9 July 2021

Committee Secretariat
Select Committee on Australia as a Technology and Financial Centre
PO Box 6100
Canberra ACT 2600

By email: fintech.sen@aph.gov.au

Dear Sir/Madam

Third Issues Paper – AFMA Submission

The Australian Financial Markets Association (AFMA) represents the interests of well over 120 participants in Australia's wholesale banking and financial markets. Our members include Australian and foreign-owned banks, securities companies, treasury corporations, traders across a wide range of markets and industry service providers. Our members are the major providers of services to Australian businesses and retail investors who use the financial markets. We are pleased to provide a submission to the Select Committee on Australia as a Technology and Financial Centre ("the Committee") on its Third Issues Paper.

Replacement to the Offshore Banking Unit (OBU) Regime

A particular focus of the Third Issues Paper is to specifically consider "options to replace the OBU regime." An expansion of the Terms of Reference of the Committee's Inquiry, this follows the announcement by the Treasurer on 12 March 2021 that the current OBU regime is to be abolished from the end of the 2022/23 income year and that the interest withholding tax exemption for interest paid from OBUs would cease to apply from 31 December 2023.

We note that the Treasurer's announcement was made to prevent the OECD Forum on Harmful Tax Practices from declaring the OBU as a harmful tax practice and to ensure that adverse regulations from the European Union would not hinder the investment by European investors into Australian securitisation vehicles. We reiterate our previous comments to the Committee that the framework through which the OECD assesses a concessional taxation regime as being a potentially harmful tax practice is flawed and the OBU regime does not distort the allocation of capital or investment to Australia but merely allows Australia to leverage its other non-tax benefits to compete with other regional jurisdictions. Notwithstanding, in considering options to replace the OBU regime, it is necessary to ensure that any options will withstand the scrutiny of the OECD

to the extent that the OECD Forum on Harmful Tax Practices will remain operative, a point on which we elaborate below.

Pillar 2 and the Impact on Forum on Harmful Tax Practices

It is important to note that there have been significant developments in the international tax landscape since the Treasurer's Media Release in March that inform both the structure of any replacement to the OBU regime and the ongoing work of the OECD Forum on Harmful Tax Practices.

On 1 July 2021, the OECD announced that 130 jurisdictions had signed up to the two-pillar solution to address tax challenges arising from the digitalisation of the global economy. Of particular importance, Pillar Two of the solution seeks to ensure that companies with associate-inclusive turnover of EUR 750 million or more have taxable income taxed at an effective tax rate of 15% or higher. In making such a commitment, the OECD and the jurisdictions that have signed up to the solution have reached consensus as to a minimum rate of tax that is not harmful. This was a point well-made by the Secretary-General of the OECD, Matthias Cormann, who stated "(t)his package does not eliminate tax competition, as it should not, but it does set multilaterally agreed limitations on it."

The clear implication from the consensus achieved on Pillar 2 is that any regime that applies a tax rate of 15% or higher cannot satisfy the gateway "low or no tax" criterion necessary to be a harmful tax practice. Indeed, given that the mechanisms underpinning Pillar 2 is that will ensure that the all income derived globally is effectively taxed at 15%, then the work of the OECD Forum will be largely obsolete once Pillar 2 is operative.

Assessing the OECD Conditions

The OECD Forum on Harmful Tax Practices articulates five key factors that will be relevant to the assessment as to whether a concessional taxation regime is viewed as a harmful tax practice

1) The regime imposes no or low effective tax rates on income from geographically mobile financial and other service activities;
2) The regime is ring-fenced from the domestic economy;
3) The regime lacks transparency;
4) There is no effective exchange of information with respect to the regime; and
5) The regime fails to require substantial activities.

In relation to the OBU regime, the only two factors that are of potential relevance are the first two, that is, that the regime imposes no or low effective tax rate on geographically mobile income and that the regime is ring-fenced from the domestic economy. Australia is a global leader on issues of tax transparency and effective exchange of information. Additionally, the requirement in the OBU rules that the eligible OB activity be undertaken in Australia ensures that substantial economic activity occurs in Australia. Indeed, AFMA has previously provided information to Treasury stating that, for each AFMA member that conducts OBU business, such business sustained more than 100 jobs in Australia.

Low or No Effective Tax Rates

In setting out the basis for the inclusion of the first criterion, the OECD states that:

> "A low or zero effective tax rate on the relevant income is a necessary starting point for an examination of whether a preferential tax regime is harmful. When a preferential regime benefits income from geographically mobile activities and meets this factor, it is in scope for the FHTP. However, the tax rate factor alone does not imply that a preferential regime is harmful; rather it is a gateway criterion that if met means that the FHTP will continue the review process to determine if one or more of the other key factors are implicated."

Unfortunately, there is little articulation from the OECD as to what constitutes "low" tax in the assessment process. Noting that the OBU regime offers a concessional tax rate of 10%, it was a live deliberation during the OECD Forum's review as to whether this rate satisfied the "low or no tax" requirement and AFMA has been advised that there is no unanimous view as to how satisfaction of this criterion is to be determined. Indeed, perversely, views within the OECD were expressed that any concessional rate lower than the headline corporate tax rate (30% in Australia's case) would be considered to be "low tax", meaning that a concessional tax rate considerably higher than the OECD average could theoretically give rise toa designation of a harmful tax practice. There are various OECD approved regimes across the world which allow for a rate which is lower than the country's headline corporate tax rate, including Singapore's FSI scheme. It has never been clear to AFMA as to why a jurisdiction's headline corporate tax rate would be relevant to the assessment of whether a concessional tax regime satisfies the "low tax" criterion; rather the consideration should be whether the concessional tax rate is so low that it distorts the allocation of income and capital purely based on tax.

