

Contact

Muhunthan Kanagaratnam
T +61 2 9263 4184
mkanagaratnam@gtlaw.com.au



L 35, Tower Two, International Towers Sydney
200 Barangaroo Avenue,
Barangaroo NSW 2000 AUS
T +61 2 9263 4000 F +61 2 9263 4111
www.gtlaw.com.au

13 April 2023

By email: MNETaxIntegrity@treasury.gov.au

International Tax Unit
Corporate and International Tax Division
Treasury
Langton Cres
Parkes ACT 2600

Multinational Tax Integrity – strengthening Australia's interest limitation (thin capitalisation) rules

Gilbert + Tobin wishes to comment on Treasury's exposure draft, *Treasury Laws Amendment (Measures for Future Bills) Bill 2023: Thin capitalisation interest limitation* (the **Exposure Draft**) and welcomes further consultation and discussion on the Exposure Draft.

We are aware there are concerns with the Exposure Draft beyond those that we have set out in our submissions below. We leave others to raise those concerns, and have focused on those that are specific to transactions and within our expertise.

1 About Gilbert + Tobin

Gilbert + Tobin is recognised as a leading transactions, regulatory and disputes law firm. We handle some of the most complex transactions in Australia and we are trusted by clients on sensitive regulatory investigations and approvals, litigation and Royal Commissions.

We advise on a broad range of tax matters, including structuring cross-border investments and financing. We draw on our extensive experience in these areas in making this submission.

2 Commencement date (item 62 of the Exposure Draft)

The announced commencement date for the measures in the Exposure Draft of 1 July 2023 is too soon given the measures do not grandfather existing arrangements and result in significant adverse implications for many classes of taxpayers.

We submit that the commencement date should be deferred until after a considered bill is introduced in Parliament.

3 Deduction for financing costs incurred in connection with deriving income that is non-assessable non-exempt income under section 768-5 (items 1 and 2 of the Exposure Draft)

We submit that the amendments proposed by items 1 and 2 of the Exposure Draft should be omitted. The proposed amendments are contrary to the policy behind the introduction of section 25-90 of the

Income Tax Assessment Act 1997 (Cth) (**1997 Act**), and that policy remains equally (if not more) applicable now given the broader changes to the thin capitalisation regime in the Exposure Draft.

Alternatively, debt financing that is in place at the time the Bill introducing the measures in the Exposure Draft (the **Bill**) should be grandfathered until a refinancing or other material change to the terms (other than merely to the interest rate and other financing costs) of that debt financing.

Section 25-90 (and ultimately section 230-15 of the 1997 Act) was originally introduced in 2001 when the thin capitalisation rules were broadened:

- 1 to capture all debt, not merely foreign related party debt; and
- 2 to extend the rules from just in-bound investors to outbound investors.

The introduction of section 25-90 was a deliberate policy choice made at that time to counterbalance the widening of the scope of the thin capitalisation rules and to ease administration by removing the then quarantining and carry forward rules. The introduction of section 25-90 was recommended by the [Review of Business Taxation \(Ralph review\)](#) (recommendation 22.6) in 1999. It is also consistent with the objective of encouraging the use of Australia as an international holding company jurisdiction.

In rejecting the 2013-2014 Budget proposal to deny the deduction, the then recently elected Liberal government [observed](#) in 2013:

The Coalition will not proceed with Labor's proposal to deny deductions made under section 25-90 of the Income Tax Assessment Act 1997 because the revenue is essentially unrealisable and it would impose unreasonable compliance costs on Australian businesses.

The explanatory memorandum to the Exposure Draft does not establish:

- 1 why a deliberate counterbalancing policy decision should be reversed when the thin capitalisation rules are being tightened further under the Exposure Draft;
- 2 how the concerns regarding realisation of revenue and unreasonable compliance costs are addressed;
- 3 how previous practices that enabled a deduction for interest would be avoided going forward;
- 4 why those practices are better than the explicit and clear deduction afforded by sections 25-90 and 230-15; and
- 5 the loss to the Australian economy as a result of the removal of deliberate policy measures aimed at encouraging the use of Australia as an international holding company jurisdiction.

