



Centre for
International
Corporate Tax
Accountability
and Research



Uniting Church in Australia
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**Submission from the Centre for International Corporate Tax
Accountability & Research, the Tax Justice Network Australia, and
the Synod of Victoria and Tasmania, Uniting Church in Australia on
Global agreement on corporate taxation: Addressing the tax
challenges arising from the digitalisation of the economy**

1 November 2022

The Centre for International Corporate Tax Accountability & Research (CICTAR), the Tax Justice Network Australia (TJN-Aus), and the Synod of Victoria and Tasmania, Uniting Church in Australia (UCA) welcome this opportunity to provide a submission to the 'Global agreement on corporate taxation: Addressing the tax challenges arising from the digitalisation of the economy' consultation paper.

Ensuring multinationals pay a fair share of corporate income tax is necessary for the broader integrity of the tax system and to level the playing field for all businesses, particularly small and medium-sized enterprises. Since the COVID-19 global pandemic, there is a growing awareness of the essential need for well-funded public health systems and an understanding that additional revenues will be needed to pay for the increased government support provided to the community through the pandemic. There is also growing awareness that increased public investments are required for aged care, early childhood education, disability services and income support and that these investments will create a better society and stronger economic future for all. Increasing income tax revenues from multinational enterprises (MNEs) is an essential part of the solution and will help improve fairness and stimulate broad-based economic growth with genuine competition.

The TJN-Aus, CICTAR and the UCA continue to strive for broader reforms to national and international tax systems, including a unitary tax system and away from the arm's length principle. We are encouraged by progress through the OECD towards a minimum corporate tax, noting that the proposed rate of 15% is far too low and encourage the Australian Government to push for a higher rate, closer to the average corporate tax rate in OECD countries and Australia's 30% corporate tax rate.

Notwithstanding the specific comments and concerns below, the following are some overall comments on the OECD's Pillars One and Two approaches and implementation, or lack thereof. The principles of Pillar Two, to create a minimum effective global tax rate, are strongly supported, and the Australian Government should move forward with implementation. However, the 15% rate is too low, and the Australian Government should be a strong voice in global discussions to increase the rate over time. The principle of creating a floor and building room for global tax cooperation rather than harmful competition and a race to the bottom is exceptionally important.

While Pillar Two seems to be on track for broad global implementation, the fate of Pillar One is far more uncertain. Pillar One, only applying to the top 100 or so global corporations, is well-intentioned but deeply flawed. Given the uncertainty of implementing Pillar One in key global economies, the Australian Government must explore alternatives to ensure that the largest MNEs are paying a fair share of tax where profits are genuinely created. If Pillar One is not widely implemented, which is a distinct possibility, there will likely be a return to a wide range of digital service taxes in dozens of countries around the world. What is the Australian Government's plan in this possible scenario?

Pillar One is critical in recognising the problem that the largest MNEs, particularly in the 'digital' economy (which is now pervasive across many sectors), are not paying a fair share and that a form of unitary taxation with formulary apportionment is part of the solution. However, within Pillar One, the unitary taxation approach is tacked on top of the failing global tax system based on transfer pricing and the 'arm's length' principle. A far better, more straightforward, and more transparent alternative would be to apply an entire unitary taxation approach with formulary apportionment to the largest MNEs to replace the deeply flawed underlying and outdated global tax system. Although with some flaws and room for improvement, this type of unitary taxation system has been functioning well for decades to determine and allocate state-level corporate income tax between states in the US.

In the absence of global agreement on Pillar One reforms, or the sufficient ability to implement it at the global level, the Australian Government should begin to explore unilateral or multilateral efforts to implement a unitary taxation system for the world's largest MNEs, currently in the scope of Pillar One.

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?

Multinational corporations' tax avoidance and tax evasion continue to play a significant role in depriving people worldwide of vital revenue to pay for hospitals, healthcare clinics, schools, universities, aged care, mental health services, and other community needs. Developing countries continue to be hit hardest.

