



## Pacific Rim Tax Conference 2023

Speech by Deputy Commissioner Hector Thompson at the Pacific Rim Tax Conference in San Francisco on 19 May 2023.

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*Check against delivery*

Good afternoon, as always it is a pleasure to have the opportunity to participate in the PACRIM Conference – a chance to share observations about global developments in tax with key officials, corporate tax experts and advisers from around our region. I would like to thank the Pacific Tax Policy Institute for the invitation.

In preparing my remarks for today I was struck by the fact that when I returned to Australia in 2019, I was asked to work on something called the Tax Challenges Arising from Digitalisation, a project to re-invigorate BEPS action item 1, led by the G20 and the OECD. If you had told me then, that four years later I would be working to implement a global minimum tax, I would have been surprised. A good reminder that the future is uncertain, and we should not overstate our ability to predict it.

Today I will focus on 2 topics.

First, the Global Anti-base Erosion (GloBE) rules, a timely subject given the Australian Government's announcement last week that it will introduce rules from 1 January 2024 (for the Income Inclusion Rule and a Domestic Minimum tax) and 1 January 2025 for the Under-Taxed Payment Rule.

Second, the work on what is known as Amount B – essentially a fixed return for baseline distributors designed to assist low-capacity jurisdictions, particularly in instances where there is an absence of local comparables for benchmarking purposes.

I would like to thank Adam Peel from our GloBE implementation team and Saranee DeSilva from our Economist Practice for their assistance in preparing these remarks.

## **Pillar 2 (the GloBE rules)**

Tax administrations have quietly been working collaboratively on building the skills and capabilities for the implementation of the GloBE rules for some time, primarily through OECD fora, such as the Forum of Tax Administration. The new rules are conceptually and technically challenging and represent a new way of thinking about the global tax system, so are a high priority for tax administrations, as I am sure they are for business.

I am fond of saying that they build on the original BEPS work which asks tax administrations to look ‘beyond the border’. This requires a greater degree of cooperation and coordination amongst administrations, with a strong reliance on our confidential exchange of information mechanisms operating in a pragmatic and efficient manner.

Many jurisdictions have now announced they intend to implement the GloBE rules. While a small number of countries, such as Hong Kong and Singapore, have plans for the GloBE Rules to take effect from 2025, most countries have proposed starting in 2024, including South Korea, Japan, Germany, Ireland, Sweden, Netherlands, Switzerland and the UK. [\(1\)](#)

Last week the Australian Government announced that the GloBE Rules and a Domestic Minimum Tax will take effect from 1 January 2024 in Australia, in line with most countries that have announced implementation details. More specifically, the Income Inclusion Rule (IIR) will start from 1 January 2024, while the Undertaxed Payment Rule (UTPR) will commence a year later, from 1 January 2025.

Overall, the GloBE rules are not expected to generate large revenue gains in Australia – last week’s Federal Budget estimated that the gain to revenue in 2025–26 will be \$160 million and \$210 million in 2026–27. [\(2\)](#) This is not surprising as Australia has a headline corporate income tax rate of 30%, so you would expect the revenue impact in Australia

to be small relative to other countries. Arguably, the measure of success of the GloBE rules will not be their impact in jurisdictions such as Australia, but in jurisdictions with low headline rates, or that offer generous concessions to multinational firms.

The ATO has already established a dedicated project team for the implementation of the GloBE rules and a Domestic Minimum Tax, including developing our compliance approach, providing guidance to in scope taxpayers and advisors, developing systems to allow for lodgment and exchange of the GloBE information return and to develop data and analytics capabilities. The team can be contacted via the Pillar 2 Project mailbox. [\(3\)](#)

The GloBE rules envisage in-scope entities being required to lodge an information return (currently being developed through the OECD) along with a separate information package and domestic returns. Incorporating these requirements into our system will mean new systems to support lodgment, assurance, and compliance. We are looking to identify the most appropriate technology infrastructure for efficient and secure information exchange. We need to ensure data security and the necessary data and analytics capabilities to process and analyse the information. It is expected that the first returns will be due for filing by 30 June 2026.

While the Common Transmission System currently facilitates Common Reporting Standards and Country-by-Country Reporting, modifications or adaptations may be required to make it fit for purpose for information exchanged under the GloBE rules. We also expect new tax software to be introduced into the market for multinational enterprises, although this software is unlikely to be global or standardised.

Due to the role that financial statements and accounting concepts play in the GloBE rules, those administering them will need to understand tax effect accounting. This includes an understanding of the accounting systems used by multinational enterprises, as well as key differences in the accounting standards across different jurisdictions.

We are also developing tailored capability programs that can support our existing staff to develop the necessary expertise to undertake this work. We are expecting that Australian based taxpayers and advisers will be simultaneously seeking to build their capability in this area, and thus there will be strong demand for these skills – a good time to be an expert in tax effect accounting!

