Property Council of Australia ABN 13 00847 4422
A Level 7, 50 Carrington Street, Sydney NSW 2000
T +61 2 9033 1900
E info@propertycouncil.com.au
W propertycouncil.com.au
@propertycouncil

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Committee Secretary
Senate Standing Committees on Economics Australia

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

Government Amendments to Treasury Laws Amendment (Making Multinationals Pay Their Fair Share-Integrity and Transparency) Bill 2023

The Property Council of Australia welcomes the opportunity to provide an additional submission on amendments required to the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023* (Bill).

A copy of our previous submission to the Committee is set out at **Appendix A**.

The Property Council of Australia champions our largest industry, employing over 1.4 million Australians, contributing 18 per cent of our national tax take and shaping the future of our communities and cities. Property Council members invest in, design, build and manage places that matter to Australians: our homes, retirement villages, shopping centres, office buildings, industrial areas, education, research and health precincts, tourism and hospitality venues and more.

The Property Council continues to support the stated tax integrity objectives of the Bill. We have engaged through the development of the Bill and we welcome the Government's willingness to amend its legislation in the Senate. In this submission, our reference to the Bill should be read as incorporating the Government's proposed amendments.

While we note that the Government's amendments improve the Bill, it is not yet fit-for-purpose. Genuine business activities will still be captured, restricting the institutional property sector's ability to debt finance projects. The Bill will disincentivise investment in and development of Australian homes.

The Government has passed important reforms to close the nation's housing supply deficit in 2023, including:

- Setting a target of 1.2 million new well-located homes by 2029
- $3 billion in competition-style incentives to boost the nation's housing supply
- the establishment of the Housing Australia Future Fund (HAFF)
- announcing that the MIT withholding rate on build-to-rent projects will be reduced from 30 to 15 per cent and
- announcing the reduction in FIRB application fees for build-to-rent projects.

If the Bill passes the Senate in its current form, many of the benefits of these reforms will not be realised.

To ensure a workable regime that maintains the integrity of Australia's taxation system, we recommend:

- a carve-out for the property industry from the Thin Capitalisation rules in Schedule 2 to keep Australia globally competitive
- the introduction of transitional arrangements for the property sector to 1 July 2024 and
- amendments to the Bill in the form of Technical Drafting Amendments (**Appendix B**) and those set out in the Issues and Solutions Register (**Appendix C**).

Requirement for a carve-out

Given the underlying economic fundamentals and structure of the property sector, we recommend that the Parliament provide a carve-out for the property sector from the EBITDA-based fixed ratio rule.

A carve-out will result in a regime similar to the US and UK, which both recognise the commercial basis on which debt is legitimately used, and both of which directly compete with the Australian property sector for investment in the creation of city assets across property types including housing.

The Organisation for Economic Co-Operation and Development (OECD) paper on Base Erosion Profit Shifting (BEPS) Action 4 recognises that a **fixed ratio rule is 'a blunt tool which does not take into account the fact that groups operating in different sectors may require different amounts of leverage'.**

With this in mind, the OECD's recommended approach allows countries to introduce provisions that reduce the impact of the rules on entities or situations which pose less BEPS risk, including additional flexibility for highly leveraged groups or certain sectors.

Australia should apply a similar carve-out to ensure we are not out of step with other developed competitor economies.

A carve-out will also provide certainty to industry, particularly fund managers, who have already made distributions to unitholders in the September quarter. A retrospective change to their tax liabilities will negatively affect investors who have engaged in good faith under the existing law.

A carve-out is the simplest and most effective choice. Failing a full carve-out, all of the amendments outlined in this submission are required to mitigate perverse and unintended consequences that will hinder our nation's ability to deliver the homes we need.

Transitional arrangements

A short transition period is required to enable the property industry to apply the new amendments to assessments from 1 July 2024 (a 12-month extension).

This 'transitional carve out' for the property sector until 1 July 2024 would:

- give Treasury sufficient time to amend the Bill and ensure that it is fit-for-purpose
- allow industry time to become compliant with the new laws
- provide clarity to industry (through its distributions to investors) so to not expose it to additional tax liability in FY 23/24and
- provide certainty to the building and construction sector.

Due to the complex and varied nature of structures in the property industry, some businesses are disproportionately affected by the proposed changes and industry needs further time to understand the impacts to different business models.

A transitional period would provide the industry time to ensure it is compliant with the law from the day of implementation. As it stands, many trust/fund structures would be non-compliant from day one, resulting in significant legal costs for business and taxpayers.

The Property Council and industry stands ready to work with the Government and Parliament during any transitional period to ensure that any measures are fit for purpose and result in no further unintended consequences.

Required solutions

We have identified eight issues that represent genuine business activities but do not reflect any risk to Australia's multinational tax regime. The Bill currently captures each of these activities – presumably unintentionally.

Issue	Description	Example of genuine business activity	Solution
Debt Deduction Creation Rules - Exceptions	Exceptions from the DDCR for the acquisition of certain CGT assets (ie. new membership interests in entities, new depreciating assets and debt interests on the same terms) and payments/distributions are ineffective and potentially apply to arrangements between wholly owned Australian entities which is not in line with policy intent.	Arrangements between wholly owned Australian entities (that are not able to form a tax consolidated group e.g. trusts) which borrow from external third party banks are potentially captured in the DDCR given its current drafting (e.g. as the exclusions to (2) do not apply to all assets despite being acquired on arm's length terms, and a number of payments/distributions are captured by (5)). This is clearly not within the stated policy intent of preventing erosion of the Australian tax base. Due to commercial and financing requirements, many Australian groups centrally manage financing with external banks. A conduit financer borrows from a bank and on-lends to a head trust. The head trust uses the funds to subscribe for new equity in a sub-trust.	Exceptions should apply to exclude arrangements between wholly owned Australian entities. While an exception to the DDCR is now provided if the entity elects the TPDT not all entities will be able to elect the TPDT. In addition, and critically, the TPDT needs to be modified to accommodate typical commercial financing structures – refer Issue 2 below. Exceptions should apply to both the first and second limbs of the DDCR and should permit on-lending at a lower (or no) interest rate.

		This arrangement will be caught under the second limb of the DDCR s820-423A(5) because the head trust has borrowed from a related entity to fund a payment to an associate pair. The exception for the acquisition of new membership interests is only relevant when applying the first limb s820-423A(2), not the second limb.	
Third Party Debt Test – conditions do not reflect typical commercial financing arrangements which means entities with genuine third party debt cannot access either the TPDT nor the TPDT exclusion to the DDCR	The amended EM states that the TPDT conditions are intended to ensure that "an entity's debt deductions are only allowed where they are attributable to genuine third party debt that is borrowed against Australian assets and its used to fund Australian operations." However, financing arrangements of wholly owned Australian entities with no offshore assets which borrow from external third party banks are potentially not able to satisfy the TPDT conditions. It is noted that the amendments now provide that an entity which chooses the TPDT is exempt from the DDCR. The EM states that the exclusion recognises that the DDCR should also permit debt deductions on the same basis as the TPDT– i.e. where they are attributable to "an entity's debt deductions are only allowed where	Holding Trust, which wholly owns a number of Mid Trusts, which in turn wholly owns Sub Trusts. The Holding Trust wholly owns a Finance Company (or Finance Companies) which borrow from external third party lenders to manage the group's financing. The Finance Company(ies) lend to the Holding Trust which in turn on-lend to Sub Trusts which own Australian properties. This structure of Australian entities is subject to the thin capitalisation rules and DDCR as a result of the profile of its unitholders and has no overseas investments/assets. No one unitholder holds an interest of 50% or more. To efficiently manage the group's financing, the Finance Company(ies) will have a large portfolio of external loans at any given time which will have been entered at	Remove the requirements for the stringent tracing of costs on on-lending being the same as external debt costs. Permit interest rate swap costs to be included as a debt deduction when managing the interest rate risk of a wholly owned entity.

