PSP Investissements Investments

NZSUPERFUND
Te Kaitiaki Tahua Penihana Kaumātua o Aotearoa

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30 October 2023

Dear Sir or Madam

Treasury Laws Amendment (Making Multinationals Pay Their Fair Share-Integrity and Transparency) Bill 2023
Submission by Foreign Funds

We thank you for the opportunity to provide a submission in respect of the exposure draft parliamentary amendments (the **Amendments**) to *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share-Integrity and Transparency) Bill 2023* (the **Interest Limitation Bill** or **the Bill**) which seeks to give effect to the technical amendments recommended by the Senate Economics Legislation Committee's final report.

This submission is made jointly by:

- Public Sector Pension Investment Board (**PSPIB**), a Canadian Crown corporation that invests amounts transferred to it by the Government of Canada for the pension plans of the Canadian Public Service, the Canadian Forces, the Royal Canadian Mounted Police and the Reserve Force. PSPIB has C$243.7 billion of net assets under management as at 31 March 2023 and invests globally in a variety of asset classes, including natural resources, public markets, private equity, real estate, infrastructure and credit investments.

- The New Zealand Superannuation Fund (**NZSF**) is a long-term, growth-oriented, global investment fund that is funded by the New Zealand Government. NZSF exists to help provide for the future funding of retirement benefits paid by the New Zealand Government which are guaranteed to all New Zealanders aged 65 and older. NZSF had NZ$65 billion of assets under management as at 30 June 2023 and invests in diversified assets throughout the world, including Australia.

together (the **Foreign Funds**).

We recognise the Government's overarching policy objective to align Australia's thin capitalisation rules with the latest Organisation for Economic Cooperation and Development (**OECD**) best practice recommendations in order to protect Australia's tax base and deliver on a Labor Party election commitment. We value the opportunity to make a further submission in relation to the proposed amendments to the Interest Limitation Bill and accompanying explanatory material.

We, the Foreign Funds, have previously made joint submissions to the Department of Treasury in response to the public consultation on the *Treasury Laws Amendment (Measures for Future Bills) Bill 2023: Thin capitalisation interest limitation* (the **Exposure Draft Legislation**) which was released on 16 March 2023 and also to the Senate Economics Legislation Committee in relation to

the Interest Limitation Bill. Our submissions dated 11 April 2023 and 21 July 2023 respectively are available on the Treasury webpage[1,2].

We wish to acknowledge that some of the changes suggested in our previous submissions have been reflected in the Interest Limitation Bill and the Amendments. The adoption of these changes and in particular the updated approach to trust structures has been well received by the Foreign Funds.

We are writing to you to share our key concerns in respect of the Amendments and provide suggested changes which we consider to be both constructive and within the policy objectives of the proposed changes to Australia’s thin capitalisation rules. We have limited our submission to aspects of the Bill where we believe the proposed rules materially depart from the desired policy objective and if legislated, could have a significant impact on foreign investment in Australia.

Our principal concerns relate to the following aspects of the proposed Amendments.

Interest Limitation Rules

The inclusion of a mechanism to share excess tax EBITDA within a chain of trusts is acknowledged and welcomed by the Foreign Funds. However, we consider the following aspects of the proposed amendments do not operate as intended and are inconsistent with the grouping principles in the existing thin capitalisation rules.

Submission 1: lower the ownership threshold for the excess tax EBITDA of a trust

Based on the current drafting of the Amendments, trusts that hold between 10% and less than 50% of a sub-trust are not eligible to claim a debt deduction on net income generated by a sub-trust. In comparison, investments below 10% are able to include the distribution from the trust and investments of 50% or more are able to benefit from the excess tax EBITDA of the trust.

Setting the ownership threshold at 50% or more, rather than 10% or more, creates a disadvantage for investors holding between 10% to less than 50%. It is common for foreign pension funds and sovereign funds such to hold an ownership interest of between 10% and 50% of a consortium trust as a means of co-investment and pooling capital on large infrastructure assets or real estate funds. The current drafting therefore creates a disadvantage for investors such as the Foreign Funds and could cause inequity between investors in a consortium vehicle.

The policy intent for adopting the 50% threshold is unclear and inconsistent with the current thin capitalisation rules which allow attribution of surplus "safe harbour debt amounts" where a 10% or more interest is held in the trust. We ask Treasury to consider aligning the proposed threshold with the current approach in Australia’s safe harbour debt rules and lower the threshold to 10% or more.

Submission:
The reference to a “TC direct control interest of 50% or more” in paragraph 820-60(2)(a) be replaced with a reference to a “TC direct control interest of 10% or more”.

