Deloitte.

Deloitte Tax Services Pty Ltd
ACN 092 223 240

Quay Quarter Tower
50 Bridge Street
Sydney NSW 2000
Australia

Phone: +61 2 9322 7000
www deloitte.com.au

5 January 2024

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

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

Dear Committee Secretary

Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023
Thin capitalisation interest limitation rules

We welcome the opportunity to make this further submission to the Committee regarding the interest limitation measures and the debt creation measures (**the measures**) contained in Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023 (**the Bill**).

Our submission is based on the Bill in its current form **together with** the Government's proposed amendments released in November 2023 (**Government amendments**). Our comments are made with the intent that the law when finalised is consistent with the policy objectives (as we understand them), does not create unintended consequences, and is drafted in the best manner to facilitate the administration of, and compliance with, the law.

We have limited our submission to a small number of key points for consideration by the Senate Committee, and we have intentionally kept our comments brief. We are happy to elaborate on any matter.

Positive changes: We welcome and acknowledge the improvements to the measures as contained in the Government amendments.

We remain concerned about a number of matters which we draw to the attention of the Committee.

Deloitte.

1. **Retrospectivity:** We are concerned that the interest limitation rules are intended to be applicable to income years commencing on or after 1 July 2023 and yet, more than six months after that date, have not yet been legislated. Needless to say, this is contrary to good governance and results in a lack of certainty, which is a key attribute of good tax law. The lack of certainty has the further consequence of effectively "locking" taxpayers into existing arrangements which ultimately may be non-compliant: even if it may be the case that existing arrangements are thought to be contrary to intended policy outcomes, taxpayers are unable at present to commit to appropriate restructures due to the lack of certainty.

2. **Commencement date:** We acknowledge the now-proposed deferred start date for the debt creation rules. We submit that in the interests of certainty, the start date for the interest limitation rules should also be deferred. More specifically, we propose a transitional start date: the interest limitation rules commence from 1 July 2023 as announced, subject to an ability for taxpayers to elect for a deferred commencement date of 1 July 2024. This permits taxpayers to see the law in effect prior to the first operative year, if they so choose. A similar one-year transitional commencement regime applied when the tax consolidation provisions were introduced[1].

3. **Fixed Ratio Test: Non-consolidated groups:** The rules inappropriately and inequitably disadvantage "associate" investments for which the investor does not relevantly have control, being broadly investments of between 10%-49.9%. That is, distributions in such arrangements are **excluded from** the investor's tax EBITDA and excess tax EBITDA of the investee **cannot be shared**. By contrast, the proposed law now contains mechanisms to appropriately deal with non-associate investments and controlled investments. It is submitted that as a matter of principle, the relative disadvantage cannot be justified.

4. **Fixed Ratio Test: Recoupment of prior year tax losses in tax EBITDA computation:**
   a. At a conceptual level, it is clear that the tax EBITDA concept is an amount that is **not** reduced by current-year tax depreciation amounts. The proposed treatment of prior year tax losses (recouped at the first step of the tax EBITDA computation) is inconsistent with that principle, as prior year tax losses will to some extent typically be attributable to prior year tax depreciation amounts. We submit that the proposed treatment of tax losses is unprincipled. Further, the proposed treatment can have the effect of understating tax EBITDA in later years, and thus deferring or preventing interest deductions.
   b. If the carry forward loss treatment remains as is, it is submitted that losses incurred **prior to** the start of the new interest limitation rules should be **excluded** from carry forward for the purposes of the tax EBITDA calculation. Such prior years and any resulting tax losses have already been subject to the then-prevailing interest limitation rules, and should not be subjected to a second round of interest limitation rules.

5. **Third party debt test:**
   a. We submit that additional clarity in respect of the third party debt test should be provided by way of examples included in the Bill, or failing that, in the Explanatory Memorandum:

[1] *New Business Tax System (Consolidation) Act (No. 1) 2002*: The explanatory memorandum states "Date of effect: Wholly-owned entity groups will be allowed to choose to consolidate under this scheme from 1 July 2002. The existing grouping provisions will continue to operate in parallel with the consolidation regime until 1 July 2003".

Deloitte.

i. Clarify that "recourse" in ss820-49(1)(b) and ss820-427A(3)(c) refers to direct recourse for payment. For example, where the third party lender has recourse to the assets of the borrower and one of those assets is a right of credit support from another entity (credit support provider), the third party lender does not have direct recourse to the assets of the credit support provider and therefore:
   1. the credit support provider is not a member of the obligor group for the purposes of ss820-49(1)(b), and
   2. the assets of the credit support provider do not need to be assessed for the purposes of ss820-427A(3)(c).

