



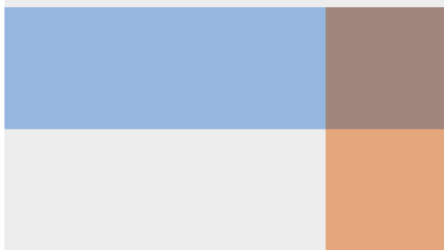
Impact Analysis

Multinational tax avoidance package

Tax integrity measures

Amending Australia's interest limitation (thin capitalisation) rules
and denying deductions for payments relating to intangibles
connected to low- or no-tax jurisdictions

May 2023



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Introduction/Executive Summary

The Government is seeking to raise revenue by implementing targeted changes to Australia’s thin capitalisation rules to limit an entity’s interest expenses in line with their taxable earnings before interest, tax, depreciation and amortisation (EBITDA) – in line with OECD/G20 Base erosion and Profit Shifting Project the report on *Limiting base erosion involving interest deductions and other financial payments Action 4, 2016 update* – and to stop related party borrowings from being deductible for tax purposes under an Australian specific third-party debt test.

The Government is also seeking to protect revenue from arrangements that involve intangibles that avoid Australian tax and seek to achieve overall low tax outcomes by denying tax deductions for payments that relate to intangible assets connected with low- or no-tax jurisdictions.

These policy changes were outlined in the Government’s Multinational Tax Integrity Package, announced in the October 2022-23 Budget. The Budget announcements were based on the Government’s election commitment to introduce a multinational tax avoidance package to raise revenue, address tax integrity issues, and improve transparency through better public reporting of multinational entity’s (MNE) tax information.

This impact analysis addresses the Government’s tax integrity measures to limit tax deductions for MNEs and forms part of the Government’s broad commitment to repair the Budget. There are two integrity measures, as outlined below.

Interest limitation (part one)

The policy options considered are:

- Maintain the status quo by not implementing any changes to Australia’s tax laws.
- Implement the Government’s Multinational Tax Integrity Package, specifically: amend Australia’s existing thin capitalisation rules to limit debt deductions for MNEs in line with the OECD’s recommended

approach under Action 4 of the Base Erosion and Profit Shifting (BEPS) program.

Denying deductions for payments related to intangible assets (part two)

- Maintain the status quo by not implementing any changes to Australia's tax laws.
- Implement the Government's Multinational Tax Integrity Package to introduce a new anti-avoidance rule limiting significant global entities' (SGEs) (entities with global revenue of at least \$1 billion) ability to claim tax deductions for payments relating to intangibles connected with low- or no-tax jurisdictions.

The recommended option for both integrity measures is to implement the Multinational Tax Integrity Package measures, as both measures are estimated to raise revenue – as opposed to the status quo option in which the benchmark revenue gain is zero – which will contribute to Budget repair.

Treasury has undertaken several rounds of consultation, including on Exposure Draft legislation in March and April 2023, which has informed the final legislation.

The transparency elements of the MNE tax avoidance package are addressed through a separate regulation impact statement, attached to this submission.

The problem

At a high level, the problem is about raising revenue and protecting revenue to assist with Budget repair by introducing legislative changes that will limit MNE's tax deductions. The legislative changes announced by the Government were an election commitment and target two of the known tax practices MNEs adopt to lower their tax payable in Australia.

The two MNE tax integrity measures announced in the October 2022-23 Budget target entities with cross-border activity. This reflects that MNEs can take advantage of the differences in tax laws between countries to minimise the amount of tax they pay, typically through structures designed to avoid profits, or limit their taxable presence, in a high(er) tax jurisdiction. This includes through adjusting debt amounts within a group and the use of intragroup (related party) borrowings to claim tax relief for interest expenses in certain jurisdictions to maximise their tax benefits – debt is deductible for tax purposes – while depleting tax receipts.

In addition, Australia's relatively high corporate tax rate and the increasing prevalence of highly mobile intangible assets (e.g., intellectual property) provide MNEs with incentives, and the opportunity, to structure arrangements to lower their tax in Australia, and shift profits to low- or no-tax jurisdictions to achieve overall lower tax outcomes.

If nothing is done – the status quo – MNEs' current structuring arrangements will continue unchanged, giving rise to an ongoing revenue benchmark (i.e., no gain in revenue).

The interest limitation change applies principally to MNEs operating in Australia (any inward/outward investor) with at least AUD \$2 million in debt deductions on an

associate inclusive basis. This is estimated to apply to approximately 2,500 entities. It is estimated to raise \$720 million to 2025-26.

The intangibles anti-avoidance rule applies to any MNE that is a significant global entity (SGE). Broadly, these are entities with global annual revenue of at least \$1 billion. As such, the anti-avoidance rule has the potential to impact around 10,000 self-assessed SGEs operating in Australia.

Both rules leverage existing thresholds.

Interest limitation

The OECD¹ notes that “...the use of third party and related party interest is perhaps one of the simplest of the profit-shifting techniques available in international tax planning. The fluidity and fungibility of money makes it a relatively simple exercise to adjust the mix of debt and equity in a controlled entity”.

Generally, there are two approaches to limiting debt-related deductions for tax purposes: either directly, by limiting the amount of interest expenses an entity can claim (e.g., an earnings-based rules), or indirectly, by limiting the amount of debt an entity can use to generate allowable interest deductions (e.g., debt-to-asset rules).

Australia’s current approach to limiting an entity’s debt deductions for tax purposes is the thin capitalisation regime – these rules limit the amount of debt-related deductions that can be claimed, based on its level of debt compared to assets. The current thin capitalisation regime has three tests: a safe harbour debt test; an arm's length debt test, and a worldwide gearing ratio test. These tests are examples of indirect approaches. However, indirect approaches to limiting debt-related deductions do not necessarily address integrity (profit shifting) risks where an excessive rate of interest is applied to a loan. This gives rise to a revenue problem, through lower tax payable on Australian income.

Intangibles

Royalties paid to foreign residents are subject to a final withholding tax in the hands of the foreign recipient. The Australian entity – the payer – has the administrative responsibility of withholding the tax on behalf of the foreign payee, and the royalty expense can be claimed by the Australian entity payer as an income tax deduction, thus reducing the Australian entity’s taxable income. The general applicable withholding tax rate is 30 per cent, but it can be lowered to rates generally of 5 to 15 per cent where the recipient is a resident of a jurisdiction that has a bilateral tax treaty with Australia.

Australia’s existing tax integrity framework includes a comprehensive range of general and specific anti-avoidance provisions. However, MNEs are still able to explore loopholes, as evidenced via ATO Taxpayer Alerts summarised below.

¹ OECD (2017), *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 - 2016 Update: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing Paris, p. 19.
<http://dx.doi.org/10.1787/9789264268333-en>

For example, where an Australian resident makes a royalty payment to a related foreign recipient located in a low- or no-tax jurisdiction, the MNE group could still obtain a two-fold unfair tax advantage, by:

- reducing the tax liability of the Australian entity (by claiming income tax deductions for the royalties paid), and
- having the royalties favourably taxed (or not taxed at all) at the recipient's jurisdiction.

In other instances, an Australian entity may be able to avoid the application of withholding tax on royalties by disguising or 'embedding' such royalties within other types of payments (such as payments for tangible goods or services or management fees). These arrangements are able to avoid the application of the royalty definition itself because the entity mischaracterises, 'embeds' or disguises amounts which in substance qualify as royalties into a payment that is not a royalty. These are known as 'embedded royalties'. These arrangements have been raised by the ATO in Taxpayer Alert TA 2018/2 and pose an integrity risk to Australia's tax base.²

Entities may also be able to reduce Australian profits through moving an intangible asset to a low- or no-tax jurisdiction so profits are instead recognised in the low- or no-tax jurisdiction rather than Australia, or the economic activity in Australia associated with an intangible offshore is purposefully mischaracterised. This reduces the Australian taxable profits given either the intangible or the economic activity is no longer associated with Australia. These arrangements have been raised by the ATO in Taxpayer Alert TA 2020/1 and pose an integrity risk to Australia's tax base.³

As indicated from the ATO Taxpayer Alerts, large MNE groups have been observed to take advantage of these arrangements involving intangibles to shift profits to low- or no-tax jurisdictions. The fast growth of the digital economy has exacerbated these practices, with an increasing number of MNEs structuring their ownership of intangibles through low- or no-tax jurisdictions, giving rise to integrity risks to Australia's tax base.