Whilst building capability internally will be an important focus, we are also considering how we can best support the Australian market in adapting to the new rules. This includes technical and practical administrative guidance to support taxpayers and advisers to understand and comply with the rules. This public guidance will be complemented by one-to-one guidance and support, provided through direct engagement with taxpayers and advisers.

We anticipate that multinational firms will want to discuss and gain certainty on whether they are in-scope of the GloBE rules prior to the first returns being due and our existing processes to provide formal binding private advice to taxpayers will be available. This will be supplemented by informal engagements and advice provided by specialist teams in the ATO who will factor in any safe harbour arrangements agreed at the OECD. Whilst our overall administrative approach will be guided by the OECD's implementation framework and domestic legislation, we are already consulting broadly to better understand the likely resourcing needs and develop a compliance program tailored to the Australian market.

Initial consultation with large multinational enterprises and professional services firms is underway. Consultation with other organisations and industry groups such as the Australian Banking Association, Property Council, Minerals Council, Tax Institute and law firms is being discussed and planned. We will of course look to minimise the compliance burden wherever possible for in scope taxpayers by leveraging off our current compliance programs, integrating GloBE reviews into existing processes, and coordinating information requests.

## **Pillar One (Amount B)**

As we discussed yesterday, work continues on Pillar One which is less progressed than Pillar 2 and where the negotiations are complex in a variety of ways – politically and technically.

We continue to see the Amount A multilateral solution as the best chance to creating stability in the international tax system. The alternative, a proliferation of unilateral measures, would potentially lead to greater complexity, and trade tensions.

Australia is very active in OECD negotiations, with the end goal of reaching consensus and hope of signing the Pillar One MLC, as this is an important piece of reform for countries the world over.

A key issue for Australia is the Amount B simplified and streamlined transfer pricing work. As you might expect, these discussions have been grappling with the challenge of how to achieve simplification consistent with the arm's length principle.

There is certainly no question that transfer pricing is complex and that simplification can potentially benefit both multinational enterprises and tax administrators by reducing the resources devoted to more routine issues, as well as providing greater certainty and transparency for taxpayers. With the background of Amount B in mind, I thought I would share the simplification and certainty mechanisms Australia has already put in place which relate to transfer pricing arrangements of inbound distributors.

Our experience with distributors in Australia shows that depending on the product, selling activities can vary significantly.

For example, we often observe that distributors of industrial machinery provide installation or maintenance services, those distributing food and groceries need to invest in refrigerated transportation and more complex warehousing, distributors of pharmaceutical products will need to meet complex regulatory requirements, and software distributors often require technical expertise to configure products.

We have published our view in relation to Australia's inbound distribution arrangements in the form of a Practical Compliance Guideline<sup>(4)</sup> (PCG). It is important to note that the returns in this PCG are not arbitrary – they are based on actual financial outcomes from a detailed benchmarking analysis conducted when the PCG was drafted. This PCG provides a range of profit markers (using EBIT margins) for general distribution, life science, information and communications technology, and motor vehicles.

Both the life science and ICT segments are further categorised to account for the differing levels of activity seen in these businesses. For example, the life science categories are differentiated on whether significant regulatory activity and technical services are performed in conjunction with selling activities.

In developing our inbound distribution PCG, consideration was given to which factors have a bearing on the financial outcomes of a distribution entity. As the PCG is for local purposes, it only uses comparables relevant to the Australian market.

The OECD has a published view that the economic factors of the market are important, as well as the economic circumstances of the relevant entity. Whilst there is flexibility to identify economically similar markets to find comparables, it seems unremarkable to note that a similar market cannot be more like the market than the one an entity actually operates in. Put another way, if there are local comparables, then those will be more reliable in determining arm's length outcomes than foreign comparables will be.

To give you a sense of the level of returns we expect in our market, I will take you through some of the financial outcomes published in the PCG. In relation to the broadest category (general distributor), we consider taxpayers to be low risk if they achieve an operating margin over 5.3%.

It is important to say at the outset that we do not necessarily expect the arm's length outcome to be 5.3% for every distributor. What we are signalling to the market is that, at such an operating margin, we will generally not allocate compliance resources to assess a firm's transfer pricing outcomes. In contrast, falling outside the low-risk zone means we consider your inbound distribution arrangements may give rise to an inappropriate transfer pricing outcome and we will generally conduct some form of compliance activity in relation to your inbound distribution arrangements.

Our risk zones vary across the 4 segments in the PCG. For example, a distributor in the life science industry performing regulatory or market access activities, is required to earn over 5.5% to avoid a high-risk outcome. Alternatively, a complex IT distributor or motor vehicle distributor would be considered low-risk if they earn over 5.4% or 4.3% respectively.