   For completeness, the credit support rights held by the borrower in this example would need to meet the requirements of ss820-427A(5) in order for the third party debt conditions to be satisfied.

ii. Clarify that the third party lender has "recourse for payment" in ss820-49(1)(b) and ss820-427A(3)(c) to the assets of an entity that provides a guarantee or other credit support directly to the third party lender. For example, where the parent of the borrower (parent) provides a guarantee directly to the third party lender in respect of the loan to the borrower, the third party lender has recourse for payment of the loan to the assets of the parent and therefore:
   1. the parent is a member of the obligor group for the purposes of ss820-49(1)(b), and
   2. the assets of the parent need to be assessed for the purposes of ss820-427A(3)(c).

b. We submit that an amendment be made to ensure that a right that provides recourse, directly or indirectly, only to one or more Australian assets held by an Australian entity that holds membership interests in the borrower is subject to an exception under ss820-427A(5), e.g.:

> *ss820-427A(3)[new subparagraph] a right that provides recourse, directly or indirectly, only to one or more Australian assets held by an Australian entity that holds the *membership interests referred to in subsection 820-427A(4)(b).*

Currently such a right is not subject to an exception under ss820-427A(5) as the entity that holds membership interests in the borrower is not a member of the obligor group by virtue of the requirement to disregard membership interests under ss820-49(3).

c. We submit that an amendment be made to subparagraph 820-427A(5)(a)(iii) to ensure that the carve out for credit support includes development projects on land situated in Australia held under a licence or other access right that is not an 'interest in land' (eg typically the case for transmission and distribution 'poles and wires').

> *Subparagraph 820-42A(5)(a)(iii) a right that relates wholly to the creation or development of a *CGT asset that is, or is reasonably expected to be, land situated in Australia (including ~~an interest~~ a quasi ownership right held over ~~in~~ land, if the land is situated in Australia) (amendments in markup)*

A 'quasi ownership right over land' is a well understood concept used in subdivision 40-B and Division 43 and, it is submitted, provides the appropriate 'connection' to land situated in Australia to maintain the intent and integrity of the provision.

Deloitte.

d. Noting the funding requirement for Australia's energy transition and the development of well located housing stock, the development carve out in subparagraphs 820-427A(5)(a)(iii)-(vi) should not be limited by subparagraph 820-427A(5)(b). That is, the carve out for credit support for qualifying development projects should permit credit support provided by a foreign entity that is an associate entity of the borrower during the project development phase.

   The amount of external bank financing required for the development of large scale greenfield infrastructure and housing projects can often only be obtained by Australian borrowers with significant credit support from foreign parent entities. The provision of credit support in these circumstances increases access of the project to relatively lower cost external third party debt capital that lowers the cost of the project and, in turn, lowers the cost to end users. In the case of infrastructure critical to Australia's energy transition, this means lower costs to Australian energy consumers including businesses and household consumers.

   In this context, we submit that an expansion of the development carve out to permit credit support from foreign associate entities of the borrower only during the development phase of an otherwise qualifying development project is a pragmatic and sensible approach to this issue.

6. **Debt creation:**
   a. It is submitted that it is unreasonable that interest incurred to fund the acquisition of trading stock can be non-deductible under the debt creation rules.
   b. The nexus rules as between the relevant borrowing and the relevant acquisition (s820-423A(2)) or payment (s820-423A(5)) are cast very broadly:
      i. s820-423A(2): The debt deduction is referable to an amount paid "either directly or indirectly" to an associate;
      ii. s820-423A(5): the payer uses the financial arrangement to ... "facilitate the funding" of the prescribed payment

      In practice, it will be very difficult to confidently demonstrate that related party borrowings have not "directly or indirectly" funded or "facilitated the funding" of in scope acquisitions/payments. This will result in considerable compliance costs and likely lead to disputes.
   c. In exercising the Commissioner's discretion in the schemes rule (s820-423D), there are no prescribed factors that the Commissioner is required to consider, leaving his discretion "at large". The discretion should be operative only after a consideration of prescribed criteria.
      i. The Supplementary EM comments that "these rules are not intended to apply to schemes where a taxpayer is merely restructuring, without any associated artificiality or contrivance, out of an arrangement that would otherwise be caught by the debt deduction creation rules". This is helpful but based on the law as drafted, it is not certain that a Court will take this comment into account or reach the same conclusion. We submit that words to the effect of the above should be included in the legislation, or as an Example in the legislation to provide greater clarity that such an outcome can be achieved under the law.

7. **Post implementation review:** We submit that Treasury should undertake an ongoing and real time post implementation review as there remain many issues and uncertainties. Further, it is expected

Deloitte.

that additional issues will arise in practice. It is not appropriate to leave such matters to the ATO and taxpayers to resolve where a legislative response is more appropriate.

We value the opportunity to provide this submission. Should you have any queries or require further detail, please do not hesitate to contact David Watkins on [redacted] or [redacted].

Yours faithfully

[redacted]

David Watkins
Partner, Tax
[redacted]