
TREASURY LAWS AMENDMENT (MEASURES FOR CONSULTATION) BILL
2023: DEDUCTIONS FOR PAYMENTS RELATING TO INTANGIBLE ASSETS
CONNECTED WITH LOW CORPORATE TAX JURISDICTIONS

EXPOSURE DRAFT EXPLANATORY MATERIALS

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Glossary

This Explanatory Memorandum uses the following abbreviations and acronyms.

Abbreviation	Definition
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
The Bill	#TBC
SGE	Significant Global Entity
OECD	Organisation for Economic Co-operation and Development

Chapter 1: Denying deductions for payments relating to intangible assets connected with low corporate tax jurisdictions

Outline of chapter

- 1.1 Schedule [x] of this Bill amends the ITAA 1997 to introduce an anti-avoidance rule designed to deter SGEs from avoiding income tax by structuring their arrangements so that income from exploiting intangible assets is derived in a jurisdiction where no or low corporate tax rates apply, while tax deductions for payments attributable to intangible assets made by the SGE to an associate are claimed in Australia. This rule prevents the SGE from claiming tax deductions for such payments.
- 1.2 This anti-avoidance rule aims to prevent large multinationals from securing an unfair tax advantage over other Australian businesses and seeks to ensure that large multinational enterprises are paying their fair share of tax in Australia.
- 1.3 These amendments operate in respect of payments or credits an SGE makes to an associate, as well as liabilities incurred by an SGE from an associate, on or after 1 July 2023.

Context of amendments

- 1.4 These amendments will deliver on part of the Government's multinational tax integrity package to address the tax avoidance practices of multinational enterprises as announced in the October 2022-23 Budget. These changes form part of the Government's commitment to ensure that multinational enterprises pay their fair share of tax in Australia to help fund vital services, repair the Budget and level the playing field for Australian businesses.
- 1.5 These amendments will complement Australia's existing anti-avoidance provisions to deter tax avoidance behaviours of SGEs who exploit intangible assets to derive income in a low corporate tax jurisdiction.
- 1.6 SGEs have significant scope as to how they structure their businesses. It is common to centralise functions and assets and then to charge subsidiaries for the use of these services or assets. For SGE group members located in Australia, these expenses will generally be deductible if they are not capital expenses or denied by a specific provision of the ITAA 1997 or ITAA 1936.

- 1.7 Whilst some assets have, by their nature, particular physical locations, other assets, in particular intangible assets, are readily mobile. This allows them to be located in jurisdictions with either a low headline corporate income tax rate or a regime that preferentially taxes income from intellectual property, called a preferential patent box regime.
- 1.8 The OECD periodically assesses patent box regimes to determine if they lack sufficient economic substance requirements or are considered harmful tax practices.
- 1.9 A jurisdiction's patent box regime is typically considered harmful if it provides tax concessions in that jurisdiction without requiring sufficient economic substance in the development of the relevant intangible asset there. Such patent box regimes facilitate uncommercial arrangements that aim to avoid income tax by exploiting intangible assets where tax concessions are available.
- 1.10 This allows for SGEs to structure their business such that income from the exploitation of the intangible assets is derived in the jurisdiction that provides the most favourable tax outcome.
- 1.11 SGEs may also mischaracterise payments that are in substance, but not legal form, made for the right or permission to exploit an intangible asset. SGEs may enter into arrangements with associates where, although the terms of the arrangement specifically preclude the transfer of any intangible assets, or consideration for the use of intangible assets, an examination of the substance of the arrangement demonstrates that the right or permission to exploit the intangible asset is a key part of the arrangement.
- 1.12 SGEs may also enter into related-party arrangements that involve the provision of services from a related party and also the right or permission to exploit an intangible asset. These arrangements might assign no value to the right to exploit the intangible asset under the arrangement, instead specifying that the consideration paid is for services.
- 1.13 In both types of these arrangements, the mischaracterisation of the payment typically results in royalty withholding tax not being paid as the taxpayer recognises no part of the payment as being a royalty for the use of the intangible asset.
- 1.14 An examination of the substance of the whole arrangement shows that despite the express provisions of the agreement to the contrary, the right to exploit, or the exploitation of, the intangible asset is of considerable value to the Australian resident entity and assigning no value to this asset is a mischaracterisation of the true substance of the arrangement, which is only possible when dealing with associates.
- 1.15 Where income from exploiting the intangible asset is assessable in Australia, the SGE is entitled to a deduction for the payment made to the associate under the arrangement at Australia's corporate rate, whilst foreign income from the exploitation of the intangible asset is derived in a jurisdiction with a much lower or no corporate income tax rate.

