Global agreement on corporate taxation

FSC Submission to Treasury

November 2022

FSC FINANCIAL SERVICES COUNCIL

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1 About the Financial Services Council

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

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

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

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

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

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2 Introduction

The FSC thanks the Treasury for the opportunity to make a submission on the Treasury discussion paper on “Global agreement on corporate taxation: addressing the tax challenges arising from the digitalisation of the economy” (**The Discussion Paper**).

The FSC’s submission covers some, but not all, of the issues raised in the Discussion Paper. The absence of a comment on a particular issue does not necessarily mean that the FSC supports (or opposes) proposals relating to that issue.

3 Pillar 1 – Exclusions

The FSC endorses the exclusions from Pillar 1 for regulated financial services, including asset management, insurance and reinsurance.[1]

4 Pillar 2 – timing

The FSC considers that Pillar 2 (or GloBE) rules should be implemented no earlier than 1 July 2024 (that is, income years starting on or after 1 July 2024), and at least one year after relevant legislation passes Parliament.

This is for the following reasons:

- The need for the ATO to develop and publish detailed guidance materials on the rules after the legislation passes Parliament but well before the commencement date.
- The challenges of taxpayers developing systems to comply with a measure as complex as this in a short time frame without details on a number of important aspects or any draft domestic legislation.
- The significant outstanding work in the OECD’s Implementation Framework which is still to be completed or at least released publicly.
- The shift in implementation timetables in other countries to the end of 2023 (at the earliest), with the coordination of timeframes across jurisdictions important from a compliance / process perspective.
    - There are no advantages to Australia in adopting early.
- The accounting standards board is yet to issue guidance on how GloBE taxes will be treated under AASB 112.
- Life insurers are facing the challenge of implementing AASB17 in 2023 for income years ending 31 December 2023 and later. These rules potentially could have substantial effects on GloBE calculations – including if the Government accepts the FSC’s recommendation that certain up-front deductions due to AASB17 are spread over time.

[1] See FSC submission to OECD consultation on the regulated financial services exclusion under Amount A of Pillar One, available from: https://www.oecd.org/tax/beps/public-comments-received-on-the-regulated-financial-services-exclusion-under-amount-a-of-pillar-one.htm

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The FSC requests further consultation with taxpayers on the domestic law and administration rules, particularly when we are still awaiting further detail on the OECD framework. This consultation is important for life insurers who face specific issues with the implementation of Pillar 2 rules.

5 GloBE rules and Australian subsidiaries

The FSC submits Australian entities who have an overseas Ultimate Parent Entity (**UPE**) in a BEPS compliant country should be excluded from having to perform the effective tax rate calculations and lodge them in Australia via a Globe information return. The UPE will be responsible for doing this in their country and for paying (and charging group entities) any top up tax amounts. It will remove the significant compliance costs for Australian entities and for the ATO to administer if the Australian rules are limited to Australian entities without an overseas UPE in a BEPS compliant country.

This is supported by paragraph 4 of the OECD Framework – see particularly the bold text:

> …while Article 8.1 places an obligation on each Constituent Entity to file a GloBE Information Return with the tax administration of the jurisdiction where it is located, a Constituent Entity is under Article 8.1.2 discharged from this obligation when the UPE or a Designated Filing Entity files the GloBE Information Return with the tax administration of the jurisdiction where it is located and the Competent Authority of that jurisdiction has a bilateral or multilateral agreement or arrangement in effect to automatically exchange the GloBE Information Return with the Competent Authority of the jurisdiction of the Constituent Entity. The Competent Authorities are the authorized representatives of those jurisdictions that are parties to a Tax Treaty, tax information exchange agreement, or the Convention on Mutual Administrative Assistance in Tax Matters that by its terms provides legal authority for the exchange of tax information between jurisdictions, including automatic exchange of such information. In this way the return filing obligations operate so that **the UPE or a Designated Filing Entity of the MNE Group can file a single GloBE Information Return covering all Constituent Entities in the MNE Group**, which can be provided to al tax administrations with a Constituent Entity(ies) located in their jurisdiction through appropriate international exchange mechanisms.

Based on the 2021 ATO Corporate Transparency Report which covers 2,468 Large corporate entities potentially in scope of Pillar 2:

- 1,376 are foreign-owned companies with an income of $100 million or more
- 563 are Australian public entities with an income with 100 million or more
- 529 are Australian-own resident private companies with an income of $200 million or more.

As a result, carving out most foreign-owned companies (ie those have a foreign UPE) will substantially decrease the compliance burden, while still ensuring the policy intent is maintained.

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6 Domestic minimum tax

The FSC submits that there is no need for Australia to have a Domestic Minimum Tax (DMT) unless there is a demonstrated strong case for one.

The consultation paper appears to be assuming that there should be a DMT unless there is a significant compliance burden or a DMT is unnecessary. The FSC instead submits that instead the starting point should be up to the Government/Treasury to articulate why a DMT is needed.

In this context, the FSC submits there is no clear need for the DMT given Australia's corporate tax rate is high, and the effective tax rate is also high. Australia has a broad corporate tax base with limited exemptions.

- Australia has accelerated depreciation – but this largely results in timing differences and in any case acceleration of depreciation has been deliberately introduced to encourage investment. Any winding back of this, including through a DMT, is likely to reduce investment.
- Other tax concessions, such as research and development (R&D) also have been introduced to promote important policy goals.