	they are attributable to genuine third party debt that is borrowed against Australian assets and its used to fund Australian operations". However as noted above, the TPDT cannot be satisfied as it is not reflective of typical commercial financing arrangements.	different times, have different loan / facility amounts, and varying terms, interest rates and costs. On an overall basis the external loan portfolio will match the needs of the wholly owned group. Due to this portfolio nature of the external loans, the Finance Company(ies) charge interest to wholly owned borrowers at a monthly average weight cost based on the costs arising on the external loan portfolio. To also efficiently managing financing, the group's hedging of interest rate risk with external parties is undertaken by one of the Finance Companies (i.e. the Finance Company hedges its external loans and the external loans of other Finance Companies). These arrangements, despite being between wholly owned Australian entities, are potentially not able to satisfy the TPDT conditions, including: • Costs of the on-lending will not be exactly the same as the cost incurred in relation to the ultimate debt interest (as it reflects a weighted average cost of the ultimate debt interests on a portfolio	

		basis)(s820-427C(1)(d)) The centralised hedging would mean that there would be potentially debt deductions that are not attributable to a debt interest issued by the entity (s820-427A(2))	
Fixed Ratio Test – Excess Tax EBITDA	Excess tax EBITDA threshold s create artificial and inequitable distinctions between economically identical arrangements.	In an investment of $100 million where you own 100%, it is worth $100 million, you get full grouping effectively under the excess tax EBITDA rule. However, if you invest $100 million along with two other investors who also invest $100 million (33% each) for a $300 million asset, you would receive no deductions. In both cases you invest $100 million yet based on the individual situation you either get full grouping or none.	Reduce the threshold to 10% (from 50%) to align with the requirement to disregard distributions. In addition, excess tax EBITDA from entities not subject to the thin capitalisation rules should be permitted – the general class investor requirement in section 820-60(2)(c) should be removed.
Third Party Debt Test – Development support	The Third-Party Debt Test will not be available where the third-party lender requires credit support from foreign equity holders for a reasonable period post-development while the asset is being leased up. This is the standard form of credit support required by lenders.	A bank providing a development funding facility for a build-to-rent project requires credit support until there is enough rental income to cover the interest costs. As leases cannot be entered into for residential property while the property is under construction (or if insufficient pre-leasing is entered into for a commercial property), time is needed to enter into leases following completion. The rules prohibit these arrangements where the credit support is provided by a foreign entity, being the	The development asset concession needs to apply up to two years beyond the date of completion of the development to allow for stabilisation of the asset (highly relevant to build-to-rent assets). In addition, foreign residents (regardless of their percentage holding) should be able to provide credit support during the development period and this period to income stabilisation.

		predominant investors in the build to rent market.	
Debt Deduction Creation Rules – Discretion of Commissioner	The extremely broad operation of the DDCR to eliminate interest deductions is very likely to give rise to outcomes that are not aligned with the policy intent.	If further unintended consequences of the Bill are realised based on the extremely broad drafting, the Commissioner cannot generally apply any flexibility in administration of the law.	Provide the Commissioner of the ATO with a broad discretion not to apply the DDCR to a particular arrangement.
Third Party Debt Test – Interest free loans within a group	A conduit financer borrows from a third party and on-lends on the same terms to a Holding Trust. The Holding Trust uses most of those funds to subscribe for equity in subsidiaries (which is permitted), and uses a small amount to on-lend on a non-interest bearing basis to subsidiaries where they have short term cash needs. As that amount is not on-lent on the same terms, debt deduction denials arise.	It is very common for a group of entities to provide cash within the group by way of non-interest bearing loans in certain circumstances, such as where cash is needed on a short term basis. This is more straightforward than contributing equity (from a legal and administrative perspective). In many instances, these daily intragroup balances will move on a daily basis.	Where the on-lending gives rise to no debt deductions (i.e., is treated as "associate entity equity" under the current law), it should be permissible under the conduit financing rules.
Third Party Debt Test – Swaps (conduit financer)	The most common form of swap arrangements involving conduit financing structures is that the conduit financer enters into third party swaps, and then enters into back to back swap arrangements with the entity (or entities) to which it on-lends.	This is the most common form of swap arrangement in a conduit financing structure because the swaps will generally have different terms than the term of the debt – e.g., the debt may have been borrowed for 5 years, whereas the swaps may be for 1 year (and new swaps entered into at that time). Accordingly, embedding the swap costs and benefits into the on-lending arrangement is complex due to the different terms, and it is	Expand the circumstances in which swap payments are considered attributable to debt interests, by allowing payments to be made to an associate entity, but only where that associate entity directly or indirectly pays an equivalent amount to a third party. These arrangements are effectively conduit swap arrangements, similar to the conduit financing arrangements. Also permit a related entity of the borrower to enter into swap arrangements, by treating the debt deductions as attributable to the debt interest. In certain

		easier to enter into back to back swaps. Taxpayers could consider closing out the back to back swap arrangements and embedding swap costs and benefits into the on-lending agreement, although this would require significant restructuring of internal arrangements, and would impact the tax neutrality of the conduit financer.	structures, downstream vehicles may borrow from a third party, and an upstream holding entity may enter into swap arrangements on a portfolio basis.
Third Party Debt Test – Stapled groups	No member of an open-ended stapled property group will be able to apply the Third-Party Debt Test because this will result in full denial of deductions on cross-stapled loans as the stapled entities are now considered associate entities.	One side of the stapled group holds real property assets, while the other side holds funds management rights. Banks will often lend to the side with real property assets, noting there is material security. This third-party debt is available without recourse to the assets of the other side of the stapled group. Operating as a stapled structure necessitates the ongoing existence of a cross staple loan which fluctuates based on available funding and expenditure requirements of each side of the group. It is not conduit financing (e.g., may be funded out of excess cash).	Remove the deemed third party debt test choice for entities that have entered into cross-staple arrangements unless the entities are members of an obligor group. In the absence of the entities being part of the obligor group, there is no credit support provided by the other side of the staple, and so there is no mischief associated with the arrangement.

Issues and Solutions Register

We also enclose a copy of the Property Council's Issues and Solutions Register (**Appendix C**). These matters represent the balance of the issues with the Bill's drafting, industry examples and proposed solutions.

Conclusion

Given the critical importance in ensuring these issues are addressed prior to the Bill's passage through the Senate, we anticipate further discussion with this Committee. We remain committed to working with the Senate in good faith to ensure that the Bill's legislative intention is met without hurting investment into the new homes Australia needs.

If you have any questions, please contact Matthew Wales, Policy Manager – Tax and Foreign Investment, at [redacted]

Yours faithfully

[redacted]

Mike Zorbas
Chief Executive
Property Council of Australia

Appendix A – Property Council of Australia's previous submission to the Committee

Committee Secretary
Senate Standing Committees on Economics
Australia

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

Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023

The Property Council of Australia welcomes the opportunity to provide a submission to the Senate Economics Legislation Committee about the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023* (**Bill**).

The Property Council of Australia champions our largest industry, employing over 1.4 million Australians, contributing 18 per cent of our national tax take and shaping the future of our communities and cities. Property Council members invest in, design, build and manage places that matter to Australians: our homes, retirement villages, shopping centres, office buildings, industrial areas, education, research and health precincts, tourism and hospitality venues and more.

Executive Summary

The Property Council's position on the Bill is summarised as follows:

1. The Bill negates the positive impact of the Federal Government's recent announcement to reduce the withholding tax rate on Build to Rent (BTR) assets, which we welcomed. **It will put at risk investment a minimum of 20,000 Build to Rent (BTR) apartments currently under construction or in the planning phase, while jeopardising the feasibility of the 150,000 BTR apartments in the pipeline over the next decade.**

2. **The Bill's provisions extend beyond its expressed objectives with unintended consequences.** If the Bill is passed without targeted and specific amendments, it will materially reduce the allocation of global capital into the Australian property sector.

3. We understand the Government's publicly stated intention that the Bill give effect to integrity measures to prevent base erosion and reduce deductibility but the Bill overreaches by expanding the Commonwealth's revenue base at the cost of new housing projects. **The Budget forecasts that the Bill will raise $720 over the next two years. Recent Property Council modelling shows that over the same forecast period more than $400 million (over 55 per cent) will flow from REITS and Wholesale Property funds alone.**

4. One of over a hundred examples, is a pipeline in excess of a thousand apartments, worth more than two billion dollars. That development, otherwise commencing in 2023 or 2024 will no longer be able to go ahead because the investment assumptions are no longer viable.

5. **Amendments to the Bill can easily be made, so that it appropriately addresses integrity risks, facilitates standard commercial lending arrangements in the property sector and avoids contributing the Australia's housing affordability crisis.** This can occur through the targeted and specific amendments recommended in the Appendix to this submission.

Bill's expansion beyond its expressed objectives

The Bill will have a disproportionately negative impact on the property sector. Without amendments, the Bill will result in Australia having one of the most restrictive interest limitation regimes in the world for investments in real estate assets.

- The Property Council and its members support the stated objectives of the Bill. Although those objectives, expressed in the Government's policy announcement and Second Reading Speech, were limited to integrity measures to prevent base erosion, the drafting of the Bill goes beyond this.

- The institutional property sector (Real Estate Investment Trusts, or REITs) does not pose a genuine risk or concern of profit shifting but, instead, will be caught by the provisions of the Bill because of the legitimate way in which they do business and use debt to finance projects.

- **Through consultation on the Bill, we have subsequently been advised that a further intention (although never publicly acknowledged) is to expand the Commonwealth's revenue base, not merely limit base erosion.**

- Given Australia competes globally for capital, this will serve to reduce capital allocation into Australia, leading to a decline in development activity and impacting employment.

- This will result in increased costs (e.g. rental expenses) for tenants across several sectors like student accommodation, commercial office, retail, industrial and logistics. Crucially, it will serve to restrict housing supply as our nation faces a shortage of homes and a housing affordability crisis.