The extent of tax avoidance and tax evasion by multinational corporations and other businesses at a global level remains significant. For example, in March 2020, the non-government organisation Global Financial Integrity released their assessment of losses to 135 developing countries and 36 advanced economies from 2008 to 2017 from just one type of tax evasion, trade misinvoicing. Trade misinvoicing involves importer and exporter corporations deliberately falsifying stated prices on the invoices for goods they are trading. The aims of trade misinvoicing are tax evasion, evasion of customs duties, money laundering of the proceeds of crime, circumventing currency controls and hiding profits offshore. The value of the fraudulent invoices was estimated to be \$13.7 trillion for

135 developing countries and 36 advanced economies from 2008 to 2017.¹ The value of the trade misinvoicing in 2017 alone was \$1,280 billion.² The Gambia suffered the most significant loss from trade misinvoicing to the value of 47% of its trade from 2008 to 2017.³

The Australian Government has made commendable efforts to stem the losses Australia has suffered from tax avoidance by multinational corporations. These efforts have made an impact. However, the struggle is far from over, and those businesses that advise companies on how to avoid paying taxes have been very aggressive in opposing reform measures. Some of those lobbying efforts have been successful at killing off announced reforms.

The support Australian Governments have given to global reforms to address the impact of corporate tax evasion and tax avoidance on people in developing countries have been far more limited.

Multinational enterprises (MNEs) tax avoidance through digitalisation has resulted in multiple governments implementing unilateral measures to claim back some of the tax that has been avoided. In the absence of a multilateral agreement to address the profit-shifting problem, such as the OECD two pillar solution, an increasing number of governments would take unilateral actions to protect their tax base against the aggressive tax avoidance activities of MNEs.

2. Do you agree the two-pillar multilateral solution will help make the international tax system fairer?

The agreement on measures to end international tax competition resulting from globalisation is a historic feat of international cooperation after a quarter-century of attempts by the OECD. The project to combat BEPS was launched by the OECD in 2012 and was adopted by the G20 in 2013. However, the large package of reforms agreed upon in 2015 only patched up some defects while creating complexity and uncertainty in some areas.⁴

Although reaching an agreement on the two-pillar solution was a significant achievement, regrettably, the design of GloBE still has serious flaws. Nevertheless, the two-pillar solution will make the international tax system fairer. However, a brief description of the deficiencies in GloBE are:⁵

(i) the agreed minimum effective tax rate of 15% is low compared to the global average corporate tax rate of 25%, particularly when combined with the possibility of offering even lower rates (down to zero) on income carved out by the substance test. The low tax rate will continue to provide incentives to shift profits out of host countries where business activities occur.

(ii) The scope is too narrow with the high threshold of €750 million turnover.

¹ Global Financial Integrity, 'Trade-Related Illicit Financial Flows in 135 Developing Countries: 2008 – 2017', 3 March 2020, <https://gfintegrity.org/report/trade-related-illicit-financial-flows-in-135-developing-countries-2008-2017/>

² Global Financial Integrity, 'Trade-Related Illicit Financial Flows in 135 Developing Countries: 2008 – 2017', March 2020, 17.

³ Global Financial Integrity, 'Trade-Related Illicit Financial Flows in 135 Developing Countries: 2008 – 2017', 3 March 2020, <https://gfintegrity.org/report/trade-related-illicit-financial-flows-in-135-developing-countries-2008-2017/>

⁴ BEPS Monitoring Group, 'Comments on the implementation framework of the global minimum corporate tax', 11 April 2022, 2.

⁵ Ibid., 2-3.

(iii) Its rules are highly complex, largely because the scheme creates a new layer on top of the existing international tax rules. The current rules are based on the misleading fiction that MNE corporate groups consist of independent entities dealing with each other at arm's length, which enables and encourages BEPS practices.