Given the high effective tax rate in Australia, a DMT would clearly increase compliance costs with limited or no benefit.

Worse, a DMT would be harmful if it unwound some or all deliberate tax policies that are specifically designed to promote economic growth (potentially including accelerated depreciation and R&D).

A DMT could be used as a 'top up' tax for Australian headquartered multinationals, but it seems unlikely that Australian headquartered businesses would have an effective tax rate below 15%. As a result, the introduction of a DMT 'just in case' an Australian multinational would be subject to non-Australian 'top up' tax appears to be creating substantial tax complexity to address an unlikely scenario.

If a DMT were introduced, the FSC submits:

- any such DMT should only apply to multinational groups (that is, companies that would otherwise be in the scope of the Pillar 2 rules) and it should not apply to wholly domestic groups. This would be consistent with the overall exemption from the Pillar 2 rules for wholly domestic entities.
- Franking credits should arise from the DMT.
- To the maximum extent possible, the DMT should be incorporated into existing tax settings, for example there should not be a separate DMT tax return if at all possible.

7 Coverage of life insurance

The unique tax regime for life insurers presents challenges for the domestic implementation of the Pillar 2 rules.

As background, Australia taxes life insurance companies on its shareholder profits at the corporate tax rate of 30%, which is well in excess of the 15% minimum rate of tax. Therefore, in concept, income of Australian life insurance operations should not be viewed as low taxed income to which top-up tax could be applied under the GloBE rules.

However, the unique taxation regime for Australian life insurers means that the Australian implementation needs careful design in order for this policy outcome to be achieved. Issues most important in the life insurance context are how policyholder income and accounting to tax timing differences are taken into account in the effective tax rate (**ETR**) calculation in the GloBE rules. If these issues are not addressed appropriately, the interests of Australian policyholders could be adversely impacted.

7.1 Policyholder income

As investment income from life insurance policies accrues economically to policyholders, this income (and tax on the income) should not impact the minimum tax calculations for the insurer. If this policyholder income is recognised for GloBE, this will likely result in an additional layer of tax can be detrimental to policyholder interests.

In an Australian context, this is relevant to:

- Concessionally taxed income of a life insurance company's complying superannuation class (taxed at 15%) and segregated exempt asset class (exempt from tax), which appropriately mirror the concessional tax treatment for superannuation. Income in the complying superannuation class and segregated exempt asset class of life insurers economically accrue to superannuation policyholders and not the life insurer.

  The FSC submits this type of income should to be excluded from the scope of the GloBE rules, consistent with the proposed treatment of pension funds in the OECD's Pillar Two Model Rules.

  It is inappropriate for an additional layer of tax to be imposed under the GloBE rules in respect of this income and this would also be detrimental to policyholder interests.

- The accounting and tax treatment of policyholder income of a life insurance company. For most types of life insurance business in Australia, the life insurance company is required to calculate tax referable to policyholders and include this in its corporate income tax return – this includes policyholder income that is included in the ordinary class of a life insurance company.

  For accounting purposes, policyholder tax is included in income tax expense, but because it is referable to policyholder it is charged to policyholders through policyholder liability with this charge being included in profit before tax.

  Thus, the FSC submits it is necessary for the ETR calculation to adjust for the accounting treatment of policyholder tax.

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Further, as flagged in the OECD's Pillar Two Model Rules, there is a need to exclude policyholder investment income from the GloBE tax base. The implementation of this concept is important, as the delineation between policyholder tax and shareholder tax is not always clear from statutory tax filings. In an Australian context, the life insurance tax rules do not quarantine shareholder and policyholder income within the Ordinary class (they are comingled in the corporate tax return). Further, imputation credits received in the complying superannuation and segregated exempt asset classes can be used to offset tax in the Ordinary class.

7.2 Accounting for tax temporary differences

Accounting to tax temporary differences can result in volatility in a life company's ETR calculation in any given year.

These are temporary impacts which reverse over the long term, and should not result in a company being considered low taxed.

The OECD's Pillar Two Model Rules contemplate a 5 year carry forward period to deal with accounting to tax temporary differences. However, in the context of a life insurance company, a 5 year carry forward period is likely to be insufficient, given the long term nature of life policy contracts which means temporary differences may taken many years to reverse.

8 Coverage of superannuation funds

While the paper reflects the OECD's proposed rules on the scope of the measures, the FSC submits the following in relation to superannuation funds:

- Any use of the Significant Global Entity (**SGE**) definition for these measures could mean that Australian superannuation funds are inadvertently included. If SGE is used for any part of the measures, the FSC recommend that there be a legislative carveout for superannuation funds.
    - Under current rules, there is a Commissioner's discretion to provide an exemption for superannuation funds from some SGE requirements including Country by Country reporting – we understand the ATO has been providing this exemption, but it is time limited and acts as unnecessary red tape on larger superannuation funds.
    - Given this, the FSC considers that an exemption for superannuation funds should be provided on a permanent basis rather than on application.
- Any exemption for a "Pension Fund" should explicitly cover an "Australian Complying Superannuation Entity" in order to remove any doubt – this is because our superannuation entities may not strictly be classified as solely Pension Funds based on OECD definitions.