



## TRANSFER PRICING AND INTERNATIONAL TAX ASPECTS FROM THE FEDERAL BUDGET 2021-2022

The take-aways for businesses from the Government's 2021-2022 Federal Budget are the promise to implement reforms, incentives, and policies to achieve a more dynamic, productive, competitive, and flexible economy.

The two essential areas that relate to Transfer pricing and International tax are firstly incentives to attract more innovative business activities and further entice the benefits of these to stay on Australian soil in the longer term.

Secondly, streamlining some of the current administrative compliance obstacles to ensure Australia appeals to international businesses, and is a competitive and winning option for foreign investments.

Whilst these Budget incentives should be applauded for measurements to assist Australian businesses back on track after a horrendous year with pandemic, lockdowns, and natural catastrophes, it is still important for Australian inbound and outbound multinational enterprises to stay put with statutory obligations, filing arm's length tax returns and complying with the comprehensive annual transfer pricing documentation requirements.

Although the Australian Government has acted swiftly to support Australian businesses, the Government have massive debts post COVID-19. Given that the ATO is already perceived as one of the most aggressive and advanced revenue authorities in the world, we expect additional targeting of multinationals to recoup some of the governmental investment in Australian businesses.



**This report details key incentives from the Budget 2021-22 that could directly or indirectly impact current International Tax and Transfer Pricing structures and planning.**

# 1. Attracting and retaining innovative business activities to Australia

The Government is taking action to enhance the competitiveness of Australian businesses and put Australia at the cutting edge of science and innovation through the following three measures:

## 1.1 Introduction of a Patent Box:

The Patent Box incentive is building on the success of the R&D Tax Incentive (RDTI) in attracting clinical trials onshore. It will tax corporate profits from Australian developed and patented medical and biotechnology innovations at a concessional 17% effective corporate tax rate with effect from 1 July. Only granted patents, which were applied for after the Budget announcement, will be eligible, representing a tax rate reduction of 8% for small to medium enterprises and 13% for large businesses.

In Australia, despite the RDTI regime, the ownership of IP at the later stages of development and commercialisation has frequently moved offshore. The Patent Box regime is the missing link to the RDTI and incentivises the international commercialisation of Australian developed technology to be retained in Australia, leading to numerous flow-on benefits, including further investment and development activities.

Consultation on the detailed design will take place this year. The Government will also consult on whether a patent box would be an effective way of supporting the clean energy sector.

The requirement for the domestic development of eligible patents is aimed at satisfying the modified nexus approach (Action 5 of the OECD BEPS Project) and encouraging medical and biotech companies to develop and commercialise their innovations in Australia.

The modified nexus approach recognises that IP companies who choose to outsource R&D activity to other group companies are unlikely to be able to benefit from reduced tax rates on the resulting income, so it will allow related party outsource expenditure (and any IP acquisition costs) to be taken into account.

The Australian Government is developing this measure concurrently with the OECD's proposed finalisation of its position on Pillar 2 (global minimum tax) and it may be necessary to consider possible interactions between these two developments.



## 1.2 Digital games tax offset

As flagged by pre-Budget interviews and announcements, the Government announced a new \$1.2 billion Digital Economy Strategy to sit alongside the previously announced Cyber Security Strategy and Digital Business Plan.

A key part of the Digital Economy Strategy is a refundable Digital Games Tax Offset (DGTO) of 30% which will target the development of transferable skills and position Australia to take a greater share of the \$250 billion global gaming market.

The new offset will commence with effect from 1 July 2022 for Australian resident companies or foreign resident companies with a permanent establishment (PE) in Australia.

To qualify, there will be a minimum spend requirement of \$500,000 on qualifying Australian games expenditure, capped at \$20 million per year. Consultation with industry in mid-2021 will inform the criteria and definition of qualifying expenditure to support the development of digital games.

## 1.3 Self-assessment of the treatment of Intangible Assets

As part of the Government's \$1.2 billion Digital Economy Strategy, the Government will amend the law to allow taxpayers to self-assess the effective life of certain intangible assets including patents, registered designs, copyrights, licenses, and in-house software.