- 1.16 Such arrangements result in insufficient tax being paid. The ability to avoid corporate income tax in this way encourages SGEs to take advantage of the highly mobile nature of intangible assets by structuring their arrangements to ensure that income from exploiting those assets is derived in jurisdictions that deliver the most tax effective outcomes.

Summary of new law

- 1.17 Schedule [x] of this Bill amends the ITAA 1997 to introduce an anti-avoidance rule. This rule is designed to deter SGEs from avoiding income tax, including withholding tax, by structuring their arrangements so that income from exploiting intangible assets is derived in a low corporate tax jurisdiction by an associate of that SGE, while deductions for payments made by the SGE to an associate that are attributable to those or related intangible assets are claimed in Australia. Under this rule, no deduction is allowable for the payment made by the SGE to its associate.
- 1.18 Where an SGE makes a payment to an associate that is attributable to a right or permission to exploit an intangible asset, and as a result of that or a related arrangement, income from the exploitation of those or related intangible assets is directly or indirectly derived by an associate of the SGE in a low corporate tax jurisdiction, the SGE will not be entitled to deduct an amount for that payment.
- 1.19 These amendments operate in respect of payments or credits an SGE makes to an associate, as well as liabilities incurred by an SGE from an associate, on or after 1 July 2023, under an arrangement where the entry into that arrangement, or the acquisition or exercise of the right results in income from the exploitation of an intangible asset being derived in a low corporate tax jurisdiction.

Detailed explanation of new law

- 1.20 These amendments deny a deduction for certain payments made by an SGE to an associate where, as a result of the arrangement under which the payment was made or, as a result of a related arrangement, the SGE or another entity acquires an intangible asset or a right to exploit an intangible asset. Where the entry into the arrangement, the exploitation of (or the acquisition of the right to exploit) an intangible asset results in income from the exploitation of the same or a related intangible asset being directly or indirectly derived in a low corporate tax jurisdiction by an associate of the SGE, no deduction is allowed for the payment made by the SGE to the extent that it is attributable to the right to exploit the intangible asset.

[Schedule xx, item 2, subsection 26-110(2) of the ITAA 1997]

- 1.21 The amendments apply in relation to credits made by an SGE to an associate, or liabilities incurred by an SGE from an associate in the same way as the section applies in relation to payments. The section also applies where the SGE or other entity does not acquire a right to exploit an intangible asset but is nevertheless permitted to exploit the intangible asset, whether that permission is express or implied.
[Schedule xx, item 2, subsections 26-110(4) and (10) of the ITAA 1997]
- 1.22 The amendments discourage SGE groups from choosing to derive income from exploiting intangible assets in jurisdictions that provide the most favourable tax outcomes.
- 1.23 The amendments apply to payments or credits made by an SGE to an associate, or liabilities incurred by an SGE from an associate, on or after 1 July 2023. SGE is defined in section 960-555 of the ITAA 1997.
[Schedule xx, item 2, subsection 26-110(4) of the ITAA 1997 and item 5, application provision]
- 1.24 The term ‘associate’ takes its meaning as defined in section 318 of the ITAA 1936.