(iv) The GloBE has been formulated with three interacting rules for allocating the right to tax undertaxed profits, ignoring proposals that were put forward for a single formulary method. The rules give priority to the home countries of MNEs to apply an income inclusion rule (IIR), while the right of host governments to apply an undertaxed profits rule (UTPR) is only a backup. The new provision for a domestic top-up tax (DMTT) would benefit only countries where MNEs declare relatively high levels of profit that are taxed below the ETR. Those jurisdictions are essentially tax havens that offer preferential tax regimes to attract 'conduit' intermediary entities used to channel profits shifted out of source countries. The design gives the lowest priority to ensuring an appropriate level of tax in the source country where the profits arise. While the bias impacts all countries, it particularly discriminates against lower-income countries, which are generally only hosts to MNEs, and are also more highly dependent on corporate income tax. The design thereby disadvantages developing countries battling economic crises resulting from the pandemic and other international events.

(v) The DMTT encourages continued tax competition, particularly since, in combination with the substance-based carve-out, it results in an overall ETR below 15%, contrary to the GloBE's aim and risks turning a minimum into a maximum.

(vi) The method for calculating the ETR encourages competition over the definition of the tax base, for example, by providing generous allowances for research and development, capital investment and depreciation, and the acquisition of intellectual property rights and other intangibles (particularly for acquisitions made before December 2021).

(vii) Using financial accounting rules as the basis for calculating the ETR, albeit with some defined adjustments, reverses the usual approach in which tax authorities have powers of detailed examination independent of audited financial accounts. Thus, MNE management is allowed considerable discretion in determining the relevant tax base.

Despite these flaws, the introduction of the GloBE by some governments could benefit all countries by reducing the temptation to offer tax incentives to attract investment since undertaxed income is likely to be subject to a top-up tax by another government. However, because of its complexity and unfairness, very few developing countries that import capital are likely to implement GloBE. Instead, some will likely adopt complementary measures to protect their tax base. Such measures are likely to include reforming their incentives regimes to ensure that, at least where such incentives result in profits taxed at a lower ETR than the minimum tax, these profits are not taxed by another government through a top-up tax. In addition, governments might also adopt complementary measures, such as alternative minimum rates and withholding taxes on fees for service, that provide stronger protection of the tax base.⁶

3. What costs and benefits do you see in Australia adopting the two-pillar multilateral solution?

Implementing the Pillar Two reforms will significantly lower the possible legal tax minimisation from MNEs shifting profits from Australia to low or no-tax jurisdictions. This is likely to increase tax revenues in Australia and begin to steer the global tax system towards greater fairness. In addition, if

⁶ Ibid., 3.

there is the necessary global agreement on the implementation of Pillar One, the Australian Government may also be able to increase corporate income tax revenue from the world's largest MNEs, most of whom have significant operations in Australia. However, without sufficient global implementation of Pillar One, the Australian Government needs to consider alternative approaches based on unitary taxation with formulary apportionment.

4. What second-round global tax system effects might arise, in regard to actions other countries may take that may impact Australian interests?

With the possible failure to sufficiently implement Pillar One reforms at the global level, there will likely be a return to the unilateral implementation of digital service taxes to ensure that the most prominent global IT giants begin to pay a fair share of corporate income tax where profits are genuinely made.

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

Pillar One begins to reduce the ability to shift profits from Australia to low or no-tax jurisdictions and the resulting race to the bottom in lowering corporate tax rates and unsustainable tax incentives. Australia's corporate tax rate and overall tax system are not a significant disincentive for domestic and foreign investment decisions. Other factors are of much more significance than the corporate income tax rate or positive reputation for the Australian Taxation Office to assert rights to tax income of MNEs generated in Australia. Therefore, the implementation of Pillars One and Two will not have any significant impact on investment decisions in Australia.

7. Do you envision Pillars One and Two incentivising any behavioural changes and/or business restructures over the medium to long term?