Case for government action/objective of reform

These integrity issues need to be addressed to reduce continuing risks to Australia's tax base. Raising and protecting revenue is best achieved by strengthening domestic tax laws through legislative changes, which can only be achieved through government intervention. Legislative changes provide taxpayers with greater certainty than other options, such as relying on administrative guidance.

Interest limitation (thin capitalisation)

The core objective of this policy is to increase revenue (taxes payable) by limiting the amount of debt deductions entities can claim in Australia for tax purposes. The objective is intended to balance raising more revenue against supporting genuine

² <https://www.ato.gov.au/law/view/document?DocID=TPA/TA20182/NAT/ATO/00001>

³ <https://www.ato.gov.au/law/view/document?docid=TPA/TA20201/NAT/ATO/00001>

commercial activities and investment in Australia and minimising compliance burdens on industry.

The interest limitation rules are complex and the amendments to the income tax laws are technical, which may give rise to genuine unintended consequences (such as transitional or compliance costs being higher than intended). Taxpayers restructuring specifically to undermine the policy intent would detract from the revenue gain.

Treasury's stakeholder engagement has sought to take into account all of these considerations to ensure the final measure is effective and operates as intended.

Deduction denial (Intangibles)

The core objective of this policy is to expediently protect the integrity of Australia's tax base from arrangements that involve intangibles to shift profits from Australia to low- or no-tax jurisdictions to achieve overall lower tax outcomes.

Whilst aiming to address tax integrity issues, the objective of the policy is also to achieve this in a balanced way. This includes considerations around not adversely affecting commercial investments between unrelated parties that are not achieving low tax outcomes, minimising compliance burdens, and simplifying administration.

Australia has existing rules in the tax integrity framework that may apply where taxpayers seek to reduce their tax liabilities in connection with transactions involving intangibles. These include the transfer pricing rules (which require cross-border transactions to be arm's length) the general anti-avoidance provisions in Part IVA of the *Income Tax Assessment Act 1936* (which cancel tax benefits in a range of circumstances) and the controlled foreign company rules (which attribute certain income parked offshore back to Australia).

However, these rules do not specifically target arrangements involving intangibles, and may not be applicable or may not apply expediently to address arrangements that involve intangibles. For example, although the general anti-avoidance rule has broad scope, it can be resource-intensive due to a requirement to consider whether there is a purpose of tax avoidance and it could take an extensive period to apply.

OECD negotiations to address the tax challenges arising from digitalisation and globalisation have been ongoing with good progress having been made. In particular, Pillar Two seeks to establish a global minimum tax on large multinationals. It primarily seeks to address the 'race to the bottom' for corporate income tax rates where countries have lowered their corporate income tax rates to attract or retain local investments from multinationals. The implementation of Pillar Two global and domestic minimum taxes would accordingly help to address profit shifting arrangements involving intangibles given it would reduce the prevalence of low- or no-tax jurisdictions. Although a number of countries have announced their implementation of the Pillar Two global and domestic minimum taxes, which signals a global desire for implementation (with more countries understood to follow with their own announcements), there is a period of time by which there remains no targeted rule to address or disincentivise large multinationals from achieving lower tax outcomes through arrangements involving intangibles. This leaves an opportunity for the continued use of arrangements involving intangibles to achieve low tax outcomes and leaves the integrity of the Australian tax base at risk.

Policy options

The options are primarily about raising revenue and revenue protection. They have been designed to target deliberate tax minimisation and avoidance activities, while balancing the need to attract and retain foreign capital and investment in Australia, compliance cost considerations for business, and continuing to support genuine commercial activity.

Thin capitalisation (interest limitation)

This impact analysis considers two options.

Status quo

This option would involve no legislative changes to Australia's current asset-based thin capitalisation tests. That is, taxpayers would continue their current practices, there would be no increase in revenue and Australia's tax laws would remain out of line with OECD best practice guidance (see below).

Revenue raising election commitment

This option would align with the OECD's earnings-based interest limitation rule (BEPS Action 4 – 2016 Update) to limit net interest expenses to 30 per cent of profits, using tax EBITDA as the measure of profits, with a carry forward rule for denied deductions.

As a revenue raising, tax integrity measure, this option strengthens Australia's tax policy settings to better mitigate against base erosion and profit shifting risks, in line with OECD best practice guidance. This option:

- includes a 15-year carry forward rule for denied interest amounts, under the fixed ratio rule
- maintains the arm's length debt test but with amendments to disallow deductions for related party debt (renamed as the 'third-party debt test') and
- replaces the worldwide gearing (asset-based) ratio test with an earnings-based group ratio rule for in-scope (general) entities (called the 'group ratio test').

Under this option, the earnings-based fixed ratio test will be the default test, with the group ratio and third-party debt tests operating as substitute tests. The carry forward rule is a standard feature of the earnings-based test and most countries with earnings-based (EBITDA) regimes have adopted it, albeit with different approaches (time periods). The OECD model provides countries with flexibility on this.

The amendments to the worldwide gearing test are also in line with the OECD guidance. The earnings-based group ratio rule will be available for entities that are 'naturally' higher geared for commercial purposes at the group level, and who would otherwise be restricted under the EBITDA fixed ratio.

The third-party debt test is an Australian specific rule, replacing the existing arm's length debt test, preventing related party debt deductions from being tax deductible. This amendment is in line with the OECD best practice guidance which suggests that if countries retain an arm's length test it should not serve to reduce the effectiveness of the fixed ratio earnings-based rule in addressing base erosion and profit shifting. Disallowing deductions for related party debt, and instead requiring deductions to be based on external commercial lending terms, limits the ability for entities to use debt as a base erosion or profit-shifting arrangement. This is consistent with the revenue raising intent of the Government.

However the third-party debt test also reflects the balance in policy approach to support continued investment in Australia (as per the policy objectives above). The design reflects that the earnings-based rules may not work appropriately for asset-heavy sectors with long depreciation periods, such as the infrastructure and property sectors. Through public consultation, property and infrastructure industry representatives shared insights on their third-party funding structures, which informed the final design parameters. This helps to mitigate transitional effects on industry.

The interest limitation rules apply to multinational entities operating in Australia, and any inward/outward investor, with at least AUD \$2 million in debt deductions (on an associate inclusive basis). This includes approximately 2,500 entities. The Option leverages the existing thin capitalisation thresholds. The earnings-based rules do not apply to financial entities or authorised deposit-taking institutions (ADIs), and ADIs continue to be subject to the existing thin capitalisation regime.

The OECD's interest limitation model

In 2013, the OECD released a report *Addressing Base Erosion and Profit Shifting* which led to OECD and G20 countries adopting a 15-point Action Plan to address BEPS in September 2013. Interest limitation was one of the Actions (item 4).

In 2015, the OECD published a best practice framework involving interest deductions which limited the level of deductible interest expense to an entity's earnings. This report was updated in 2016, and it is this 2016 report which anchors the Government's decision.

The OECD guidance initiated a global movement towards earnings-based (EBITDA) tests, with the majority of OECD countries having since adopted earnings-based interest limitation rules⁴. In this regard, the Government's election commitment will bring Australia into line with the rest of the world.

Intangibles

This impact analysis considers two options.

Status quo

This option would involve no changes to Australia's current legislative framework around deductions for payments relating to intangible assets. That is, large MNE

⁴ Burnett, C.; 2019; Interest deductibility: implementation of BEPS Action 4 and the future of transfer pricing of intragroup finance; <http://ssrn.com/abstract=3459350>

taxpayers would continue to claim an income tax deduction for payments relating to intangibles made to related parties for the exploitation of intangibles connected with low- or no-tax jurisdictions. There would be no increase in revenue.