We have long been aware that the returns achieved by Australian distributors typically exceed those seen in other jurisdictions. Whilst the full explanation of this phenomenon is an open question, there are some features of the Australian economy that may go some way to explaining these higher returns.

First, Australia is a relatively remote and isolated jurisdiction. In fact, it is the second most remote advanced economy in the world, next to New Zealand.<sup>(5)</sup> Whilst rapid economic growth in Asia has brought a larger portion of the global economy closer to us, we continue to experience greater barriers to physical trade in goods when compared to many jurisdictions.<sup>(6)</sup>

Distance matters when trading goods and we have plenty of that - a study of the distance to potential trading partners for 172 countries resulted in an average distance of approximately 8,300 km. Western European countries are the least remote, with an average distance of 5,500 km. In contrast, Australia's average distance to potential trading partners is 13,700 km.<sup>(7)</sup>

Distance is not the only geographical factor to consider. Australia is a very urbanised country with approximately 86% of the population living in cities compared to the global average of 56%.<sup>(8)</sup> It is characterised by heavily populated cities with large distances between them. For example, the distance between Perth and Melbourne is 3,400 km. As a comparison, the distance from Paris to Istanbul is 2,800 km. This means that it is not only expensive for Australian entities to trade with the rest of the world, but also to trade domestically.

As such, transport and logistics functions are either expensive when outsourced, or require additional activities and expertise to manage when done in-house. The distance between commercial hubs can also lead to decentralised warehousing requirements. With increased costs and risks in the supply chain due to remoteness and distance, Australian distribution entities require more resources to source product in a timely, efficient manner. In our experience, this typically leads to higher intensity functions, as well as a greater assumption of risk.

Linked to remoteness and distance is a second factor – competition.

Compared to many other jurisdictions, Australian businesses operate in less competitive domestic environments. For example, across all industries, the average market share of the top four firms in each industry is almost 43%.<sup>(9)</sup> In the wholesale industry, the top four firms in Australia represented over 30% of industry sales, whereas in the US the equivalent number is approximately 20%.<sup>(10)</sup> These firms tend to be sticky as well, with three of the 4 top four firms remaining the same within a three-year period, and this number increasing compared to 20 years ago.<sup>(11)</sup>

A third factor is that some industries in Australia are highly regulated relative to other countries. A good example is the pharmaceutical industry. Life expectancy in Australia is now the sixth highest out of the OECD countries, at an average of 83,<sup>(12)</sup> while higher levels of health consciousness and changes in prescribing habits have increased the use of pharmaceutical products in Australia.<sup>(13)</sup>

Australia's Pharmaceutical Benefits Scheme (PBS) is a longstanding and popular feature of the Australian health landscape as it seeks to regulate and reduce the costs of pharmaceutical products to Australian consumers. The Therapeutic Goods Administration monitors the supply of pharmaceutical products. From ensuring that a manufacturer is up to scratch, to dictating which products can and can't be advertised, there is a high level of scrutiny before a product can be cleared for sale to Australian consumers.<sup>(14)</sup>

Managing distribution in this regulatory environment is a key challenge for wholesalers.<sup>(15)</sup> The activities required for the establishment and continued operation of a distributor cannot be compared to, and priced on, the same basis as a company that simply moves boxes. We see a wide array of activities being performed by pharmaceutical distributors. These can include managing regulatory requirements, obtaining new product approvals, performing technical services, and even running clinical trials.


While none of these three factors can necessarily explain the higher returns achieved by Australian distributors, perhaps the combination provides some insight.



## Conclusion

In conclusion I'd like to leave you with a couple of reflections.

On the GloBE rules, Australia is moving to the implementation phase and the ATO is ramping up its investment and engagement. We welcome ongoing consultation with multinationals and professional services firms as we develop the human capital and technology platforms necessary for effective administration of the new rules.



On Amount B, we look forward to continuing to consider how this approach could be most effective as the work at the OECD moves to completion. As an administrator the ATO is always focussed on how to simplify our transfer pricing approach while remaining consistent with the arm's length principle and providing certainty and transparency to taxpayers.

1 KPMG Global Tax & Legal, 2023, BEPS 2.0: state of play – April 2023, [BEPS 2.0: state of play](#) 

2 Department of the Treasury, 2023, Budget Strategy and Outlook, [Budget Paper No.1](#) ; Department of the Treasury, 2023, Budget Measures, [Budget Paper No. 2](#) 

3 Pillar2Project@ato.gov.au



- 4 Practical Compliance Guideline PCG 2019/1 - Transfer pricing issues related to inbound distribution arrangements
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- 6 Robert Ewing and Bryn Battersby, 2005, International Trade Performance: The Gravity of Australia's Remoteness, pg 2
- 7 Simon Guttman and Anthony Richards, 2004, Trade Openness: An Australian Perspective, pg 12
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