Perpetual GROUP

Perpetual Limited
ABN 86 000 431 827

Angel Place,
Level 18, 123 Pitt Street
Sydney NSW 2000
Australia

+61 9229 9000
perpetual.com.au

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,

Exposure Draft Legislation
Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023

Perpetual Limited ("Perpetual") welcomes the opportunity to make a submission in relation to the Exposure Draft legislation and materials released on 18 October 2023 entitled "*Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023*". This Exposure Draft seeks to amend the thin capitalisation and debt deduction creation rule measures that were tabled in Parliament on 23 June 2023.

We acknowledge that the proposed amendments address several issues that were raised during the Senate Economics Committee hearings on the Bill and noted in the Committee's Report issued on 22 September 2023. In particular, we welcome the following proposed amendments to the debt deduction creation rules:

- The limitation on the application of the rule **only to debt deductions paid or payable to an associate**, meaning third party borrowings to acquire assets from associates are not within scope.

- The exemption for a new membership interest in an Australian entity or a foreign company and for the acquisition of new depreciating assets.

Irrespective of the amendments made, we submit that issues remain in terms of the complexity and breadth of the rules. Although the proposed amendments do narrow application of the debt deduction creation rules, the drafting approach is still to cast a wide net with limited exceptions. We consider that the debt deduction creation rules, as proposed to be amended, will still cover many purely domestic arrangements where there is no overall net increase in interest deductions or no net loss to revenue. For example, where assets are transferred between members of a group of Australian trusts (e.g., as part of portfolio rebalancing) and the consideration is in the form of a debt, the debt deduction creation rules could apply to deny deductions for the interest on the outstanding debt, even though there is no net loss to revenue from the transaction because interest on the debt should be assessable to the transferor.

We submit that the breath of the debt deduction rules should be further limited as follows:

- The introduction of a simple overarching purpose test (i.e. transactions where the predominant purpose is to increase debt deductions in Australia or reduce assessable interest income in Australia) – such a test would assist in ensuring that commercially justifiable transactions are excluded from the debt deduction creation rules and provide more certainty for taxpayers. This would also more closely align with what the OECD envisaged in the BEPS Action 4 Report.

- We note that many of the exclusory amendments proposed mirror those exemptions provided under the old Division 16G of the Income Tax Assessment Act. However, a number of exclusions have not been reiterated, including an exclusion for the acquisition of trading stock. This exclusion was included in Division 16G to recognize that debt (via inter-company balances) is commonly used as working capital to fund the acquisition of trading stock from other group members. We consider that such an exemption should be included to the debt deduction creation rules in order to ensure the exclusion of commercially justifiable transactions.

- In addition to an exclusion for trading stock, we submit that an exemption should be provided for short-term loans or financial arrangements arising in the ordinary course of business on commercial terms. By way of example, the Perpetual asset management business involves the use of inter-company billings between associated companies cross-jurisdiction to appropriately allocate the elements of revenue generated from a client amongst the various services that contribute to that revenue (such as distribution, investment management, and sub-advisory services). That cross-jurisdictional allocation complies with transfer pricing principles to ensure the world-wide allocation of revenue based upon the location of economic activity and service. Inter-company balances (receivables and payables) might arise from inter-company billings which cannot be immediately cash settled. Proposed section 820-423(5) operates to deny debt deductions where an entity enters into a financial arrangement with an associated entity and uses "some or all" of the proceeds to "facilitate the funding" or "increase the ability of the entity" to make a "payment" to an associate recipient. If Perpetual had inter-company balances with both US and UK associated companies, but only cash settled the UK fees, is it arguable that the inter-company balance with the US is a financial arrangement with Perpetual in Australia which has increased its ability to pay that which is owed to the UK.

  Under transfer pricing principles, the US might require interest to be charged on that inter-company balance, which the debt deduction creation rules might deny as deductible in Australia. It seems an incongruous and inequitable outcome that inter-company commercial arrangements on which interest is charged in order to satisfy transfer pricing requirements may result in the denial of interest deductions in Australia.

  We consider that there is world-wide precedent for the exclusion of short-term loans or facilities. We note in this regard that section 385 of the US Internal Revenue Code contains rules similar to the proposed Australian debt deduction creation rules which recharacterize certain "created" debt with the effect of denying deductions for interest. Under the US rules, exceptions exist for short-term loans issued in the course of the issuer's trade or business and financial arrangements arising in exchange for the performance of services, ensuring that debt used to fund ordinary business operations is respected.

- If the above exception for short-term financial arrangements was not included, then detailed tracing of the use of fungible working capital would be required. Such tracing is onerous and subject to interpretation and manipulation, and is something that previous iterations of the thin capitalisation rules were designed to avoid.

- The transitional rule proposed in the Exposure Draft Legislation is very limited – it simply allows a **deferral** of the operation of the rules until 1 July 2024. We submit that financial arrangements in place at 22 June 2023 be entirely excluded from the operation of the rules. The fact that the rules will apply to pre-existing arrangements from 1 July 2024 means that the tracing of fund usage prior to the introduction of the rules would still be necessary, and this covers a period when such tracing was not required before and records were not necessarily retained.

Thank you for the opportunity to make this submission. If you require any further information, please do not hesitate to contact John Kirkness (Head of Tax) at john.kirkness@perpetual.com.au.

Yours faithfully,

Chris Green
Chief Financial Officer
Perpetual Limited