



Centre for  
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Corporate Tax  
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## **Centre for International Corporate Tax Accountability & Research and Tax Justice Network - Australia Joint Submission on Multinational Tax Integrity – strengthening Australia's interest limitation (thin capitalisation) rules**

**13 April 2023**

The Tax Justice Network Australia (TJN-Aus) and the Centre for International Corporate Tax Accountability and Research (CICTAR) welcome this opportunity to make a joint submission to the consultation on strengthening Australia's interest limitation (thin capitalisation) rules.

Ensuring multinationals pay a fair share of corporate income tax is necessary for the broader integrity of the tax system and to level the playing field for all businesses, particularly small and medium-sized enterprises. In addition to direct efforts to close loopholes for multinational tax avoidance and raise revenues for public services, we note that transparency efforts can increase corporate income tax revenue by shifting corporate behaviour and public attitudes towards fair taxation. Since the COVID-19 global pandemic, there has been a growing awareness of the essential need for well-funded public health systems and an understanding that additional revenues will be needed to pay for the increased government support provided to the community through the pandemic. There is also growing awareness that increased public investments are required for aged care, early childhood education, disability services and income support and that these investments will create a better society and stronger economic future for all. Increasing income tax revenues from multinationals is essential to the solution and increasing fairness and broad-based economic growth.

TJN-Aus and CICTAR welcome this and other proposed multinational tax reforms from the Commonwealth Government but continue to strive for broader reforms to national and international tax systems, including towards a unitary tax system and away from the arm's length principle.

The Exposure Draft Explanatory Memorandum noted that "excessive interest deductions (or debt deductions) pose a significant risk to Australia's domestic tax base." The risk particularly applies where a corporation creates an arrangement to make interest repayments on a debt it owes to itself (through a subsidiary located in a low tax secrecy

jurisdiction). When a corporation can finance an investment through equity, laws that allow it to make a loan to itself for the purpose of being able to claim interest repayments as a tax deduction operate effectively as a tax concession to the corporation. As the Explanatory Memorandum notes, the OECD has observed that "the use of third party and related party interest is perhaps one of the simplest of the profit-shifting techniques available in international tax planning. The fluidity and fungibility of money makes it a relatively simple exercise to adjust the mix of debt and equity in a controlled entity."

The submitting bodies continue to be concerned that allowing interest repayments to related parties has been misused by corporations as giving them an acceptable limit of tax avoidance they are allowed to engage in through artificial debt loading through intra-party loans. In other words, the corporation makes a loan it does not need, as the financing in question could be provided through equity, from a low-tax jurisdiction for the primary or sole purpose of avoiding paying tax in Australia through being able to claim interest repayments to itself as a tax deduction.

As per our previous submission, we strongly recommend that the Group Ratio Rule should be regarded as the primary rule for entities that are members of a relevant worldwide group, and if a fixed cap is offered as an alternative, it should be set low. MNEs should only be allowed to claim their actual interest expense to third parties as a tax deduction, no more and no less. There is plenty of evidence of significant variations of gearing between different business sectors and companies in the same sector. Evidence of the variation was provided in a study by PwC included in the comments by the Business at OECD (BIAC) on the BEPS Action 4 discussion draft.<sup>1</sup> Hence, the best and fairest method to accommodate interest payments as deductions is a Group Ratio Rule, as was recommended in Action 4 of the BEPS project in 2015.

We are disappointed the fixed ratio test will be set to allow claiming net debt deductions up to 30% of tax EBITDA, as we would have preferred to see a lower ratio. As we previously noted, a PwC study showed that 55% to 61% of businesses had interest expenses less than 10% of EBITDA. Only 17% to 22% had a ratio of over 30%.<sup>2</sup> Those with debt deductions of greater than 30% would include those with artificial debt arrangements designed to shift profits, so the proportion with genuine debt deductions of greater than 30% of EBITDA would be lower than that found in the PwC study.

