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Pillar 2 Concerns Persist Amid Australia's Draft Intangibles Rule

by Stephanie Soong

Australia's amended draft rule denying deductions for intangibles payments linked to low-tax jurisdictions reflects some stakeholder concerns, but its interaction with OECD global minimum tax rules remains to be seen, practitioners said.

The Australian Treasury on June 23 published revised legislation and explanatory materials for the intangibles measure, following a March 31-April 28 public consultation.

The proposed rule is part of the government's multinational tax integrity package, which includes amendments to Australia's thin capitalization rules to limit multinational enterprise interest deductions in line with action 4 of the OECD base erosion and profit-shifting project. The package also provides for public country-by-country reporting. The government introduced legislation to Parliament on June 22 for those two components of the package, which, among other things, delays the public CbC reporting rules' application by a year to July 1, 2024.

The proposed intangibles rule would target structures in which an associate of a significant global entity (SGE) derives income in a low-tax jurisdiction after exploiting an intangible asset. The SGE would then claim a deduction in Australia for any payment to the associate that is attributable to the intangible asset or a related intangible asset. The new rule would not allow the deduction for the SGE's payment to the associate, according to the updated explanatory materials. SGEs have global revenue of at least AUD 1 billion ($668.5 million).

The rule would deny a deduction for any intercompany payment by an SGE for rights to an intangible asset if, as a result of the arrangement, an associated enterprise in a low-tax jurisdiction receives the income from exploiting the intangible or related intangibles.

It would also deny a deduction for payments if the recipient is in a jurisdiction with a patent box that is deemed to have insufficient economic substance.

Income that is subject to Australia's controlled foreign corporation rules or a foreign effective income tax rate of at least 15 percent will be out of scope of the new rule, according to the updated draft. If an SGE payment is a royalty and the SGE has paid withholding tax on that royalty, then the denied deduction would be adjusted accordingly. The new rule would take effect on July 1.

The revised bill clarifies that the rule will rely on a jurisdiction's national headline corporate tax rate for determining whether it is a low-tax jurisdiction.

"The previous draft had significant flaws, not least that all jurisdictions likely qualified as such, including Australia," Liam Delahunty of RSM Australia said. "However, Treasury has listened to submissions and resolved this defect, aligning it effectively with a headline corporate tax rate."

The government amended the intangibles measure in an effort to better meet its policy intent, an Australian Treasury Department spokesperson told *Tax Notes* June 27 in an emailed statement.

As Australia implements pillar 2 of the OECD's two-pillar global tax reform plan, "the Government will further consider interactions with Australia's existing income tax laws and amendments made as part of the Government's Multinational Tax Integrity Package, which includes the intangibles measure," the spokesperson said. "The Government is further considering interactions of the intangibles measure with global minimum taxes and domestic minimum taxes."

The government's confirmation that it will consider how the intangibles rule will work with pillar 2 reflects input that RSM Australia and others had given during the consultation period, Delahunty said.

Presumably, the government hasn't made any relevant changes to the revised exposure draft because Australia hasn't yet drafted pillar 2 legislation, according to Lance Cunningham of BDO Australia. It's assumed that "any provisions that deal with the interaction between pillar 2 and the denial of deductions for intangible assets would be included in the amending bill that introduces the pillar 2 legislation for Australia," he added.

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Business lobby groups, including the Silicon Valley Tax Directors Group, have called on the Australian Treasury to align with pillar 2 rules instead of pursuing a unilateral and uncoordinated measure, saying the intangibles rule would be redundant.

Australia is one of the 139 members of the OECD's 143-member BEPS inclusive framework that have agreed on a two-pillar overhaul of the international corporate tax system. Pillar 2 of the plan aims to ensure that MNEs with annual group revenue exceeding €750 million pay a minimum effective tax rate of 15 percent in all jurisdictions in which they operate.

At the center of pillar 2 are the global anti-base-erosion (GLOBE) rules, which create a top-up taxation framework for in-scope MNEs. The main components of the GLOBE rules are the income inclusion rule and the UTPR, which was originally known as the undertaxed payments rule, although some countries call it the undertaxed profits rule. Ordering is a key feature of pillar 2. A country can opt to implement a qualified domestic minimum top-up tax, which would apply first, followed by CFC rules, then the IIR, and finally the UTPR.

Australia indicated in May that it will implement a domestic minimum tax and GLOBE rules. The IIR and the domestic minimum tax would apply to income years starting on or after January 1, 2024, while the UTPR will apply to income years starting on or after January 1, 2025.

