# Direct tax considerations of a potential EU-Australia free trade agreement

*Update created: 16 May 2025*

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Undeniably, in 2025, international trade has been shaken by the tariffs imposed by the United States despite its existing trade agreements with other countries. This situation may, however, present unique opportunities for trade among countries which do not currently operate by means of a free trade agreement. This note builds on the prospect of an EU-Australia free trade agreement and explores its potential direct tax considerations.

## 1. Setting the scene

The beginning of 2025 has been punctuated by the undermining of economic liberalism due to the tariffs imposed by the United States. Trading partners who would have thought they were in a preferential and trustworthy position have not been spared these measures. Australia is among them, with a tariff imposed at 10% despite the existence of a free trade agreement (FTA) between the two countries.

While the infringement of the US-Australia free trade agreement is a threat to the Australian economy, it can also serve as an opportunity for strengthening the economic ties between Australia and other significant markets. With a market of about half a million consumers, the European Union could become an opportune continent to implement sales channels, while Australia can position itself as a stable alternate market to the United States for foreign operations and investment.

It is worth mentioning that the prospect of reaching an EU-Australia free trade agreement is nothing revolutionary, as both parties already endeavored to abolish tariff barriers in the wake of the COVID-19 pandemic, without success. In light of the recent US tariffs, the option to establish an EU-Australia free trade agreement is back on the table. The purpose of this paper is to explore the direct tax considerations of a potential EU-Australia free trade agreement. Reference to "customers" and "operations" entails both Australian consumers of European operations and European customers of Australian operations.

## 2. Lowering Tariffs between the European Union and Australia

### a. Customs valuation: Legal and economic considerations

The customs value of the goods covered by any FTA need to be determined. This directly influences the duties levied on imported goods. Both the European Union and Australia employ customs valuation systems consistent with the World Trade Organization Valuation Agreement. However, interpretive differences remain, particularly regarding the treatment of intellectual property (IP) license fees.

In the New Zealand case *Country Road*, involving an Australian taxpayer with licensed IP rights, the court held that license fees payable by a New Zealand importer to an Australian related entity should be included in the customs value of imported goods, as they were a condition of sale. This aligns with legislation within the European Union, particularly the Union

Customs Code, which similarly advocated for the inclusion of royalties in the customs base when paid as a condition of sale. The convergence in legal treatment reinforces the efficiency of a future EU-Australia FTA.

### b. Current tariff structures

Understanding the existing customs regime is crucial for appreciating the extent of the economic benefits a future FTA could bring. Presently, both jurisdictions apply the following average tariffs on each other's goods:

| Jurisdiction | Average Tariff on Imports | Notable High-Tariff Goods |
|---|---|---|
| Australia on EU goods | 0-5% | Automobiles (5%), textiles (5%) |
| European Union on Australian goods | 0-7% | Wine (up to EUR 32/hL), dairy, processed foods |

The removal or reduction of these tariffs would not only enhance market access but also affect indirect taxation by lowering the import base for VAT and GST purposes, thereby influencing pricing and consumption patterns in both jurisdictions.

## 3. Greater Trade Opportunities through the Lens of Direct Taxation

The abolition of tariffs is expected to increase cross-border trade flows by reducing the cost of goods. As imported goods become more price-competitive relative to domestic alternatives, businesses may see an increase in sales volume and profits, with these profits subject to corporate income tax in the source or residence jurisdiction, depending on the structure of the operations.

The implications of this increased profitability are twofold. First, the anticipated increase in profitability could incentivize both EU and Australian enterprises to establish permanent establishments or wholly owned subsidiaries within each other's jurisdictions, thereby fostering deeper economic integration and expanding the territorial scope of direct taxation.

Second, while the elimination of tariffs may reduce customs-related revenue, this shortfall could be offset by higher corporate tax receipts derived from increased cross-border business activity and the resulting growth in taxable income.

### a. Comparative corporate income tax rates

The corporate tax landscape is heterogeneous, and firms may seek to leverage these differences to minimize their effective tax burden. The following table provides an overview of statutory corporate tax rates in Australia and its five largest EU trading partners:

| Country | Corporate Tax Rate (2025) | Notes |
|---|---|---|
| Australia | 30% | SME rate of 25% applies for turnover < AUD 50 million |
| Germany | 29.9% | Includes trade tax (~14%) and solidarity |
| France | 25.8% | Unified CIT rate since 2022 |
| Netherlands | 25.8% | 19% rate applies up to EUR 200,000 |
| United Kingdom | 25.0% | Flat rate since 2023 |
| Ireland | 12.5% | 15% minimum for large MNEs from 2024 |

This variance may lead to tax-induced locational decisions and highlights the importance of robust anti-abuse provisions in double tax treaties (DTTs).

### b. Double tax treaties

DTTs mitigate the risk of juridical double taxation and facilitate cross-border investment by allocating taxing rights and providing relief mechanisms. Australia has signed DTTs with all five major EU trading partners. However, the scope and robustness of these agreements vary.

