

Australia

Consultation Paper on the tax challenges arising from the digitalization of the economy

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The authors examine a Consultation Paper released by the Australian Treasury in October 2022 seeking comments on the OECD's two-pillar response to the challenges posed by the digitalization of the world economy. By way of preliminary comment, there will be significant challenges in Australia meeting the OECD timelines, which envisage Pillar Two coming into effect in 2023 and Pillar One in 2024. However, given the Australian government's strong support for OECD and G20 initiatives, it seems likely Australia will commit, to the extent possible, to implementing the new global agreement in accordance with the OECD timetable.

1. Introduction

On 4 October 2022, the Australian Treasury (Treasury) released for comment a Consultation Paper entitled "Global agreement on corporate taxation: Addressing the tax challenges arising from the digitalization of the economy" (Consultation Paper).

The Consultation Paper invites comments on the new two-pillar global agreement on corporate taxation and responses to the questions posed in the Consultation Paper.

The Consultation Paper states that Treasury would like views: "on how Australia can best engage with a new global agreement on corporate taxation that applies to large multinational companies"; and indicates "submissions will help inform consideration of domestic implementation issues", including:

- interactions with Australia's existing corporate tax system;
- ways to minimize compliance costs; and
- the implementation of a Domestic Minimum Tax.

The Consultation Paper includes 40 specific, detailed questions on the implications and implementation of the two-pillar system – in particular, the implementation of the Global anti-Base Erosion (GloBE) rules, including "Top-up Tax" liability, the GloBE Information Return, tax paid under the GloBE model rules and imputation, and Domestic Minimum Tax.

2. Two-Pillar Global Agreement

The Consultation Paper refers to the multilateral agreement reached in October 2021 through the OECD/G20 Inclusive Framework, involving over 140 countries, and notes that:

globalisation and digitalisation of the economy have allowed businesses to engage in cross-border sales of goods and services more easily, with little or no physical presence in a jurisdiction. Digitalisation and globalisation have increased the ability of businesses to locate operations and intangible property in jurisdictions with low corporate income tax rates, allowing them to lower their global effective tax rate.

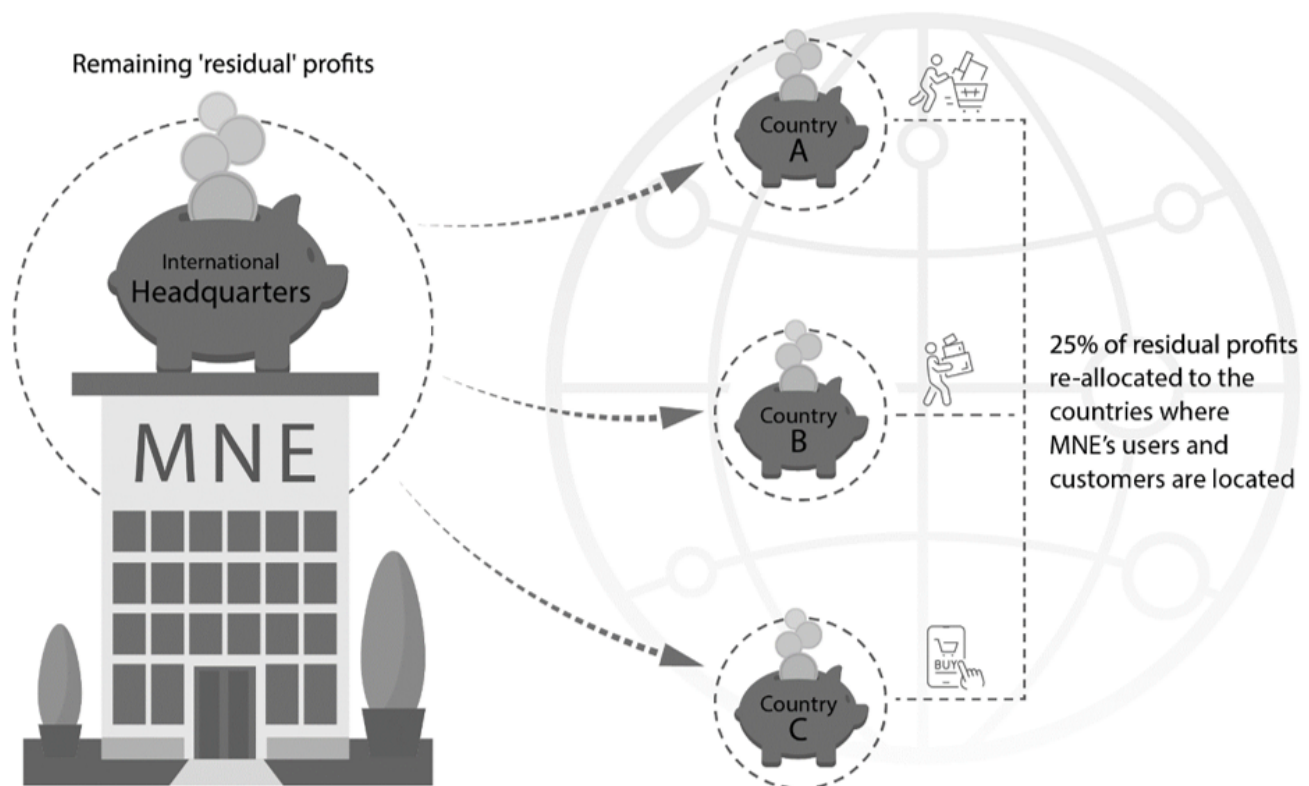
The Consultation Paper then provides a succinct summary of main aspects of the OECD "two-pillar" multilateral solution.