The proposed intangibles law and the pillar 2 rules share a common goal of deterring structures resulting in related-party payments to low-tax jurisdictions, which effectively move profits out of high-tax jurisdictions like Australia, according to Andy Bubb of Clayton Utz.

"Both measures use a 15 percent tax rate as the threshold, although the intangibles rule looks at a country's headline corporate tax rate whereas pillar 2 will look at a taxpayer's effective tax rate," Bubb said. He also noted that the intangibles rule's effective date would be only six months before the IIR and domestic minimum tax would take effect.

Australia must publish pillar 2 legislation soon, given its proposed timeline. However, "the interactions of the new intangibles rule and pillar 2 may be complex," Bubb said.

One issue is whether pillar 2 domestic top-up taxes would be relevant in determining if a jurisdiction would be considered a low-corporate-tax jurisdiction under the intangibles rule, according to Bubb. "Another notable point is the use of different thresholds between the measures," he said, pointing to the intangible rule's headline national corporate tax rate and pillar 2's reliance on an ETR.

"Although the approach under the intangibles law may be simpler and not require taxpayer-specific calculations, any divergences between these regimes will result in complexity and cost for MNEs, and the potential for double taxation," Bubb added.

Other Concerns

The revised explanatory materials also indicate that, in some cases, the proposed rule would require the bifurcation of embedded royalties from distribution arrangements, according to Delahunty, who noted the limited guidance on the issue.

The embedded royalties concept isn't new, but the government should give more consideration and clearer guidance on how to identify, value, and tax an embedded royalty, Delahunty added.

The rule's embedded royalties provision "will be extraordinarily difficult to apply in practice," Bubb said, noting that it would apply in cases in which a payment is made for goods or services but substantively involves an Australian entity's use of an intangible asset.

"It will require the identification of the portion of a related-party payment, which, in substance but not legal form, relates to the use of an intangible" like a brand name, Bubb said. "Most MNEs will have significant brand value, and therefore need to grapple with this. There are some carveouts, but they appear to be limited."

Cunningham noted that the revised exposure draft confirms there won't be direct tracing for payments made through interposed entities. "This means a payment from an Australian entity to an interposed associated entity can be caught by the proposed rules even if there is no evidence that the payment by the Australian entity funded the payment by the interposed entity to the ultimate entity holding the intangible asset," he said.

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"If there is more than one interposed entity making payments, there is no requirement for each payment in the chain to fund the payment through to the ultimate entity that holds the intangible asset," Cunningham added. "This will cause administrative tracing issues for taxpayers."

Bubb noted that penalties would be multiplied by a factor of four under the intangibles rule. "MNEs in Australia generally face double penalties, and this measure doubles them again," he said. "The higher penalties will have practical implications for MNEs because they will be more incentivized to seek comfort from the [Australian Taxation Office] or to take detailed advice." ■

BELGIUM

Belgian Court Rejects Varo's Request To Suspend Windfall Tax

by William Hoke

Belgium's Constitutional Court has rejected a request by a subsidiary of Switzerland's Varo Energy for a temporary suspension of a windfall tax on the excess profits of oil companies.

The Court said in a ruling dated June 15 — published June 26 — that Varo Energy Belgium failed to meet a statutory requirement that it provide concrete evidence to demonstrate that the law would cause the company serious harm that would be difficult to reverse.

The government said in August 2022 that it would take the necessary steps to skim off the excess profits of energy companies. In September 2022 EU energy ministers approved a 33 percent "solidarity contribution" payable on profits from fossil fuels that exceed a company's average profits for 2018-2021 by at least 20 percent. Revenues from the windfall tax — which is required to be implemented by each EU member state — are to be used to provide relief to consumers struggling with high energy prices. The Belgian Parliament passed legislation in December 2022 transposing the EU regulation mandating the solidarity contribution.

Varo Energy challenged the Belgian law on several grounds. It said the EU regulation has no valid legal basis because it mandates a direct tax, which requires the unanimous consent of member states as well as the consultation of the European Parliament and the European Economic and Social Committee, an advisory group made up of employer organizations, trade unions, and civil society organizations. The plaintiff said the Court must refer the question to the Court of Justice of the European Union for a preliminary ruling on the validity of the tax.

It also said that the Belgian law gives "rise to several forms of discrimination" because it limits the scope of the tax to registered oil companies that are active in the refining sector and have refining capacity in Belgium and to oil companies that were defined in 2022 as "primary participants" for diesel fuel and diesel and gasoline products. "The fact that a sector is — in

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