Revenue protection election commitment

This option denies deductions for payments made by a SGE to a related party for the exploitation of an intangible asset, where the arrangement leads to income derived in a low- or no-tax jurisdiction. Under this option a low- or no-tax jurisdiction is a jurisdiction with:

- a tax rate of less than 15 per cent; or
- determined to have a tax preferential patent box regime without sufficient economic substance.

As an anti-avoidance rule which aims to protect revenue, this option is specifically targeted towards deterring SGEs from avoiding corporate income tax by structuring their arrangements so that income from exploiting intangible assets is derived in low corporate tax jurisdictions.

The option also applies where a payment to exploit an intangible directly or indirectly leads to income derived in a low- or no-tax jurisdiction. This reduces the potential for the option to be circumvented, for example through a payment being made to a high tax jurisdiction.

There is a risk that correct information to support the amount subject to a denial may not be provided by the taxpayer. To address this, an increased penalty may be imposed where the amount has not been appropriately characterised.

Cost benefit analysis/Impact analysis

Interest limitation

Option 1 – status quo

Maintaining the status quo would not increase revenue because there would be no increase in debt deductions denied. It would also mean Australia's current approach to interest limitation would continue to be based on a debt-to-asset ratio with no nexus to economic activity. The current rules allow, generally, for a larger quantum of interest deductions – for instance, up to 60 per cent of the value of the entity's assets – than under the earnings-based test.

This approach would be inconsistent with the OECD best practice framework, which has seen a generally consistent uptake globally. For example, in the US, interest deductions are limited to the sum of business interest income, 30 per cent of adjusted

taxable income, and floor plan financing interest.⁵ Similarly, in the UK⁶ and Canada⁷, interest deductions are limited to either 30 per cent of tax EBITDA or the group's ratio of interest expense to tax EBITDA.

Under this option, investment intention effects and any compliance burdens (e.g., general tax compliance, arm's length debt testing) are assumed to be neutral, reflecting no change to tax policy settings.

On balance, this option presents no net benefit. It will bring no gain to revenue, limiting the Government's broader fiscal repair intent and with no changes to Australia's interest limitation rules, taxpayers will continue to have incentives to engage in BEPS arrangements.

Option 2 – implementation of election commitment

Amending Australia's interest limitation rules in line with the OECD best practice framework (30 per cent EBITDA test) will raise revenue, increasing receipts by an estimated \$720 million over the four years until 2025-26 compared to the status quo option. The \$720 million increase in revenue is a result of the increase in denied debt deductions. Approximately 2,500 taxpayers are in scope of the new interest limitation rules.

*Amending Australia's interest limitation rules - ATO receipts (\$m)**

	2022-23	2023-24	2024-25	2025-26
Receipts	-	-	370.0	350.0

**Extract: 2022-23 Budget*

This option supports the Government's Budget repair focus. It ensures an entity's debt-related deductions are directly linked to its economic activity and its taxable income, making the rule reasonably robust against tax planning and BEPS risks.

While revenue raising is the primary focus, the option also ensures the tax design of the interest limitation rules balances broader macroeconomic considerations. That is, this option is intended to support the Government's revenue raising intent by ensuring the tax system is better placed to raise the revenue required, while appropriately balancing neutrality and equity considerations against non-revenue and other broader macro-objectives such as continuing to position Australia as an attractive destination for foreign investment.

From a tax framework perspective, the option addresses a known tax avoidance arrangement, as identified by the OECD, and brings Australia into line with most OECD countries who have also implemented an earnings-based interest limitation rule. Consistency in international tax standards supports efforts to reduce base erosion and profit shifting arrangements, by reducing variability in approaches which MNEs could

⁵ IRS, 2023, [Basic questions and ...~https://www.irs.gov/newsroom/basic-questions-and-answers-about-the-limitation-on-the-deduction-for-business-interest-expense](https://www.irs.gov/newsroom/basic-questions-and-answers-about-the-limitation-on-the-deduction-for-business-interest-expense).

⁶ HM Revenue and Customs, 2022, [Restriction on Corpo...~https://www.gov.uk/guidance/corporate-interest-restriction-on-deductions-for-groups](https://www.gov.uk/guidance/corporate-interest-restriction-on-deductions-for-groups).

⁷ Canada, Department of Finance, 2023; <https://fin.canada.ca/drleg-apl/2022/ita-lir-1122-n-1-eng.html>

exploit. This option would implement the same 30 per cent of tax EBITDA limitation (the fixed ratio rule) as most OECD countries (e.g., EU, US, UK, Canada).

While an earnings-based test will directly limit the amount of debt deductions taxpayers can claim to a proportion of their earnings – effectively imposing a cap on the amount of deductions that can be claimed and reducing the amount of debt deductions claimed in Australia – these tests are also intended to be simple to administer relative to the current thin capitalisation rules. This will help to minimise the overall compliance burden on taxpayers.

This reflects that the move to an earnings-based rule is based on common commercial concepts (i.e., tax EBITDA) which are well understood by industry. That said, given the earnings-based rules apply across all sectors (except financial/ADI), entities would be expected to incur some transitional adjustments and compliance costs in applying the new rules. This would include education impacts (keeping abreast of the new rules) and potential refinancing or debt restructuring considerations.

Treasury sought to test the extent of these impacts as part of the initial public consultation process (see section below), however stakeholders did not quantify the estimated costs and impacts.

During subsequent consultation, stakeholders accepted, generally, that the shift to earnings-based rules based on EBITDA concepts, would be a simplification on the existing rules however they had concerns with elements of the exposure draft legislation, which they claimed were overly restrictive and would impose transitional and restructuring costs. An example was with the proposed amendment to section 25.90, in which industry asserted would require taxpayers to track and record their sources of debt funding, where the funding has been allocated and in what proportions. Stakeholders indicated this would be significant, as the general industry practice is to fund projects through a common capital allocation pool, as the current rules have not required specific tracing. This feedback was observed from stakeholders across the economy.

Stakeholders also outlined that the earnings-based interest limitation rules would be particularly restrictive for the property and infrastructure sectors because these sectors are typically highly leveraged compared to other sectors and experience timing delays from when they acquire debt and pay related expenses (i.e., construction of a property or infrastructure asset) to the flow through of earnings (i.e., sale of the property/asset). Industry representatives claimed that the earnings-based rules would have a disproportionate impact on these sectors, particularly on new construction projects which have specific external funding arrangements.

While the third-party debt test is intended to address these issues, stakeholders, particularly within the property and infrastructure sector, indicated that changes to restrict third-party (e.g., bank) debt deductions were broader than anticipated and would likely result in higher capital costs for investment in Australia (or deter inbound investment, including from foreign superannuation/pension funds), which may result in some debt financed projects not proceeding.

The third-party debt test was refined in response to this stakeholder feedback, expanding the conditions to accommodate most common financing arrangements. The intended outcome is that property and infrastructure entities can claim third-party debt deductions (such as bank debt), with no links to earnings, subject to satisfying test conditions (a set of restrictions intended to prevent an unlimited quantum of third-party debt replacing the existing related party debt, and to prevent debt dumping into

Australia from offshore). This reflects the need to balance tax integrity with genuine commercial investments.