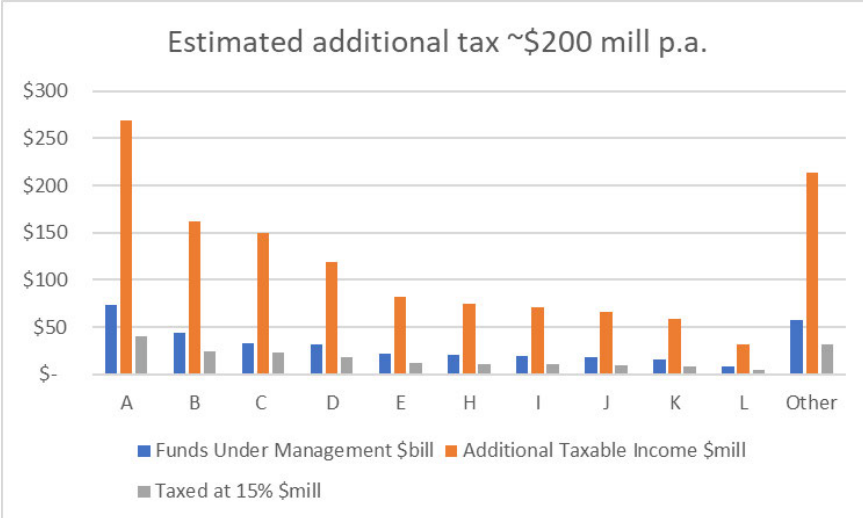
The Budget forecasts that the measures to which the Bill will give effect will raise around $360 million per year.

The Property Council's modelling, which is based on extensive consultation and de-identified case studies (commercial-in-confidence), suggests that REITs and Wholesale Property Funds will contribute $200 million per annum (approximately), owing to the fact that many will no longer meet the Third-Party Debt Test or the Group Ratio Test.

Over 50 per cent of forecast revenue will come from a broader property industry that contributes 13 per cent of GDP and which has never been the stated target of these measures like other industries have.

This illustrates that the Bill will either disproportionately impact REITs (in contrast to what was intended) or that revenue forecasts are significantly less than what is likely to be collected.

Table 1 below has been compiled based on direct feedback from Property Council members (each of whom have been de-identified and labelled as "A" through "L"), based on analysis of their likely taxation obligations now and should the Bill pass the Parliament and the legislation commence.



The property industry is a capital-intensive sector, requiring significant investment to deliver projects. The use of genuine Third-Party Debt deductions allows investment returns to remain competitive within the global market.

Australian deals compete with other jurisdictions that offer "carve-outs" and exemptions for the property sector.

Borrowing from external lenders, in particular foreign capital, is often the only option for developers in the current macroeconomic climate while superannuation funds remain unengaged with the sector and REITs are capital constrained.

The Bill will negatively impact genuine third-party foreign debt which is the only way at present Australia finances the BTR sector.

Commencement Date

The Bill proposes significant changes, and the commencement date of 1 July 2023 is inadequate, given that the legislation remains in Bill form, differs significantly from the Government's October 2022 policy announcement and remains subject to this Committee's review. Owing to the breadth of amendments required, the commencement date must be delayed by 12 months, to 1 July 2024.

If the commencement date is not delayed, then the Bill should only apply for income years commencing after 1 January 2024 to avoid retrospective application.

The Bill will hurt housing supply and affordability

Australia is facing a severe housing supply deficit, which is the primary factor hurting housing affordability.

Australia needs better planning, more land supply, proper housing targets and a national strategy on build-to-rent and purpose-built student accommodation to ensure our housing supply keeps pace, let alone improves.

The National Housing Finance and Investment Corporation's *State of the Nation's Housing Report 2022-23* outlines a shortfall in new Australia homes of over 79,300 to 2033. Just as the Property Council supports any measure to boost housing supply, we are concerned by any measure that will restrict it.

We welcomed the Government's recent announcement to reduce the withholding tax rate on BTR projects from 30 per cent to 15 per cent. According to research from EY, this measure could encourage the delivery of an additional 150,000 new apartments over 10 years. The Bill will negate those benefits.

Following the Government's announcement, certain new BTR projects have been announced which are proposed to be delivered through JV developer arrangements, funded by genuine third-party global capital.

However, the introduction of the Bill has resulted in significant uncertainty and threatens many of these projects.

The advice we have received from several members is that the Bill could reduce the typical Internal Rate of Return on a BTR project from 13 per cent to 9 per cent. Further advice suggests that this will serve to render the delivery of BTR projects unviable. Assuming this is the case, the Bill puts at risk approximately 20,000 BTR projects across Australia, including 3,500 in NSW, 4,200 in Queensland, 15,000 in Vitoria and 500 in Western Australia.

Of course, these figures do not take into account the impact of the Bill on typical Build to Sell projects and the impact on housing supply is likely to be far greater.

Specific and targeted amendments

Through eight separate consultation sessions between the Property Council and Treasury, we have raised our concerns in relation to the Bill. We propose several amendments which will serve to maintain the integrity of the legislation and achieve its expressed objectives, while mitigating the unintended consequences that it will otherwise have on housing supply.

It is clear that a one-size-fits-all approach is not appropriate for both consolidated groups and trust structures. In fact, we note that the complexity of the issues is the main reason why both the US and UK provide carve-outs for the property sector from their equivalent regimes, given that the feasibility of housing as key social infrastructure is at stake.

Set out in the **Appendix** is a summary of each of the relevant issues with the Bill, and the solution to fix each of them. This list seeks to address integrity risks identified by Treasury and is a list of the basic changes that need to be made to ensure that the legislation does not have significant adverse impacts on taxpayers. Versions of this list have been provided to Treasury throughout the consultation process and, in many instances, Treasury has indicated that the impact of the legislation was unintended and would be remedied. This remediation has not occurred.

Third Party Debt Test (TPDT)

The Government committed in the October Budget 2022-23 to "retain an arm's length debt test as a substitute test which will apply only to an entity's external (third party) debt". Most of the Property Council's members are discovering that the TPDT, as drafted, results in a denial of debt deductions on third party debt. At the most general level, the relevant requirements to satisfy the TPDT are inconsistent with standard third-party lending practices and security arrangements. This will have not only a detrimental impact on the real estate sector, but also lending volumes of Australian banks and non-bank lenders.

The critical issues with respect to the TPDT are set out in detail in the Appendix.

While we understand the purpose of elements of the TPDT is to achieve certain integrity objectives, the breadth of the drafting constitutes significant overreach. Rather, particular integrity measures should be seriously considered and targeted measures be drafted appropriately.

<u>Debt Creation</u>

The Bill contains unanticipated measures on which the Government did not consult, being the so-called "debt creation" rules, with which there are numerous problems.

First, they apply to deny debt deductions from 1 July 2023, but there is no requirement that the relevant transaction needs to have been implemented on or after 1 July 2023. Accordingly, the debt creation rules are, in effect, retrospective.

Second, they are intended to address what the Explanatory Memorandum describes as "debt creation schemes that lack genuine commercial justification". However, the breadth of the rules will apply to a very large number of ordinary commercial (and third party) transactions, and there is no requirement in the legislation that the scheme lacks a commercial purpose or is motivated by obtaining debt deductions. Most tax integrity measures of this nature would (and, as a matter of good tax policy design, should) include a purpose test.

Third, although the rules are purportedly to target cases of "debt creation", the rules do not require there to be any increase in debt levels before they can apply. This is in contrast to Australia's former debt creation rules, which contained an exclusion for schemes where there was no net debt creation.

There are also several legislative drafting issues that we recommend be addressed, which are set out in the Appendix.

The debt creation rules should be removed from the Bill, and further consultation should be undertaken. At a minimum, the debt creation rules should be deferred until income years commencing on or after 1 July 2024 and should only apply to future arrangements.

<u>The Fixed Ratio Test (FRT)</u>

The Property Council asks for a few simple amendments so that the FRT works appropriately, summarised as follows:

- excluding prior year capital and revenue losses in the calculation of tax EBITDA;
- including a separate provision setting out the calculation of tax EBITDA for Attribution Managed Investment Trusts (AMITs); and
- allowing excess thin capitalisation capacity of a downstream associate entity to flow to an upstream associate entity, to ensure that structures where external debt is sourced at an upstream level (e.g., debt related to a portfolio of assets) are not adversely impacted. Integrity concerns in respect of double gearing structures can be appropriately addressed, consistent with the current associate entity rules.

The Group Ratio Test (GRT)

The GRT allows an entity in a group to claim debt-related deductions up to the level of the worldwide group's net interest expense as a share of earnings. In other jurisdictions, it is often the equivalent of this test that is used by highly leveraged groups where the debt that is provided is third party debt.

However, as drafted, the GRT is not appropriate, because:

- the GRT applies a ratio to tax EBITDA. As tax EBITDA is required to be calculated disregarding income derived through downstream associate entities, any debt sitting at a holding level in a non-consolidated structure will likely have nominal or nil tax EBITDA. Other jurisdictions' versions of the GRT do not operate in this manner.

