MinterEllison.

30 October 2023

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

By email: MNETaxIntegrity@treasury.gov.au

Dear Sir / Madam

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

MinterEllison welcomes the opportunity to make a submission to Treasury in relation to the second Exposure Draft of the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share—Integrity and Transparency) Bill 2023* issued on 18 October 2023 (**Amending Bill**).

We have received feedback from our clients in relation to the draft amendments in the Amending Bill and provide the following comments.

Calculation of Tax EBITDA - Trusts

1. We welcome the addition of proposed sections 820-52(1)(ca) and 820-60 to provide for the transfer of excess tax EBITDA amounts by a unit trust to its unitholders. This is a welcome progression from the position adopted at pages 92-93 of the Explanatory Memorandum to the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share—Integrity and Transparency) Bill 2023*.

2. It is submitted that the method statement in proposed section 820-60 could be clarified, particularly in relation to the drafting of Step 2(b), which refers to adding the 'amounts', as it is unclear which *amounts* are required to be added.

3. Separately, it is submitted that restricting the excess push up to circumstances where there is a *TC direct control interest* of 50% or more interest in the trust can lead to some anomalous outcomes where there is a stake in the trust of between 10% and <50%. This is because such trusts will not be permitted to transfer the excess up the chain, whereas:

   (a) entities that hold less than 10% of the trust should generally be permitted to include trust distributions in their tax EBITDA calculation; and

   (b) subject to the Amending Bill proceeding, entities that hold 50% or more of the trust should benefit from the excess tax EBITDA transfer calculation.

4. The above is particularly problematic in circumstances where there are consortiums which have multiple members (e.g. three members with one-third of the venture each).

5. No policy basis for this position is outlined in the Explanatory Memorandum to the Amending Bill.

6. It is submitted that the excess should apply to all holding structures where the next tiered holder has a non-portfolio interest (i.e. 10% or more), which ties in with the *associate entity* definition. Distributions where there is a portfolio holding will continue to be included.

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Calculation of Tax EBITDA – Partnerships

7. We observe that the comments at pages 92-93 of the Explanatory Memorandum to the Bill also recognised that similar issues to those above regarding trusts arise in relation to interests of a taxpayer in partnerships.

8. We submit that it would be appropriate for a similar solution as above to be applied to partnerships, to enable Australian resident partnerships to transfer excess tax EBITDA amounts to partners of those partnerships.

9. The extension of the excess push up mechanisms to partnerships should not pose any additional integrity issues if it is aligned with the finalised unit trust position, whereas the absence of provisions dealing with partnerships in the current Amending Bill provide an inappropriate detriment to partnership structures. This is particularly important given the tax law's expansive definition of partnerships to include certain joint ventures.

10. We would submit that a partnership excess push up rule should be included.

11. Further, consistent with our observations above in relation to trusts, it should apply to all partnerships in which the partner has at least a 10% interest.

Third party debt test (TPDT)

12. The broadening of the asset recourse provisions in proposed section 820-427A(3)(c) is welcome. However, it is submitted that the Amending Bill will still produce anomalous outcomes and significant compliance difficulties, resulting in a number of genuine third party debts failing to qualify as *third party debt* for the purposes of section 820-427A.

13. In particular, we observe:

    (a) paragraph 820-427A(3)(c) retains its prohibition against the inclusion of any foreign assets in the security pool; and

    (b) paragraph 820-427A(3)(ca) retains its prohibition against recourse to any guarantee or credit support.

Security pool includes foreign assets

14. We submit that there is still an obvious issue in how the test operates where a borrower or obligor group has both Australian and non-Australian assets (e.g. a foreign permanent establishment or foreign subsidiaries).

15. We expect that lenders would ordinarily seek to have recourse over all assets held by a particular entity or entities, whether or not those assets are located in Australia. Given this, the TPDT may still be unavailable to borrowers unless lenders forgo security over non-Australian assets, even where the quantum of the foreign assets are low relative to the Australian assets. This can add significant compliance costs and delays in negotiating debt security packages, particularly where the foreign assets do not represent a significant portion of the underlying asset pool.

16. We submit that this condition should be removed, or a *de minimis* be introduced permitting recourse to foreign assets where, for example, the value of those assets is less than 25% of the security pool. Such a de minimis based on value is already a part of Division 820 – see the Australian net assets test in existing section 820-37 of the ITAA97.

Guarantee or credit support

<u>Definition of "Moveable Property"</u>

17. We observe that the Bill's prohibition on recourse to credit support rights is maintained, subject to the limited exception where the rights relate wholly to the creation or development of a CGT asset relating to Australian real property.