For more than 20 years, businesses have structured their international affairs with the certainty afforded by sections 25-90 and 230-15. If the Exposure Draft becomes law, it will adversely affect the economics of many such structures. The Exposure Draft should have ameliorating measures, such as grandfathering of existing debt until debt is refinanced or there is other material change to the terms of the debt (other than interest rates and other financing costs). Although this has the potential to create some inequity, this will generally only be for a limited time as businesses regularly refinance debt. Taxpayers will have regard to the impact of the Exposure Draft when looking to refinance their debt.

4 Adjustment in working out allocable cost amounts (items 3, 4 and 5 of the Exposure Draft)

In our experience, purchasers of companies do not factor in a dollar for dollar payment for tax attributes into their pricing decision. Whilst some transactions may take into account a value for tax losses, other tax attributes are generally not taken into account in pricing at all. The adjustments made by the consolidation rules for tax attributes are inequitable and do not reflect the reality of transaction pricing. This should not continue to be perpetuated by introducing new adjustments.

We submit that no adjustment should be made on account of brought forward FRT disallowed amounts to the calculation of allocable cost amounts. The amendment proposed by item 5 of the Exposure Draft should be omitted.

5 Thin capitalisation measures (item 12 of the Exposure Draft)

Investment decisions have been made by businesses based on the thin capitalisation rules in existence at the time of the investment. The proposed measures in the Exposure Draft will adversely affect the commercial returns from some of these investments. This will particularly be the case for investments geared to the existing maximum permitted levels or that rely on the alternative arm's length debt test or worldwide gearing test.

We submit that the entire suite of thin capitalisation measures in the Exposure Draft should not apply to debt financing that is in place at the time the Bill is introduced until a refinancing or other material change to the terms (other than merely to the interest rate and other financing costs) of that debt financing. We acknowledge the formulation of this grandfathering requires further consideration.

An alternative approach could be a phased introduction of the measures over, say, five years, which would allow a more orderly reorganisation of investments, including to address other concerns with the proposed measures (such as those discussed below in relation to associate entities). Such an approach will also provide time for some investments to be disposed of altogether – for typical private equity investments, a five to seven year phase-in will cover a full investment cycle.

6 Associate entity (proposed section 820-43(6), item 12 of the Exposure Draft)

The broadening of the concept of an “associate entity” to capture entities with TC control interests of 10% or more should be omitted.

The proposed change gives rise to adverse and impractical issues. Some of these include:

- 1 A taxpayer will be required to determine whether each of its shareholders with a TC control interest of 10% or more has a TC control interest of 10% or more in another taxpayer. There is no compulsion on the shareholder to provide that information, nor is there any compulsion on the other taxpayer to provide that information to a minority shareholder. The Exposure Draft seems to assume there is perfect access to information when there is not because of the very low ownership interests involved.
- 2 Even if there is the ability to obtain such information, the two taxpayers may be, in business and practical senses, completely unrelated other than because of a small, common shareholding by a third party. It is not appropriate for one such taxpayer to be affected by decisions made or not made by the other taxpayer.

- 3 This position is exacerbated where the other taxpayer is not subject to the thin capitalisation rules.

In lowering the threshold, consideration should also be given to the common ownership of interests in multiple taxpayers by entities such as venture capital fund entities, private capital and custodians. These entities may own small parcels of interests in many businesses, which will be treated as associates under the proposed measures despite their lack of a connection otherwise.

We hope these submissions are of assistance to Treasury.

Yours sincerely
Gilbert + Tobin

A handwritten signature in black ink, appearing to read 'Muhunthan Kanagaratnam'.

Muhunthan Kanagaratnam
Partner
+61 2 9263 4184
mkanagaratnam@gtlaw.com.au