Multinational tax integrity and tax transparency

FSC Submission

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FSC FINANCIAL SERVICES COUNCIL

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1 About the Financial Services Council

The FSC is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advice licensees. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing more than $3 trillion on behalf of over 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is one of the largest pool of managed funds in the world.

The FSC's mission is to assist our members achieve the following outcomes for Australians:

- to increase their financial security and wellbeing;
- to protect their livelihoods;
- to provide them with a comfortable retirement;
- to champion integrity, ethics and social responsibility in financial services; and
- to advocate for financial literacy and inclusion.

2 Introduction and summary

The FSC thanks Treasury for the opportunity to provide a submission on the *Multinational tax integrity and enhanced tax transparency Consultation Paper* (**The Consultation Paper**).

The FSC acknowledges the Government's commitments made in 2022 to make a range of changes relating to the taxation of multinationals, following the OECD's Base Erosion and Profit Shifting (**BEPS**) program.

The FSC supports the Government's stated objectives of these policy changes to target activities deliberately designed to minimise tax, while also considering the need to attract and retain foreign capital and investment in Australia, limit potential additional compliance cost considerations for business, and continue to support genuine commercial activity.[1]

We also submit there is an additional objective, namely consistency with the measures announced by the Government during the 2022 election. The FSC's comments in this submission are aimed at ensuring these objectives are achieved.

The FSC submits that the measures in this paper should be viewed in the context of the ongoing OECD work on the 'two pillar' proposals to address tax challenges of the digitalising economy, including positions that have already been agreed at the OECD level.

[1] Consultation Paper, page 4.

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Given the Government's stated goals and the OECD work, the FSC submits the measures should be appropriately limited in their scope, in particular the FSC recommends the measures should not apply to collective investment vehicles (managed investments) because these vehicles are meant to be 'tax neutral' – so that investors are not subject to additional tax merely because they used one of these vehicles. A direct investment in a share should be treated no differently from an investment in the same share through a collective investment vehicle. This approach to the tax treatment of collective investments is consistent with the OECD approach to BEPS measures.

As a result, the measures considered in this paper should not apply to collective investments, otherwise the 'tax neutrality' of collective investments could be lost. The FSC also submits that CIVs being 'tax neutral' means the Government's disclosure measures are not needed, as CIVs are, by their nature, not meant to pay tax and so disclosure of this 'tax neutrality' is not required, and would give a misleading view that there is something unusual about a tax approach that occurs by design.

The FSC submits there should be a permanent exclusion relating to life insurers from the measure limiting interest deductibility. The FSC recommends this permanent exclusion given the prudential rules that already limit the ability for insurers to use debt, the unique way that interest is used in financial services, and the long-term movements in underlying profitability for life insurers that would cause problems for the application of the measure.

To the extent the limit on interest deductibility does apply, the FSC submits there should be carryforward of denied interest deductions, exclusions for businesses without global operations, clear definitions of amounts used in the measure, and a number of other technical changes to ensure the measure works appropriately.

The FSC submits that the royalty measure should be focussed on the stated intent of limiting treaty abuse relating to intellectual property located in tax havens and should not have a broader reach.

The FSC recommends disclosure of country-by-country reports should be based on agreed overseas precedents, and there should not be bespoke Australian approaches. The FSC submits that the disclosure measures should only apply to Australian listed entities, excluding Exchange Traded Funds, and should take careful note of existing accounting standards that require disclosure of tax risks.

The FSC further submits that the tax risk measure should not be based on ATO administrative guidance, as this guidance does not have the force of law, and any disclosures would likely be viewed without the essential context provided by the underlying ATO guidance.

In support of excluding collective investments from the tax risk measure, we note that the 'tax neutral' nature of collective investments would mean disclosure be misleading – these structures should not be paying tax regardless of the country they are located in; and lower tax on these structures can mean more tax is paid in the country of the final investor (eg in Australia). For life insurers, the FSC notes specific measures result in Australian tax being

paid on reinsurance profits that relate to Australian risks, removing the need for particular focus on any offshore location of reinsurance.

The FSC recommends further consultation on the details of the measures, including transitional/grandfathering rules and reporting standards.

Finally, the FSC recommends that, for taxpayers with substituted accounting periods, the measures should not start any earlier than 1 July 2023.

3 Coverage of measures

The FSC seeks confirmation that the general target of these measures is Significant Global Entities (**SGEs**) that are general trading businesses.

The FSC recommends that the measures do not apply to collective investment vehicles, which are the entities that manage and invest money from underlying investors and on their behalf. In the Australian context, collective investments include Managed Investment Trusts (**MITs**), Attribution MITs (**AMITs**), Corporate Collective Investment Vehicles (**CCIVs** – including CCIV sub-funds) and can include other trusts.

