21 July 2023

Economics Legislation Committee

Dear Sirs

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

As requested, we are providing feedback in relation to specific provisions of the above bill, primarily relating to the Debt Deduction Limitations contained within proposed subdivision 820-EAA.

We note these rules have been introduced without any prior consultation on their proposed effect.

1. **Scope of proposed rules**

Based on our understanding of the proposed rules, they effectively prohibit debt deductions in relation to the acquisition or holding of a CGT asset where that asset is acquired from an "associate pair" (820-423A(2)). It does not seem to matter whether the debt itself is with a 3rd party or a related party.

The meaning of CGT asset is widely defined (refer section 108-5) to be "any kind of property".

The draft Explanatory Memorandum (EM) refers to the new rules denying debt deductions to the extent "they are incurred in relation to debt creation schemes that lack **genuine commercial justification**" or "**artificial** interest-bearing debt".

Furthermore, the EM provides a couple of examples where debt deductions would be denied (being where shares in a foreign subsidiary are acquired from a foreign associate or where business assets from foreign and domestic associates are acquired in an internal reorganisation after a global merger).

The above comments and examples seem to require two aspects to be present before debt deductions would be denied under 820-EAA, namely:

1. Some form of artificial nature to the transactions in question;
2. The targeted transactions are transactions not in the ordinary course of business.

This seems to provide a reasonable and balanced outcome in relation to how the new law could apply.

The actual legislation, however, contains no such specific requirements.

Rather, the effect of 820-423(2) linking back to the definition of CGT assets, without any exception for commercial transactions or restriction to apply to only artificial arrangements, would seem to capture any acquisition of assets from an overseas related party and not just assets acquired in major restructures or outside of the ordinary course of business.

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It would thus appear that any Australian importer/distributor/retailer/business that acquires trading stock or depreciating assets from an overseas related party would no longer be entitled to a deduction for interest costs arising in relation to the acquisition or holding of these assets.

These are genuine business transactions that need to be funded somehow. It does not seem appropriate that Australian taxpayers in this position will no longer be eligible for a tax deduction on interest. Furthermore, our understanding of the provisions are that it doesn't matter whether the debt in question comes from an associate or a 3rd party – it is the purpose to which the funds were put that is important, not the source of those funds.

That does not seem to present a balanced outcome and will certainly put subsidiaries of multinationals in a worse position than independent entities in the Australian market (who would be able to debt fund the holding costs of such assets) creating a competitive disadvantage for foreign owned subsidiaries.

To remedy this outcome, the legislation could be made to apply only to certain specified types of transactions (e.g. those in the EM), the legislation could carve-out the acquisition of trading stock/depreciating assets and/or some form of overarching purpose test could be introduced requiring an inherent element of avoidance or artificiality before the provisions are applicable

2. Retrospective effect

It appears that the legislation is being enacted without any grandfathering of existing arrangements.

This is problematic for various reasons including the general principle that laws should not be enacted with retrospective effect. Furthermore, it is not always practical to trace the source of funding going back potentially for a number of years to determine whether some or all of a borrowing is now in breach of a newly enacted provision. To require this sort of tracing exercise to be undertaken will cause significant difficulties for practitioners and taxpayers.

We would encourage the Committee to consider that these changes should only be applicable to new debt entered into after the commencement date of the new legislation.

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Should you have any queries on the above please do not hesitate to contact me on 8346 6000.

Yours sincerely,

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