Currently, the effective lives for intangible depreciating assets such as patents, registered designs, copyrights, and in-house software are prescribed in the tax legislation (section 40-95(7) of the Income Tax Assessment Act 1997 (ITAA 1997).

Unlike tangible depreciating assets, taxpayers do not currently have the option of self-assessing the effective life of intangibles and thereby increasing their depreciation deductions.

This measure allows taxpayers to self-assess the effective lives of eligible intangibles giving businesses a greater ability to align the tax treatment with the actual economic benefits provided from the asset.

The new rules will apply from 1 July 2023 (after the temporary full expensing measures cease).

## 2. Cross border tax coherency, streamline foreign investments and transparency.

In line with the global push to safeguard against offshore tax avoidance and evasion, the Government has introduced measures promoting international tax coherency, transparency and streamline foreign investment application process through the following Budget initiatives:

### 2.1 Fast-tracking foreign investment application process

The ATO will introduce a new early engagement service aimed at encouraging and supporting new business investments into Australia.

The service will be available for eligible investors from 1 July 2021 following a period of consultation between the ATO, business and other stakeholders during May and June 2021.

The Government announced the service will:

- Provide “up front” confidence to investors about how Australian tax laws will apply.
- Be tailored to the needs of each investor.
- Offer support in relation to any or all federal tax obligation.
- Accommodate specific project timeframes, and other time sensitive aspects of a transaction such as Foreign Investment Review Board (FIRB) approvals.
- Where binding advice is desired, it will also incorporate access to expedited private binding rulings and advance pricing agreements.
- Integrate with the tax aspects of the FIRB approval process (if applicable) so that investors only need to provide information once.

### 2.2 Amendments to Taxation of the Financial Arrangements (TOFA) regime

The Government will make technical amendments to the TOFA legislation to simplify the application of an unnecessarily complex set of provisions that produce anomalous outcomes.

The amendments will include facilitating access to hedging rules on a portfolio hedging basis.

The amendments will also reduce compliance costs and correct unintended outcomes so that taxpayers are not subject to unrealised taxation on foreign exchange gains and losses unless this is elected. These changes will take effect for relevant transactions entered on or after 1 July 2022.

## 2.3 Unwinding of the Offshore Banking Unit (OBU) regime

The Government will proceed with removing concessional tax treatment for Offshore Banking Units (OBUs), eliminating the interest withholding tax exemption and close the regime to new entrants. This follows the OECD raising concerns about the OBU regime as part of its practice of reviewing jurisdictions' preferential tax regimes.

Legislation giving effect to this measure was introduced into Parliament on 17 March 2021.

The Government will consult on alternative measures to support the industry and help ensure activity remains in Australia. The Government will consult with industry on alternative measures to seek to retain existing OBU activities in Australia and to ensure Australia remains competitive as a centre for financial services.

## 2.4 Broadening of corporate tax residency rules

In the 2020-21 Budget, the Government announced that it will amend the law to clarify that a company that is incorporated offshore will be treated as an Australian tax resident if it has a 'significant economic connection to Australia'.

This test will be satisfied where both:

- The company's core commercial activities are undertaken in Australia; and
- Its central management and control are in Australia.

The Government has announced in the 2021-22 Budget that it will be consulting on broadening this amendment to trusts and corporate limited partnerships.

## 2.5 Increased international tax transparency

Jurisdictions around the world have collectively moved towards greater tax transparency and the exchange of information. The Government will update the list of jurisdictions that have an Effective Information Sharing Agreement (EISA) with Australia.

Residents of jurisdictions with an EISA are eligible to access the reduced Managed Investment Trust (MIT) withholding tax rate of 15% on certain distributions, instead of the default tax rate of 30%.

Effective from 1 January 2022, the list of countries will be expanded to include Armenia, Cabo Verde, Kenya, Mongolia, Montenegro, and Oman.

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