The collective investment vehicles (**CIVs**) listed above are usually 'tax neutral', meaning they are not meant to be taxpayers – instead the tax is paid by the investments of the fund and the end investor. This approach to taxation ensures that there is not a double taxation of the returns on investments, and (broadly) an investor is taxed in the same way if they make a direct investment in a share, or if they invest indirectly in the same share through a CIV.

The tax system in Australia generally delivers tax neutrality for CIVs because CIVs are only subject to tax in very limited circumstances. These circumstances can be where income is not fully distributed or attributed to unitholders/members; or for AMITs, where there has been an over attribution of franking credits to members in a previous year that could not be fully absorbed in the current year. However, these circumstances are unusual and in almost all cases Australian CIVs are effectively tax neutral.

The OECD has recognised the principle that CIVs should be tax neutral.[2] For example, see paragraph 22 of Commentary to Article 1 of the OECD Model Tax Convention of November 2017,[3] and the European Commission has recognised this in The Notice on State aid, Paragraph 161 and following.[4] In the latter document, the EC states that tax neutrality for CIVs is a way of "reducing or eliminating double economic taxation in accordance with the overall principles inherent to the tax system".

[2] Tax neutrality for a CIV means the CIV is fiscally transparent; the CIV is tax exempt; or the CIV is subject to low or minimal tax rate.
[3] https://www.oecd.org/ctp/treaties/model-tax-convention-on-income-and-on-capital-condensed-version-20745419.htm
[4] https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016XC0719(05)

Given the tax neutrality of CIVs in Australia, the FSC submits it is not warranted to apply the measures in the Consultation Paper to CIVs because they are not meant to be taxpayers, and measures that treat them as though they are taxpayers are inappropriate.

In addition, the FSC notes:

- Any proposals to increase the taxation of Australian CIVs could easily result in reduced tax paid by underlying Australian investors, as the tax paid by the CIV would often be creditable to the underlying investor. As a result, the net impact on overall tax revenue would be zero or close to zero. The CIV would have had a large increase in compliance costs for negligible tax revenue impact.
- Australian CIVs overwhelmingly have Australian residents as underlying investors, and largely do not have overseas investors.[5] As a result, Australia's significant expertise in investment management is not being exported to the rest of the globe. To address this shortcoming, an expressed Government policy is to encourage increased overseas investment into Australian CIVs – and this was one of the main reasons for the recent introduction of the CCIV regime. An increase in tax, potential increase in tax, or increase in tax compliance costs, for Australian CIVs would discourage foreign investors from using Australian CIVs, as our CIVs would become less competitive compared to CIVs in other countries.
- An increase in tax or tax compliance costs for multinational businesses operating in Australia will discourage global businesses (including fund managers) without an Australian presence from expanding into Australia. This will decrease choices for Australian consumers, decrease the innovation that global businesses can bring, and decrease competition in Australia.

For clarity, the FSC submits the measures should not apply to Corporate CIVs, or CCIVs, even though CCIVs are a type of company, and the measures should not apply to any CIV even if the CIV is part of an SGE. These two exclusions will ensure that collective investments are treated consistently, regardless of whether or not they are CCIVs or part of an SGE.

In comparison with the CIVs listed earlier, superannuation funds can pay tax on behalf of the end investor, so they are not 'tax neutral'. However, super funds still invest collectively on behalf of underlying investors, and the FSC has concerns about applying the measures to superannuation funds – these concerns are discussed under the individual measures as appropriate.

The FSC **recommends** that the measures in the Consultation Paper should not apply to collective investment vehicles, including superannuation funds and Corporate Collective Investment Vehicles (CCIVs). The existing rules should continue to apply to these structures.

[5] The latest ABS data indicates approximately 5.1% of funds invested in Australian domiciled managed funds are sourced from foreign investors, see Table 1 of ABS Managed Funds, Australia, March 2022.

4 Interest deductibility

The fixed ratio rule proposed in the Consultation Paper reflects work of the Organisation for Economic Cooperation and Development (**OECD**), particularly Action 4 of the Base Erosion and Profit Shifting (**BEPS**) project. As part of this approach, the OECD recommended a limitation on net interest deductions to 30 per cent of Earnings Before Interest, Taxes, Depreciation, and Amortisation (**EBITDA**).

In developing this proposal, the OECD acknowledged that a different approach would be more appropriate for financial entities, an approach the FSC supports. Consequently, the FSC also supports the proposal in the Consultation Paper that the interest deductibility measure should not apply to financial entities.