- many entities fall outside the definition of a "GR group", which is a requisite gateway to access the test. For example, many large inbound investors, such as foreign superannuation funds, are classified as "investment entities" for accounting purposes, and so do not prepare consolidated financial statements. One of the requirements associated with a GR group is that they prepare consolidated financial statements. Although the OECD recommended an alternative test for investment entities, the legislation as introduced departs from the OECD's recommendations, and in so doing penalises investment entities.

Conclusion

The Property Council will work with Treasury, Government, and the Senate Economics Legislation Committee to ensure that the legislation appropriately addresses integrity risks while also facilitating standard commercial lending arrangements in the property sector.

A failure to do so will have serious negative consequences on economic activity, housing supply and housing affordability in the short, medium and long term.

Please see below for attached **Appendix** of *Issues register with Tabled Legislation* for reference.

If you have any questions about our submission, please contact Antony Knep, Executive Director – Capital Markets, on [redacted] or at [redacted]

Kind regards

[redacted]

Mike Zorbas
Chief Executive
Property Council of Australia

Appendix B – Technical Drafting Amendments

THIRD PARTY DEBT TEST AMENDMENTS

820 48 Where entity is taken to make third party debt test choice

…

(3) For the purposes of subsection 820-46(5), this section also applies to the entity mentioned in that subsection (also the first entity) in relation to an income year if:

(a) the first entity has entered into a *cross staple arrangement with one or more other entities;

(b) one or more of those other entities has made a choice under subsection 820-46(4) in relation to that income year (including a choice that is taken to be made under subsection 820-46(5)) (each of which is a second entity); and

(c) the first entity and one or more of the second entities are members of an obligor group.

820-427A Meaning of third party earnings limit and third party debt conditions

…

(2A) for the purposes of subsection (2)(b) do not treat an amount as a debt deduction to the extent that;

(a) it is an amount directly associated with hedging or managing the interest rate risk by an entity (the hedging entity) with an entity that is not an associate entity in respect of an ultimate debt interest issued by another entity (the other entity), where the other entity and that entity is Australian entity which are part of the same wholly owned group (and any interposed entities are Australian entities); or

(b) it is an amount payable to the hedging entity which is directly associated with the amount in (2A(a)) by the other entity.

(3) A *debt interest issued by an entity satisfies the third party debt conditions in relation to an income year if the following conditions are satisfied:

(a) the entity issued the debt interest to an entity that is not an *associate entity (see section 820-427D) of the entity;

(b) the debt interest is not held at any time in the income year by an entity that is an associate entity of the entity;

(c) the holder of the debt interest has recourse only to or substantially only to assets of the following kind for payment of the debt to which the debt interests relates:

(i) Australian assets held by the entity;

(ii) Australian assets that are *membership interests in the entity (unless the entity has a legal or equitable interest, whether directly or indirectly, in an asset that is not an Australian asset);

(iii) Australian assets held by an *Australian entity that is a *member of the *obligor group in relation to the debt interest;

(ca) none of the assets mentioned in paragraph (c) are rights under or in relation to a guarantee, security or other form of credit support provided by a *foreign entity which is an associate entity;

OR

(ca) none of the assets mentioned in paragraph (c) are rights under or in relation to a guarantee, security or other form of credit support provided by an associate entity other than an associate entity that is the entity mentioned in subparagraph (c)(iii) ;

(3)(d) the entity uses all, or substantially all, of the proceeds of issuing the debt interest to fund its commercial activities in connection with Australia that do not include:

(i) any *business carried on by the entity at or through its *overseas permanent establishments; and

(ii) the holding by the entity of any *associate entity debt, *controlled foreign entity debt or *controlled foreign entity equity.

…

(4) A right is not taken to be a right of a kind mentioned in paragraph (3)(ca) if:

(a) the right relates wholly to the creation or development of a *CGT asset that is, or is reasonably expected to be:

(i) land or other real property situated in Australia (including a lease of land, if the land is situated in Australia); or

(ii) moveable property of a kind covered by subsection (6) situated on such land; and

(5) For the purposes of paragraph (4)(a), in determining whether a right relates wholly to the creation or development of a *CGT asset of a kind mentioned in that subsection, disregard the extent (if any) to which the right relates incidentally to another matter.

(6) For the purposes of subparagraph (4)(a)(ii), moveable property situated on land is of a kind covered by this subsection if the property is, or is reasonably expected to be:

(a) incidental to and relevant to the ownership and use of the land; and

(b) situated on the land for the majority of its useful life.

(7) For the purposes of paragraph (4)(a), if:

(a) the creation or development of the CGT asset mentioned in paragraph (4)(a) has reached completion during an income year or during the prior income year; and

(b) paragraph (4)(a) was satisfied in respect of a right at any time in the income year prior to the income year mentioned in paragraph (7)(a)

the right shall be taken to relate wholly to the creation or development of a *CGT asset.

…

820-427C Conduit financing conditions

(1) This subsection applies in relation to an income year (the relevant year) if all of the following conditions are met in relation to the income year:

(a) an entity (the conduit financer) issues a *debt interest (the ultimate debt interest) to another entity (the ultimate lender);

(b) one or more other entities are *associate entities (see section 820-427D) of each other and of the conduit financer; (c) one or more of those associate entities (each of which is a borrower) issues a debt interest to:

(i) the conduit financer; or

(ii) another borrower ~~associate entity~~ (including an entity that is a borrower because of another operation of this subparagraph);

…

(d) the amount loaned under the debt interest (each of which is a relevant debt interest, but excluding any debt interest which is classified as associate entity equity):

(i) if subparagraph (c)(i) applies—was financed by the conduit financer only with proceeds from the ultimate debt interest; or

(ii) if subparagraph (c)(ii) applies—was financed by the associate entity only with proceeds from another borrower;

(f) disregard the terms (if any) of a debt interest between:

(i) Australian entities where the Australian entities wholly own each other (and any interposed entities are an Australian entity); or

(ii) Australian entities that are wholly owned by the same Australian entity (and any interposed entities are an Australian entity); or

(iii) Australian entities which are able to enter into a cross staple arrangement with each other

…

(2) (d) disregard the terms (if any) of a relevant debt interest, to the extent that those terms have the effect of:

(i) allowing the recovery of costs of the conduit financer that:

(A) are a *debt deduction for the income year of the conduit financer; and

(B) are a debt deduction that is treated as being attributable to the ultimate debt interest under subsection 820-427A(2) because it is directly associated with hedging or managing the interest rate risk in respect of the ultimate debt interest; or

(ii) reflect passing on of benefits directly associated with hedging or managing the interest rate risk in respect of the ultimate debt interest and

(e) disregard the terms (if any) of a relevant debt interest, to the extent that those terms have the effect of:

(i) allowing the recovery of costs of a borrower that:

(A) are a debt deduction for the income year of the borrower; and

(B) are a debt deduction that is treated as being attributable to the relevant debt interest under subsection 820-427A(2) because it is directly associated with hedging or managing the interest rate risk in respect of the relevant debt interest.

ii) reflect passing on of benefits directly associated with hedging or managing the interest rate risk in respect of the relevant debt interest

(3) The Commissioner can decide, in writing, that one or more conditions in subsection (1) may be treated as being met.

DEBT DEDUCTION CREATION RULE AMENDMENTS

820-423A Debt deduction limitation rule for debt deduction creation (all relevant entities)

(5A) For the purposes of paragraph (5)(b), this subsection covers a payment or distribution if:

(a) the recipient has issued a debt interest to the payer; and

(b) the recipient is an *Australian entity; and

(c) the payment or distribution is entirely referable to the proceeds from the issue of the debt interest; and

(d) in a case where the payment or distribution is predominantly funded from the proceeds of another debt interest (the ***earlier debt interest***)—the terms of the ~~earlier~~ debt interest mentioned in paragraph (a), to the extent that those terms relate to costs incurred in relation to the debt interest, are the same as the terms of the earlier debt interest ~~mentioned in paragraph (a)~~, to the extent those terms relate to such costs incurred in relation to that debt interest.

(e) To avoid doubt, where a debt interest referred to in paragraph (c) has no terms that relate to costs, paragraph (d) will be satisfied in relation to the debt interest.

(f) For the purposes of paragraph (d), the modifications in subsection 820-427C(2) apply as if the references in that subsection to the ultimate debt interest were a reference to the earlier debt interest and a reference to the relevant debt interest were a reference to the debt interest mentioned in paragraph (a).

…

(8) Where one or more of the conditions in subsection (2) or subsection (5) has been satisfied, the Commissioner can decide, in writing, that an entity can treat the condition as not being satisfied.

Additional exclusions need to be included in 820-423A as follows:

Remove section (3A) (a) and (b) and the example.