Pillars One and Two will encourage MNEs to dismantle complex structures involving subsidiaries in tax havens where they do not have genuine business activities. There will also be incentives for jurisdictions to raise income tax rates to meet the 15% minimum if there is no longer any benefit for MNEs to book profits in low or no-tax jurisdictions.

8. Do you agree with the assumption that no Australian-headquartered multinational will be in the scope of Amount A, given the current proposed thresholds and exclusions?

This assumption appears to be correct under current Pillar One proposals.

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?

As with the Australian Government's recent commitment to public country-by-country reporting for all significant global entities (SGEs) beginning 1 July 2023, the Australian Government should lead the way in the implementation of Pillar Two and be an early adopter. However, it appears that effective global implementation of Pillar One is far less certain, and the Australian Government should be exploring alternative approaches if agreement on implementation is insufficient and/or timely.

10. What design features would you like to see within the existing Pillar One and Two frameworks? For example, are there any approaches to implementation which may mitigate implementation challenges?

The Australian Government's recent commitment to public country-by-country reporting for all SGEs will strongly support the implementation of Pillars One and Two at the global level, particularly in jurisdictions that currently have no access to country-by-country reporting through the OECD. Pillar One would be far simpler to implement if it fully embraced the concept of unitary taxation rather than applying it only to the 'residual' profits of the largest MNEs. A more straightforward and transparent approach to Pillar One could be of benefit to MNEs and would likely generate much stronger agreement and certainty amongst global governments and taxpayers alike. This is particularly the case if Pillar One is not broadly implemented and replaced by a plethora of divergent digital service taxes.

12. Are there any other comments or issues you wish to raise in relation to the Pillar One and Two rules that should be considered by Australia in the design and implementation stage?

We believe that variations between governments in implementing Pillar Two are desirable to ensure it is effective in each jurisdiction that implements it. We are concerned that the paid advisers to MNEs will plead for a high degree of uniformity in the implementation of Pillar Two, arguing that variations would increase compliance costs. Such special pleading should be treated sceptically. MNEs gain significant economic advantages from globalisation and the ability to operate in many countries and must accept the costs of complying with the laws and regulations of every jurisdiction where they have a presence. In fact, they frequently choose to create complex structures involving entities in jurisdictions where they do not have genuine business activities for the purpose of avoiding tax and other regulations. The GloBE encourages them to dismantle such structures, and doing so would be the best way for them to reduce the transaction costs involved in any diversity of regulatory requirements.⁷

We are concerned by the references in the Commentary to the need to avoid "the risks of double or over-taxation" (Introduction paragraphs 1 and 14). We see no risk of "over-taxation" of MNEs, and "double taxation" risks are overstated. For too long, the global tax rules have prioritised the prevention of double taxation with the result of double non-taxation. As a result, tax competition over the past 30 years has resulted in a severe under-taxation of the profits of MNEs, helping to enable many of them to become mega-sized global entities by exploiting the weaknesses in the international tax framework. The GloBE should be implemented in a way that helps to reverse this process.⁸

13. What changes (e.g. to processes or systems) do you anticipate that businesses may be required to make in order to comply with Pillar Two?

It is anticipated that as a result of Pillar Two, MNEs are likely to simplify and rationalise complex global corporate structures to be more aligned with genuine operations rather than the ability to shift profits to low or no-tax jurisdictions.

15. Would a Domestic Minimum Tax in Australia add to, or alternatively, mitigate the compliance costs of implementing Pillar Two?

The Australian Government should explore the option of a domestic minimum tax, including an evaluation of the differences between the recent adoption of a minimum corporate tax under the US *Inflation Reduction Act* and the minimum tax rate in Pillar Two.

⁷ Ibid., 4.

⁸ Ibid., 4.

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

The Australian Government should implement the GloBE Model Rules in a way that retains sufficient flexibility to allow the incorporation of the following:

- (i) clarifications and interpretations;
- (ii) modifications resulting from economic developments and changes in business models and practices, and;
- (iii) improvements to remedy some of the defects and limitations of the current rules.