However, we note that the definition 'financial entity' in the current thin capitalisation rules does not include APRA-regulated insurers by default. The coverage of insurers is considered in Section 4.3 below.

4.1 Interim application

We note that the Consultation Paper states that this measure will not apply to financial entities "in the interim" (page 6). This qualification suggests that the measures should apply, or will apply, to financial entities in the longer term. The FSC does not consider a case has been made for this longer term change, and submits that there should be further discussions with the industry before any change is considered.

The FSC **recommends** the exemption from the interest deductibility measure for financial entities should be permanent and should not be an interim exclusion only.

4.2 Application to collective investments

The arguments against applying the interest deduction limitation to CIVs defined broadly are outlined in Section 3 above, in particular the substantial added complexity with negligible impact on tax revenue; and the further discouragement of the use of Australian CIVs compared to overseas CIVs. In addition, we note:

- Many CIVs, including superannuation funds, would ordinarily be net recipients of interest income, meaning the appropriateness of EBITDA as a measure is unclear, while it is unclear how to adjust EBITDA so it becomes an appropriate measure.
  - For a bond fund, EBITDA might be meaningless because interest would be all or nearly all of their usual earnings. Both the numerator and denominator in the calculation will be essentially meaningless.
- For these CIVs that are usually net interest recipients, the interest deduction limitation would only apply in unusual circumstances where the net interest income became a net loss – and EBITDA could be zero or negative at the same time.
- The inappropriateness of EBITDA for CIVs will not be addressed by the solutions for general corporates discussed in Section 4.4 below (for example permitting carryforward). As a result, the measure remains inappropriate for CIVs, including super funds, even if the issues for general corporates are addressed.

The FSC **recommends** that the interest deductibility measure should not apply to collective investment vehicles, including CCIVs and superannuation funds.

4.3 Application to insurers

While the Consultation Paper states that 'financial entities' should be excluded from the measure, the definition of 'financial entity' in the current thin capitalisation rules does not automatically include APRA regulated insurers. Therefore, the existing thin capitalisation safe harbour rules specific to financial entities do not apply to insurers, although in practice insurers would generally satisfy the general safe harbour debt amount (that is, 60 per cent of the average value of the insurer's Australian assets). This is because insurers are already subject to regulatory capital requirements which impose minimum amounts of equity, restrict their ability to place debt in certain entities, or to use debts for funding equity investments in subsidiaries and so on.

These prudential rules limit the ability of insurers to gear, and so these rules effectively act as a restriction on the ability to claim tax deductions for debt. In this context, there is no need for an additional restriction on debt deductions when the APRA rules achieve this outcome already.

A decision to exclude insurers would be consistent with the OECD's comments on BEPS Action 4 that a fixed ratio rule is unlikely to be effective for insurers because:

- Insurers typically have net interest incomes rather than net interest expenses, but the fixed ratio rule only operates to limit net interest expenses.
- Interest income is usually a major part of an insurer's revenue which implies that EBITDA would not be a suitable measure for economic activity across a group in the insurance sector. Similar to the point made about CIVs above, the appropriateness of using EBITDA in a fixed ratio rule for insurers is unclear.
- There is a fundamental difference in the nature and role of interest in the insurance sectors as compared to most other businesses.
- Insurers are typically subject to strict regulations which impose restrictions on their capital structure. This reduces the BEPS risks from insurers that the BEPS Action 4 seeks to address.

There are important additional problems with applying this rule to insurers:

- Life insurers are subject to large and sustained movements in profitability, and hence EBITDA. These movements may persist for some time. As a result, EBITDA would appear to be much higher than the long term trend in some years, and much lower in other years. Insurers would be unreasonably restricted from using debt deductions in the years with low EBITDA, even though their long-term EBITDA may be much higher.
  - Any disallowed interest deductions in a period of low EBITDA would merely reflect timing differences which will correct in a future period, and are likely to result in double taxation if the lender is taxed on the corresponding interest income.

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    - This issue might be partly addressed by averaging and/or carry forward (see Section 4.4.1 below). However, adding these changes would add substantial complexity which the FSC submits is unwarranted, given the prudential regulations that address the risk of excessive interest deductions as argued above.
- Insurers usually are net recipients of interest income, but an insurer can sometimes incur net interest expense, such as in times where there is significant local market uncertainty. If an Australian insurer is part of a multinational group, the overall group may be net recipient of interest income, but the domestic business may incur net interest expenses – in these situations the fixed ratio and group ratio rules would not work for the domestic business as the global group is in a 'net interest income' position.

The FSC also notes there is significant tax legislative precedents for providing special regimes for both banks and insurers, in recognition of their prudential regulation by APRA. For example, regulation 974-135F in the debt/equity rules cater for tier 2 capital instruments issued by both insurers and banks, and section 207-158 in the imputation rules caters for additional tier 1 capital issued by banks and insurers.