(5) (b)(iii) increase the ability of any entity (including the payer) to make; one or more payments or distributions (within the meaning of section 26BC of the Income Tax Assessment ACT 1936), other than payment or distribution covered by subsection (5A), ~~or~~ (5B) or (5C) of this section, that it makes to one or more other entities (each of which is a recipient);

(5C) For the purposes of the paragraph (5)(b), this subsection covers payment or distribution:

(a) to the extent of the payer's cash earnings for the income year; or

for the acquisition of a *CGT asset (other than a CGT asset covered by section 820-423AA) under subsection 820-423(2).

Suggested markups for this exclusion to subsections 820-423A(2) below:

(iii) an associate pair of an associate disposer.

(f) the recipient and disposer ~~and the payer~~ are not:

(i) each an Australian entity where the acquirer and disposer are wholly owned by each other (and any interposed entities are an Australian Entity); or

(ii) each Australian entity wholly owned by-the same Australian entity (and any interposed entities are an Australian entity); or

(iii) each an Australian entity which are able to enter into a cross staple arrangement with each other

and 820-423A(5) below:

(iii) an associate pair of an associate recipient.

(g) ~~The~~ the recipient and the payer are not:

(i) each an Australian entity where the recipient is wholly owned by the payer (and any interposed entities are an Australian entity); or

(ii) each an Australian entity ~~and~~ which are wholly owned by the same Australian entity (and any interposed entities are an Australian entity); or

(iii) each an Australian entity which are able to enter into a cross staple arrangement with each other ~~not~~

Suggested amendments to section 820-50 below:

(2) Subdivision 820-EAA does not apply to a debt deduction that relates to an ~~financial arrangement~~ agreement entered into before 22 June 2023.

Remove subsection (3)

Appendix C – Issues and Solutions Register with Tabled Legislation

Key	
	Critical Substantive issue
	Critical Drafting issue
	High
	Medium
	Low

#	Category	Status under June Bill	Status under October ED	Priority	Ref	Proposed solution
1	TPDT - Choice	Where the Commissioner has decided to allow revocation a TPDT choice under 820-46(4) any deemed choice under 820-46(5) automatically ceases to apply (820-47(5)). The entity to which the deemed choice previously applied would then be out of time to make the choice (absent the Commissioner's discretion).	No change.	Low		Where the entity has itself made a choice under 820-46(4), 820-46(5) should not apply to it such that the choice can be preserved (subject to a separate application to revoke).
2	TPDT – Deemed Choice	Deemed choice applies to an entity that has entered into a *cross staple arrangement with an entity that has made a choice under 820-46(4) or is taken to have made a choice under 820-46(5). Where an entity on the trust side borrows from a bank (as would usually be the case) and therefore makes a choice to apply the TPDT, the deemed choice on the company side would result in	No change.	Critical – Substantive Issue	820-48(3)	Remove 820-48(3) or at a minimum include a requirement that the party to the cross staple arrangement must be a member of the borrower's obligor group.

		denial of interest deductions on any cross stapled loan that does not meet the third party debt conditions. In this regard, many cross stapled loans will not qualify as conduit financing as they may not be sourced from third party debt but rather from cash reserves, capital raisings, proceeds on disposal of assets etc. The integrity concerns in relation to different choices only arises for upstream entities, and should not arise for stapled entities.				
3	TPDT – Deemed Choice	A 20%+ associate entity that is in the obligor group is deemed to make the third party debt test choice where the borrower in the obligor group makes this choice.	820-49(3) now provides: "For the purposes of paragraph (1)(b), disregard assets that are *membership interests in the borrower." It would not be unusual for a lender to take security over membership interests in entities other than the direct borrower, and so the rule should operate to disregard membership interests in any member of the obligor group. In addition, the exclusion should capture incidental security, such as over controlled accounts into which distributions are paid.	Medium	820-49(3)	Entities that are in the obligor group only because they provide loans to such members should not be subject to the deemed choice as the security is not in the nature of additional credit support (but rather is required to assist the bank with enforcement of its security over the underlying assets of the obligor group). Change to: *(3) For the purposes of paragraph (1)(b) disregard assets that are *membership interests or *debt interests, or assets that are incidental to membership interests or debt interests, in an entity that is a member of the obligor group (disregarding this subsection).*
4	FRT – Excess capacity	To avoid penalising groups of trusts that are not eligible to form a tax consolidated group, the fixed ratio earnings limit should include an ownership based proportional share of any excess fixed ratio earning limit over the	Where a holding trust has a direct control interest of 50% or more in another trust at any time in the income year, excess fixed ratio earning limit can be transferred. A number of issues:	Critical – Substantive Issue	820-60	Reduce the threshold to 10% to align with the threshold for exclusion for distributions. The ability to benefit from excess capacity should be available to all entities (not just trusts).

		net debt deductions of associate entities (i.e. associate entity excess amount). The fixed earnings limit should then be reduced with reference to the tax EBITDA relating to distributions from an associate entity. Australian businesses that undertake substantial business activities through joint venture companies, trusts & partnerships (common in the property development and construction industry) will be significantly impacted by this change. It is not uncommon for JV partners to debt fund a portion of their equity interest in the JV, with limited or no debt within the JV. There are numerous commercial reasons why the debt may be sourced by the JV partner and not the JV including: 1. JV partners have different gearing requirements/policies 2. Individual JV partner may have access to cheaper funding as part of broader group facilities 3. Mitigate against risk of default by the other partner if each JV partner is only responsible for their own	• The 50%+ requirement seems arbitrary noting that the associate entity rule under the existing thin capitalisation provisions only requires a 10%+ interest. • Where an interest is between 10% and 50% any distributions must be excluded but no excess capacity is available, the threshold for exclusion for distributions should line up with the threshold to include excess capacity. • The transfer is based on the number of days a 50%+ interest was held. A proportion based on the share of net income of the trust or proportion of determined trust components is more reflective of an earnings based model. • No transfer of excess capacity for companies or partnerships (e.g., for tenants in common interests). • No ability to benefit from excess capacity where the holding entity is not a trust. • Excess capacity is not available for the calculation of tax EBITDA for the			Excess tax EBITDA should also be able to be transferred upwards and to ‘sister’ entities, and for interests of 10% or more. This is in line with how the “associate entity excess amount” rules operated in the existing rules Required markups to section 820-60(2) (delete (c)). The inclusion of excess capacity in tax EBITDA should also apply for the purposes of the GRT.

		debt financing Based on current drafting, JV partners will not be able to include any EBITDA from the JV in their thin cap calculations, resulting in denial of interest deductions.	purposes of the GRT. • Drafting requires that the downstream trust is subject to the thin cap rules (ie a general class investor) and has made the FRT election. If not a general class investor is not able to make the FRT election. All downstream (and upstream and sister) entities should be able to transfer excess tax EBITDA.			
5	FRT - Losses	Carry forward capital losses are required to be separately added back in calculating tax EBITDA in s820-49 (as such losses do not form part of tax losses for earlier income years, rather form part of the calculation of the net capital gain included in taxable income. Carry forward revenue losses are also not added back. Apart from causing the FRT to deviate from its stated objective of reflecting economic activity for an income year, this change creates complexity and potential circularity in the Tax EBITDA calculation (as the tax loss utilised can be impacted by the denial under the FRT).	The ED provides that "820-52(1A) In working out the taxable income or *tax loss of a *corporate tax entity for an income year for the purposes of subsection (1), assume that: (a) the entity chooses to deduct, under subsection 36-17(2) or (3), all of the entity's tax losses for *loss years occurring before the income year; and (b) subsection 36-17(5) does not apply to that choice" (relating to preventing refreshing losses for franking offsets) . This amendment does not deal with the iteration issues when applying the rules, i.e. it is not clear that the assumption regarding utilisation of losses should take into account denial of debt deductions.	High	820-52(1)(a) 820-52(1A)	Exclude the application of prior year revenue and capital losses in the calculation of taxable income.
6	FRT – Excess capacity	No interest deductions are available under the fixed ratio test for a	Refer to item 7 above where these comments have been consolidated.	Critical – Substantive Issue	820-52(6)	Refer to item 7 above.

		head trust borrower, where the head trust's only income relates to distributions from sub-trusts – While this is an intended outcome, it is particularly adverse where the third party debt test is unavailable to the head trust borrower. Note that this does not apply to a beneficiary of an AMIT that includes amounts in assessable income under 276-80. Drafting requires that a TC direct control interest of 50% or more is held. This does not allow for excess tax EBITDA for entities in which a 10-49.9% interest is held. Drafting requires that the downstream trust is subject to the thin cap rules (ie a general class investor) and has made the FRT election. If not a general class investor is not able to make the FRT election. All downstream (and upstream and sister) entities should be able to transfer excess tax EBITDA. The reason for the amendment is that the excess fixed ratio earning limit of any subtrust needs to be capable of being transferred to a holding trust, irrespective of whether or not the subtrust is a general class investor and has elected to use the FRT. The rules place investments in entities that are not subject to the thin capitalisation rules at a disadvantage.	Distributions from a company where the direct interest is less than 10% are not disregarded for the purposes of calculating tax EBITDA.			

