30 October 2023

Assistant Secretary
International Tax Unit
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: MNETaxIntegrity@treasury.gov.au

Dear Assistant Secretary

Multinational tax integrity – strengthening Australia's interest limitation rules

The Australian Investment Council (the **Council**) welcomes the opportunity to consult with Treasury on the Exposure Draft (**ED**) released on 18 October 2023 which proposes changes to the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill* 2023 (the **Bill**).

The Council welcomes Treasury's continued engagement with both the views of stakeholders and the findings from the Senate Economics Legislation Committee Inquiry, which has resulted in drafting refinements that enhance the Bill's clarity. In particular, the broadening of the scope of the third-party debt test and the narrowing of the scope of the debt deduction creation rules will positively impact Australia's private capital industry by creating a tax system that is easier to navigate, more transparent and consistent with existing domestic and international taxation regimes.

We draw your attention to some issues that remain. The Council believes that the Bill would benefit from further clarification to address outstanding ambiguity. We suggest that the following would enhance the operational efficacy of the Bill:

1. **820-427A Lender recourse**
   We welcome the change the Bill proposes by Amendment 71 of the ED which will broaden the scope of assets which a lender can have recourse to for the purposes of the third-party debt test. However, this change would benefit from further clarification or examples in the ED to the Bill or in ATO guidance such as a Practical Compliance Guide or a Ruling as to what constitutes a permissible security net. For example, it is not clear if an 'Australian asset' held by an entity includes shares in a foreign subsidiary.

2. **820-423A Debt creation rule**
   When applying the third-party debt test, one of the conditions is that the debt interest must be issued by the taxpayer to an entity that is not an 'associate entity'. The ED proposes that the requirement in section 820-905 that the entity be an 'associate' of the taxpayer will be disregarded. Accordingly, the only requirement is that there be an 'associate interest' relationship between the taxpayer and the other entity which, under proposed section 820-427D of the Bill, which be determined by reference to a 20 per cent threshold.

It is proposed that the debt creation rules will apply in priority to the other provisions in the thin capitalisation rules. Although Amendments 52 and 54 of the ED propose to limit the debt creation rules to related party debt deductions, whether parties are related for these purposes will be based on the proposed definition of 'associate pair' which in turn hinges on the definition of 'associate' in section 318. This seems to be at odds with the proposed changes to third-party debt test where, as noted above, there will only be an associate interest requirement to be determined by reference to a 20 per cent threshold.

To align the third-party debt test with the debt creation rule, we consider that it may be reasonable to link the 'associate pair' definition with the 'associate entity' definition, rather than the 'associate' definition.

3. **Section 820-427D Definition of Associate entity**
   The modified definition of 'associate entity' still requires a determination of whether an entity is accustomed or under an obligation (whether formal or informal), or might reasonably be expected, to act in accordance with the directions, instructions or wishes of another entity in relation to the distribution or retention of the first entity's profits, or the financial policies relating to the first entity's assets, debt capital or equity capital.

   The Bill would benefit from clarification regarding this aspect of the modified definition to enhance its commercial application and alleviate practical burdens on taxpayers by, for example, removing paragraph 820-905(1)(b) from the definition of 'associate entity' for the purposes of the third-party debt test [noting the similarity to paragraph 318(6)(b)], for a similar reason to that noted in paragraph 1.46 of the explanatory memorandum to the ED.

4. **820-423F Modified meaning of *Australian entity***
   For the purposes of the third-party debt test, the new definition of an 'Australian entity' requires a partnership to have at least 50 per cent of its partners be Australian residents. It may be more appropriate to adopt a central management and control concept, like that used to determine if trusts are Australian entities in section 338. For example, venture capital limited partnerships (**VCLPs**) are frequently used in private equity fund structures and are typically targeted at foreign resident investors due to the nature of the tax concessions available to such investors in VCLPs.

If you have any questions about specific points made in this submission, please do not hesitate to contact me or our policy team via email at policy@investmentcouncil.com.au

Yours sincerely

Emma Dowsett
Director – Advocacy and Corporate Affairs
Australian Investment Council