Payments made by SGEs to associates in connection with income from exploiting intangible assets being derived in low corporate tax jurisdictions

- 1.25 These amendments apply where a payment or credit is made, or a liability is incurred under an arrangement or a related arrangement that results in the SGE or another entity acquiring an intangible asset or a right to exploit an intangible asset, or results in that entity exploiting the intangible asset. It is sufficient that the SGE or other entity doesn’t acquire the intangible asset or a right to exploit the intangible, but is permitted to exploit the intangible asset, whether the permission is express or implied.
[Schedule xx, item 2, paragraph 26-110(2)(b) and subsection 26-110(10) of the ITAA 1997]
- 1.26 Exploiting an intangible asset takes a broad meaning. It includes using, marketing, selling, licensing and distributing the intangible asset. It also includes a supply, receipt or forbearance in respect of the asset, if paragraphs (c), (d), (da) or (f) of the definition of ‘royalty’ in subsection 6(1) ITAA 1936 applies to that supply, reception or forbearance. Further, exploiting another asset that is a right in respect of, or an interest in, the asset or anything else in respect of the asset also constitutes exploiting an intangible asset.
[Schedule xx, item 2, subsection 26-110(9) of the ITAA 1997]
- 1.27 This definition is broad in order to capture the variety of ways in which intangible assets can be exploited in the businesses of an SGE group.
- 1.28 The term ‘arrangement’ uses the existing definition of that term in subsection 995-1(1). This is a broad definition and will include not just the ordinary meaning or arrangement but also an agreement, understanding,

promise or undertaking, whether express or implied, and whether or not enforceable (or intended to be enforceable) by legal proceedings.

- 1.29 In addition to ‘arrangement’ taking a broad meaning, the provision requires that the SGE or another entity acquires the right to exploit, or actually exploits, an intangible asset ‘*as a result of*’ the arrangement under which the payment is made. This phrase, together with the broad meaning of ‘arrangement’, ensures that it is not necessary that the payment and the acquisition of the right to exploit or exploitation of an intangible asset is provided for in the same contract. This is an objective test that requires an examination of the whole of the arrangement, including collateral contracts and legally unenforceable understandings between the parties (per the definition of ‘arrangement’ in subsection 995-1(1) of the ITAA 1997).
[Schedule xx, item 2, paragraph 26-110(2)(b) of the ITAA 1997]
- 1.30 These amendments also apply where the right to exploit an intangible asset is acquired under an arrangement related to the one which provides for the payment from the SGE to its associate. This captures a situation where the SGE or another entity doesn’t acquire any express right to exploit an intangible asset under the arrangement providing for the payment, but as a result of a common understanding between associates, has access to intangible assets.
[Schedule xx, item 2, paragraph 26-110(2)(b) of the ITAA 1997]
- 1.31 For example, an Australian entity might enter into a distribution agreement as part of an arrangement with an associate in a low corporate tax jurisdiction. This arrangement may make no mention of any intangible assets but was made on the common understanding between the parties that the associate in the low corporate tax jurisdiction would make available, for no cost and without any written or formal agreement, access to a server that contains valuable confidential information that the Australian entity may use in its role as a distributor. This common understanding between the parties constitutes a related arrangement.
- 1.32 As an anti-avoidance rule, these amendments are intended to have a broad application. A deduction is proportionately denied where the payment is genuinely made as consideration for other things provided the result of the arrangement under which the payment is made, or a related arrangement, is that the SGE or another entity acquires an intangible asset, a right to exploit an intangible asset or exploits an intangible asset.

Example 1.1

Blue Co is an Australian subsidiary of Hexagon Co. The Hexagon Co group is an SGE headquartered in a foreign country whose primary business is the manufacture and sale of clothing and shoes. Hexagon Co licenses the right to its trademark to White Co. White Co is an associate of Blue Co and is located in a low corporate tax jurisdiction.

White Co and Hexagon Co have a cost sharing agreement in relation to the development of various business strategies,

processes and intellectual property, which includes the Hexagon Co trademark. As part of this cost sharing agreement Hexagon Co allows White Co to sub-license the trademark in certain jurisdictions including Australia.

Blue Co enters into an arrangement with White Co under which Blue Co is obliged to market and sell Hexagon Co's clothing and shoes. As part of this arrangement Blue Co is granted a sub-licence from White Co to use Hexagon Co's trademark. This arrangement allows Blue Co to brand its local stores with Hexagon Co's trademark and use that trademark as part of its general marketing strategy. The agreement between Blue Co and White Co specifies that Blue Co pay White Co a fee for management and other services. The agreement also authorises Blue Co to use any of the intellectual property necessary to fulfill its obligation to market and sell clothing and shoes. The agreement specifies that access to this intellectual property, which includes the trademark is provided to Blue Co at no cost.