6.1	FRT – Excess capacity	Tax EBITDA now excludes any income derived from interests in companies, trusts and partnerships. Australian businesses that undertake substantial business activities through joint venture companies, trusts & partnerships (common in the property development and construction industry) will be significantly impacted by this change. It is not uncommon for JV partners to debt fund a portion of their equity interest in the JV, with limited or no debt within the JV. There are numerous commercial reasons why the debt may be sourced by the JV partner and not the JV including: 4. JV partners have different gearing requirements/policies 5. Individual JV partner may have access to cheaper funding as part of broader group facilities 6. Mitigate against risk of default by the other partner if each JV partner is only responsible for their own debt financing Based on current drafting, JV partners will not be able to include any EBITDA from the JV in their thin cap	Refer to item 7 above where these comments have been consolidated.	Critical – Substantive Issue	820-52 (3), (6) & (8)	Refer to item 7 above.

		calculations, resulting in denial of interest deductions.				
7	GRT	The GR group net third party interest expense definition and financial statement net third party interest expense seem circular.	No change.	Low		Suggest a single defined concept being GR group net third party interest expense.
8	GRT	Net interest expense in 820-54(4)(a) is not defined	No change.	Low	820-54(4)(a)	
9	GRT	The requirement to determine if any GR group member has negative entity EBITDA and to exclude this from GR group EBITDA is onerous and in any event is difficult to understand from a policy perspective (why should the fact that a particular activity is undertaken in a separate entity make a difference?).	No change.	Medium	820-55(3)	Remove 820-55(3)
10	Debt deduction creation - Acquisitions	A "legal or equitable obligation" is not a CGT asset. It is not clear how it is possible to debt fund the assumption of an obligation.	No change.	Medium	820-423A(2)	Remove "or a legal or equitable obligation".
10.1	Debt deduction creation		S 820-423E contains a modified meaning of associate pair which treats a unit trust as if it were a company. Presumably this is to deal with the issue that any beneficiary of a trust is an associate, however in order to be effective a number of technical issues need to be addressed: • S318 applies to "trustees" and not trusts • The rules in relation to sufficient influence	Critical – Drafting Issue	820-423E	Include additional deeming rules to ensure that the associate pair rules for trusts operates appropriately. This could include deeming a unit trust to be a public unit trust entity for the purposes of s318, such that ss318(5) operates in respect of sufficient influence and majority voting power requirements.

			and majority voting power are not directly applicable to trusts.			
11	Debt deduction creation - Acquisitions	For 820-423A to apply there is no requirement that the debt deduction relates to an arrangement with an associate (i.e. third party debt deductions can be denied). There is also no recognition that there may have been existing third party debt which is being refinanced as part of the transfer of an asset (i.e. there is no additional debt funding overall). There was no consultation in respect of this new integrity rule and it has potentially extreme breadth of application (including principal purpose anti-avoidance rules).	820-423A has been restricted to loans from an associate. There is also an exclusion for the acquisition of certain CGT assets: • Newly issued membership interests in an Australian entity or foreign company • "New" depreciating assets (other than intangibles) • On-lending arrangements While the restriction to loans from associates deals with a number of obvious issues, the potential for unintended consequences remains extremely high.	Critical – Substantive issue	Subdivision 820-EAA	Remove the debt deduction creation rules from the Bill. Subject to the above, adopt additional carve outs from former Div 16G (former 159GZZF): • Trading stock • Other "new" assets • Commissioner's discretion where no increase in overall indebtedness Limit the operation of the rules consistent with the former Div 16G such that it only applied to transactions with a foreign controller (such that additional net debt was introduced into Australia) and does not apply to trusts (refer former 159GZZE). In any event, given the breadth of potential application, include a general Commissioner's discretion to not deny debt deductions under the rules inbuilt into the provisions. Given the amount of on-lending arrangements between wholly owned Australian entities this would require an onerous number of arrangements to seek Commissioner discretion if an exemption is not provided. If debt deduction creation is not removed from the Bill, the application of debt deduction creation rules should be deferred in their entirety and not to apply to debt interests unless they are entered into from income years commencing on or after 1 July 2024 (one the basis that the rules receive royal assent pre-31 December 2023, if later, then deferred by 6 months from that later date. As the rules are not yet in final form, they should only apply to arrangements entered into on or

						after the Bill is passed allowing for a subsequent grace period. It is not possible to change arrangements already entered and costs arise to change arrangements, plus it is not known how Commissioner will view restructuring arrangements (e.g. application of Part IVA) so taxpayers have taken prudent approach awaiting for certainty / clarification on the rules. There should be an exclusion of for debt deductions related to arrangements between wholly owned Australian entities, including stapled entities (e.g. wholly owned Australian trusts lending amongst themselves should not be subject to the debt deduction creation rules). i.e. on-lending between wholly owned Australian entities should be excluded in their entirety. There is no basis for the debt deduction rules to apply. Also such an exclusion is in line with the intent in the June 2023 EM – i.e. there are no "profits being shifted out of Australia in the form of tax deductible interest payments". The rules as currently drafted are not in line with the intent in the EM. The debt deduction rules as currently drafted apply to arrangements between wholly owned Australian entities with no overseas entities or assets which have ultimately borrowed from an external bank. This is clearly outside the remit of the policy for these rules. As currently drafted, entities with external debt and no overseas arrangements will have debt deductions denied within the group. Large ASX Australian listed entities with no overseas operations will be unfairly penalised as a result of the drafting of the debt creation rules which do not take account of the manner in which in house treasury functions operate with one or two entities entering into the arrangements with external borrowers and then acting as an internal bank with other entities in the Group. The ATO should provide comprehensive guidance on

						scenarios where the rules will apply (including where the ATO will not allocate compliance resources) and (if a discretion is included) where the Commissioner will exercise his discretion.
12	Debt deduction creation - Payments	Where a trust seeks to 'push down' debt to a subsidiary trust to address the complete denial of deductions under the FRT as a result of the requirement to exclude distributions from trusts in tax EBITDA, deductions of the subsidiary trust in relation to the new debt (which would be used to fund a return of capital by the subsidiary trust) would be wholly denied.	This specific issue has been addressed by 820-423(5A) which excludes payments from a "payer" that are wholly in relation to making a loan to the "recipient". If the loan to the recipient is "predominantly funded from the proceeds of another debt interest (the earlier debt interest)" then the terms relating to costs must be the same (i.e. back to back).	Critical – Substantive Issue	820-423A(5A)	Remove the debt deduction creation rules from the Bill. Subject to the above, remove the back-to-back requirement on the basis that: • the thin capitalisation rules already address general concerns regarding deductibility of interest (i.e. there is no thin capitalisation related basis for introducing a separate 'integrity' rule within a concession to allow on-lending without triggering the debt deduction creation rule for payments and distributions). • the thin capitalisation rules already include a similar (but not identical) requirement for "conduit" loans. In any event, there are a number of modifications (i.e. s820-427C(2)) in respect of the "same terms" requirements in the conduit financing rules which need to be mirrored in any 'back to back' requirement in the debt deduction creation rules otherwise these modifications will effectively not be available where a third party debt is sought to be on-lent from one "borrower" to another "borrower" after 1 July 2023.
12.1	Debt deduction creation - Payments		The positive requirement in 820-423A(5)(b) that "the payer uses some or all of the proceeds to: (i) fund; or (ii) facilitate the funding of; or (iii)	Critical – Substantive Issue	820-423A (5)	Remove the debt deduction creation rules from the Bill. There is a requirement to include exclusions for arrangements between wholly owned Australian entities for sections 820-423A(2)

			increase the ability of any entity (including the payer) to make one or more payments or distributions" means that 820-423A(5) is broad enough to capture all loans from associates. This also makes the exclusion for refinancing of loans in 820-423A(5B) redundant, in that all loans arguably satisfy paragraphs (5)(a), (b) and (c). The amendments also change the requirement from "uses the proceeds of issuing the debt interest *predominantly* to:" to "uses *some or all* of the proceeds to:" which broadens the scope of the rules (e.g. if $1 is used then the rules are triggered).			and 820-423A(5) as a critical issue – refer comments above. Subject to the above, the concept of payment is much broader than distribution and includes payments for services, assets (including membership interests), loan principal, loan repayments etc.). Many such "payments" would not increase the overall indebtedness of the group (for example loans or membership interests) or would be covered by s820-423A (2) (acquisitions of assets) and also potentially excluded from s820-423A(2) by the operation of s820-423AA. Based on: • the wide array of situations where a "payment" does not result in debt deduction creation; • the significant overlap between "payments" covered by s820-423A (5) and acquisitions covered by s s820-423A(2); and • the effective removal of the exclusions in s820-423AA Given the amount of on-lending arrangements between wholly owned Australian entities this would require an onerous number of arrangements to seek Commissioner discretion if an exemption is not provided. it is submitted that the term "payment" should be removed from 820-423A(5)(b)(iii). Subject to the above, the connection between the loan and the payment or distribution should be clearer, i.e. only where the loan actually funds the payment or distribution and should be limited to a situation where the loan is used

