

**Senate Economics Legislation Committee
Treasury Laws Amendment (2023 Measures No. 1) Bill 2023**

ANSWERS TO QUESTIONS ON NOTICE

Agency: Australian Taxation Office
Topic: Potential for shifting debt
Senator: Senator McKim

Question:

Senator McKIM: I know that we're under some time pressure, so could I just ask the ATO please, on notice, to commit to reading the submissions that have raised the potential for a shift to debt funding to result in an increase in tax avoidance and come back to the committee with a response to those concerns on notice?

Mr Webrik: We can do that.

Answer:

One issue raised in submissions is that the measure proposed in Schedule 5 (the measure) will lead to more debt funding (so as to be outside the scope of the measure) and that this in turn results in an increase in tax avoidance.

From the ATO's perspective, the proposition that this measure will have a material impact on increasing debt levels is highly contestable at best. Further, even if it were so, a shift to debt funding does not necessarily result in more tax avoidance.

Firstly, a company that needs additional capital has no obligation to pay discretionary dividends that would exacerbate this need.

Secondly, even if a dividend was paid the decision to fund by equity or debt is an important one for a company, and will usually encompass broader commercial considerations. The measure requires all relevant circumstances of a company paying a distribution to be taken into account in determining whether the purpose and effect of a capital raising is to fund a distribution. Companies that undertake capital raisings which have material economic or commercial consequences beyond the mere funding of a distribution are not expected to be caught by the measure. This was a matter set out in the ATO's Taxpayer Alert TA 2015/2 and is reflected in proposed section 207-159.

More broadly, we observe that the ability to frank and pay franked distributions is only one of several factors that entities take into account when making decisions about whether to fund their operations with debt or equity. In particular, the cost of debt versus the cost of equity will ordinarily be a significant factor.

Thirdly, the measure is expected to have limited application in practice even if there is a capital raising that involves issuing equity. Based on the ATO's experience of reviewing many corporate capital raising arrangements, in our view the measure would have very limited application to distributions which are not otherwise covered by the exception for those paid as part of an established practice.

Fourthly, to the extent that the submissions suggest that more debt funding leads to more interest deductions in the system which leads to greater opportunities to reduce or avoid tax, the ATO notes that there are already a number of anti-avoidance rules in the tax law which companies need to consider when undertaking corporate funding and distribution transactions. This includes anti-streaming rules, thin capitalisation rules, transfer pricing rules and the general anti-avoidance rule. We do not see a link between this measure and any current risks with interest deductibility that may be present in the system.

For completeness we note that from a compliance perspective, due to ongoing investments by Government in the Tax Avoidance Taskforce, the ATO is well placed to detect and address tax avoidance matters. The Tax Avoidance Taskforce has been successful in addressing profit shifting arrangements involving financing arrangements with notable Court victories such as that in Chevron case. To date the Taskforce has raised \$19.1B in liabilities.