The trademark is an intangible asset. Blue Co also acquires a right in respect of, or an interest in an intangible asset, being the sub-licence that it has acquired to use the trademark.

As a result of the arrangement between White Co and Blue Co, Blue Co uses the trademark to brand its local retail stores where clothing and shoes are sold. The trademark is prominently displayed in all marketing material. Blue Co exploits the trademark within the meaning of exploit in subsection 26-110(9) by using the trademark to brand its shops and in its marketing material. By using the trademark, Blue Co also exploits the sub-licence it has acquired. The payment made by Blue Co to White Co is income of White Co in the low corporate tax jurisdiction. This is income derived by White Co in a low corporate tax jurisdiction as a result of entering into the arrangement with Blue Co under which Blue Co exploits both intangible assets, being the trademark and the sub-licence. Blue Co claims a deduction in Australia equal to the fees for management and other services

As a result of the arrangements between the parties, and despite the contract providing these intangible assets are made available at no cost, Blue Co has acquired the right to use the trademark and exploits the sub-licence. White Co derives income in the low corporate tax jurisdiction, being the management and services fees from Blue Co, from exploiting its licence. To the extent that the payment of these fees is attributable to the right to exploit the trademark and the sub-licence by branding its shops and using the trademark as part of its marketing, the deduction for Blue Co is denied.

- 1.33 These amendments apply when the payment is made by the SGE directly to an associate, or through one or more other entities (which may or may not be

located in low corporate tax jurisdictions) to the associate. This, together with the fact that the right to exploit, or the exploitation of, an intangible asset may arise under a related arrangement, ensures that SGEs cannot circumvent the operation of the section by making payments through other entities. It is also not relevant where the associate of the SGE is located – that is, there is no requirement that the recipient of the direct or indirect payment is located in a low corporate tax jurisdiction.

[Schedule xx, item 2, paragraphs 26-110(3)(a) and (b) of the ITAA 1997]

- 1.34 Similarly, where income is derived in a low corporate tax jurisdiction by the recipient or another associate of the SGE from the exploitation of the intangible asset, or a related intangible asset, that income can be derived either directly from that exploitation or indirectly. Where income is derived indirectly, strict tracing through the flow of funds is not required, in particular, it is not necessary to demonstrate that each payment in a series of payments funds the next payment or is made one after the other. Rather, it is sufficient if the payment exists between each entity.

[Schedule xx, item 2, paragraph 26-110(2)(c) of the ITAA 1997]

- 1.35 The amendments apply to SGEs using the existing definition in section 960-555 ITAA 1997 and where the payment or credit is made by the SGE to an associate, or the liability is incurred by the SGE from an associate.
- 1.36 The existing definition of ‘associate’ in section 318 ITAA 1936 is relevant.

Mischaracterisation

- 1.37 These amendments apply where a contract provides that a payment is made for other things, such as services or tangible goods, and the arrangement also results in the SGE or another entity exploiting, or acquiring a right to exploit, an intangible asset, even at no cost.
- 1.38 In these cases, a deduction that is denied for a payment attributable to the right to exploit an intangible asset may be apportioned. Where such an acquisition results from the arrangement that provides for the payment (regardless of whether it is stated in the written contract that the payment is for services or tangible goods), a deduction for the payment will be denied to the extent that the payment is attributable to the right to exploit the intangible asset. As discussed at paragraphs #1.21 and #1.25 above, where no express right to exploit is acquired under the arrangement, but the SGE or other entity is permitted to exploit the intangible asset, the deduction will be similarly denied to the extent that it is attributable to that permission to exploit the intangible asset, whether that permission is express or implied.

[Schedule xx, item 2, subsections 26-110(2) and (10) of the ITAA 1997]

- 1.39 This is designed to complement the anti-avoidance nature of these amendments. Mischaracterising payments that are, at least to some extent, effectively made to acquire a right or have permission to exploit an intangible asset as payments made for other things such as services or tangible goods, will not avoid the operation of this anti-avoidance rule.