However, as noted above, clarity on this issue has arrived in the form of the unilateral consensus from the 130 jurisdictions that have agreed to the OECD proposal to impose a global minimum tax rate of 15%. Our view is that any regime with a tax rate of 15% or higher could not be considered to meet the "low or no tax" criterion.

The Regime is Ring-Fenced from the Domestic Economy

The other threshold criterion used by the OECD Forum to determine whether a concessional regime is a harmful tax practice relevant to the OBU regime is the extent to which the regime is "ring-fenced" from the domestic economy. The OECD has articulated the basis for this criterion as follows:

> "The fact that a jurisdiction has designed the regime in a way that protects its own economy from the regime by ring-fencing provides a strong indication that a regime has the potential to create harmful spill-over effects. Ring-fencing focusses on the legal or administrative barriers to participation in the domestic economy, rather than the case where only a small number of domestic taxpayers take advantage of the regime.

Given the preliminary finding of the OECD Forum then it is appropriate to address this criterion in developing any future regime.

The Global Markets Incentive Regime

In considering the work of the OECD, both through the Forum on Harmful Tax Practices and also through the development of the minimum tax rate through Pillar 2, AFMA has formulated the Global Markets Incentive (GMI) Regime which will allow Australia's tax settings as they apply to financial centre business to be largely maintained while ameliorating any concerns of the OECD Forum identified through its review of the OBU regime.

The goal of the GMI is to ensure that Australian-based financial market participants are able to equitably compete in international markets. Current financial markets operate on an international basis and enable participants to access a range of services and products both in their local market and from foreign providers. The Australian tax system should not adversely impact an Australian-based entity's competitiveness in these markets.

The principal features of the GMI regime are as follows:

- ***A tax rate of 15% to apply to eligible GMI activities;***
  - The nature of activities to be included in the GMI should also take into account whether the activity is one which Australia wishes to incentivise as part of its drive to be a technology and financial centre and how impactful the removal of the non-resident ring-fencing would be to existing domestic tax revenue.
  - Certain OBU trading activities are currently not ring-fenced in the OBU rules (or the ringfence has no practical effect as a result of non-tax reasons). The inclusion of these activities in the GMI should not result in significant tax revenue consequences.
- ***GMI activities to be determined with reference to the existing suite of eligible OB-activities;***
  - The definition of an eligible counterparty can be defined to exclude individuals and/or small business entities under section 328 of the ITAA. This will ensure that the GMI regime only applies to financial market participants of sufficient scale and does not inadvertently create new domestic low tax markets for non-AUD financial products and services, thereby mitigating material adverse Federal tax revenue impacts.
  - A restriction based on the nature of the counterparty (i.e. individual or small business) should not cause ring-fencing concerns as the restrictions would apply to both residents and non-residents.
- ***GMI activities able to be conducted with any eligible counterparty (both domestic and international), thereby removing the ring-fencing concern that was expressed in relation to the OBU regime;***
- ***Given that the focus of the GMI regime is to allow Australia to compete in relation to transactions that would otherwise be conducted with international competitors, a prohibition against GMI activities being denominated in AUD.***

This structure would address each of the concerns articulated by the OECD Forum and ensure alignment between the policy intent of enhancing the competitiveness of Australia's taxation settings for international transactions and the types of transactions that will be conducted within a GMI framework.

Consideration of the IBAR

The 2020 Report into Australia as a Financial & Technology Centre, chaired by Andrew Low (**the Low Report**), was tasked with considering the tax and regulatory settings that would enhance the competitiveness of Australia as an attractive jurisdiction in which to base regional financial services businesses. The report explored opportunities for Australia arising from factors such as the geopolitical turmoil in Hong Kong, the waning of attractiveness of offshore financial centres due to tax rule harmonisation and the re-assessment of locations for business to be undertaken as a result of the COVID-19 pandemic. The recommendations of the Low Report were aimed at attracting overseas businesses to relocate to Australia, not ensuring that existing financial services businesses would look to establish business operations elsewhere. We note that the pending abolition of the OBU regime will result in current OBU transactions no longer being conducted in Australia and would therefore hinder the objectives the Low Report is seeking to address.

Consistent with its terms of reference, one of the recommendations of the Low Report was the introduction of an Incremental Business Activity Rate, or "IBAR". The aim of the IBAR is to provide a concessional tax rate to incremental business brought to the country, with participants in the IBAR receiving a concessional tax rate for seven years on incremental business brought to Australia. The Low Report specifies that this rate of tax would be 12.5% or any other rate that is consistent with the Pillar 2 outcomes; we now assume that the rate will be set at 15%. The Low Report further sets out a number of integrity and administrative features of the IBAR to ensure that the concessional tax rate only applies to genuinely incremental activity.

Given its policy rationale, the IBAR should be seen as operating in conjunction with, as opposed to a replacement of, the OBU regime. This is acknowledged by the Low Report, which sets out as one of the features of the IBAR that financial services businesses are unable to claim both the IBAR and the OBU concession in relation to the same income. To the extent that the GMI regime is considered to be an appropriate replacement to the OBU regime, then depending on the ultimate design of the regime it may be possible for both the IBAR and the GMI to operate in parallel.

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Please contact me on 02 9776 7996 or rcolquhoun@afma.com.au if you have any queries about this submission.

Yours sincerely,

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