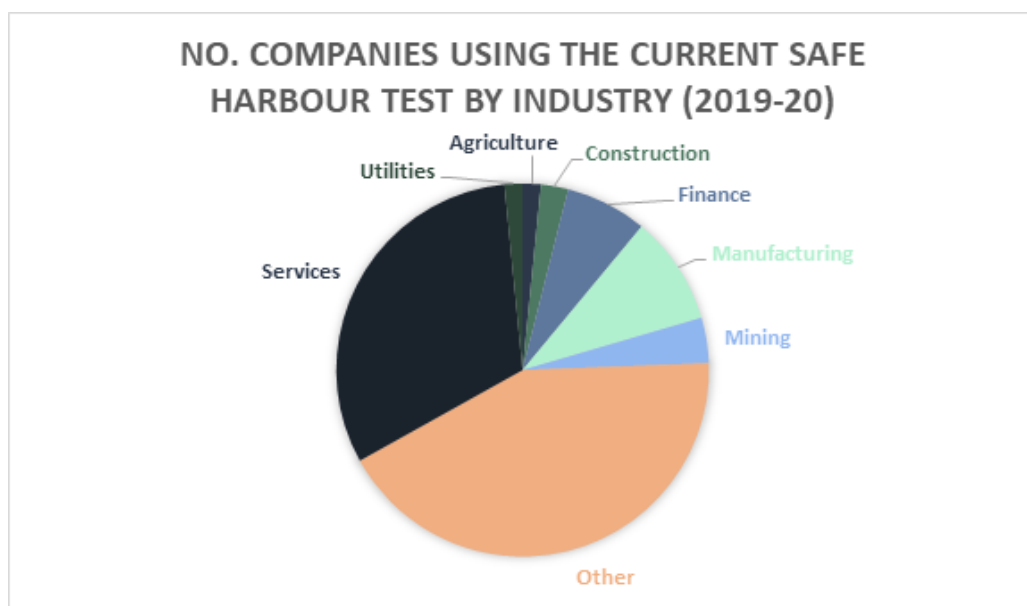
The amendments to the third-party debt test recognise the role of external debt in funding real property developments and helps to mitigate any unintended impacts or uncertainty for future investments projects in Australia (including on related government policy, such as supporting investment into the build-to-rent sector), or transitional costs in applying the new rules.

The third-party debt test is specific to Australia, although though most countries have some form of bespoke arrangement for real property industries. For instance, Canada, the UK, and the US all provide some form of special treatment for real property projects.

Businesses impacted

The current thin capitalisation regime distinguishes general entities from financial entities and ADIs. The rules also provide a de minimis threshold, such that entities with total debt deductions below the current \$2 million de minimis threshold are excluded from the rules.

The option applies to general entities that are above the de minimis threshold. Financial entities/ADIs are typically net lenders of interest and present less of an observed base erosion/profit shifting risk. There are approximately 2,500 general entities in scope, across all sectors of the economy:



Net impact

This option is the preferred option. It is estimated to increase revenue by \$720 million over the four years until 2025-26, compared to the ‘benchmark’ under the status quo option (i.e., a zero gain to revenue). The shift to earnings-based rules away from the current asset-based rules will also align Australia with international standards and provide for a relatively robust protection against BEPS activity.

The thin capitalisation rules are a specialised area of tax law characterised by taxpayers with access to sophisticated tax advice. The changes under this option are designed to

target MNEs with cross-border activity (large businesses), with the majority of affected taxpayers already operating in jurisdictions which have enacted the OECD earnings-based rules. There will be some medium-sized entities affected. Small businesses are expected to be excluded, due to the \$2m de minimis exemption. In practice, tax advisory firms are likely to provide their initial advice on the impact of the changes as a service to existing clients (which they may not initially charge for) as part of their ongoing client engagement and preparation of client tax information.

However, the amendments are estimated to increase the compliance burden on taxpayers in the initial year they come into effect, in the form of one-off costs. As businesses adjust to the new rules, they will likely seek updated tax advice responding to the changed rules for the first applicable income year. Once this initial advice is received, nil ongoing regulatory costs are estimated, as these costs are expected to fall under the business-as-usual costs of the company that they already incur as part of their annual tax management arrangements. This costing has not considered any behavioural response, such as entities restructuring to maximise their debt deductions, and has not been tested with stakeholders – stakeholders did not provide information on regulatory costs in response to questions in consultation processes, in a quantitative manner. The compliance cost assumptions subsequently reflect limited comments that need to be extrapolated to a wider stakeholder base.

Estimated compliance costs for businesses subject to the amended thin capitalisation rules

	Cost per medium-sized business (\$) ⁸	Cost per large business (\$) ⁹	Total cost for all businesses (\$) ¹⁰
Start-up cost	13,000	30,000	70,118,000
Ongoing compliance cost per year	0	0	0

The compliance burden is mitigated through the design of the earnings-based test. For example:

- the use of tax EBITDA is a common commercial concept, well understood within industry.

⁸ Based on the assumption of 2 tax advisors per firm costing \$800/hour for 8 hours. Medium-sized business typically use mid-tier tax advisory firms for tax advice. These firms typically charge slightly less than the leading advisory firms. Therefore, \$800/hour has been chosen as the average charge-out rate, based on the average charge-out rate for the leading tax advisory firms (see footnote below).

⁹ Based on the assumption of 3 tax advisors per firm costing \$1000/hour for 10 hours. The blended charge-out rate for specialist tax advice from leading tax advisory firms ranges from \$500-\$1500/hour depending on the seniority of the consultant. \$1000/hour has been chosen as the charge-out rate because it is the mid-point of this range, reflecting that tax advice is typically prepared with input from consultants at a range of seniority levels and hence will be billed at a range of rates.

¹⁰ Based on the assumption of an 80:20 split between large and medium sized businesses affected. Charge out rates are not generally published and differ per client (weighted against bulk work, one off request etc).

- the carry forward rule (15 years) will smooth the effects of temporary volatility in earnings, and limit distortions on investment decisions where high up-front capital investment is required before earnings are generated.
- allowing for denied debt related deductions to be claimed in a subsequent income year (i.e., amounts that exceed the proposed 30 per cent EBITDA ratio) provides the same general outcome as the status quo, for entities in a negative tax EBITDA phase.

Additionally, the third-party debt test is intended to:

- support genuine commercial financing arrangements, with no or limited refinancing needed (generally), specifically in the property and infrastructure sectors.
- ensure entities can raise external (arm's length) debt finance as appropriate, while preventing the use of related party debt as a profit-shifting arrangement.
- simplify compliance by removing the 'standalone entity' notional test, which is required under the current arm's length debt test to prove what a business acting at arm's length would borrow, and what independent commercial lenders would lend to the business.

We also anticipate that the move to an earnings-based test could be deregulatory for entities with low asset bases or higher levels of intangibles/internally generated goodwill (such as service-based entities). The current asset-based approach favours asset-based industries (such as the infrastructure and property industries), as it does not recognise 'material assets' such as goodwill, meaning that service-based entities may have been led to use the more compliance-heavy arm's length debt test to access debt deductions. Under the tests proposed in this option, service-based entities will instead be able to claim debt deductions in line with their tax EBITDA, which is a simpler calculation compared to the existing arm's length debt test approach.

Additionally, some groups of trusts and other non-consolidated groups may opt to simplify their operating structures in absence of specific excess capacity rules, such as by limiting the number of interposed trusts in their structure. This response could arise by restructuring the trust's debt financing to align the debt with the income earning asset (rather than structuring whereby debt is on-lent through a chain of trusts) to support their debt deductions under the fixed ratio (earnings-based) test, which would also help to increase the transparency of trust structures.

Ultimately, the final design parameters seek to balance tax integrity considerations with non-tax considerations, such as continuing to attract and retain foreign capital and investment in Australia, limiting investment distortions, minimising unnecessary compliance costs for business, and continuing to support genuine commercial activity. This includes consideration of broader policy objectives on infrastructure investment, the renewable energy transition, and fostering start-ups/ innovation (see consultation section below).

Intangibles

Option 1 – status quo

Maintaining the status quo would not protect the revenue base because MNEs will continue to claim an income tax deduction for payments relating to intangibles made to related parties for intangibles connected with low- or no-tax jurisdictions.

This approach is also inconsistent with the actions taken by various other jurisdictions to address profit-shifting issues related to intangibles. For example, jurisdictions such as the United States, United Kingdom, Netherlands and Germany have implemented measures to address similar issues.

This option presents no net benefit. It will not protect Australia's revenue base or bring any gain to revenue. It limits the Government's broader fiscal repair intent with no changes to Australia's anti-avoidance provisions.

Option 2 – implementation of election commitment

Denying deductions on payments provides an efficient mechanism to protect revenue, given deductions would be relevant for an Australian taxpayer over which the ATO has better oversight. Where the criteria for the application of the measure are met, the option would deny a deduction for the Australian taxpayer, allowing an increased level of taxable income to remain in Australia, thereby protecting Australia's revenue base.