- 1.40 To complement this anti-avoidance rule, a shortfall penalty provision is being considered as a punitive measure to penalise SGEs who mischaracterise such payments in an attempt to avoid income tax, including withholding tax. We are seeking stakeholder views on how to ensure that this proposed penalty provision is appropriately targeted.

Intangible Assets

- 1.41 ‘Intangible asset’ is an expression that is used in numerous other provisions in the ITAA 1997. In those provisions, it takes its ordinary meaning, unaffected by the extensions to and carve-outs from the types of assets relevant for this section.

[Schedule xx, item 2, subsection 26-110(8) of the ITAA 1997]

- 1.42 This section applies in relation to intangible assets within the ordinary meaning of that term, in addition to applying in the same way in relation to the following:

- certain things (whether property or not) referred to in paragraphs (a) or (c) to (e) of the definition of ‘royalty’ in subsection 6(1) of the ITAA 1936;
- a right in respect of, or an interest in, any asset which the section applies to; and
- any asset prescribed by the regulations.

[Schedule xx, item 2, subsection 26-110(5) of the ITAA 1997]

- 1.43 The reference to ‘paragraph (b)’ in paragraph (d) of the definition of ‘royalty’ in subsection 6(1) of the ITAA 1936 is disregarded for the purposes of determining how this anti-avoidance rule applies because paragraph (b) refers to tangible assets that are not in scope.

[Schedule xx, item 2, paragraph 26-110(5)(a) and subsection 26-110(6) of the ITAA 1997]

- 1.44 For the avoidance of doubt, the above listed assets are specified as falling within the operation of the amendments, whether or not they are already captured within the ordinary meaning of ‘intangible asset’, such as:

- Intellectual property
- Copyright
- Access to customer databases
- Algorithms
- Software Licences
- Licences
- Trademarks
- Patents

- Leases, licences or other rights over assets.
- 1.45 Given the evolving nature of intangible assets, these amendments include a regulation-making power to provide for the ability to prescribe new assets to which the section applies. This allows the Government to make timely changes to the regime. The regulations would be subject to parliamentary scrutiny, including disallowance and sunseting after 10 years.
[Schedule xx, item 2, paragraph 26-110(5)(c) of the ITAA 1997]
- 1.46 These amendments do not apply to tangible assets, interests in land or financial arrangements to which Division 230 of the ITAA 1997 applies. This is because these types of assets are less mobile or are subject to other regulatory frameworks. The assets this measure does not apply to are:
- A right in respect of, or an interest in, a tangible asset
 - an estate, interest or right in or over land
 - a right in respect of such an estate interest or right
 - a financial arrangement where Division 230 (TOFA) applies to the gains and losses from that financial arrangement
 - a right in respect of, or an interest in, an intangible asset that is already covered by any of the above.
- [Schedule xx, item 2, subsection 26-110(7) of the ITAA 1997]***
- 1.47 It is not intended for this anti-avoidance rule to inappropriately apply to genuine supply and distribution arrangements between associates, where there is no tax avoidance behaviour. For example, trademarks printed on finished goods that are marketed and sold by an SGE to customers, without payments to an associate being mischaracterised or being effectively for the use of that trademark in the SGE's business beyond the mere marketing and selling of those finished goods, would be unlikely to attract the operation of this anti-avoidance rule. To ensure these arrangements are not inappropriately caught, the provisions preclude the section from applying in relation to an intangible asset that is a right in respect of, or an interest in:
- a tangible asset; or
 - an intangible asset to which the section doesn't apply and the payment relates to the tangible good or other excluded asset.
- [Schedule xx, item 2, paragraphs 26-110(1) and (7)(a) and (d) of the ITAA 1997]***
- 1.48 Arrangements that are the subject of these amendments often involve several intangible assets. In particular, some of these intangible assets may be interrelated to each other, such as via the granting of a licence over an intangible asset. For example, an entity that owns a patent may grant a licence to an associate conferring the right to use that patent without being in breach of

the legal protection that the patent affords the owner. That associate may grant a sub-licence to another associate. In this example, the patent, the licence and the sub-licence are all intangible assets. If any of the patent, the licence or the sub-licence are exploited such that income is derived in a low corporate tax jurisdiction by an associate, subject to satisfying the remaining criteria of the provision, deductibility for the payment, credit or liability incurred will be denied.