The FSC **recommends** that there be an ongoing exclusion from the interest deductibility measure for prudentially regulated insurers.

4.4 General comments

As recommended above, the FSC considers the interest deductibility test should not apply to CIVs or life insurers, and this approach should apply on an ongoing basis (not on an 'interim' basis).

To the extent the measure applies to FSC member businesses, the FSC submits that a number of changes to the measure are warranted as outlined below.

4.4.1 Carry forward

The FSC submits it is essential that any denied interest deductions should be able to be carried forward to future years with no limit on the carry forward period. In addition, carry forward should be permitted for excess capacity (the income years where net interest expense is below 30% of EBITDA). The option of carry back should also be explored, but on an optional basis, as a carry back rule may cause issues for trusts that are not AMITs.

Most countries that have adopted the OECD recommendations in BEPS Action 4 have also brought in the ability to carry forward unused interest deductions for use in future years where there is excess capacity in order to address the issue of earnings volatility.

The FSC **recommends** that both denied interest deductions and excess capacity be able to be carried forward to future income years.

4.4.2 Calculation of EBITDA

The FSC submits that entities subject to this measure should be provided with an option to use accounting measures or tax measures to calculate EBITDA:

- The accounting measure of EBITDA would generally be easier to calculate. If this measure is used, it should specifically include other items permitted in accordance with the accounting standards, such as asset revaluations. The differences in accounting and tax consolidation rules would need to be considered.
- If instead a tax EBITDA measure is used, the FSC submits that this should be calculated by adding or subtracting specific amounts already calculated for a tax return in order to reduce compliance costs (instead of requiring bespoke calculations that were not already done for the tax return).

The FSC also requests the key concepts used in the proposed fixed ratio rule, such as EBITDA, net interest expense and net debt deductions be defined clearly because this is a 'bright line' test. The FSC furthermore recommends the meaning of 'interest' (for both income and expense) be clarified and defined with some specificity:

- does it include all gains and losses from interest-bearing securities and financial arrangements?
- does it include foreign exchange gains and losses relating to interest or principal?
- does it include amounts 'in the nature' of interest?
- does it include borrowing costs?
- does interest income include interest and the amounts noted above when they are derived indirectly through trusts (see further discussion in Section 4.4.6 below – the FSC submits that it should).

The FSC **recommends** that entities be provided with the option of using tax or accounting methods to calculate interest/EBITDA. If accounting measures are used, this should allow adjustments permitted by accounting standards. If tax measures are used, this should be calculated using specific amounts already calculated for a tax return.

The FSC **recommends** that the definitions of key used in this measure be defined clearly given the fixed ratio rule is a bright line test.

4.4.3 Arms' length debt test

The Consultation Paper (see pages 9–10) suggests that there will be changes to the arm's length debt test (**ALDT**). The FSC submits any change to the ALDT would go over and above the Government's announcement which was to keep this test.

The FSC submits that the ALDT does not permit BEPS practices to occur. The ALDT allows taxpayers to demonstrate in their specific circumstances that their debt levels and interest deductions are commercial and not excessive. In order to rely on the ALDT, taxpayers have the burden of proof to demonstrate that gearing levels are within levels acceptable to arm's length lenders. Advice is obtained by taxpayers, and positions adopted are auditable by the ATO. Therefore, the FSC supports the retention of the ALDT.

Further, the FSC notes that the Board of Tax in its report to the then Government on the ALDT recommended changes to the ALDT to make the test more workable and easier to comply with.[6] The FSC supports these recommendations.

The FSC **recommends** that the arms' length debt test (ALDT) be retained in the event that a fixed ratio rule is introduced. The FSC also supports the Board of Tax's previous recommendations on reducing compliance and administration costs associated with the ALDT.

4.4.4 Application to corporate groups

Under the current thin capitalisation rules, any excess debt capacity of an associate entity can be 'rolled up' to the parent entity for the purposes of calculating the safe harbour debt amount or worldwide gearing debt amount of the parent entity. However, the introduction of the proposed fixed ratio rule makes it uncertain whether any excess debt capacity or unused interest deduction capacity can be transferred between associate entities in a corporate group. For example, in a group where the parent entity is a general entity and therefore subject to the fixed ratio rule and an associate entity is a financial entity and therefore excluded from the fixed ratio rule, any excess debt capacity at the associate entity level cannot be 'rolled up' to and utilised by the parent entity because it is subject to a different set of rules for thin capitalisation purposes.

