

**SENATE ECONOMICS LEGISLATION COMMITTEE**

**TREASURY LAWS AMENDMENT (MAKING MULTINATIONALS PAY THEIR  
FAIR SHARE-INTEGRITY AND TRANSPARENCY) BILL 2023 [PROVISIONS]**

**ANSWERS TO QUESTIONS ON NOTICE**

**Agency:** Australian Taxation Office  
**Question:** Scale of the problem  
**Senator:** Senator Walsh

**Question:**

**CHAIR:** Thank you, Senator Smith. I might segue there with the ATO. Just briefly, do you have information that would help us understand the scale of the problem that this bill is trying to address? You just mentioned growth in debt creation schemes. Can you give us a sense of the ATO's understanding of the scale of the problem?

**Mr Kelly:** Certainly. We have a range of data on the operation of the current thin capitalisation rules. The one thing I would say about the debt creation rule is it hasn't been a feature of the Australian thin capitalisation regime, as Mr Robinson indicated, since 2001. The cases that we just referred to in response to Senator Smith sit in a slightly different category. But, in terms of actual data points, we have some around the operation of the current rules, but obviously they're the rules based on asset based tests rather than earnings based tests. If you think that would be of some assistance to the committee, we're happy to take that on notice.

**CHAIR:** Perhaps just more broadly on the scale of the problem that we're generally trying to address here, in terms of use of debt in this way for these sorts of deductions and the impact on base erosion, can the ATO expand on the problem there?

**Mr Kelly:** I wouldn't add too much more to my last answer, but I'll just check whether Mr Manley wanted to add anything further on that point.

**Mr Manley:** I think that that covers it. The only thing is that we can provide information and examples about structures that are of concern. If you're asking for data about tax risk, that might be a bit more challenging, but we can certainly provide examples of the structures that we would be worried about

**Answer:**

Australia's thin capitalisation rules as currently enacted do not address debt deduction creation arrangements. As such, we cannot provide a precise costing of the scale of the problem.

That said, there are many examples of transactions we are aware of to which the debt deduction creation rules may apply. *Taxpayer Alert TA 2016/10 Cross-Border Round Robin Financing Arrangements* ('the Alert') sets out three such examples – all of which involve related party transactions that increase debt deductions in Australia.

Example 1 in the Alert reflects a simplified version of the scheme *Orica Limited v FCT* ('Orica') [2015] FCA 1399; 2015 ATC 20-547. The scheme in *Orica* commenced in 2002, one year after the removal of the former Division 16G of the *Income Tax Assessment Act 1936* (ITAA 1936).

The Orica arrangement commenced in 2002 – one year after the former Division 16G of the Income Tax Assessment Act 1936 was repealed. The opportunity for entities to create debt after the repeal of former of Division 16G was explicitly recognised by tax advisors at that time.

It also should be noted that while the general anti-avoidance rule in Part IVA of the ITAA 1936 can apply and in some cases have applied to such transactions, Part IVA is a provision of last resort and is not suited to addressing specific areas of tax minimisation considered undesirable from a policy perspective.

Further, the Commissioner's discretion to apply Part IVA is subject to significant internal governance and assurance procedures. As such, for this and other reasons, preparing and running Part IVA cases is highly resource-intensive for both the ATO and taxpayers.

Beyond the Alert, below are two additional examples of a transaction the ATO has seen to which that the debt deduction creation rules may apply. The names and precise figures used in these examples have been altered to preserve taxpayer secrecy.

***Example 1: Australian reorganisation of global group with debt creation***

In 200X, MNE Co, the global parent company of the MNE group undertook an internal reorganisation. MNE Hold Co, a foreign subsidiary of MNE Co, held the Australian subsidiaries and other Asia-Pacific subsidiaries. Those subsidiaries were transferred to a newly created Australian subsidiary of MNE Hold Co through a 'top-hatting' arrangement. The relevant steps were:

**Step 1.** MNE Hold Co establishes MNE AU New Co, a new Australian subsidiary, injecting equity of AUD \$1.5 billion.

**Step 2.** MNE AU New Co borrows \$2.5 billion loan from MNE Co to fund the internal reorganisation.

**Step 3.** MNE Hold Co transfers all of its Australian and Asia-Pacific subsidiaries to MNE AU New Co. The market value of all subsidiaries transferred is \$4 billion.

This arrangement created debt deductions from \$2.5 billion of related party debt created in Australia under Step 2. The interposition of a holding company is commonly used to increase debt deductions.

This example demonstrates a kind of debt creation arrangement where the Australian debt created is not referable to any global debt at the parent level or any new investment in investment in the Australian operations.

***Example 2: Global acquisition with subsequent debt creation in Australia***

In 201X, foreign-headquartered global group, XYZ acquired another foreign-headquartered global group, ABC. One of the offshore subsidiaries in the XYZ group is XYZ Treasury.

At the time of the acquisition, ABC included Australian subsidiary companies (for this purpose collectively called ABC Australia). Through the global acquisition, ABC Australia became owned and controlled entities of XYZ. The relevant acquisition steps were:

**Step 1.** XYZ acquires ABC by having XYZ Treasury acquire ABC for USD \$5 billion.

**Step 2.** Four months after the global acquisition, XYZ internally restructured. As a result, XYZ's pre-acquisition Australian subsidiary company (XYZ Australia) acquired its now related Australian subsidiaries, ABC Australia (valued at AUD \$1.5 billion).

**Step 3.** XYZ Australia funds the acquisition of ABC Australia by borrowing AUD \$1.5 billion from a foreign subsidiary of XYZ, XYZ Treasury.

The result of the internal restructure creates debt deductions relating to the \$1.5 billion in related party debt created in Australia under Step 3.

This example demonstrates a kind of debt creation arrangement that can arise in the course of an offshore merger or acquisition transaction that does not involve the need for any new investment in the Australian operations. Debt creation arrangements are commonly put in place in order to be able to claim a higher level of Australian debt deductions under the 'thin capitalisation' limit, rather than for commercial purposes.