Under Pillar One, which is diagrammatically represented in Figure 1:

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- taxing rights over the largest and most profitable multinational enterprises (MNEs) would be reallocated to the countries where their goods and services are consumed (“market jurisdictions”);
- the amount of taxing rights to be redistributed under Pillar One is known as “Amount A”;
- this redistribution would only apply where an MNE has global revenues exceeding EUR 20 billion per annum and a “profit-before-tax to revenue” ratio exceeding 10 per cent;
- Amount A would be equal to 25 per cent of the MNE’s “global residual profits”, defined as all profits above a 10 per cent (profit before tax/revenue) profitability threshold;
- the MNE would allocate Amount A profits among market jurisdictions based on the share of revenue sourced from each of those jurisdictions;
- the market jurisdiction would apply their domestic corporate tax system to tax the allocated residual profits, while another “relieving jurisdiction” would relinquish their taxing rights over these profits;
- there would be a “marketing and distribution profits safe harbour” to cap the amount of profit reallocated to a market jurisdiction that is already able to tax the MNE’s residual profits; and
- the OECD estimates that 100 multinationals would be in the scope of Pillar One initially.

Figure 1 – OECD illustration of Pillar One



Under Pillar One, taxing rights on more than **USD 125 billion of profit** are expected to be reallocated to market jurisdictions

* OECD, *Brochure: Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (8 Oct. 2021), available at <https://www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf>.

Pillar Two, which is diagrammatically represented in Figure 2:

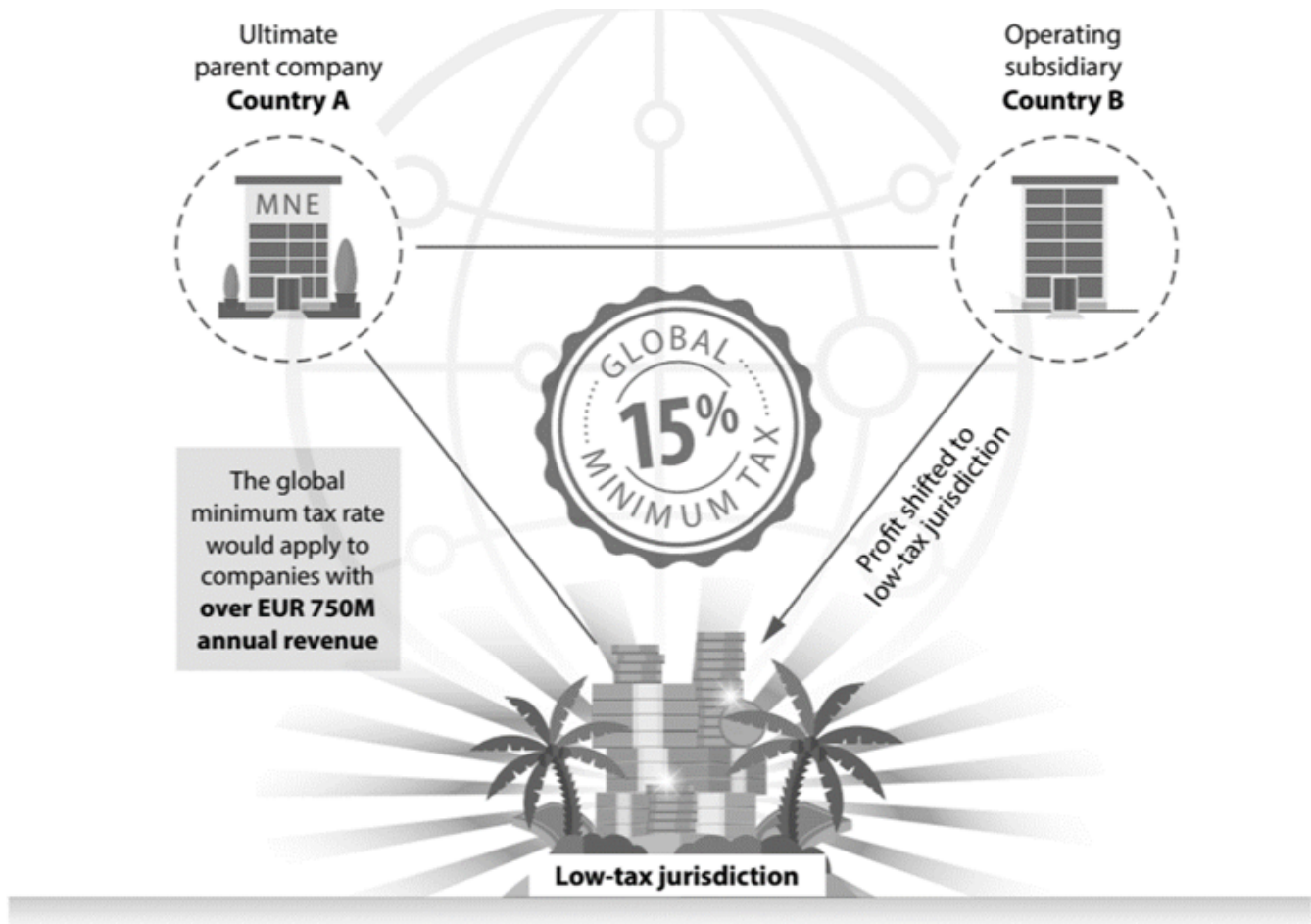
- reduces the incentive for MNEs to profit-shift to low tax jurisdictions and helps address the “race to the bottom”, where countries are competing with each other to attract mobile capital through offering ever lower corporate tax rates;
- creates new taxing rights over undertaxed profits of entities within a MNE, which are taxed below the globally agreed minimum tax rate; and
- consists of GloBE Rules and the subject to tax rule (STTR).

The GloBE Rules:

- ensure an effective minimum tax rate of 15 per cent for MNEs with global revenue of at least EUR 750 million per annum; and
- consist of two interlocking rules (the Income Inclusion Rule (IIR) and the Undertaxed Payments Rule (UTPR)), designed to collect a top-up tax on profits in undertaxed jurisdictions within a MNE Group:
 - the IIR would allow jurisdictions to apply a top-up tax on a resident multinational “parent” company, where the group’s income in another jurisdiction is being taxed below the global minimum rate of 15 per cent; and
 - the UTPR would allow jurisdictions to apply a top-up tax on a resident subsidiary member of an MNE if the group’s income in another jurisdiction is being taxed below the global minimum rate of 15 per cent and where no IIR applies.