Accordingly, the interaction of the current thin capitalisation rules and the proposed fixed ratio rule (and group ratio rule) needs to be appropriately designed to ensure the two sets of rules interact well within a corporate group containing both general and financial entities.

The FSC **recommends** that any excess interest deduction capacity of an associate entity can be 'rolled up' to the parent entity.

4.4.5 De minimis (Question 6)

This relates to question 6: Would the existing $2 million de minimis threshold be an appropriate threshold for the fixed ratio rule, to exclude low-risk entities?

Apart from the $2 million de minimis threshold, we recommend the existing 90% Australian asset threshold test under section 820-37 of the Income Tax Assessment Act 1997 to be retained as a threshold test for the fixed ratio rule. This exemption excludes entities that have low BEPS risks because of the domestic nature of their operations.

The FSC **recommends** that the existing 90% Australian asset threshold test be an additional threshold test for the fixed ratio rule.

The FSC also submits this threshold test should be considered for use in other components of the multinational tax measures, to ensure the measures are genuinely targeted at multinationals rather than Australian businesses with *de minimis* overseas operations. See in particular Section 6 below.

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[6] See: https://taxboard.gov.au/consultation/thin-capitalisation-arms-length-debt-test

4.4.6 Maintenance of character through trusts

The OECD acknowledges that a best practice approach to address BEPS using interest expense should apply to interest on all forms of debt, payments economically equivalent to interest and expenses incurred in connection with the raising of finance.

It is common for insurers (and groups in other sectors) to hold investments in managed funds in the form of trusts. For example, a group may invest in a debt fund which generates interest income from lending to other entities. Where the group is presently entitled to distributions (from Division 6 trusts) or attributed distributions (from AMITs), these distributions are legal form trust income for financial reporting purposes. As such, if the net interest expenses are calculated based on unadjusted financial reporting figures, it may overstate the group's net interest expenses, by understating its interest income in the form of trust distributions.

Accordingly, the FSC recommends that for the purposes of calculating net interest expenses on which the group ratio rule or fixed ratio rule is applied, distributions from trusts should retain their tax character, that is, interest income flowing through from trust distribution should be included in calculating the net interest expenses.

The FSC **recommends** that the interest deduction rules correctly include amounts distributed or attributed by a trust in relevant calculations for the interest deduction measure.

5 Royalty measure

The FSC submits there are important questions about this measure. The Consultation Paper has not explained the need for these measures, as the Paper suggests existing rules already address the perceived issues with royalties (see pages 11–12) but then suggests a new rule for royalties regardless. This appears to go beyond the Government's announcement about a measure relating to "the ability of large multinationals to abuse Australia's tax treaties while holding intellectual property in tax havens."[7]

The Paper does not clarify the mischief the proposed royalty rule is targeting and why existing rules do not suffice, and why there is a need for a specific rule for intangibles. There are Taxpayer Alerts relating to royalties, but the alerts are highly targeted at specific situations and the Paper does not explain why the Alerts are a sound basis for a new rule.

It is also unclear why the Paper suggests the measure could potentially apply to arm's length third party transactions. As noted in the section on the ALDT (Section 4.4.3 above), it is unclear how there can be any mischief with an arm's length transaction.

In addition, we have concerns about the meaning of 'embedded royalty' as this is very broad and could cover potentially anything that has any IP embedded in it, including potentially all service contracts. The Consultation Paper considers this definition: "any amount in respect of rights over intangibles which enable, facilitate, or promote Australian sales (in relation to

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[7] See: https://alp.org.au/policies/labors-plan-to-ensure-multinationals-pay-their-fair-share-of-tax

services, goods, or other property) directly or indirectly" (page 14). This proposal on the face of it appears to be very broad and could, as noted, cover all service contracts.

If this measure is to apply, the FSC submits it should not apply to collective investment vehicles, see Section 4.2 above, including CIVs that are included in an SGE.

The FSC **recommends** the Government limit the measure to the stated intent of limiting the ability of multinationals to "abuse Australia's tax treaties while holding intellectual property in tax havens", and explain why existing rules are not adequate for dealing with concerns.

The FSC **recommends** any measure relating to royalties should not apply to collective investment vehicles, including CCIVs, superannuation funds, and CIVs that are included in an SGE.

6 Tax disclosure measures – general

This section relates to Question 2. How should large MNEs be defined for the purpose of enhanced public reporting of tax information? Would the Significant Global Entity definition be appropriate to use?

The FSC notes that the Australian SGE definition has moved beyond what was contemplated in the OECD's Country by Country (**CbC**) reporting regime and is different from the approaches to defining a multinational group in the Pillar Two Model Rules. For example, Australia's SGE definition can apply to a single entity without a foreign group member or foreign permanent establishment, whereas the Model rules for Pillar Two require a Multinational Entity (**MNE**) Group to include at least one other entity or permanent establishment in another foreign jurisdiction. We note that the EU Directive of 2021 applies to MNEs that are **active** in more than one EU member state.