Exploiting an Asset

1.49 The deduction for the payment will be denied only to the extent that it is attributable to the right, or permission, of the SGE or another entity to exploit an intangible asset. In addition, an associate must derive income in a low corporate tax jurisdiction, directly or indirectly, from the exploitation of the intangible asset, or a related intangible asset. For these purposes, ‘exploiting an intangible asset’ is prescribed to have a broad meaning.

[Schedule xx, item 2, subsections 26-110(2) and (9) of the ITAA 1997]

1.50 The phrase ‘exploiting an intangible asset’, in the context of these provisions is intended to be broad to capture the variety of ways that SGE’s benefit from intangible assets. It captures:

- the use of, marketing, selling and distributing the intangible asset;
- the supply of an intangible asset mentioned in paragraph 6(c) of the definition of royalty ITAA 1936;
- the reception of an intangible asset mentioned in paragraphs 6(d) or 6(da) of the definition of ‘royalty’ in the ITAA 1936;
- the forbearance of an intangible asset mentioned in paragraph 6(f) of the definition of ‘royalty’ in the ITAA 1936
- exploiting another asset that is a right in respect of, or an interest in, the intangible asset; and
- doing anything else in respect of the intangible asset.

[Schedule xx, item 2, subsection 26-110(9) of the ITAA 1997]

1.51 The amendments apply to a broader range of circumstances than just ‘use of the intangible asset’ as the ways in which intangible assets can be exploited to benefit an SGE is equally broad. In addition, as discussed at paragraphs #1.21, #1.25 and #1.38 above, the section applies to a permission to exploit an intangible asset in the same way that it applies to a right to exploit an intangible asset. As the arrangements subject to this anti-avoidance rule are between related parties, the rights that are acquired might not rise to the level of legally enforceable rights. By extending the section to apply to ‘permission to exploit an intangible asset’, these amendments will also apply where the

right to exploit the intangible asset that is acquired is an implicit right or an understanding between the parties.

[Schedule xx, item 2, subsection 26-110(10) of the ITAA 1997]

1.52 This is commensurate with the provision being an anti-avoidance measure to capture a broad spectrum of arrangements to minimise the risk of associates structuring arrangements in such a way so as to circumvent the operation of the provision. For the purposes of these amendments, examples of activities that would be considered to be within the meaning of exploiting an intangible asset are:

- the copying of an item of copyright or software;
- the issuance of a licence key or other piece of information that allows access to a piece of software or a database;
- accessing information contained on a database;
- the deploying of or accessing the output of an algorithm;
- a brand, trademark or other intangible asset that is a source of goodwill that can be used by an entity holding themselves out as a representative of that brand or group;
- a right or obligation to distribute or sell products on behalf of an associate in return for consideration from either the associate or third party customers that involves marketing, selling or distributing the intangible asset even when that intangible asset, such as a software licence, is distributed directly from the offshore associate to the customer.

Low corporate tax jurisdictions

1.53 Deductibility for an amount of the payment will be denied, subject to satisfying the remaining elements of the section, only if an associate of the SGE derives income in a low corporate tax jurisdiction from exploiting an intangible asset.

[Schedule xx, item 2, paragraph 26-110(2)(c) of the ITAA 1997]

1.54 A low corporate tax jurisdiction is one where the lowest corporate income tax rate under the laws of that foreign country, applicable to an SGE, is less than 15% or nil.

[Schedule xx, item 2, subsection 26-110(11) and item 3, subsection 960-258(1) of the ITAA 1997]

1.55 In determining what the relevant corporate income tax rate is, deductions, offsets, tax credits, tax losses, tax treaties, concessions for intra-group dividends and tax rates that only apply to foreign residents are disregarded. Only national level corporate tax is relevant for determining whether a foreign country is a low corporate tax jurisdiction.