18. The Amending Bill slightly broadens this exclusion so that it also applies to '*moveable property*' where that moveable property is incidental to and relevant to the ownership and use of the land, and is situated on the land for the majority of its useful life.

19. We submit that these concepts need further illustration in the explanatory materials. They appear to be consistent with the language in section 102MB(1)(a) of Division 6C of the ITAA36, but those provisions are in the context of a safe harbour in relation to a trust's trading activities. We submit it would be of assistance to include additional analysis in the explanatory materials which makes it clear whether Parliament's intention is to import these concepts from Division 6C into Division 820.

Provision goes beyond the stated goal of preventing "debt dumping"

20. The Explanatory Memorandum explains that the retention of the general prohibition on guarantees and credit support ensures that multinational groups do not have an unfettered ability to 'debt dump' third party debt in Australia that is recoverable against the global group.

21. As drafted, we submit that paragraph 820-427A(3)(ca) goes beyond this stated goal. For example, it does not require that the guarantee or credit support be offered by a *parent entity*. This provision can, on its face, inappropriately apply where the guarantee or support is offered by an Australian subsidiary.

22. By way of example, if an Australian consolidated group (**AusCo TCG**) held 90% of the shares in an entity of substance (**SubCo**) and SubCo guaranteed the debt, then this would mean that the debt is ineligible to be a third party debt.

23. This appears to be an inappropriate outcome given the structure of the borrowing group. Accordingly, we submit that either paragraph 820-427A(3)(ca) should be removed entirely, or it should be amended to permit guarantees of the kind which do not permit debt dumping.

24. One way in which this proposal could be implemented with minimal additional drafting is to deem a debt to qualify as a third party debt if the debt is the subject of a section 128F or section 128FA public offer, even if there is a parental guarantee involved.

Facilities negotiated prior to the new laws

25. Existing arrangements negotiated prior to the issue of the first Exposure Draft were negotiated in an environment in which it was not known or expected that the grant of guarantees or credit support would impact on the availability of the TPDT.

26. It is submitted that a transitional rule should apply permitting entities that entered into arrangements prior to 22 June 2023 to disregard paragraph 820-427A(3)(ca) either while the relevant instrument remains in place, or, for simplicity, for a period of 5 years.

27. This will ensure that these arrangements do not have to be re-negotiated in a rushed process and a challenging economic environment.

28. It will also give borrowers who are otherwise subject to significant break fees the opportunity to avoid having to incur those break fees (and additional fees associated with entry into new facilities) as a result of a change in tax law which was not necessarily able to be anticipated when the break fees were agreed.

Debt deduction creation rules

Grandfathering of existing debts

29. While we welcome the introduction of a 'grace period' in relation to the debt deduction creation rule (**DDCR**), it continues to have retrospective effect and we submit that it remains inappropriate to retrospectively deny interest deductions in relation to financial arrangements which were entered into prior to the announcement of the DDCR and which may operate for a considerable period of time.

30. There are a number of situations in which this outcome is particularly inappropriate, in relation to which specific grandfathering provisions would be appropriate, including:

    (a) where the taxpayer has actively engaged with the ATO, e.g., by way of seeking a private ruling, before entering into the borrowing arrangement; and

    (b) where there is a less than 100% ownership relationship (whether direct or indirect) between the lender, or lenders, and the borrower (where the lenders are unrelated to each other). In these circumstances, it cannot be assumed that arrangements between the lender and borrower can be restructured to achieve the integrity outcome which the Government is seeking. As a consequence, the borrower may be in a position where, for the life of the loan, they are subject

to the obligation to make loan repayments, but not entitled to deductions in relation to those business expenses.

31. It would be appropriate to provide for specific grandfathering provisions in both of these cases (as well as in relation to the exception in subsection 820-423A(5B) which we cover below at paragraph 54). We submit that a 'one year' period may be insufficient to unwind complex and large arrangements, particularly as the period is almost half over for June balancers. We would submit that the 'grace' period be extended to two years.

32. In addition to grandfathering rules, there are a number of further technical amendments to the DDCR which would would result in better targeted rules.

Exceptions to first limb of DDCR

33. Firstly, the exceptions to the first limb of the DDCR in proposed section 820-423A(2), which are set out in proposed section 820-423AA, include an exception in relation to the acquisition of certain new tangible depreciating assets.

34. The Senate Explanatory Memorandum accompanying the Amending Bill indicates this exception is intended to allow an entity to bulk acquire depreciating assets on behalf of its *associate pair*. This exception, which is based on an exception in former Division 16G of the ITAA36, omits the acquisition of trading stock, without any policy reason for the omission.

35. We submit that, unless a clear policy reason is enunciated, this exception should be amended to explicitly cover the acquisition of trading stock, as was the case in former Division 16G.