Given this, the FSC considers that any new disclosure measures, or any other reforms aimed at MNEs, are consistent with the Pillar Two definition of an MNE Group as by definition an Australian entity or group with a purely domestic focus and no foreign subsidiaries or permanent establishments is not a multinational. The FSC submits the SGE definition should not be used.

One additional approach that could also be used (in addition to the Pillar Two definition above) is to use the 90% Australian asset ratio formula for the Australian group as set out in paragraph (c) of subsection 820-37(1), as mentioned in Section 4.4.5 above.

The FSC **recommends** that measures are consistent with the Pillar Two definition of an MNE Group, and therefore should not apply to entities with a purely domestic focus.

The FSC **recommends** the SGE definition should not be used. The current 90 per cent Australian asset ratio formula used for thin capitalisation purposes could be included as an additional test for the Australian group.

7 Disclosure of country by country reports

The FSC reiterates that we do not consider this measure should apply to collective investment vehicles – see Section 4.2 above.

To the extent the measures do apply, the FSC recommends that the CbC disclosures be based on agreed overseas precedents and not be bespoke to Australia. A bespoke Australian approach will just unnecessarily increase tax compliance costs.

If Australia is not aligned with global norms, we risk creating a disadvantage for multinational groups operating in Australia by imposing disclosure requirements relating to potentially commercially sensitive information and imposing additional compliance costs relative to other countries. This can create a disadvantage for financial services activities in Australia where multinational groups are not already subject to the same requirements (such as with Australia's tax transparency code) or where disclosure is voluntary (for example, GRI 207).

For example, if a managed fund were to become subject to new public reporting requirements, the costs of compliance would likely be passed on to investors, costs which would not apply for investors in a foreign fund. The advent of the Asian Funds Passport makes it even more important to consider the relative competitive impact of new regulatory requirements compared with other countries within the Passport.

To ensure a targeted, balanced approach that aligns with other mandatory global regimes, the FSC submits a better path is to permit a choice to follow existing mandatory reporting regimes that are already applicable to the MNE group. This could be done either through publication of information from extracts of existing CbC reports or by adopting the EU public CbC rules where applicable.

To the extent that an Australian entity or group is subject to the proposed new disclosures under Australian law but is not otherwise subject to similar overseas reporting or disclosure regimes, the FSC recommendations on content are stated below.

The FSC submits that additional disclosures for related party expenses, intangible assets, deferred tax and effective tax rate per jurisdiction are unnecessary as transfer pricing laws ensure the former are at arm's length and adding the latter will increase the compliance burden.

The FSC recommends that:

- If the existing CbC reports are published, then only table 1 information of the current OECD version of the CbC report should be publicly disclosed, to minimise compliance burdens.
- The disclosing entity should be allowed a written narrative on any aspect of the data that is reported. This would allow groups to include additional information at their choice if there is a risk of the data being misunderstood, for example if a data field is influenced by extraordinary items, or a data field is frequently misunderstood. This

will be consistent with recent changes to superannuation disclosures permitting funds to include 'contextual information' in relation to mandated expenditure disclosures.[8]

- In Australia's case, the public disclosure of corporate tax data is frequently misunderstood, with some commentators incorrectly suggesting that the "total income" field actually contains data for profits.

- Businesses should be permitted flexibility to allow a choice between regimes, in particular where a global group becomes subject to another mandatory public reporting regime in other jurisdictions.

The FSC also notes that the Consultation Paper states that large multinationals "should already have" the data for CbC reports (see page 25). However, Australian subsidiaries of multinationals do not necessarily receive the CbC reports of their parent entity – the subsidiary may be informed that the CbC report has been lodged but does not necessarily receive a copy. The entity submitting the CbC report is under no obligation to share the CbC report with the rest of the group. This would particularly be true of non-wholly owned subsidiaries.

The FSC **recommends** the CbC disclosure regime should not apply to any CIV, including CIVs that are part of an SGE.

The FSC **recommends** that, to the extent the CbC disclosure regime applies, the regime should not be bespoke to Australia, disclosure should only be of table 1 of the current OECD version of the CbC report, the disclosing entity should be able to provide commentary on any field, and disclosing entities should be able to choose between disclosure regimes.

7.1 Questions 10-13: Format, content and timing of public CbC reporting

The FSC submits the required format and timing of public CbC reporting should be flexible in recognition of the additional compliance costs of new reporting in addition to existing heavy reporting obligations on regulated financial services entities. The intended policy aim of public disclosure would be achieved through flexibility to allow publication in an annual report, as a stand alone report, or by other publication such as including on a website.