In adopting the GloBE, it must be applied in a way that benefits all countries by helping to phase out all artificial profit-shifting arrangements and end the race to the bottom in corporate tax. If it is implemented in a way that reinforces the unfair and inappropriate priority that GloBE rules give to MNE home countries, it could instead become another weapon in the international tax conflict.

18. Do you agree that the GloBE Model Rules should apply in Australia for fiscal years commencing on or after a specific date?

To be consistent with recent multinational tax and integrity reform measures and maintain Australia's status as a new global leader in multinational tax transparency, the GloBE Model Rules should apply for fiscal years commencing on or after 1 July 2023.

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 stated above, Australia should be an early adopter of Pillar Two reforms to maintain global momentum and support the consensus. As a leader in adopting Pillar Two, the Australian Government will be in a better position to advocate for raising the minimum corporate tax rate above 15% over time.

Once again, thank you for the opportunity to participate in this important Treasury consultation, and don't hesitate to get in touch with us if you have any questions or require any additional information.

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Background on the Centre for International Corporate Tax Accountability & Research (CICTAR)

CICTAR is a global corporate tax research centre that produces information and analysis to untangle the corporate tax web. The Centre is a collective resource for workers and the wider public to understand how multinational tax policy and practice affect their daily lives. CICTAR's work supports public participation in the tax debate so that everybody can participate in decision-making that affects their communities.

For more information, visit the CICTAR website here: <https://cictar.org/>

Background on the Tax Justice Network Australia

The Tax Justice Network Australia (TJN-Aus) is the Australian branch of the Tax Justice Network (TJN) and the Global Alliance for Tax Justice. TJN is an independent organisation launched in the British Houses of Parliament in March 2003. It is dedicated to high-level research, analysis and advocacy in the field of tax and regulation. TJN works to map, analyse and explain the role of taxation and the harmful impacts of tax evasion, tax avoidance, tax competition and tax havens. TJN's objective is to encourage reform at the global and national levels.

The Tax Justice Network aims to:

- (a) promote sustainable finance for development;
- (b) promote international cooperation on tax regulation and tax-related crimes;
- (c) oppose tax havens;
- (d) promote progressive and equitable taxation;
- (e) promote corporate responsibility and accountability; and
- (f) promote tax compliance and a culture of responsibility.

In Australia, the current members of TJN-Aus are:

- ActionAid Australia
- Aid/Watch
- Anglican Overseas Aid
- Australian Council for International Development (ACFID)
- Australian Council of Social Service (ACOSS)
- Australian Council of Trade Unions (ACTU)
- Australian Education Union (AEU)
- Australian Manufacturing Workers Union (AMWU)
- Australian Nursing & Midwifery Federation (ANMF)
- Australian Services Union (ASU)
- Australian Workers Union, Victorian Branch (AWU)
- Baptist World Aid
- Caritas Australia
- Centre for International Corporate Tax Accountability & Research (CICTAR)
- Community and Public Service Union (CPSU)
- Electrical Trades Union, Victorian Branch (ETU)
- Evatt Foundation
- Friends of the Earth (FoE)
- GetUp!
- Greenpeace Australia Pacific
- International Transport Workers Federation (ITF)
- Jubilee Australia
- Maritime Union of Australia (MUA)
- National Tertiary Education Union (NTEU)
- New South Wales Nurses and Midwives' Association (NSWMWA)
- Oaktree Foundation
- Oxfam Australia
- Save the Children Australia

- Save Our Schools
- SEARCH Foundation
- SJ around the Bay
- Social Policy Connections
- TEAR Australia
- The Australia Institute
- Union Aid Abroad – APHEDA
- United Workers’ Union (UWU)
- Uniting Church in Australia, Synod of Victoria and Tasmania
- UnitingWorld
- Victorian Trades Hall Council
- World Vision Australia