The STTR is primarily intended to overcome problems for developing countries with bilateral tax treaties, where they have reduced taxing rights on certain income under those treaties. The STTR is seen by developing countries as integral to the two-pillar agreement and allows the payer country to collect tax before the GloBE Rules are applied.

Figure 2 – OECD illustration of Pillar Two



Under Pillar Two, the global minimum tax, with a **rate of 15%**, is expected to generate around **USD 150 billion** in new tax revenues globally.

* OECD, *Brochure: Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (8 Oct. 2021), available at <https://www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf>.

It has been suggested that the two-pillar solution could raise up to AUD 3 billion for Australia.^[3]

3. Consultation to Date

Treasury released a discussion paper in 2018 entitled: *The digital economy and Australia's corporate tax system*,^[4] which explored digital taxation issues in depth. In response to stakeholders' feedback, the Australian Government announced it

3. M. Cranston & T. McIlroy, *Australia signs on for \$3b gain in global tax floor*, Financial Review (2 July 2021), available at <https://www.afr.com/policy/tax-and-super/australia-signs-on-for-3bn-gain-in-global-tax-floor-20210702-p5864q> (accessed 7 Nov. 2022).
 4. The Treasury, *The digital economy and Australia's corporate tax system* (2018), available at <https://treasury.gov.au/sites/default/files/2019-03/c2018-t306182-discussion-paper-1.pdf>.

would not be pursuing a digital services tax at the time and was committed to working with the OECD to develop a multilateral solution.^[5]

It should be noted, however, that in 2017 Australia introduced a 40 per cent Diverted Profits Tax “to prevent significant global entities from reducing the amount of Australian tax they pay by diverting profits offshore through contrived arrangements with related parties”.^[6]

Treasury has also been undertaking continued targeted consultation with the Digital Tax Working Group, the Board of Taxation and the Australian Taxation Office’s National Tax Liaison Group to discuss digital taxation issues.

4. Specific Questions Raised in Consultation Paper

As noted above, the Consultation Paper raises 40 specific, detailed questions seeking views on the implications and implementation of the two-pillar system, including as regards:

- the proposed two-pillar system;
- outcomes for the Australian economy;
- estimated revenue impacts (and noting that no Australian headquartered multinational is expected to be in the scope of Amount A, given current thresholds and exclusions);
- how the global deal will be implemented;
- compliance costs and impacts on large multinationals; and
- Australian implementation of the GloBE rules, including:
 - mode of, timing of, and readiness for, implementation;
 - imposing “Top-up Tax” liability;
 - administrative provisions;
 - GloBE Information Return;
 - safe harbors;
 - interaction with Australia’s existing integrity provisions;
 - corporate restructuring under GloBE;
 - tax paid under the GloBE model rules and imputation; and
 - Domestic Minimum Tax.

5. Next Steps

The consultation period is very brief, with a closing date for submissions of 1 November 2022.

The Consultation Paper states that Australia will continue to work with the OECD and that:

[f]urther consultation with stakeholders will be necessary to assess the impacts and various implementation options available, and to minimize complexity and compliance costs for business, prior to a final decision to implement the two-pillar solution.

6. Initial Comments

By way of very initial and preliminary comment, given the issues facing the Australian economy at the time of writing this article (November 2022), including steeply rising inflation and energy prices, there will certainly be challenges in Australia meeting the OECD timelines, which envisage Pillar Two coming into effect in 2023 and Pillar One starting in 2024.

5. The Hon Josh Frydenberg MP, Treasurer of the Commonwealth of Australia, *Government response to digital economy consultation* (2019) available at <https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/government-response-digital-economy-consultation> (accessed 7 Nov. 2022).

6. AU: Income Tax Assessment Act 1936 (Cth), sec. 177H (1936).

Those challenges will likely be magnified by the proposed review of the “scope threshold” for Pillar One being reduced to EUR 10 billion that is scheduled for seven years after implementation.

Nevertheless, given the Australian government’s strong support for OECD and G20 initiatives, and given the very real threats to the Australian tax base posed by the digitalization of the world economy, it seems likely Australia will commit, to the extent possible, to implementing the new global agreement in accordance with the OECD timetable.