There are around 10,000 tax lodging entities operating in Australia that have self-assessed as having SGE status in their most recent income tax returns, and could therefore be impacted by this option. This option is targeted at SGEs as these are the entities at higher risk of entering into profit-shifting arrangements involving intangibles. Denying a deduction would reduce incentives for these taxpayers to engage in arrangements involving intangibles to reduce their Australian tax and consequently their overall tax outcomes.

The option affects industry sectors to the extent their business involves related party payments for the exploitation of an intangible where income is derived in a low- or no-tax jurisdiction. Intangible assets include intellectual property, copyright, access to customer databases, algorithms, licences, trademarks and patents.

The option would address arrangements of concern that have been raised publicly by the ATO where arrangements involve income being derived in a low- or no-tax jurisdiction, particularly where an Australian entity may be able to avoid the application of withholding tax on royalties by disguising or 'embedding' such royalties within other types of payments, or where entities have reduced Australian profits through moving an intangible asset to a low- or no-tax jurisdiction so profits are instead recognised in the low- or no-tax jurisdiction rather than Australia, or the economic activity in Australia associated with an intangible offshore is purposefully mischaracterised. The option would discourage this activity and incentivise appropriate characterisation given the consequence of a deduction being denied and penalties being applied.

Stakeholders have noted that denying deductions for payments in relation to intangibles may disincentivise investment in Australia due to increased tax liabilities, increased compliance costs and difficulties in applying the option. These issues are raised in the context of business transactions in Australia involving intangibles potentially incurring higher tax (via a denial of a deduction) or needing to consider the application of the option and update systems accordingly.

This option aims to balance these considerations by targeting the option to areas of higher risk by applying to large multinationals and payments between related parties.

The option also aims to balance compliance and administration considerations as it provides a simple way to identify a low- or no-tax jurisdiction, such as utilising the headline corporate income tax rate of a jurisdiction.

Stakeholders have also noted possible complexities and compliance burdens from a new integrity rule on top of a number of existing integrity rules and upcoming international changes at a global level.

The option will complement Australia’s existing anti-avoidance provisions by providing an efficient and straight-forward rule to tackle arrangements involving intangibles, and it does not require proof of a tax avoidance purpose.

It is recognised that progress is being made on widespread implementation of Pillar Two global and domestic minimum taxes which will help address profit-shifting arrangements involving intangibles. While the widespread implementation of Pillar Two global and domestic minimum taxes occurs, this option complements the objectives of Pillar Two as it would tackle the integrity issues involving intangibles where income is derived in low- or no tax jurisdictions expeditiously and protect Australia’s revenue. In addition, this option would address other integrity concerns not dealt with by Pillar Two, such as those related to ‘embedded royalties’.

Net impact

On balance, the benefits of this option outweigh the costs given the increased protection it will provide to Australia’s revenue base. It seeks to fill a gap in the existing antiavoidance legislation to expeditiously address arrangements involving intangibles, and it aims to address tax avoidance arrangements that have been made public by the ATO.

Estimated compliance costs

	Cost per entity (\$)	Total cost for all businesses (\$) ¹¹
Start-up cost	1,973	19,734,900
Ongoing compliance cost per year	508	5,081,300

The impacted population is significant global entities, that is multinational groups with annual global income of \$1 billion or more.

¹¹ Based on assumed upfront learning and education costs of \$170-\$900 per hour, upfront evaluation and planning costs of \$900 per hour, and ongoing evaluation, planning and record-keeping costs of \$170 per hour. Assumptions made based on advice from an industry expert.

These taxpayers will face an upfront increase in compliance burdens as they will need to be aware of and become familiar with the option and consider whether the rule applies to them. Taxpayers will also seek advice and update their systems and processes to assist with complying with the rule. Taxpayers who are affected in particular will undertake further work to evaluate and plan in accordance with the rule.

On an ongoing basis, taxpayers may need to re-assess implications, maintain records and review the costs and benefits of their arrangements.

Despite the likely increase in compliance burdens, this may be somewhat mitigated due to existing integrity rules and reporting mechanisms SGEs are required to follow. For example, there are existing integrity rules that require taxpayers to consider the tax paid on their payments, and the information required for the application of the option could be sourced from the statements and documents already required from SGEs under their corporate and tax reporting obligations (such as transfer pricing documentation and country-by-country reporting).

Consultation plan

Treasury conducted extensive stakeholder engagement on these policy changes. Public submissions received by Treasury are available on the Treasury consultation website. The general feedback on each measure is summarised below.

Interest limitation

Consultation: discussion paper (August 2022)

A discussion paper on the election commitment was released for public consultation, from 5 August to 2 September 2022. Treasury met virtually and in-person with industry representatives from the property, infrastructure and large corporates sectors, individual firms in the infrastructure and funds management industries, tax advisory firms and the academic community. Treasury received 70 submissions (some in confidence) reflecting broad feedback from businesses, industry groups, academics, civil society groups and individuals. These submissions have been published on Treasury's website.¹²

This preliminary consultation informed the policy design options for the Government's Budget announcement (25 October 2022). Consultation at this stage was important as the Government's stated policy to move to an earnings-based interest limitation rule was a fundamental change to the current tax rules. This provided Treasury an insight into how stakeholders may be affected by the proposed changes, helping to balance the Government's revenue raising and tax integrity intent, while having regard for current industry practice, and implementation considerations to minimise unintended consequences. The main issues raised in this initial consultation included:

¹² See Government election commitments: [Multinational tax integrity and enhanced tax transparency Consultation Paper August 2022](#)

- **Income volatility:** industry stakeholders noted the use of an earnings-based test will disadvantage sectors with income volatility, and long-term projects which give rise to earnings in future years. On this basis, some stakeholders requested various concessions ranging from an outright exemption from the fixed ratio rules, various forms of transitional relief, grandfathering of existing arrangements, and specific industry exemptions.
- **Carry-forward rule:** stakeholders almost universally supported a carry forward mechanism to address income volatility issues. Comments primarily focused on denied interest amounts, with some support for additional carry forward of unused capacity to provide further flexibility. Stakeholders generally sought an indefinite carry forward period for denied interest amounts.
- **External third-party debt test:** stakeholder comments were weighted towards retaining the existing arm's length debt test without change or exempting particular sectors from any policy changes. Stakeholders noted the potential adverse effects on investment if genuine debt financing arrangements were restricted – particularly in asset heavy industries such as the real estate and infrastructure sectors – providing various financing examples which were described as common practice in industry and should be accommodated under the measure. Most examples focussed on third-party debt arrangements.
- **Timing:** views on the complexity of the legislative changes required and concerns that a 1 July 2023 start might not allow sufficient time for businesses to adjust to the new rules. Stakeholders sought a deferred commencement and/or transitional arrangements.

In response to this feedback, a 15-year carry forward rule was incorporated into the design of the fixed ratio rule, and the modified arm's length debt test was refined to include a narrow conduit financing arrangement targeting certain on-lent (prima facie related party) financing arrangements within the real estate and infrastructure sectors, while still balancing integrity concerns.

Consultation: post-Budget announcement (November 2022)

Following the October Budget announcement, Treasury met with industry representatives from the property sector and tax advisory firms on behalf of individual entities, to discuss certain technical parameters, including:

- The group trust rule and associate entity excess provisions in relation to the fixed ratio test.
- The third-party debt test, including examples of debt financing arrangements.
- Stakeholders used this consultation to clarify the Budget announcement, particularly around the third-party debt test. Stakeholders passed on further insights on how a third-party debt would be utilised within industry. This further informed the exposure draft legislation.