If consistent public accessibility is desired, then the government can play a role in providing access similar to the list of (and links to) voluntary tax transparency code reports that is available on www.data.gov.au.

If centralised reporting to the ATO or another regulator is required, a standard template is preferable to ensure efficient reporting and presentation of the data. An approach similar to EU public CbC reporting would be preferable in these circumstances. This report would need to be due after income tax returns and any existing CbC reporting is due. We request Treasury and the ATO consult with industry prior to developing standard reporting templates.

[8] See: https://ministers.treasury.gov.au/ministers/stephen-jones-2022/media-releases/notice-amm-disclosure-rules-finalised

The FSC **recommends** that disclosing entities be provided flexibility about where they publish CbC reports, and if centralised reporting is required, then a standard template should be used.

8 Disclosure of tax risk

The FSC reiterates that we do not consider this measure should apply to collective investment vehicles – see Section 4.2 above.

The FSC submits the tax risk disclosure proposal goes beyond what was originally announced, as this related to tax haven exposure. We also note that material risks are already disclosed in annual reports.

AASB Interpretation 23 Uncertainty over Income Tax Treatments (**Interpretation 23**) provides guidance on the application of AASB 112 Income Taxes when there is uncertainty over income tax treatments. Interpretation 23 defines an "uncertain tax treatment" and it applies to the recognition and measurement of both current and deferred taxes in the financial statements. Interpretation 23 presumes 100% detection risk when assessing and recognising tax positions. Therefore, uncertain tax positions are already considered and, if required by Interpretation 23, disclosed in the financial statements.

8.1 Scope of disclosure measures

With the context in the earlier part of this submission, the FSC submits that this measure should only apply to Australian listed entities that are not CIVs, in alignment with the stated policy intention of requiring disclosure only by listed entities to their shareholders.

The FSC submits it is unnecessary for this measure to apply to unlisted businesses, including Australian subsidiaries of offshore listed parent entities, which generally have a small number of shareholders. Investors in privately held companies already have access to underlying structural and financial data of their company such that there is limited, if any, benefit in imposing a new disclosure regime on unlisted entities.

The FSC also submits the measure should also not apply to listed/quoted CIVs, specifically Exchange Traded Funds (**ETFs**). There is a need for ETFs to maintain liquid portfolios to meet day-to-day redemption requirements and as a result, there can be frequent changes in an ETF's investments, and they tend to invest in more 'vanilla' assets such as bonds and listed equities rather than unlisted (illiquid) assets such as private equity and infrastructure.

In addition, ETFs tend to be substantially less involved in the management and governance issues of underlying investments.

The FSC **recommends** the tax risk disclosure measures should not apply to unlisted entities, and should not apply to Exchange Traded Funds (**ETFs**).

Notwithstanding the above, the FSC maintains the need for this disclosure measure is unclear, as accounting standards would likely already cover the need to measure tax risk exposures, and it is unclear what is missing from existing standards.

The FSC **recommends** the Government clarify the need for the tax risk disclosure measure in the context of existing accounting standards relating to material risks.

8.2 Meaning of 'material tax risk'

The FSC submits the term 'material tax risk' should be clearly and simply defined in a way that is easily understood, both from the perspective of the entity that needs to make disclosures as well as the public when reading the disclosure.

Further, the threshold for materiality should be consistent with the approach for Australian financial reporting standards which is well-established and reflects a long history of public interest in defining and disclosing material risks. In contrast, defining "material tax risk" by reference to ATO administrative guidance would not support the objective of greater public appreciation of tax risks for a number of reasons, including:

- Disclosure by reference to ATO administrative guidance will be difficult for the general public to understand as they would need to separately read the (often very lengthy) relevant ATO guidance which requires technical expertise to understand in context. This is unlikely to occur so there is a significant risk the public would draw incorrect conclusions from public disclosures without independently reading and understanding the ATO's guidance.
- ATO administrative guidance has not been considered by the courts and may be unsupported by the law.
- The ATO itself acknowledges that a higher risk rating under its self-assessment frameworks does not necessarily represent non-compliance, for example paragraph 22 of PCG 2017/4 for related party cross-border financing arrangements.
- By design, PCGs are not an interpretation of the tax law, instead they are risk assessment tools, contain no materiality thresholds and are not limited to 'tax haven' exposure.
- ATO administrative guidance can be unilaterally changed by the ATO, which may occur without reasonable public consultation.

The FSC **recommends** material tax risk should be defined clearly and simply, consistent with financial reporting standards, and should not be defined by reference to ATO public guidance (or rulings).

