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30 October 2023

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

Dear Sir/Madam,

EXPOSURE DRAFT - MULTINATIONAL TAX INTEGRITY – STRENGTHENING AUSTRALIA'S INTEREST LIMITATION (THIN CAPITALISATION) RULES

BDO refers to the invitation by the Treasury to provide comments on the second exposure draft parliamentary amendments Bill (**exposure draft**) and accompanying supplementary exposure draft Explanatory Memorandum (**supplementary EM**) to the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023* (**Bill)** and accompanying Explanatory Memorandum (**EM**).

BDO is pleased to provide feedback and comments in relation to the exposure draft. While it was pleasing to see some of the feedback provided by the Australian tax community in response to the Senate Economics Legislation Committee (**Senate Committee**) inquiry being reflected in the exposure draft, there are some further important matters that require consideration prior to finalising the legislation. In summary, BDO's comments and suggestions for changes to improve the exposure draft are (see Appendix 1 for more details:

- Debt Deduction Creation Rule
    - Subsection 820-423A(5) under the Debt Deduction Creation rule should be amended to exclude payments for the acquisition of new membership interests in entities (i.e. for the issue of new shares). Without this amendment, the exception in proposed section 820-423AA(1)(a) will be ineffective in excluding such payments from the debt creation rules because subsection 820-423A(5) will also apply to such payments for the issue of the shares because the proposed exception in proposed subsection 820-423A(5) only applies for subsection 820-423A(2). This appears to make the exception in proposed subsection 820-423AA(1)(a) ineffective for the purpose identified in the Supplementary EM. BDO's detailed comments in this regard are in the attached Appendix 1.
    - Third-party Debt Test

      We welcome the exposure draft amendments to the third party debt test (TPDT) conditions in s820-427A(3)(c) wherein the holder of the debt interest being tested can now have recourse to the various Australian assets of the group.:

However, our concern is that as there is no definition of 'recourse' which means that in some situations the TPDT may be very difficult to apply or may not be available at all.

Please see the Appendix 1 for details of an example where a 'featherweight floating charge' over certain foreign assets can only be subject to recourse by the lender if the Australian owner went into administration.

Should you have any questions, or wish to discuss any of the comments made in our submission, please do not hesitate to contact me on 02 9240 9736 or lance.cunningham@bdo.com.au.

Yours sincerely

Lance Cunningham

Digitally signed by Lance Cunningham
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Lance Cunningham

BDO National Tax Technical Leader

APPENDIX 1

BDO Submission to the Treasury
Exposure draft - Multinational tax integrity – strengthening Australia's interest limitation (thin capitalisation) rules

Debt Deduction Creation Rules

Debt deduction limitation rule - s820-423A

The supplementary exposure draft Explanatory Memorandum (**supplementary EM**) explains at paragraph 1.35 that:

> *There are now three exceptions to the condition provided by paragraph 820-423A(2)(a) (about the acquisition of an asset from an associate pair):*
>
> - *The acquisition of a new membership interest in an Australian entity is disregarded. Additionally, the acquisition of a new membership interest in a foreign entity that is a company is disregarded.*
>
> - *The acquisition of certain new tangible depreciating assets is disregarded. This exception is broadly intended to allow an entity to bulk-acquire tangible depreciating assets on behalf of its associate pairs.*
>
> - *The acquisition of certain debt interests is disregarded. This is a technical exception which ensures that mere related party lending is not caught by the rules. This exception only relates to 820-423A(2) and* ***not 820-423A(5)****.*
>
> ***[Amendment 60, section 820-423AA]***

However as the provisions are drafted in proposed section 820-423AA(1) regarding *Acquisition of new membership interests in entities* (below), the exception in section 820-423AA(1) only has implications for paragraph 820-423A(2)(a):

> **820-423AA Exceptions for acquisition of certain CGT assets**
>
> *Acquisition of new membership interests in entities*
>
> 1) For the purposes of paragraph 820-423A(2)(a), the acquisition of a *CGT asset is covered by this section if:
>
> (a) the CGT asset is a *membership interest in:
>
> (i) an *Australian entity; or
>
> (ii) a *foreign entity that is a company; and
>
> (b) the membership interest has not previously been held by any entity.

The supplementary EM makes it clear that the exception in proposed section 820-423AA(1) is there to ensure the mere related party lending to acquire certain new membership interests (e.g. the issue of

new shares) is not caught by the debt deduction creation rules. However, BDO is concerned that this exception does not seem to work because subsection 820-423A(5) is specifically excluded from this exception. Also the wide meaning of 'payment' in subsection 820-423A(5) could include a payment for the issue of new shares which may have the effect of undoing the proposed exception in relation to a debt interest issued to an associate pair. This appears to completely contradict the comments in the supplementary EM at paragraph 1.35 (i.e. '*Additionally, the acquisition of a new membership interest in a foreign entity that is a company is disregarded')*.

BDO suggests that the fix to this appears to be an amendment to subsection 820-423A(5) that excludes payments for the issue of new shares.

Third party debt test

Lender recourse to assets

We welcome the exposure draft amendments to the third party debt test (TPDT) conditions in s820-427A(3)(c) wherein the holder of the debt interest being tested can now have recourse to the following kinds of assets without there being a failure of the TPDT conditions:

> *'(c) the holder of the debt interest has recourse only to assets of the following kind for payment of the debt to which the debt interests relates:*
>
> *i. Australian assets held by the entity;*
>
> *ii. Australian assets that are *membership interests in the entity (unless the entity has a legal or equitable interest, whether directly or indirectly, in an asset that is not an Australian asset);*
>
> *iii. Australian assets held by an *Australian entity that is a *member of the *obligor group in relation to the debt interest;*
>
> *(ca) none of the assets mentioned in paragraph (c) are rights under or in relation to a guarantee, security or other form of credit support;'*

However, our concern is that as there is no definition of 'recourse' which means that in some situations the TPDT may be very difficult to apply or may not be available at all.

For example, there is an issue which arises in respect of the above condition in s820-427A(3)(c), where an Australian group owns foreign membership interests in several foreign entities but the Australian companies in the group do not own any other foreign assets.

Under the loan agreement, the foreign companies in the accounting group are 'Excluded Subsidiaries'. This means the starting point is that the lender does not have recourse to the shares in those companies or their assets where there is a default etc.

However, the Excluded Subsidiaries shares are subject to a 'featherweight floating charge' to cater for creditor's administration risk (i.e. to permit creditors to enforce security without obtaining written consent of administration or with leave of the court). The featherweight floating charge will float over the excluded assets and shall not fix on them and cannot be enforced unless and until the Australian companies in the group that are the direct owners of the foreign shares go into administration. Until such a point that these entities go into administration creditors would have no recourse over those

‘Excluded Assets’. For example, should companies in the group default on the debt but the ‘Excluded Subsidiaries’ are not in administration, recourse could not be had to the foreign shares/assets.

We would suggest that in this circumstance the featherweight floating charge should be disregarded in determining whether the lenders have recourse only to Australian asset. Our argument is based on the fact that recourse over the non-Australian assets is contingent on the borrower entering administration. There is no recourse over the non-Australian assets until such a time as these entities enter administration. Therefore, on the basis that neither companies have or will enter administration during the 2024 income year, we consider that the lenders should not be considered to have recourse to non-Australian assets.