						"predominantly" to fund the payment or distribution. In any event, given the breadth of potential application, a general Commissioner's discretion to not deny debt deductions under the rules should be included. The ATO should provide comprehensive guidance on scenarios where the rules will apply (including where the ATO will not allocate compliance resources) and (if a discretion is included) where the Commissioner will exercise his discretion. The connection must be stricter. The rules should apply a strict connection between the debt funds and the distribution/payment i.e. only when the loan actually funds the payment (and only to the extent actually funded by the loan). To the extent that a distribution can be paid out of cash earnings for the financial year it should not be taken to be paid out of borrowings. This should include whether or not the cash earnings are used to repay borrowings at some point prior to the distribution for the year – i.e. if borrowings and redraws are less than cash earnings for the year, the DDC rules should not apply. In addition, indirect asset acquisitions should be permitted.
12.2	Debt deduction creation	It is not clear whether Subdivision 820-EEA can apply to arrangements that were entered into prior to the income year commencing on or after 1 July 2023.	It is now clear that the rules are intended to apply retrospectively, with a grace period for debt deductions that relate to financial arrangements entered into before 22 June 2023. The debt deduction creation rules apply in relation to all debt deductions for income years beginning on or after 1 July 2024, regardless of when the financial arrangements to which the debt	Critical – Substantive Issue	820-423A	Remove the debt deduction creation rules from the Bill. Subject to the above, the rules should only apply to arrangements entered into on or after 22 June 2023. Debt arising under agreements entered pre-22 June 2023 should not be subject to the debt deduction creation rules. For example, facilities established pre-22 June 2023 (which may have amounts drawn down and repaid post 22 June 2023) should be excluded.

			deductions relate were entered into. As the rules operate retrospectively this will trigger a range of issues: • the rules adversely impact structures where there could have been no awareness of the debt creation rules applying to those arrangements in the future. • It imposes a significant burden on taxpayers to review historical transactions, including transactions that may pre-date their ownership (or for which records do not exist). Given that the rationale advanced by Treasury in the Senate Committee for these rules related to taxpayers exploiting variance in tax EBITDA to gear up with related party debt, and since that risk is a prospective risk, the rules should not apply to debt interests issued before 22 June 2023 (being the date the legislation was introduced into Parliament).			
12.3	TPDT–associate entity		For the purposes of Subdivision 820-EAB (Third party debt concepts): *820-427D(2) (a) treat an entity (the first entity) that has entered into a *cross-staple arrangement with another entity as an*	Critical – Substantive Issue	820-427D(2)	Remove 820-427D(2)(a) or make it elective for taxpayers that wish to use conduit financing for cross-stapled arrangements.

			associate entity of that other entity; and *(b) if that other entity is itself an associate entity of a conduit financer mentioned in section 820-427C (whether because of another operation of this subsection or otherwise)—treat the first entity as an associate entity of the conduit financer.* This means that cross stapled loans will **not** meet the third party debt conditions.			
13	TPDT– Conditions	820-427A requires that the entity *"uses all, or substantially all, of the proceeds of issuing the debt interest to fund its commercial activities in connection with Australia that do not include:* *(i) any *business carried on by the entity at or through its *overseas permanent establishments; and* *(ii) the holding by the entity of any *associate entity debt, *controlled foreign entity debt or *controlled foreign entity equity."* The exclusion for "associate entity debt" will severally limit or even effectively remove the ability for the ultimate borrower to on-lend borrowed funds to an Australian group entity, and also seems to make the conduit financing rule inaccessible. It is also not clear whether the activities of the entity cannot include a foreign PE or	S820-427B(6) disregards associate entity debt that is a "relevant debt interest". Associate debt that does not give rise to debt deductions for interest (i.e. non-interest bearing loans) should also be disregarded or excluded.	Critical – Drafting Issue	820-427A(3)(d)	Amend as follows: 820-427A(3)(d) *the entity uses all, or substantially all, of the proceeds of issuing the debt interest to fund its commercial activities in connection with Australia that do not include:* *(i) any *business carried on by the entity at or through its *overseas permanent establishments; and* *(ii) the holding by the entity of any *associate entity debt giving rise to debt deductions under subparagraph 820-40(1)(a)(i), *controlled foreign entity debt or *controlled foreign entity equity."*

		investment in foreign assets, or whether the proceeds of the debt interest cannot be used to fund such activities, although the EM provides that the "conditions aim to ensure the third party debt test only captures genuine third party debt which is used to fund Australian business operations", suggesting the narrower interpretation.				
14	TPDT–Conditions	The requirement that the third party lender only have recourse for payment to the assets of the entity will often mean that the TPDT will not be available, for example it is common for the third party lender to have recourse to the membership interests in the borrowing entity, assets of subsidiary entities, or for another entity to provide a guarantee (although this could potentially be structured as an asset of the borrower). The conditions also generally exclude assets of the borrower that are "rights under or in relation to a guarantee, security or other form of credit support". This is stated to be "to ensure that multinational enterprises do not have an unfettered ability to fund their Australian operations with third party debt." but applies even if rights are provided from an Australian entity in the obligor group.	The ED changes the recourse requirement to: *(c) the holder of the debt interest has recourse only to assets of the following kind for payment of the debt to which the debt interests relates:* *(i) Australian assets held by the entity;* ***(ii) Australian assets that are *membership interests in the entity (unless the entity has a legal or equitable interest, whether directly or indirectly, in an asset that is not an Australian asset);*** ***(iii) Australian assets held by an *Australian entity that is a *member of the *obligor group in relation to the debt interest;*** *(ca) none of the assets mentioned in paragraph (c) are rights under or in relation to a guarantee, security or other form of credit support;* [emphasis added] Therefore the following issues remain:	Critical – Substantive Issue	820-427A(3)(c)	Change as follows: *(c) the holder of the debt interest has recourse only to or substantially only to assets of the following kind for payment of the debt to which the debt interests relates:* *(i) Australian assets held by the entity;* *(ii) Australian assets that are *membership interests or debt interests in the entity (unless the entity has a legal or equitable interest, whether directly or indirectly, in an asset that is not an Australian asset);* *(iii) Australian assets held by an *Australian entity that is a *member of the *obligor group in relation to the debt interest;* In relation to credits support, amend as follows: *(ca) none of the assets mentioned in paragraph (c) are rights under or in relation to a guarantee, security or other form of credit support provided by a *foreign entity which is an associate entity;* Alternatively, limit to credit support from an associate entity, i.e.: *(ca) none of the assets mentioned in paragraph (c) are rights under or in relation to a guarantee, security or other form of credit*

		In addition, a strict limitation on recourse to Australian assets may preclude Australian multinational groups applying the TPDT if the entities have granted security over all assets, as there will often be limited foreign assets (e.g., a foreign bank account). Accordingly, some form of permissible foreign assets is necessary, to ensure entities are not adversely impacted by nominal assets that may arise from time to time.	• guarantee, security or other form of credit support exclusion • issue regarding *de minimis* non-Australian assets Third party guarantees (e.g., a bank guarantee, or lessee guarantees from an entity of substance), seems to also result in a failure of the third party debt conditions.			*support provided by an associate entity other than an associate entity that is the entity mentioned in subparagraph (c)(iii);*
15	TPDT–Conditions	Recourse to assets of the borrower that are "rights under or in relation to a guarantee, security or other form of credit support" are permitted if ... the right relates wholly to the creation or development of a *CGT asset that is, or is reasonably expected to be, real property situated in Australia (including a lease of land, if the land is situated in Australia)" and "... the right would not reasonably be expected to allow, directly or indirectly, the holder or another entity to have recourse for payment of the debt ... against a *foreign entity that is an *associate entity of the holder." While "the extent (if any) to which the right relates incidentally to another matter" is disregarded, it is not clear whether this will capture the creation or development of chattels	The ED includes certain moveable assets: *(6) For the purposes of subparagraph (4)(a)(ii), moveable property situated on land is of a kind covered by this subsection if the property is, or is reasonably expected to be: (a) incidental to and relevant to the ownership and use of the land; and (b) situated on the land for the majority of its useful life.* No changes to recourse condition.	High	820-427A(4)	Remove the restriction on credit support etc. from a foreign resident for the creation or development of Australian investments in land.

		as part of a large property development (e.g. fit-out assets, signage, telecommunication towers). To facilitate foreign investment in Australian development projects (e.g. build to rent projects), credit support from a foreign investor should be permitted.				
15.1	TPDT - conditions	Credit support rights are disregarded in relation to development of real property assets. The EM notes that 'the connection between a credit support right and the creation or development of real property must be tested continuously ..... where a credit support right initially related wholly to funding the creation or development of real property, but subsequently relates to other business activities in later income years in relation to the same real property (such as an investment holding activity where the real property development activity is completed), then the exception provided by subsection 820-427A(4) will not apply.' Practically this will be problematic for BTR developments. Banks are requiring the credit support to continue during the lease up period until the asset reaches stabilisation (c96% leased). The lease up period for BTR (1-2 years depending on size of the	No change.	Critical – Substantive issue	820-427A(4)	Allow the exception provided in subsection 820-427A(4) to apply for up to 2 years post completion of the development.