[Schedule xx, item 3, paragraphs 960-258(2)(a) and (b) of the ITAA 1997]

- 1.56 For foreign countries with progressive corporate income tax rates, only the highest rate will be relevant in determining whether that country is a low corporate tax rate jurisdiction. Where no income tax applies on a particular amount of income, the rate is treated as being nil. Where different income tax rates apply, depending on the type of income derived, only the lowest tax rate is relevant for this purpose.

[Schedule xx, item 3, paragraphs 960-258(2)(c), (d) and (e) of the ITAA 1997]

- 1.57 This ensures that the amendments capture the relevant rate that is likely to apply to the income of the SGE and will capture situations where there are different rates of corporate income tax on different types of income.

- 1.58 However, it will not capture situations where a jurisdiction may have concessional corporate income tax rate for small or medium businesses, as such rates are not relevant for an SGE.

[Schedule xx, item 2, subsection 26-110(11) of the ITAA 1997]

Tax Preferential Patent Box Regime

- 1.59 These amendments also apply to deny deductions for payments to associates where income from exploiting the intangible asset is derived in a jurisdiction determined by Minister as providing for a preferential patent box regime without sufficient economic substance in that jurisdiction.

[Schedule xx, item 3, subsection 960-258(3) of the ITAA 1997]

- 1.60 A patent-box regime is a regime that typically provides tax concessions, usually in the form of a concessional rate of tax, for income that is derived by the exploitation of intellectual property. A regime of this kind usually involves income that is derived from the ownership of patents and offers these concessions to encourage companies to locate and/or develop their intellectual property onshore in those countries.

- 1.61 This amendment is not designed to capture all patent-box regimes, only those that provide tax concessions without requiring sufficient economic substance and therefore provide concessional tax treatment without requiring any economic activity to develop the relevant intellectual property in the country which provides the patent box concession.

- 1.62 The OECD periodically reviews preferential tax regimes, including those focused on intellectual property, such as patent box regimes, to determine if sufficient economic substance exists. This is done through the *OECD Forum on harmful tax practices*.

- 1.63 The Minister may make a legislative instrument to determine a foreign country if the Minister is satisfied that the income tax laws of the foreign country provide for a preferential patent box regime without sufficient economic substance. This is intended to ensure that any harmful patent-box regimes are captured. The legislative instrument would supplement existing measures in the Act to ensure that the existing approach in the Act are maintained and enforceable. The power is required to ensure the legislation can quickly adapt to changes in patent-box regimes in other countries or the introduction of new

patent box regimes in other countries.

[Schedule xx, item 3, subsection 960-258(4) of the ITAA 1997]

- 1.64 In determining a jurisdiction, the Minister may have regard to any relevant findings, determinations, advice, reports or other publications of the Council of the OECD, such as “*Harmful Tax Practices – 2018 Progress Report on Preferential Regimes* and the *Harmful Tax Practices – Peer Review Results – Inclusive Framework on BEPS: Action 5*” and the most recent conclusions of the OECD *Forum on harmful tax practices* in this regard.

[Schedule xx, item 3, subsection 960-258(4) of the ITAA 1997]

- 1.65 The legislative instrument would be subject to disallowance and would sunset after 10 years and will therefore be subject to appropriate parliamentary scrutiny.

Consequential amendments

- 1.66 Schedule [x] of this Bill makes consequential amendments to insert a reference to this section in the list of provisions about deductions in section 12-5 of the ITAA 1997. The Bill also inserts new definitions of the terms ‘*exploiting an intangible asset*’ and ‘*low corporate tax jurisdiction*’ into subsection 995-1(1) of the ITAA 1997.

[Schedule xx, item 1, section 12-5 of the ITAA 1997 and item 4, subsection 995-1(1) of the ITAA 1997]

Commencement, application, and transitional provisions

- 1.67 The amendments commence the day after Royal Assent.
- 1.68 The amendments apply to all payments made or credited or liabilities incurred after 1 July 2023.