AFMA

30 October 2023

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

Via Email: MNETaxIntegrity@treasury.gov.au

Dear Treasury,

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

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 Treasury consultation on technical amendments to the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share-Integrity and Transparency) Bill* 2023 (**the Bill**) to better align the provisions of the Bill to the Government's policy intent. AFMA remains of the view that, due to the consultation process and the manner in which the Bill has progressed through Parliament, the risk of unintended consequences arising from the Bill is high and our recommendations below are aimed at reducing the potential detriment on Australia's attractiveness as a destination for capital.

Executive Summary

AFMA recommends:

- That the proposed exemptions from the Debt Deduction Creation Rules for Authorised Deposit-Taking Institutions (**ADIs**) and securitisation vehicles be extended to include entities that are classified as "financial entities" for thin capitalisation purposes;
- That the expanded definition of "debt deduction" to include costs that are considered to be economically equivalent to interest, such as payments on interest rate derivatives, applies only to general entities for thin capitalisation purposes; and

- That the Debt Deduction Creation Rules in proposed Subdivision 820-EAA apply only to arrangements entered into in income years commencing on 1 July 2024 or later.

Specific Comments

Extension of Exemptions – Financial Entities

AFMA appreciates the proposed amendments to exempt ADIs and securitisation vehicles from the proposed Debt Deduction Creation Rules. These proposed amendments reflect the core business of such entities, particularly the raising of finance in global markets and the provision of finance to Australian businesses. The exemptions also reflect that, in the case of ADIs, the thin capitalisation arrangements applying to such entities are not amended by the Bill, with the primary catalyst for the inclusion of the Debt Deduction Creation Rules being the amendments to the thin capitalisation arrangements for general-class entities.

In AFMA's view, the proposed exemptions for ADIs and securitisation vehicles should be extended to entities classified as a "financial entity (non-ADI)" for thin capitalisation purposes. This would reflect both the similar role that such entities play in financial markets and the fact that many financial entities operate in a similar way to ADIs, as reflected in the thin capitalisation arrangements that apply to such entities. Such an exemption would also be consistent with the policy rationale for the Debt Deduction Creation Rules, given that the Bill does not alter the thin capitalisation arrangements for financial entities.

AFMA notes that proposed Section 820-423AA exempts related party debt interests from the Debt Deduction Creation Rules, but only in respect of Section 820-423(2) and not Section 820-423(5). This means that, in the absence of a carve-out, financial entities that borrow from financial markets and on-lend to other entities within the corporate group could still be caught by the Debt Deduction Creation Rules.

Definition of "Debt Deduction"

One concern that AFMA has raised with the Government does not appear to have been addressed by the proposed amendments relates to the expanded definition of "debt deduction" under Section 820-40, particularly to include amounts that may be considered to be economically equivalent to interest but are not actually interest, such as payments made under interest rate swaps. The Explanatory Memorandum to the Bill states that "the definition is amended to ensure that a cost incurred by an entity does not need to be incurred in relation to a debt interest issued by the entity for the cost to be a debt deduction," with the amended definition stated to be in line with OECD best practice guidance.

The residual concern that AFMA has is that there are other reasons that an entity may enter into instruments such as interest rate swaps that are entirely unrelated to debt, such as the counterparty to the swap or an entity that enters into swaps for trading or speculative purposes. By removing the nexus between the deduction and the debt interest issued by the entity, our concern is that deductions on losses arising from circumstances entirely unrelated to a debt interest could be caught within the expanded definition of "debt deduction."

Additionally, there does not appear to be a concept of "net debt deduction" in the expanded definition. Generally, banks and other financial entities will look to hedge exposures on a portfolio basis and under the TOFA provisions in Division 230, there is no requirement for such taxpayers to “gross out” gains and losses on individual positions. As such, to the extent that the definition of “debt deduction” is expanded to include payments on interest rate swaps without the nexus to a debt interest, this would significantly exacerbate not only compliance costs but also the quantum of disallowance in a manner entirely disproportionate to what could be considered to be economically equivalent to a cost of debt.

A further concern that AFMA has with the proposed drafting is that while swap payments on an interest rate derivative could potentially be included within the definition of “debt deduction,” the definition of “average debt” in Section 820-415 still requires there to be “debt capital,” meaning that the derivative would not be included in the “average debt” definition. This would again have the effect of disproportionately exacerbating the quantum of the denial.

AFMA has provided Treasury with 2022 data from the Reserve Bank of Australia that showed that, on average, OTC interest rate derivative turnover in Australia averages $113 billion per day, with the bulk of the transactions occurring with financial institutions. To the extent that the definition of “debt deduction” is not calibrated properly such that non-debt costs are inadvertently included, then the impact of such an unintended consequence could be highly detrimental to financial entities operating in Australia.

Accordingly, our recommendation is that the expanded definition of “debt deduction” not apply to ADIs, securitisation vehicles or financial entities. This would reduce the risk of significant unintended consequences for such entities and be consistent with the general approach of the Bill, namely to amend the thin capitalisation arrangements for general entities only.

Commencement

AFMA acknowledges that, in relation to the application of the Debt Deduction Creation Rules in Subdivision 820-EAA of the Bill, the proposed approach is that generally the Rules apply to income years commencing on or after 1 July 2023; however where an arrangement was entered into prior to 22 June 2023, then the Rules have application for income years commencing on or after 1 July 2024. The significance of the 22 June 2023 date is that it is the date on which the Bill was introduced into the House of Representatives, which, given that the Debt Deduction Creation Rules were not included in the Exposure Draft that was the subject of stakeholder consultation, was also the first date on which the proposed Rules were made available.

AFMA appreciates the proposed one-year grace period for pre-22 June 2023 arrangements. However, our preferred policy position in relation to commencement is that the Debt Deduction Creation Rules apply to arrangements entered into in income years commencing on or after 1 July 2024. This would ensure that the ATO is able to provide entities potentially affected by the Debt Deduction Creation Rules with guidance as to how it proposes to administer the Rules and also to allow such entities to restructure to ensure that the Rules do not have application. It would also allow for further technical amendment to the Rules to the extent that further potential unintended consequences are identified.

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Thank you for the opportunity to provide a submission in relation to the Treasury consultation. 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