ACTU Ref: D08 2023

Joint Parliamentary Committee on Corporations and Financial Services

Inquiry into Corporate Insolvency in Australia

Question 2

Question on notice Senator SCARR: Alright, I will. I'll move to capital adequacy. To give you an insight into my background, I used to be a company secretary in a mid-tier mining company. I was involved in setting up a lot of subsidiaries for overseas investments et cetera, so I've got some real working knowledge in relation to the sorts of issues that go into capital adequacy, and I understand the point which you're making. I absolutely understand the point. Feel free to take some of these questions on notice. One of the handbrakes, if you like, stopping Australian subsidiaries of overseas corporations, and it occurs when Australian companies invest overseas, are taxation rules relating to thin capitalisation—which basically means you can't get a deduction for loans unless you've got sufficient capital invested in the company. Has the ACTU considered how the operation of those thin capitalisation rules in practice may assist in making sure that operating subsidiaries, particularly of companies, have a significant level of capital? Does that give you some comfort?...Senator SCARR: I'll ask you to take this on notice. Again, it might have been touched on. This has been a very successful inquiry so far. There have been lots of submissions received so there might have been some discussion of this in some of the other submissions—I'm just trying to remember—from the AMWU, ETU, CFMMEU and others. It would be helpful for me if you could provide on notice some examples or case studies of things which have happened in practice where these specific issues have arisen, just to perhaps give me and other members of the committee a greater appreciation of what it is that we should be reflecting on in order to stop illegitimate practices. Would that be possible?

ACTU Response: We thank Senator Scarr for his question. The thin capitalisation rules, as the Senator correctly points out, go to the deductibility of interest costs associated with loans taken out by an onshore subsidiary. However these rules only have implications for firms with interest expense claims that exceed the threshold (ie greater than $2million). In this context the thin capitalisation rules do not apply to onshore subsidiary companies that seek a deduction below the amount and/or have incurred significant liabilities using letters of comfort from a foreign parent or related foreign entity. The thin capitalisation rules do not prevent the foreign parent or related foreign entity withdrawing the letter of comfort at any time to avoid onshore liabilities. The most infamous case of such a withdrawal was in the 1998 collapse of Cobar Mines Pty Ltd where the foreign parent Ashanti Goldmines withdrew its letter of comfort just prior to Cobar's insolvency (see Australian Financial Review 1998, ASC examines Cobar collapse, February 19, reporter Bill Pheasant; ASIC deal for Cobar copper miners, December 8, reporter Katherine Murphy; Arch Bevis (1999) House of Representatives, Matters of Public Importance: Industrial relations – employee entitlements, 22 June 1999). More broadly letters of comfort issued by foreign parents were the subject of a recent article in the Insolvency Law Bulletin (October 2021). That article reviewed another relevant case - Gate Gourmet Australia Pty Ltd (In Liquidation) v Gate Gourmet Holding AG where the parent walked back from commitments it provided in a letter of comfort. Failures of local arms of foreign parents are not atypical. For example the CFMMEU in its submission to the Joint Committee overviewed the Probuild case where the foreign parent refused to cover losses incurred by its onshore subsidiary. Lastly thin capitalisation rules do not assist where parent or related entities are domiciled in low transparency jurisdictions or in jurisdictions where the cost and time involved in holding foreign companies and directors to their word are prohibitive. Webs of related undercapitalised entities that extend across national borders are a feature of industries such as cleaning, security, and horticulture that are heavily reliant on tiered labour supply chains using workers on temporary visas.

ENDS