Carry forward of interest payments that exceed the EBITDA ratio should not be permitted unless they are assessed by the third-party debt test to be attributable to genuine third-party debt, which is used wholly to fund Australian business operations. The inclusion of a carry-forward provision of excessive debt deductions does not curb profit-shifting losses from government tax revenue. It spreads the losses to government revenue into future years. Thus, the carry forward provision does not address the stated aim of the legislation to address the significant risk to Australian Government revenue from excessive interest and debt deductions. If carry forward of excessive debt deductions is to be allowed, then the case is strongest for smaller corporations that can have volatility in an investment that carries higher business risk, such as the development of a mine. Thus, any carry forward provision should not be allowed for significant global entities as defined under Subdivision 960-U of ITAA 1997.

We welcome the external third-party debt test to replace the existing arm's length debt test for 'general class investors' and financial entities.

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<sup>1</sup> BIAC comments on Discussion Draft on BEPS Action 4 (February 2015), Part 1, 136.

<sup>2</sup> BIAC comments on Discussion Draft on BEPS Action 4 (February 2015), Part 1, 136.

We welcome that a general class investor and all of its associate entities must make a mutual choice to use the third-party debt test if any one of those entities wishes to use that test. We agree that the safeguard is needed to ensure that general class investors and their associates cannot structure their affairs in a way that allows them to artificially maximise their tax benefits by applying a combination of different thin capitalisation tests.

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## **Background on the Centre for International Corporate Tax Accountability & Research (CICTAR)**

CICTAR is a global corporate tax research centre that produces information and analysis to untangle the corporate tax web. The Centre is a collective resource for workers and the wider public to understand how multinational tax policy and practice affects their daily lives. CICTAR's work supports public participation in the tax debate so that everybody can take part in decision-making that affects their communities.

For more information, visit the CICTAR website here: <https://cictar.org/>

## **Background on the Tax Justice Network Australia**

The Tax Justice Network Australia (TJN-Aus) is the Australian branch of the Tax Justice Network (TJN) and the Global Alliance for Tax Justice. TJN is an independent organisation launched in the British Houses of Parliament in March 2003. It is dedicated to high-level research, analysis and advocacy in the field of tax and regulation. TJN works to map, analyse and explain the role of taxation and the harmful impacts of tax evasion, tax avoidance, tax competition and tax havens. TJN's objective is to encourage reform at the global and national levels.

The Tax Justice Network aims to:

- (a) promote sustainable finance for development;
- (b) promote international cooperation on tax regulation and tax-related crimes;
- (c) oppose tax havens;
- (d) promote progressive and equitable taxation;
- (e) promote corporate responsibility and accountability; and
- (f) promote tax compliance and a culture of responsibility.

In Australia, the current members of TJN-Aus are:

- ActionAid Australia
- Aid/Watch
- Anglican Overseas Aid
- Australian Council for International Development (ACFID)
- Australian Council of Social Service (ACOSS)
- Australian Council of Trade Unions (ACTU)
- Australian Education Union (AEU)
- Australian Manufacturing Workers Union (AMWU)
- Australian Nursing & Midwifery Federation (ANMF)
- Australian Services Union (ASU)
- Australian Workers Union, Victorian Branch (AWU)
- Baptist World Aid
- Caritas Australia
- Centre for International Corporate Tax Accountability & Research (CICTAR)
- Community and Public Service Union (CPSU)
- Electrical Trades Union, Victorian Branch (ETU)
- Evatt Foundation
- Friends of the Earth (FoE)
- GetUp!
- Greenpeace Australia Pacific
- International Transport Workers Federation (ITF)
- Jubilee Australia
- Maritime Union of Australia (MUA)
- National Tertiary Education Union (NTEU)
- New South Wales Nurses and Midwives' Association (NSWMWA)
- Oaktree Foundation
- Oxfam Australia
- Save the Children Australia
- Save Our Schools
- SEARCH Foundation
- SJ around the Bay
- Social Policy Connections
- TEAR Australia
- The Australia Institute
- Union Aid Abroad – APHEDA
- United Workers' Union (UWU)
- Uniting Church in Australia, Synod of Victoria and Tasmania
- UnitingWorld
- Victorian Trades Hall Council
- World Vision Australia