Consultation: exposure draft legislation (March 2023)

On 16 March 2023, Treasury released the exposure draft Bill and explanatory memorandum for public consultation for a four-week period ending on 13 April 2023. Treasury met with a range of stakeholder groups – industry representatives, individual firms, tax advisory firms – across all sectors. The dominant focus of this consultation period was an announced integrity change, the proposed amendment to section 25.90 (see below). Treasury received 54 submissions on the exposure draft legislation, including some in confidence. The public submissions will be published on the Treasury consultation website after legislation is introduced. The main themes raised by stakeholders included:

- **Disallowance of deductions for interest expenses incurred to derive non-assessable non-exempt (NANE) income from certain foreign equity distributions:** this amendment (known as the section 25.90 amendment, reflecting section 25.90 of the *Income Tax Assessment Act 1997*) was proposed with a revenue raising and tax integrity intent, to ensure that debt (interest) deductions are linked to taxable income, and to address tax planning by creating a nexus between interest deductions and earnings/economic activity in Australia. It had not been signalled to industry in the initial discussions and it attracted a broadly consistent response from the large corporate sector, across all sectors. Stakeholders raised four general issues:
 - that the proposed amendment went beyond the thin capitalisation provisions.
 - that not enough time was given for consideration, for what industry asserted was a substantive policy change. Stakeholders indicated the change would have retrospective application by re-introducing tracing and apportionment calculations for existing debt pools – an exercise industry claimed was impractical and not in keeping with general industry capital allocation frameworks (essentially a pool of funds arrangement; a mix of debt and income) – and result in a large compliance burden.
 - that the change would disadvantage Australian businesses (relative to foreign entities) that fund foreign operations with Australian debt rather than equity or foreign-sourced debt. Stakeholders claimed, generally, that Australian entities source debt domestically to fund overseas operations for reasons of simplicity, efficiency, or their general limited access to foreign capital markets, and that limiting debt deductions for such economic activity would increase the cost of capital and have adverse effects on investment/business growth.
 - that the government should not proceed with this change (or if it did proceed, that any such change should be prospective, or at least accommodate a form of grandfathering or grace period), or alternatively, progress it as a separate measure independent of the ‘core’ thin capitalisation to allow for more detailed consideration of the issue.

Stakeholder concerns regarding section 25-90 were considered by Government, with the proposed amendment deferred, reflected in its removal from the final legislation, to be considered via a separate process to this interest limitation measure. Targeted debt creation rules were progressed in its place.

- **Third-party debt test (TPDT):** stakeholders (generally from the property and infrastructure sectors) identified limitations with the proposed rule and claimed it would have only limited application, with many common commercial third-party debt arrangements involving conduit entities likely unable to not meet the conditions of the TPDT, specifically in relation to the narrow ‘recourse’ and ‘same terms’ requirements imposed on the debt. Stakeholders commented that the rules needed to be expanded to minimise adverse effects on investment, including on investment in renewable energy infrastructure.

In response to these concerns, the third-party debt test was adjusted to better accommodate the common financing arrangements presented to Treasury, specifically by the real estate and infrastructure sectors. These changes included broadening the access conditions around ‘recourse’ and ‘same terms’, while balancing integrity concerns to protect against uneconomic quantum of debt.

- **Mutual election/associate entity test:** stakeholders commented that the proposed threshold test was unpractical and would limit the availability of the third-party debt test because certain entities subject to the perceived low threshold would not have a material level of control over (or in some instances visibility of) the tax affairs of other entities. Stakeholders noted this would give rise to a ‘domino effect’ bringing ever increasing numbers of entities into the election test.

The broad reach of this test was unintended and in response to these issues, the associate entity test threshold was amended in line to introduce a new concept around the obligor group.

- **Trust grouping rules (and general neutrality with tax consolidated groups):** stakeholders noted the draft legislation seemed to be weighted towards accommodating corporate structures and that further consideration was required for trusts and partnerships. This included facilitating excess interest capacity for trust ‘groups’, to reflect the existing arrangements possible under current law, noting this aligns with the ‘natural capacity’ of corporate groups.

In response to these issues, a number of technical changes were adopted to better accommodate trusts and non-consolidated groups, for example by amending the tax EBITDA calculation. Feedback was considered on the inclusion of an ability to share excess interest capacity within trust groups, but ultimately decided against including this for simplicity and integrity reasons.

- **Carry forward deductions:** stakeholders noted the proposed loss of carry-forward deductions when entities depart from the fixed ratio test – to use either the group ratio test or third-party debt test – was overly restrictive. Similarly, stakeholders noted that reliance on the (modified) continuity of ownership test, with no option to use the same business test, could result in forgone carry-forward deductions in what industry described as general acquisition scenarios and for start-ups which change ownership.

In response to this feedback, the business continuity test was introduced as an alternate requirement to access carry-forward deductions, to better accommodate acquisition arrangements.

- **Definitional clarity:** stakeholders requested further clarity on the definitions of debt deduction and net debt deduction, noting that the concept of debt deduction was broadened without a commensurate approach to interest income. The tax

EBITDA calculation, specifically the ‘depreciation’ element, was claimed by many stakeholders to be overly narrow.

In response, the definitions of debt deduction and net debt deduction were revised to be better aligned and the depreciation component of the tax EBITDA calculation was broadened to more closely align with the existing provisions in the income tax law.

Consultation: post-exposure draft legislation (April 2023)

Treasury continued to meet with industry representatives after the public consultation period ended, mostly in relation to the third-party debt test and trust grouping rules. These bilateral meetings provided a further opportunity for stakeholders to discuss in specific detail the technical elements of their submissions and to discuss the proposed drafting approach.

Stakeholder feedback in these meetings were considered and, where appropriate, reflected in the final design (as indicated above) to improve the functionality and operability of the legislation, with a view to minimising unintended consequences. This included targeted, in-confidence consultations on revised draft legislation.

Intangibles

Consultation: discussion paper (August 2022)

Under the same discussion paper as outlined above, public consultation occurred on the election commitment, from 5 August to 2 September 2022. Treasury received 70 submissions on the discussion paper (some in confidence) reflecting broad feedback from the MNEs and professional services advisors. These submissions have been published on Treasury’s website.¹³

This preliminary consultation informed the policy design options for the Government’s Budget announcement (25 October 2022).¹⁴ This provided insight into how stakeholders may be affected by the proposed changes, helping to balance the Government’s tax integrity intent, while having regard for current industry practice, and implementation considerations to minimise unintended consequences. The main issues raised in this initial consultation included:

- Taxpayers in scope, including seeking views on whether the measure should apply to SGEs or be broader than SGEs.
- The payments that should be in scope of the measure.
- Whether the measure should apply to related and unrelated parties.

¹³ See [Government election commitments: Multinational tax integrity and enhanced tax transparency Consultation Paper August 2022](#)

¹⁴ Budget, October 2022-23, Budget Measures, Budget Paper No:2, p.16/196, [Budget Paper No.](#)

- The threshold for insufficient tax, canvassing options including: the hybrid mismatch targeted integrity rule (payments made to jurisdictions where they are taxed at a rate of 10 per cent or less), the Pillar Two global minimum tax rate (an effective tax rate of less than 15 per cent), a sufficient foreign tax test (payments made to jurisdictions with broadly a corporate tax rate of less than 24 per cent), an intellectual property tax-preferential regime (payments made to jurisdictions with an intellectual property tax-tax preferential regime), and low or nominal tax jurisdiction lists (payments made to jurisdictions listed on low or nominal tax jurisdiction lists published by international organisations).

Stakeholder views were as follows:

- Stakeholders noted the need for the measure to be designed in a way that limits impact on commercial arrangements, and avoids disincentivising business investment in Australia. In addition, stakeholders expressed the view that the measure should be designed in a way that limits complexity and compliance costs.
- Stakeholders also noted the importance of ensuring consistency with the multilateral OECD Two Pillars work.
- Most stakeholders thought that the measure should be limited to SGEs and related parties.
- Some stakeholders preferred the criteria to be based on a specific tax rate rather than a list identifying low tax jurisdictions. Stakeholders generally preferred the insufficient tax threshold being 10 per cent under the hybrid mismatch rules, or a prescribed rate under the OECD digital work such as the 9 per cent Subject to tax rule rate or the 15 per cent global minimum tax rate. Other stakeholders preferred a 24 per cent rate.
- Some stakeholders suggested carve-outs, such as industry carve-outs for R&D and manufacturing. Some also suggested the measure should not apply in respect of jurisdictions covered by a tax treaty.

