21 December 2023

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

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

Dear Committee,

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

The Australian Financial Markets Association (**AFMA**) represents the interests of over 125 participants in Australia's financial markets. Our members include Australian and foreign-owned banks, securities companies, treasury corporations and traders across a wide range of markets and industry service providers.

We are pleased to lodge a submission to the Committee's inquiry into the Government's proposed amendments to the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share-Integrity and Transparency) Bill* 2023 (**the Bill**), as detailed on Amendment Sheet RU100. AFMA has engaged with Treasury and the Committee throughout the formulation of this Bill and has consistently stated in submissions that, due to the consultation process and the manner in which the Bill has progressed through Parliament, the risk of unintended consequences arising from the Bill is high.

It is acknowledged, however, that two of the proposed amendments included on the Government's amendment sheet are consistent with AFMA's previous submissions and are welcomed. These proposed amendments are:

- Exempting Authorised Deposit-Taking Institutions (ADIs) and securitisation vehicles from the Debt Deduction Creation rules contained in proposed Subdivision 820-EAA through amendments 46 and 47; and
- Extending the commencement of the operation of Subdivision 820-EAA to income years starting on or after 1 July 2024 through amendment 89.

Australian Financial Markets Association
ABN 69 793 968 987
Level 25, 123 Pitt Street GPO Box 3655 Sydney NSW 2001
Tel: +612 9776 7955 Fax: +61 2 9776 4488
Email: info@afma.com.au Web: www.afma.com.au

AFMA would like to bring two additional suggested points to the Committee's attention through the review of Amendment Sheet RU400, as per the below.

Extension of Exemption from Debt Deduction Creation Rules – Financial Entities

As noted above, AFMA appreciates the proposed amendments to exempt ADIs and securitisation vehicles from the proposed Debt Deduction Creation Rules. These proposed amendments reflect the core business of such entities, particularly the raising of finance in global markets and the provision of finance to Australian businesses. The exemptions also reflect that, in the case of ADIs, the thin capitalisation arrangements applying to such entities are not amended by the Bill, with the primary catalyst for the inclusion of the Debt Deduction Creation Rules being the amendments to the thin capitalisation arrangements for general-class entities only.

In AFMA's view, the proposed exemptions for ADIs and securitisation vehicles should be extended to entities classified as a "financial entity (non-ADI)" for thin capitalisation purposes. This would reflect both the similar role that such entities play in financial markets and the fact that many financial entities operate in a similar way to ADIs, as reflected in the thin capitalisation arrangements that apply to such entities. Such an exemption would also be consistent with the policy rationale for the Debt Deduction Creation Rules, given that the Bill does not alter the thin capitalisation arrangements for financial entities.

Definition of "Debt Deduction"

The Bill proposes to expand the definition of "debt deduction" to include amounts which are economically equivalent to interest. While these amendments may be appropriate for general class entities for thin capitalisation purposes, AFMA remains concerned that the expanded definition may give rise to unintended consequences for banks or other entities that enter into derivative transactions for purposes entirely unrelated to debt, such as for trading or hedging purposes. By removing the nexus between the deduction and a debt interest issued by the entity, our concern is that deductions on losses arising from circumstances entirely unrelated to a debt interest could be caught within the expanded definition of "debt deduction."

The proposed amendments remove the requirement for a nexus between the debt deduction and a debt interest issued by the entity and replace "calculated by reference to the time value of money" with "economically equivalent to interest." In addition, there is a proposed amendment to subsection (3), which sets out amounts which are specifically excluded from the definition of debt deduction to remove "losses and outgoings directly associated with hedging or managing the financial risk in respect of the debt interest." On this reading, it is tenable that all flows under interest rate derivatives could be included in the definition of a "debt deduction," especially noting the comment at 2.159 of the Explanatory Memorandum.

Additionally, there does not appear to be a concept of "net debt deduction" in the expanded definition. Generally, banks and other financial entities will look to hedge exposures on a portfolio basis and under the Taxation of Financial Arrangements (TOFA) provisions in Division 230, there is no requirement for such taxpayers to "gross out" gains and losses on individual positions. As such, to the extent that the definition of "debt deduction" is expanded to include payments on interest rate swaps without the nexus to a debt interest, this would significantly

exacerbate not only compliance costs but also the quantum of disallowance in a manner entirely disproportionate to what could be considered to be economically equivalent to a cost of debt.

The Explanatory Memorandum states that the proposed amendments are in line with OECD best practice. However, we note that while the OECD guidance from 2016 does note the expansion of the definition of "interest" to include amounts that are economically equivalent to interest, the guidance states that "payments that are economically equivalent to interest include those which are linked to the financing of an entity." Accordingly, AFMA submits that the any proposed amendments retain a nexus between the deduction and a debt interest.

Our recommendation is that the amendment to Section 820-40(1) is to only remove "by the entity" such that there is still a nexus between the cost and "a debt interest." This should exclude payments on interest rate swaps that are unrelated to financing from being a debt deduction. In the alternative, the expanded definition of "debt deduction" should not apply to ADIs, securitisation vehicles or financial entities. This would reduce the risk of significant unintended consequences for financing entities and be consistent with the general approach of the Bill, namely to amend the thin capitalisation arrangements for general entities only.

* * * * *

Thank you for the opportunity to provide a submission in relation to the Committee's inquiry. Please contact me on [redacted] or at [redacted] to discuss any of the matters that we have raised in this submission.

Yours sincerely,

Rob Colquhoun
Director, Policy