24 July 2023

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Via email: economics.sen@aph.gov.au

Dear Committee

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

The Australian Financial Markets Association (**AFMA**) represents the interests of over 125 participants in Australia's financial markets. Our members include Australian and foreign-owned banks, securities companies, treasury corporations and traders across a wide range of markets and industry service providers. They are the major providers of wholesale banking and financial market services to Australian businesses and investors.

We are pleased to lodge a submission to the Committee in relation to the provisions contained in the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share-Integrity and Transparency) Bill 2023* (**the Bill**), together with comments included in the accompanying Explanatory Memorandum.

Executive Summary

AFMA recommends that:

- The Government adhere to its own best practice standards on consultation in relation to the proposed debt creation rules, as articulated in the Guidance Note issued by the Office of Impact Analysis;
- Proposed Subdivision 820-EAA be removed from the Bill for consultation on the scope of the provisions and to minimise the risk of unintended consequences, noting that the proposed debt creation Rules have the potential to impact to genuine commercial business/transactions;
- In the event that Subdivision 820-EAA remains in the Bill, that the provisions only apply to general class investors and not ADIs or financial entities;
- In the event that Subdivision 820-EAA remains in the Bill, a provision be included to require that the taxpayer had a principal purpose of increasing the quantum of debt deductions in order for the provisions to apply;

- In the event that Subdivision 820-EAA remains in the Bill, it be clarified that the proposed provisions in Subdivision 820-EAA do not apply within a legal entity;
- The amendments in the Bill commence for income years starting on or after 1 July 2024; and
- The Government continues to consult on the proposed Public Country-by-Country reporting requirements to ensure that the final requirements meet the Government's policy intent while balancing the compliance burden for affected entities.

Introductory Comments

AFMA has consistently engaged with the Government on the proposals to amend Australia's taxation legislation regarding the ability for entities to claim debt deductions through changes to Australia's thin capitalisation provisions, including our submissions to the Government's Consultation Paper in September 2022 and to the Exposure Draft of the Bill in April 2023.

As noted in AFMA's submission to the Exposure Draft, the vast majority of AFMA members are either classified as ADIs or financial entities for the purposes of Division 820. As such, the proposed modifications to the Australian thin capitalisation rules for general class investors contained in the Bill have limited application to AFMA's members. Notwithstanding, there are proposed amendments to the thin capitalisation provisions in the Bill, namely the proposed debt creation rules in Subdivision 820-EAA, that have significant potential to give rise to unintended consequences and are accordingly of concern to AFMA. We elaborate on these points below.

We would like to place on record our disappointment as to the process that has been undertaken in relation to the inclusion of Subdivision 820-EAA into the Bill. The provisions were not part of the Exposure Draft and have not been the subject of consultation with industry. The proposed debt creation rules have been drafted broadly and have the potential to apply detrimentally to commercial transactions that have no purpose or effect of inflating debt deductions. The process undertaken falls significantly short of the standards articulated in the Guidance Note issued by the Office of Impact Analysis in May 2023 regarding consultation best practice and our view is that it would be inappropriate for the proposed debt creation rules to be legislated without proper consultation.

Debt Creation Rules

Interaction with Section 25-90/230-15 Repeal

One of the primary submission points raised by AFMA in relation to the Exposure Draft was that the Government should not proceed with the proposed repeal of Section 25-90/230-15 which, broadly, allows an entity to claim a debt deduction where the debt was used to derive non-assessable, non-exempt income, subject to meeting relevant thin capitalisation thresholds. In our submission, AFMA noted the practical difficulties that the proposed repeal would give rise to, particularly for ADIs and financial entities that operate on a "pool of funds" basis and cannot readily trace debt funding to particular activities. Accordingly, we are pleased that the proposed repeal did not proceed and is not included in the current Bill.

However, our reading of proposed Subdivision 820-EAA suggests that the concerns that were raised in relation to the repeal of Section 25-90/230-15 remain valid, given the scope of the proposed measures (as highlighted in the Explanatory Memorandum) and the lack of consultation regarding the intent of the measures and their application. In essence, our view is that, as drafted, the proposed debt creation rules give rise to the same substantive outcome as the repeal of Section 25-90/230-15 would have and accordingly our concerns remain on foot.

Summary of Debt Creation Rules

The first limb of proposed Subdivision 820-EAA will, broadly, deny a debt deduction where the deduction is in relation to the acquisition of a CGT asset, or a legal or equitable obligation from an associate of the acquirer. The second limb of the proposed debt creation rules will, broadly, deny a debt deduction where the deduction is in relation to a debt interest that is issued to fund payments or distributions to an associate, including the entity to which the debt interest was issued.

As noted in the Explanatory Memorandum, "the provisions are drafted broadly to help ensure that they are capable of applying to debt creation schemes of varying complexity. This approach is necessary given the ability of multinational groups to enter into complex debt creation arrangements." This breadth is particularly evident in relation to the second limb, and it is difficult to conceive of circumstances involving related party debt where the provisions do not apply.