A review of the submissions informed the Government's decision on policy parameters, as announced in the October 2022-23 Budget. Throughout the process, Treasury worked closely with the ATO to identify and minimise likely implementation issues and unintended consequences.

Consultation: exposure draft legislation (March-April 2023)

Public consultation was undertaken on exposure draft legislation and accompanying explanatory material for four weeks over 31 March 2023 to 28 April 2023. 28 submissions were received (three were confidential).

Stakeholder views were as follows:

- Stakeholders noted potential economic double taxation or excessive taxation and unintended economic consequences, particularly where taxes such as subnational taxes, foreign and Australian controlled foreign company taxes and royalty withholding taxes were not factored into the calculation to identify a low- or no-tax jurisdiction, and noted the increases in penalties.

- Stakeholders raised technical issues with the calculation for a federal headline corporate tax rate.
- Stakeholders queried interactions between the exposure draft legislation and the OECD Pillar Two global minimum tax and domestic minimum tax.
- Stakeholders noted compliance burdens.
- Stakeholders suggested carve-outs, such as a tax avoidance purpose test, a substance-based carve-out and an incidental use carve-out.
- Stakeholders sought further guidance and examples on the application of the legislation.

Treasury also met with industry representatives during the public consultation period, and after the public consultation period ended. These bilateral meetings provided a further opportunity for stakeholders to discuss in specific detail the technical elements of their submissions.

The Government will further consider stakeholder feedback received.

The interactions between the intangibles legislation and Pillar Two global and domestic minimum taxes will be considered during Australia's implementation of its global and domestic minimum taxes. Information on this was made public in the context of the 2023-24 Budget when Australia's implementation of a global and domestic minimum tax was announced.

To provide stakeholders with further guidance, the ATO intends to issue guidance materials to assist taxpayers, after the legislation has passed Parliament.

Option selection and implementation

The preferred option is to implement the Government's revenue raising and protection election commitments. The interest limitation measure is estimated to result in a gain to receipts of \$720 million over the four years to 2025-26 and will strengthen the integrity of Australia's tax system, whilst still allowing genuine commercial activity and investment in Australia to continue. This contrasts with the option of continuing the status quo, which will raise no additional revenue and will continue to allow BEPS activity through the use of debt deductions and intangibles arrangements.

Interest limitation

The option to implement the Government's revenue raising election commitment is the preferred option. It has been refined to address stakeholder feedback on earnings volatility concerns, investment intention impacts and general taxpayer/project financing certainty, while still achieving the Government's policy intent of raising revenue.

At a broad framework level, the group ratio test and third-party debt test operate as substitute tests will help minimise transitional issues from the shift to an earnings-based test away from an asset-based test. The carry forward rule for denied deductions provides flexibility for entities and responds to income volatility concerns; the 15-year period (as opposed to an indefinite period) balances the Government's revenue focus.

The earnings-based group ratio will provide some additional flexibility for entities with naturally higher debt levels, by allowing them to exceed the 30 per cent EBITDA ratio (up to their group level).

The third-party debt test is an Australian specific feature. Limiting the third-party debt test to disallow debt deductions for related debt also balances the Government's revenue focus with ensuring genuine commercial arrangements (for higher geared entities) can continue to support investment intentions.

At a technical level, the calculation of tax EBITDA was clarified and broadened to accommodate a broader range of depreciation activities – this was in response to stakeholder feedback that the exposure draft parameter was too limiting. To prevent the duplication of EBITDA capacity between associate entities (an integrity measure), franked distributions and dividends have also been excluded from the calculation of an entity's tax EBITDA, and beneficiaries of a trust and partners in a partnership will need to adjust their tax EBITDA calculation, which some stakeholders suggested.

The parameters of the third-party debt test have also been refined in response to stakeholder feedback – the operation and application of this test attracted most interest from industry. The third-party debt test was expanded to better align with commercial practice by broadening the recourse and same terms requirements to support additional capacity within the test, including for development assets, such as for large scale construction. The mutual election obligation was limited to only the associate entities (of the relevant entity) in the obligor group (a common commercial concept). This removed the unintended consequence of requiring a wide range of unrelated entities to elect to apply the third-party debt test.

Stakeholder concerns regarding section 25-90 were considered by Government, with the proposed amendment deferred, reflected in its removal from the final legislation, to be considered via a separate process to this interest limitation measure.

The new interest limitation rules were announced to commence from 1 July 2023. The ATO will be responsible for administering this measure in line with their standard practice. The ATO's public advice and guidance will assist with implementation and industry certainty.

Treasury has worked closely with the Australian Taxation Office and a broad range of industry stakeholders as part of the implementation and legislative design process, to minimise unintended consequences. However, the changes to the interest limitation rules are a very complex undertaking with broad application in the taxpayer community. There are potential risks for unintended consequences which may only come to light as taxpayers seek to apply the new rules. Treasury will continue to engage stakeholders on the operation of this measure to ensure the rules (and the income tax laws more broadly) are operating as intended.

Implementation plan

Action	Timeframe
Government announcement	October 2022
Public consultation on exposure draft legislation	March/April 2023

Treasury consideration of consultation feedback	April/May 2023
Government introduction of Bill into Parliament	June 2023
Policy start date	1 July 2023
Tax system maintenance (ongoing)	July 2023+
The ATO intends to issue guidance material to assist taxpayers, after legislation has passed the Parliament.	

Intangibles

The option is the preferred option as it addresses the issue of profit shifting through arrangements involving intangibles connected with low- or no-tax jurisdictions, particularly tax avoidance issues already publicly raised by the ATO.

The option complements the OECD’s work to address the tax challenges of digitalisation and globalisation, particularly given it also addresses base erosion and profit shifting risks. It also addresses other integrity concerns not dealt with by Pillar Two, such as those related to ‘embedded royalties’.

The option prevents tax avoidance as it covers arrangements intended to minimise income tax (through a combination of shifting profits via a low- or no-tax jurisdiction while claiming a corresponding royalty deduction in Australia).

Finally, the option’s anti-avoidance character also helps ensure consistency with Australia’s bilateral tax treaties as anti-avoidance rules can continue to apply.

The option applies to payments made from 1 July 2023.

Treasury has worked closely with the ATO and a broad range of industry stakeholders as part of the implementation and legislative design process to minimise unintended consequences and to achieve an appropriate balance between ease of compliance and administrability.

The Government will further consider stakeholder feedback received on the option.

Implementation plan

Action	Timeframe
Government announcement	October 2022
Public consultation on exposure draft legislation	March/April 2023
Treasury consideration of consultation feedback	April/May 2023
Policy start date	1 July 2023
Tax system maintenance (ongoing)	July 2023+

The ATO intends to issue guidance materials to assist taxpayers, after the legislation has passed Parliament.

Evaluation

The preferred options (implementation of the interest limitation and intangibles election commitments) are scheduled to commence from 1 July 2023, in line with the Government's election commitment and Budget announcement. While the preferred options reflect the best means of implementing the Government's election commitments, taking into account stakeholder feedback and broader policy framework issues, the measures are complex and the amendments to the income tax laws are technical. As such, while there is no formal review of these policies planned, Treasury and the ATO will monitor their operation after implementation to detect and address any unintended consequences that may arise, and to ensure the policies are effective and operating as intended.

Interest limitation

Consistent with standard practice, after implementation Treasury will continue to ensure the income tax laws are operating as intended and achieving the previously stated objectives and success metrics (see objectives section). This will include regular engagement with stakeholders to better understand whether the practical application of the policy changes has given rise to any unintended consequences and/or compliance costs, particularly those that may impact investment behaviour towards Australia. Subject to these considerations, Treasury will assess whether a subsequent technical amendment process and/or review is required. Treasury will also continue to work closely with the ATO to calculate revenue raised as a result of the changes and to identify taxpayer behavioural responses which may give rise to ongoing revenue risks. Subject to this, further integrity measures may be developed and implemented to adjust or supplement the new interest limitation rules.