Scope of the second limb of DDCR

36. In our view, the scope of the second limb of the DDCR as set out in proposed section 820-423A(5)(b) remains too broad, even after the additional narrowing in the Amending Bill.

37. In particular, the reference in proposed subparagraph 820-423A(5)(b)(iii) to a payer using the proceeds of a financial arrangement to *increase the ability of* any entity (including the payer) to make a payment or distribution is incredibly wide.

38. It is unclear from the Explanatory Memorandum to the original Bill why this is required in addition to proposed subparagraphs 820-423A(5)(b)(i) and 820-423A(5)(b)(ii) and what level of investigation or tracing is required in order to determine whether the use of the proceeds contributed to the payer's *ability* to make a subsequent distribution being increased.

39. The drafting in subparagraph 820-423A(5)(b)(ii) is not significantly better. The extension from subparagraph 820-423A(5)(b)(i) to provide for 'facilitation' does not clearly highlight the activities being sought to be addressed.

40. The fact that money is fungible means that there is always likely to be reasonable disagreement as to whether this criterion is satisfied. We submit that creating vagueness is not the path to adopt with drafting of taxation laws.

41. In order to improve certainty, we submit that proposed subparagraph 820-423A(5)(b)(iii) be deleted.

42. We further submit that subparagraph 820-423A(5)(b)(ii) be deleted.

43. In the alternative, we submit that both paragraphs be amended to clarify what is intended, or additional guidance be given in the explanatory materials as to what types of transaction are intended to not come within the ambit of the provision and what evidence is required of taxpayer to demonstrate where the provision does not apply.

Exceptions to second limb of DDCR

44. While the exception in proposed new subsection 820-423A(5B) relating to refinancing existing debt, which would not otherwise be covered by the DDCR is a welcome addition, there are a number of practical difficulties with the exception which, we submit, should be the subject of further technical amendments.

Australian recipient condition should be removed

45. Firstly, it is unclear why the provision only applies to Australian entities.

46. As currently drafted, if the original debt is from a related foreign party, then **any** refinancing of that debt will not fit within the refinancing exception given the payment will not be made to a recipient that is an Australian entity.

47. This means that the DDCR will apply to deny deductibility of interest incurred on the new debt even where the existing debt from a foreign lender was not initially subject to the DDCR.

48. Accordingly, if there is a change over time of foreign related party debt owed by an Australian subsidiary (e.g. through maturity), any refinancing with new foreign related party debt will automatically fail the DDCR. This is even the case if the original financing was not caught by the DDCR, for example because it was obtained to fund tangible depreciating assets.

49. This seems to be directed at moving all multinationals away from using related party debt, which would pose a real problem for any Australian entities that are part of a group with an offshore treasury function that borrows centrally and on-lends to global operating subsidiaries or operates cash pool functions, both of which are ordinary commercially justifiable funding transactions to which other integrity rules, including the transfer pricing rules in Division 815 of the ITAA97, will continue to apply.

50. For this reason, we would submit that the requirement in proposed paragraph 820-423A(5B)(a) is removed.

Drafting of subsection 820-423A(5B)

51. Secondly, the drafting of the exception lacks clarity.

52. There is a reference to a *debt interest* in proposed paragraph 820-423A(5B)(c). It is presumed that this is a reference to the debt interest in proposed paragraph 820-423A(5B)(b), which is being refinanced, but we submit this should be clarified. It should also be made clear that the notional application of the DDCR to the debt interest being refinanced is on the basis that the DDCR rules applied at the time of entry into the original debt (and the notional test is being applied at that time).

53. We also submit that the explanatory materials to be issued include a number of examples illustrating examples of when the rule is intended to apply to clarify the scope of its operation.

Tracing requirements are difficult

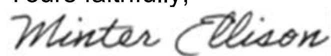
54. Finally, as noted above the exception in proposed subsection 820-423A(5B) appears to require a notional application of the DDCR to an existing debt interest, which is being refinanced by a new financial arrangement.

55. It appears to us that the only way in which the notional application of the DDCR can be applied is to trace the use of the proceeds of the original debt which is being refinanced. Where the original debt has been on foot for an extended period this may be difficult particularly given that records were not originally required to be maintained to trace the use of those funds in the detail now required to satisfy subsection 820-423A(5B).

56. We would submit that further relief is given to companies with respect to debts which were on foot prior to 22 June 2023 by permitting these loans to be refinanced without application of the DDCR on a once-off basis.

Please contact Adrian Varrasso (03) 8608 2483 or Robert Yunan (03) 8608 2486 if you would like to discuss this submission in any further detail.

Yours faithfully,



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