Key considerations include:

- Scope: All DTTs include provisions on dividends, interest, royalties and business profits.
- Anti-abuse rules: The extent of limitation on benefits provisions and principal purpose tests differs across treaties.
- OECD MLI: Australia and most EU Member States are signatories to the MLI, which modifies existing treaties to include minimum standards on treaty abuse and dispute resolution.
- Exchange of information: All treaties comply with article 26 of the OECD Model Tax Convention.

### c. Transfer pricing

*Relevant industries*

Industries likely to benefit most from an EU-Australia FTA include:

- Pharmaceuticals: Heavy intellectual property use and cross-border R&D cost sharing.
- Automotive manufacturing: Integrated supply chains and component imports.
- Technology and software services: Licensing and cloud infrastructure provisioning.
- Agriculture and food processing: Seasonal exports with pricing volatility.

*Comparison of transfer pricing frameworks*

Both the European Union and Australia adhere to the OECD Transfer Pricing Guidelines. However, local differences do exist.

**i) Documentation thresholds:**

| Jurisdiction | Transfer Pricing Documentation Requirements |
|---|---|
| **Australia** | Yes, for MNEs above AUD 1 billion |
| **United Kingdom** | Yes, from 2024-2025 for MNEs above EUR 750 million |
| **Ireland** | Yes, from 2024 for MNEs above EUR 750 million |
| **France** | Yes, for entities with turnover or assets exceeding EUR 400 million |
| **Germany** | Yes, for transactions exceeding EUR 5 million (goods) or EUR 500,000 (services) |
| **Netherlands** | Yes, for MNEs above EUR 750 million |

**ii) Penalties and enforcement:**

The enforcement landscape surrounding transfer pricing compliance varies considerably across jurisdictions, both in terms of monetary penalties and procedural rigour. Australia adopts a stringent stance: significant administrative penalties can be imposed for transfer pricing misstatements, ranging from 25% to 75% of the tax shortfall, depending on the taxpayer's level of culpability (e.g. lack of reasonable care, recklessness or intentional disregard). Furthermore, Australia mandates contemporaneous documentation to qualify for reduced penalties, placing the burden on taxpayers to substantiate arm's length conditions.

In contrast, several EU Member States implement less punitive regimes. For example, Ireland provides for relatively modest penalties (up to EUR 25,000 and a daily default penalty), though recent legislative updates have sought to tighten enforcement. France and Germany apply more moderate financial penalties but increase scrutiny through audit intensity and strict documentation requirements. The Netherlands adopts a cooperative compliance approach, with an emphasis on horizontal monitoring rather than punitive enforcement, though failure to meet documentation obligations can still trigger administrative fines. The United Kingdom applies general tax-geared penalties based on the behaviour linked to inaccuracies in tax returns, with mitigation possible through disclosure.

#### iii) Interpretation of the arm's length principle

Divergences exist in the treatment of low value-adding services — typically routine support functions such as accounting, legal or IT services. The OECD's 2017 guidance allows for simplified approaches to pricing these services using a cost-plus method with a standard mark-up of 5%, subject to proper documentation. Australia, however, applies this guidance with caution. The Australian Taxation Office may challenge the application of the 5% mark-up if insufficient evidence is provided to demonstrate the arm's length nature of the service or its benefit to the recipient.

In contrast, many EU jurisdictions are more accepting of the OECD's simplified approach, provided that the documentation substantiates the services' low-risk and supportive nature. However, countries like France are more conservative and may require detailed functional analyses even for routine services.

#### iv) OECD Pillar One amount B

Pillar One's Amount B aims to streamline the application of the arm's length principle for baseline marketing and distribution functions by offering a fixed return. This could reduce compliance costs and disputes for EU and Australian entities engaging in cross-border sales.

The introduction of Amount B could provide several benefits for both EU companies exporting to Australia and Australian businesses distributing to the European Union. By standardizing returns for routine distribution activities, it would reduce the need for complex benchmarking and functional analyses. This clarity could also lower audit risks, as tax authorities would have predefined parameters for assessing intra-group transactions. Additionally, predictable pricing outcomes would enhance tax certainty, especially for mid-sized firms, and reduce the reliance on mutual agreement procedures, streamlining dispute resolution.

## 4. Conclusion

A prospective EU-Australia FTA offers not only opportunities for enhanced trade flows but also significant implications for direct taxation. While reduced tariffs may initially diminish customs revenues, the resulting increase in cross-border activity is likely to expand corporate tax bases in both jurisdictions. This shift necessitates careful attention to transfer pricing alignment, DTT coverage and the administrative capacity to manage new tax dynamics. With initiatives such as OECD

Pillar One Amount B on the horizon, harmonizing compliance standards and fostering tax certainty will be critical to maximizing the benefits of closer EU–Australia economic integration.

# IBFD references:

- EU tax law developments are reported on the daily IBFD Tax News Service page.
- For an overview of legislative initiatives at the EU level on direct tax matters (inclusive of the Transfer Pricing Directive), *see* the EU Direct Tax Law Initiatives Dossier.
- For an overview of the implementation of Amount A and Amount B of Pillar One, *see* the Pillar One Dossier.
- W. Choi, United States - Business and Investment sec. 9., Country Tax Guides IBFD.


 