Intangibles

Consistent with standard practice, after implementation, Treasury will continue to ensure the income tax laws are operating as intended. This will include regular engagement with stakeholders to better understand whether the practical application of the policy changes has given rise to any unintended consequences. Treasury will also continue to work closely with the ATO to assess any impacts. Effectiveness of the measure will also be evaluated based on ATO insights on taxpayer behaviour in relation to the use of intangibles in achieving low tax outcomes.

With the implementation of a 15 per cent global minimum tax and domestic minimum tax in Australia, with the first rules applying from 1 January 2024, interactions with the intangibles option will be further considered and reviewed during the implementation of the global and domestic minimum taxes. Further stakeholder engagement will also be undertaken on any issues.

Appendix

Submissions received

Discussion paper – public submissions

AMERICAN CHAMBER OF COMMERCE IN AUSTRALIA

ANDERSON, CHRIS

ASHURST

ASSOCIATION OF SUPERANNUATION FUNDS OF AUSTRALIA

AUSTRALIAN BANKING ASSOCIATION

AUSTRALIAN COUNCIL OF TRADE UNIONS

AUSTRALIAN FINANCIAL MARKETS ASSOCIATION

AUSTRALIAN NURSING AND MIDWIFERY FEDERATION

AUSTRALIAN PETROLEUM PRODUCTS AND EXPLORATION ASSOCIATION
LIMITED

AUSTRALIAN RETAILERS ASSOCIATION

AUSTRALIAN SUPER

BDO SERVICES

BUSINESS COUNCIL OF AUSTRALIA

CHARTERED ACCOUNTANTS AUSTRALIA AND NEW ZEALAND

CLIMATE ENERGY FINANCE

COCHLEAR

COMMUNITY AND PUBLIC SECTOR UNION

CORPORATE TAX ASSOCIATION

CPA AUSTRALIA

DELOITTE

ETHICAL PARTNERS FUNDS MANAGEMENT

EY

FACT COALITION

FEDERAL CHAMBER OF AUTOMOTIVE INDUSTRIES

FINANCIAL SERVICES COUNCIL

GLOBAL REPORTING INITIATIVE

GUTHRIE, PROF JAMES AND LUCAS, DR ADAM

INFRASTRUCTURE PARTNERSHIPS AUSTRALIA - SUBMISSION 1

INFRASTRUCTURE PARTNERSHIPS AUSTRALIA - SUBMISSION 2
INSURANCE AUSTRALIA GROUP
INSURANCE COUNCIL OF AUSTRALIA
KPMG
LAW COUNCIL OF AUSTRALIA
LENZO, JOE
MARITIME UNION OF AUSTRALIA
META
MINERALS COUNCIL OF AUSTRALIA
MINING AND ENERGY UNION
NATIONAL FOREIGN TRADE COUNCIL
NORGES BANK INVESTMENT MANAGEMENT
OMERS AND CDPQ
PENSIONERS AND INVESTMENT RESEARCH CONSULTANTS
PITCHER PARTNERS
PRINCIPLES FOR RESPONSIBLE INVESTMENT
PRIVATE HEALTHCARE AUSTRALIA
PROPERTY COUNCIL OF AUSTRALIA
PUBLIC SERVICES INTERNATIONAL AND THE INTERNATIONAL TRADE
UNION CONFEDERATION
PUBLISH WHAT YOU PAY AUSTRALIA
PWC
RESMED
SADIQ, PROF KERRIE
SILICON VALLEY TAX DIRECTORS
TATE, JACQUI
TAX JUSTICE NETWORK AUSTRALIA – CENTRE FOR INTERNATIONAL
CORPORATE TAX ACCOUNTABILITY AND RESEARCH JOINT SUBMISSION
TECHNOLOGYONE
THE AUSTRALIA INSTITUTE
THE LAW SOCIETY OF NSW
THE TAX INSTITUTE
VBDO TAX TRANSPARENCY BENCHMARK 2021
WATSON, TONY

Exposure draft consultation – interest limitation

ALLENS

ASHURST

ASSOCIATION OF SUPER FUNDS OF AUSTRALIA

AUSTRALIAN BANKING ASSOCIATION

AUSTRALIAN FOREST PRODUCTS ASSOCIATION

AUSTRALIAN INVESTMENT COUNCIL

AUSTRALIAN SUPER

BDO

BOARD OF TAXATION

CANADA PENSION PLAN INVESTMENT BOARD

CARSALES.COM

CHARTERED ACCOUNTANTS AUSTRALIA AND NEW ZEALAND

COMPUTERSHARE

CORPORATE TAX ASSOCIATION

CPA AUSTRALIA

CSL

DELOITTE

EY

FINANCIAL SERVICES COUNCIL

GILBERT + TOBIN

GRANT THORNTON

HANCOCK VICTORIAN PLANTATIONS HOLDINGS PTY LIMITED

IFM INVESTORS

IMDEX

INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

INPEX

INSURANCE AUSTRALIA GROUP LIMITED

KPMG

LAW COUNCIL OF AUSTRALIA

ONTARIO MUNICIPAL EMPLOYEES' RETIREMENT SYSTEM, CAISSE DE DÉPÔT ET PLACEMENT DU QUÉBEC, BRITISH COLUMBIA INVESTMENT MANAGEMENT CORPORATION, AND THE ONTARIO TEACHERS' PENSION PLAN

ORICA

PERPETUAL
PITCHER PARTNERS
PROPERTY COUNCIL OF AUSTRALIA
PUBLIC SECTOR PENSION INVESTMENT BOARD, GUARDIANS OF NEW
ZEALAND SUPERANNUATION FUND
PWC
QBE
QIC
REA GROUP LIMITED
SEEK
SERENITAS
SHELL
SONIC
TASMAN TOURISM TRUST
TAX JUSTICE NETWORK AUSTRALIA, CENTRE FOR INTERNATIONAL
CORPORATE TAX ACCOUNTABILITY AND RESEARCH
TELSTRA
THE AUSTRALIAN FINANCE INDUSTRY ASSOCIATION
THE AUSTRALIAN FINANCIAL MARKETS ASSOCIATION
THE AUSTRALIAN PETROLEUM PRODUCTION & EXPLORATION
ASSOCIATION
THE AUSTRALIAN SECURITISATION FORUM
THE COUNCIL OF AUSTRALIAN LIFE INSURERS
THE TAX INSTITUTE
THE TECH COUNCIL OF AUSTRALIA
TRANSGRID

Exposure draft consultation – Intangibles

AMERICAN CHAMBER OF COMMERCE IN AUSTRALIA
ASHURST
AUSTRALIAN RETAILERS ASSOCIATION
BDO
BUSINESS COUNCIL OF AUSTRALIA
CHARTERED ACCOUNTANTS AUSTRALIA AND NEW ZEALAND
COCHLEAR LIMITED

CORPORATE TAX ASSOCIATION
 CSL LIMITED
 DELOITTE
 ERNST & YOUNG
 INFORMATION TECHNOLOGY INDUSTRY COUNCIL
 KPMG
 LAW COUNCIL OF AUSTRALIA
 MEDICINES AUSTRALIA
 NATIONAL FOREIGN TRADE COUNCIL
 NESTLÉ AUSTRALIA LTD
 PITCHER PARTNERS
 PWC
 RESMED
 RSM AUSTRALIA
 SWISSHOLDINGS
 TAX EXECUTIVES INSTITUTE
 TAX JUSTICE NETWORK AND THE CENTRE FOR INTERNATIONAL
 CORPORATE TAX ACCOUNTABILITY AND RESEARCH
 THE TAX INSTITUTE

Impact Analysis timeline

Timing	Process/action
July 2022	Measure assessed by OIA as having a minor regulatory impact
August 2022	Public consultation on discussion paper First draft of IA sent to OIA for comment
September 2022	Revised draft of IA sent to OIA for comment
October 2022	Measures announced in Budget
March/April 2022	Consultation on exposure draft legislation
April 2023	Revised draft of IA sent to OIA for comment
May 2023	IA sent to OIA for First and then Second Pass Final Assessment