Submission 2: Holding companies should benefit from tax EBITDA sharing

The current drafting of the Amendments permits the attribution of excess tax EBITDA to an upstream trust entity only (provided that upstream trust holds an interest of 50% or more). This is because the “relevant entity” in paragraph 820-60(1)(a) is limited to a unit trust or managed investment trust and does not include other types of entities (such as companies or partnerships).

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[11] https://treasury.gov.au/consultation/c2023-370776

[2] https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/TLABMultinationalTax/Submissions

Based on the current drafting of subsection 820-60(1), where 50% or more of the units in a trust are held by a *company* beneficiary, the company cannot include the excess tax EBITDA – this is despite the company beneficiary being liable for tax on its share of the distributions from the underlying unit trust. The policy rationale for differentiating between a trust and company beneficiary in relation to the attribution of excess tax EBITDA is unclear to the Foreign Funds. We request Treasury consider updating the Amendments to allow a company beneficiary to access the excess tax EBITDA.

Submission:
The requirement in paragraph 820-60(1)(a) be extended to include a company.

Debt Deduction Creation Rule (DDC Rule)

The Amendments include a number of exceptions and additional conditions in the DDC Rule which are intended to carve out arrangements which do not present a risk to Australia's tax revenue base. These exceptions and conditions are acknowledged and welcomed by the Foreign Funds. Notwithstanding this, we have identified a number of technical drafting issues and inconsistencies in the amended DDC Rule which we have outlined below for Treasury's consideration.

Submission 3: The DDC should permit refinancing of foreign related party loans

The exception proposed in subsection 820-423A(5B) allows the refinancing of related party loans provided by "Australian entities", provided the original loan is not otherwise captured by subsection 820-423A(5) (i.e., the loan is a "good loan").

However, the refinancing exception does not extend to refinancing of related party loans with foreign residents or non-Australian entities. The proposed drafting therefore discriminates between Australian related party lenders and foreign related party lenders. The policy rationale for this distinction is unclear in the circumstances where the original loan from the foreign resident is not otherwise captured by subsection 820-423A(5).

The drafting also produces some anomalies for foreign residents as the definition of "Australian entity" includes a trust, meaning an equity funded Australian trust held by a foreign entity with loans to an Australian related party would be able to refinance the loans, whereas a direct loan from a foreign parent to the same Australian related party would not qualify for the refinancing exception.

We believe the refinancing exception for "good loans" should be available to both Australian and foreign related party lenders, and there are other existing provisions to protect the Australian tax base in respect of simple refinancing transactions. These existing provisions would include for example Australia's transfer pricing rules, debt/equity rules and general anti-avoidance rules.

Submission:
The requirement in paragraph 820-423A(5B)(a) that the recipient be an 'Australian entity' be removed to allow any entity (foreign or Australian) to access the refinancing exception in respect of loans that otherwise do not trigger the DDC Rule.

Submission 4:

Our understanding is that Subsection 820-423(5A) is intended to provide an exception from the DDC Rule in circumstances where the payment or distribution to an associate pair is funded indirectly by a third party borrowing (e.g. the borrowing is through a conduit financing entity (FinCo) that on-lends the debt to a related party which pays a distribution to an associate).

However, the drafting of the exception in subsection 820-423(5A) does not appear to operate as intended. This is because the exception appears to be limited to loans between a conduit financing entity and an associated borrower. In particular, there is no limb that extends the exception to include subsequent payments or distributions by a borrower to an associate pair. The lack of an exception for payments or distributions funded through third party borrowings via a conduit financing entity appears to be an unintended outcome given a direct external funding of the payment would otherwise be permissible under the DDC Rule.

We ask Treasury to review the drafting of subsection 820-423A(5A) to ensure the exception covers payments or distributions that are subsequently made by the borrower to related entities.

Submission:
The exception in subsection 820-423A(5A) be amended to ensure payments funded via a conduit financing entity are subject to exclusion, consistent with the treatment applied to direct externally funded payments.

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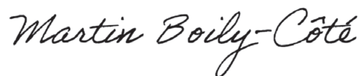
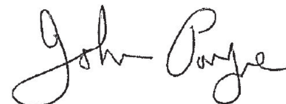
Finally, we acknowledge that Treasury is likely to receive submissions from other interested parties in respect of the Amendments. As part of preparing this submission, we have identified other technical deficiencies in respect of the specific text of the Amendments. We expect that Treasury will review these items in conjunction with other submissions made by professional bodies or industry groups and have therefore not sought to address these technical matters in our submission.

The Foreign Funds value and appreciate the ability to provide our views through the consultation process.

Yours sincerely





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