Rules domestically, we strongly urge Australia to implement the Model Rules without any deviations, and to advocate for other jurisdictions to do the same.

17. Do you have any comments on how Australia should implement the GloBE Model Rules into domestic law?

As discussed in response to Questions 1, 2, 5, 11, and 16, we strongly urge that Australia's domestic implementation should not (i) deviate from the GloBE Model Rules; nor (ii) require reporting before accounting standards for the GloBE rules have been issued by the U.S. Financial Accounting Standards Board and the International Accounting Standards Board.

19. Do you have any comments on Australia's timing of adoption of the GloBE Model Rules, including any advantages or disadvantages of being an early/late adopter? What challenges do you foresee if the GloBE Model Rules were to commence in 2023 as proposed under the OECD timeline?

As noted in response to question 14, we strongly encourage participating jurisdictions to identify a harmonized implementation date for the GloBE rules in order to reduce uncertainty and minimize compliance costs.

Conclusion

The NFTC and ITI appreciate the opportunity to comment on the proposals outlined in the Consultation Document. We look forward to continuing opportunities for constructive engagement as the OECD/G20 Inclusive Framework finalizes the GloBE Model Rules and Australia implements those rules.