8.3 Tax haven disclosure

The FSC reiterates that we consider this measure should only apply to listed entities, and not to unlisted entities or Exchange Traded Funds (ETFs) – see Section 8.1 above.

We make some additional points relating to collective investments and life insurers further emphasising the need for these entities to be excluded from the measure.

8.3.1 Collective investments

For investment through low tax jurisdictions, there are unique circumstances for investment funds, insurers and institutional investors compared to many corporate multinational groups.

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In particular, these entities commonly use various low-tax jurisdictions for important commercial reasons, including to pool capital and achieve tax neutral fund holding structures. This is not directed towards, and does not achieve, tax avoidance as income is typically generated in other countries within subsidiary portfolio investment entities/businesses, where it is subject to tax, flows through the holding entity jurisdiction without a further layer of tax and is then subject to further tax in the countries of investors when distributed to them. If tax were applied in the middle (holding entity) jurisdiction, this would usually result in double or even triple taxation, and can result in less tax being paid in the country of investors (ie less tax paid in Australia) due to the use of foreign tax credits.

Any measurement of tax risk based on the headline rate in a low-tax country would fail to reflect the tax neutrality of such fund structures. As noted earlier, the tax neutrality of CIVs is a deliberate policy design feature and should not be stigmatised.

Many global asset managers choose to establish funds in jurisdictions such as the Cayman Islands and market their fund to a global audience of institutional investors. This is very common across a range of asset classes, including infrastructure, private equity and venture capital. The choice of a tax neutral jurisdiction for the fund, such as the Cayman Islands, offers flexibility where investors come from different jurisdictions or the fund invests globally across different countries. Australian superannuation funds and other investors are presented with the opportunity to invest in the fund and do not have any choice, or ability to change, the location of the fund entity.

We also note that an entity that is fully fiscally neutral should not pay tax in a jurisdiction regardless of the headline tax rate of the jurisdiction – so a CIV should not pay tax in a 'tax haven' and also should not pay tax in a high tax jurisdiction. The classification of the jurisdiction should have little effect on the tax paid by the CIV in its own right.[9] This means it is misleading to focus on whether a CIV operates in a low tax jurisdiction or not.

Given the above, we recommend that any new disclosure regime for CIVs, to recognise these types of activities are not motivated by tax avoidance and do not represent a 'material tax risk' when good commercial reasons exist.

The importance of tax neutrality for fund entities has been recognised in the OECD BEPS program, most recently through the exception to the Pillar Two Model Rules for investment funds, real estate investment vehicles and (for similar reasons) pension funds.

8.3.2 Insurers

Similar to collective investments, there are substantial commercial reasons for insurers to operate through low-tax jurisdictions, particularly Bermuda, which is where most global reinsurance business occurs. This however does not mean that such transactions are 'high tax risk' or result in a loss of Australian tax revenue because of various Australian tax rules

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[9] It could be asked if tax has no effect on a CIV, then why do CIVs set up in low tax jurisdictions. The answer is that while CIVs should be tax neutral, in practice they often are not *fully* tax neutral, and some tax can be applied to CIVs in specific situations (see Section 3 for Australian examples). This incomplete neutrality of CIVs encourages investment structures to be set up in jurisdictions with lower tax rates and/or fewer situations where CIVs pay tax.

including our strong transfer pricing rules, Controlled Foreign Company (CFC) rules and rules relating to offshore reinsurance (Division 15) which result in Australian tax being paid on reinsurance profits that relate to Australian risks.

There already exists a number of overlapping tax transparency and BEPS integrity rules, globally and domestically. As more rules are introduced this complexity will increase, giving rise to costs on Australian funds management and insurance businesses, which are often subject to similar rules in other countries, for example EU transparency rules where they operate in EU countries. To avoid Australia becoming less competitive it is important that any reforms are well targeted and consistent with regimes in our trading partners and competitor jurisdictions for financial services.

9 Timing

The FSC submits that, to the extent the measures apply, they should not apply to any taxpayer before 1 July 2023 at the earliest. As a result for taxpayers with substituted accounting periods (**SAPs**), the FSC recommends measures should apply to income years commencing on or after 1 July 2023 (and similarly for any measures that commence after July 2023).

The FSC also recommends that there be further consultation on the details of the measure, including any transitional/grandfathering rules, and the implementation of any reporting standards (as noted in Section 7.1 above).

The FSC **recommends** that the measures, to the extent they apply from 1 July 2023, should apply to the first income year commencing on or after 1 July 2023.

The FSC **recommends** that there be further consultation on the details of the measure, including any transitional/grandfathering rules and reporting standards.