		development) is typically longer than a commercial asset. This means that BTR funds will not be eligible to apply the TPDT during the lease up phase.				
16	TPDT – Conduit financier	The general exclusion for assets that are "rights under or in relation to a guarantee, security or other form of credit support" also applies in relation to the assets of the obligor group in the context of the conduit financing conditions. Recourse to Australian assets of the obligor group should be permitted, including rights of credit support. As drafted, any assets of an obligor group that is not held by the borrower is arguably credit support to the borrower, which makes the extension of recourse to assets of the obligor group meaningless.	No change.	Critical – Substantive Issue	820-427A(3)(ca)	As above for item 27.
17	TPDT – Conduit financier	As the ultimate debt interest issued by the conduit financier needs to meet the external third party debt conditions, the conduit financier cannot be an offshore entity with a loan to an Australian subsidiary as the requirement in 820-427C(1)(g) and 820-427A(3)(e) would not be satisfied, even if all the other requirements are met (same terms, recourse etc.). It is unclear why cross border back to back loans should be excluded.	No change.	Medium		

18	TPDT – Conduit financier	Borrowers are defined in ss 820-427C(1)(b) as one or more associate entities of each other, there is no requirement that the entity is actually issuing a debt interest to the conduit financier. In this case the ETPDT cannot apply unless the conduit financier on-lends to an entity and <u>all</u> of its associate entities.	The definitions of "borrower" and "relevant debt interest" are now intended to restrict the application of the conduit financing conditions to loans that are directly or indirectly financed by the ultimate debt interest. If an associate entity (AE1) lends (Loan 1) to a second associate entity (AE2) and AE2 on-lends (Loan 2) to a third associate entity (AE3), each of AE 1 -3 would be "borrowers". As Loan 2 is financed only with proceeds from Loan 1, then Loan 2 would be a "relevant debt interest" and must therefore be on the same terms as the ultimate debt interest.	High – Drafting Issue	820-427C(1)(c)	820-427C(1)(c)(ii) should refer to another "borrower" based on one or more applications of 820-427C(1)(c). See also item 32 below.
19	TPDT– Conduit financier	Under 820-427C(1)(e) "the terms of each relevant debt interest, to the extent that those terms relate to a cost incurred in relation to the relevant debt interest, are the same as the terms of the ultimate debt interest, to the extent that those terms relate to a cost incurred in relation to the ultimate debt interest." It seems that <u>each</u> cost under the on-lending must be the same as a cost incurred in relation to the ultimate debt interest. There will generally be a range of fees, including interest, line fees, commitment fees, administration / management fees etc. which would be on-charged as an 'all-in' cost.	Amended to refer to "costs"	Critical – Substantive Issue	820-427C(1)(e)	This would seem to still be an issue as many on-lending arrangements will not be able to meet this requirement due to the group treasury function that finance companies undertake (e.g. different external borrowings with different terms to the relevant debt interests) and the fungible nature of money. This requirement disregards the manner by which in house treasury functions operate with one or two entities entering into the arrangements with external borrowers and then acting as an internal bank with other entities in the group. Further explanation of how such arrangements are conducted is provided below: • conduit financer borrows from various third party banks and lenders. To efficiently manage the group's financing

						requirements, external loans will be entered into at different times for different loan facility limits, varying terms (including some loans with the ability to repay and redraw funds within the agreed facility limit), interest rates, and costs. • external borrowings will be sourced and retired at various times by conduit financer which will in total match the needs of the wholly owned group • conduit financer loans funds sourced as above will lend to an entity in the wholly owned group (an 'internal conduit financer') which then further on-lends to other wholly owned entities at a facility limit (in total) no greater than the external facilities. One loan document is entered into between the conduit financer and internal conduit financer. External loans are not backed to backed but rather split / aggregated and funds on-lent to entities depending on their financial requirements. The loan terms also allow listed internal conduit financer (and its wholly owned entities) the ability to prepay and redraw funds as required. The interest rate on the relevant debt interests will reflect conduit financer's cost of funds on a monthly basis (i.e. conduit financer makes no margin).

						As this is a common feature of such functions and it is a threshold issue to accessing the conduit financing conditions and therefore the TPDT. This requirement also ignores the fungible nature of money. It is impossible to trace the third party external source of each internal loan given external third party loans are hedged, are continually repaid, redrawn, cancelled or replaced to ensure external interest cost are minimised, making the external source of funds in respect of internal loans indistinguishable over time It is not so much about the costs as the number of varied ultimate debt interests which would not necessarily exactly align to the relevant debt interests given the treasury function undertaken.
20	TPDT– Conduit financier	Swap costs "directly associated with hedging or managing the interest rate risk in respect of the debt interest" are deductible where attributable to a debt interest that satisfies the TPD conditions unless "referrable to an amount paid, directly or indirectly, to an *associate entity". This will prevent deductibility of swap costs that have been on-charged to a borrower, even if the on-charge is on the same terms. It is not unusually for a FinCo to on-charge swap costs to the entity that holds the relevant income producing assets.	Such costs are now disregarded in assessing whether conduit financing is on the same terms and therefore the conduit financier can recover such costs. A borrower that incurs external swap costs can also recover those costs under a relevant debt interest with another borrower. 820-427B modifications for conduit financing conditions have been amended to remove the requirement to disregard 820-427A(2) (such that a borrower other than the conduit financier can claim third party swap costs). Back to back swap costs (i.e. not recovered as costs under a relevant debt interest) remain non-deductible. Swap <u>receipts</u> are not dealt with in relation to	Critical – Substantive Issue	820-427A(2)(b) 820-427C(2)(d) and (e)	Remove swaps from the debt deduction definition. Subject to the above, disregard terms that have either provide for recovery of costs or passing on of benefits in respect of a swap, e.g.: *820-427C(2) (d) disregard the terms (if any) of a relevant debt interest, to the extent that those terms have the effect of:* *(i) allowing the recovery of costs of the conduit financer that:* *(A) are a *debt deduction for the income year of the conduit financer; and* *(B) are a debt deduction that is treated as being attributable to the ultimate debt interest under subsection 820-427A(2) because it is directly associated with hedging or managing the interest rate risk in respect of the ultimate debt interest; or* *(ii) reflect passing on of benefits directly associated with hedging or managing the interest rate risk in respect of the ultimate debt interest* *and* *(e) disregard the terms (if any) of a relevant debt interest, to the*

			a borrower, i.e. where the conduit financier must pay the borrower (because the swap is in the money), the payment would not be deductible.			*extent that those terms have the effect of:* *(i) allowing the recovery of costs of a borrower that:* *(A) are a debt deduction for the income year of the borrower; and* *(B) are a debt deduction that is treated as being attributable to the relevant debt interest under subsection 820-427A(2) because it is directly associated with hedging or managing the interest rate risk in respect of the relevant debt interest.* *ii) reflect passing on of benefits directly associated with hedging or managing the interest rate risk in respect of the relevant debt interest*
21	TPDT–Conduit financier	While the rules "disregard the terms (if any) of a relevant debt interest issued to the conduit financer that have the effect of allowing the recovery of reasonable administrative costs of the conduit financer that relate directly to the relevant debt interest", any other costs are not able to be on-charged (for example audit fees, directors fees or other costs in relation to the operation of the conduit financier). Where existing on-lending arrangements include recovery of such costs, these agreements will need to be amended.	No change. On-charging of administrative costs is not disregard for a relevant debt interest that is not issued to the conduit financier.	High	820-427C(2)(b) and (c)	Amend as set out below: (c) disregard the terms (if any) of a relevant debt interest issued to the conduit financer that have the effect of allowing the recovery of reasonable administrative costs of the conduit financer that relate directly to the relevant debt interest; *(c)disregard the terms (if any) of a relevant debt interest ~~issued to the conduit financer~~ that have the effect of allowing the recovery by the conduit financer or another borrower of reasonable administrative costs or costs that relate directly to the relevant debt interest or the ultimate debt interest*
22	TPDT–Conduit financier	The rules <u>disregard</u> the terms of a relevant debt interest that allow for the recovery of costs "directly associated with hedging or managing the interest rate risk" of the conduit financer in relation to	Refer to item 34 above.	High		Refer to item 34 above.

		the ultimate debt interest. Given the requirement in 820-427C(1)(e) is only that the terms of a cost under the relevant debt interest are the same as the terms of the ultimate debt interest it is not clear what 820-427C(2)(d) is intended to achieve, noting also that hedging costs under a relevant debt interest are not deductible if paid to an associate entity.				
23	TPDT– General	Debt deductions other than swap costs that are not related to a debt interest will be denied.	No change. This impacts on the availability of deductions for currency swaps.	Medium	820-427A(1) 820-427A(2)(a)	