Noting the examples in the Explanatory Memorandum, it appears to AFMA that the policy intent behind the debt creation rules is aligned to the proposed repeal of Section 25-90/230-15. On that basis, AFMA restates its concerns regarding the application of the debt creation rules to banks/financial entities, namely that:

- The previously expressed policy rationale for the proposed repeal of Section 25-90/230-15 related solely to the changes to the thin capitalisation rules for general investors, and hence should not apply to financial entities or ADIs;
- The compliance burden associated with adherence to the proposed first limb of the debt creation rules is greater for financial entities and ADIs as it requires such entities to trace debt funding to the use for which the funds are deployed, which is impractical for entities operating in a pool of funds environment.

Practical Uncertainty with the Debt Creation Provisions

As noted above, the proposed debt creation rules in Subdivision 820-EAA have not been the subject of consultation with industry and accordingly their scope and application is unclear. However, given the comments in the Explanatory Memorandum, it is expected that the proposed provisions will apply in a broad number of circumstances, with the potential for unintended consequences being high.

A number of practical issues and concerns would appear to arise for AFMA members from the proposed debt creation provisions, such as:

- The provisions appear to apply to deny debt deductions even in circumstances where there is no increase in the overall debt held in Australia. The rules will apply to rationalisation of domestic businesses, where the debt in the aggregated entity is the same or even less than the debt of the segregated entities, which appears counterintuitive;

- Routine securities transactions such as securities lending arrangements and repo transactions could potentially be in scope from the proposed provisions, thereby disrupting the efficient operation of capital markets;
- Vanilla financing transactions where a bank raises funds in a certain jurisdiction to access capital markets and then on-lends those funds to the jurisdictions where business is undertaken, which is a routine transaction for any bank, would appear to be caught by the second limb, such that the proposed Rules will be a significant obstacle to the efficient operation of funding markets;
- Routine restructuring/rationalisation transactions and working capital arrangements may potentially be within scope of the operation of the proposed rules;
- In circumstances where related party debt is on-lent to an associate, the interest income will be assessable while the interest expense will be non-deductible, resulting in significant asymmetry;
- By applying to income years commencing on or after 1 July 2023 without any grandfathering, the provisions are retrospective in operation as they apply to arrangements that are already in place.

AFMA Recommendations

In summary, AFMA's recommendations in relation to the proposed debt creation rules in Subdivision 820-EAA are as follows:

- That given the lack of consultation on the provisions, that they be removed from the Bill and subject to further consultation to ensure that they are targeted and do not give rise to significant unintended consequences;
- To the extent that the provisions remain in the Bill, that they only apply to "general class investors" to reflect the burden being placed on the taxpayer to trace debt funding and the inability for banks and financial entities that operate on a pool of funds basis to conduct such tracing. This approach is also consistent with the policy rationale for the proposed repeal of Section 25-90/230-15 in the Exposure Draft;
- That a purpose/anti-avoidance element be included for both limbs of the proposed debt creation rules, such that the provisions apply to schemes that are conducted for a principal purpose of enhancing the quantum of debt deductions claimed in Australia. This would be consistent with the narrative of the Explanatory Memorandum that states (at paragraph 2.146) that "(n)ew Subdivision 820-EAA seeks to directly address this risk by disallowing debt deductions to the extent that they are incurred in relation to debt creation schemes that lack genuine commercial justification";
- Given Australia's approach of adopting the Relevant Business Activity approach to branch attribution, the Bill should confirm that the debt creation rules do not apply to internal dealings within an entity;
- It should be made clear that the proposed rules in Subdivision 820-EAA do not apply to insolvency remote special purpose vehicles that are otherwise exempt from the thin capitalisation rules under Section 820-39;
- That any amendments in the Bill commence for income years starting on or after 1 July 2024 to ensure that the application of the amendments may be determined by affected taxpayers and to mitigate the extent to which the amendments are retrospective in operation.

Public Country-By-Country Reporting

While the legislation to give effect to the Government's commitment to implement Public Country-by-Country Reporting is not explicitly included in the Bill, AFMA notes that the Explanatory Memorandum includes an Impact Analysis on the range of tax transparency measures that the Government has committed to, which provides additional clarity on the scope of the proposed measures and the likely policy direction that the Government will take. In relation to the comments included in the Impact Analysis relating to Public Country-by-County Reporting, AFMA makes the following comments:

- AFMA appreciates the decision by Government not to proceed with the four additional data disclosures, namely related party expenses, the effective tax rate disclosure and the listing and valuing of intangible assets;
- AFMA appreciates the decision of Government to defer commencement of the Public Country-by-Country reporting requirements to 1 July 2024 and requests clarity that this reference should be read as "income years starting on or after 1 July 2024;"
- AFMA maintains that the final design should include a *de minimis* exemption such that significant global entities that are subject to Country-by-Country reporting but have an immaterial presence in Australia are not obliged to report under Australia's regime. This is particularly the case given the Government's intention that in-scope entities report on global operations;
- AFMA welcomes the opportunity to further consult with Government on the specific disclosures to be made by in-scope entities, noting our caution around making mandatory disclosures currently being made under a voluntary standard and ensuring alignment with international disclosure regimes.

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Thank you for the opportunity to provide a submission in relation to the Committee's inquiry, Please contact me on (02) 9776 7996 or at rcolquhoun@afma.com.au to discuss any of the matters that we have raised in this submission.

Yours sincerely,

Rob Colquhoun
Director, Policy