5 January 2024

Committee Secretary
Senate Economics Legislation Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

BY EMAIL: economics.sen@aph.gov.au; seniorclerk.committees@aph.gov.au

RE: *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023* referred to the Economics Legislation Committee on 5 December 2023

Dear Senate Economics Legislation Committee

We are writing in respect of amendments RU100 (**Amendments**) to the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share - Integrity and Transparency) Bill 2023* (**Bill**), which was referred by the Senate to this Committee for inquiry on 5 December 2023.

This joint submission is made by the Ontario Municipal Employees' Retirement System (**OMERS**), Caisse de dépôt et placement du Québec (**CDPQ**), British Columbia Investment Management Corporation (**BCI**) and the Ontario Teachers' Pension Plan (**OTPP**) (together, the **Canadian Investors**), with assistance from Ashurst.

The Canadian Investors previously provided submissions in respect of the Bill when it was referred to the Committee for inquiry on 22 June 2023. The Canadian Investors' submission dated 21 July 2023 sets out details of each of the Canadian Investor's investments in Australia. In short, the Canadian Investors have collectively invested over A$35 billion in Australia, comprising investments in key Australian real property and infrastructure assets.

As a result of the Committee's report dated 22 September 2023, technical amendments were released by Treasury on 18 October 2023 in respect of the Bill (**Exposure Draft Legislation**). The Canadian Investors further consulted with Treasury on the Exposure Draft Legislation and provided written submissions to Treasury. On 24 November 2023, the Government introduced the Amendments in the Senate. The Amendments broadly reflect the Exposure Draft Legislation with some modifications. The Amendments represent an improvement on the Bill as introduced into Parliament on 22 June 2023.

5 January 2024

Committee Secretary
Senate Economics Legislation Committee
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600

BY EMAIL: economics.sen@aph.gov.au; seniorclerk.committees@aph.gov.au

RE: *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023* referred to the Economics Legislation Committee on 5 December 2023

Dear Senate Economics Legislation Committee

We are writing in respect of amendments RU100 (**Amendments**) to the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share - Integrity and Transparency) Bill 2023* (**Bill**), which was referred by the Senate to this Committee for inquiry on 5 December 2023.

This joint submission is made by the Ontario Municipal Employees' Retirement System (**OMERS**), Caisse de dépôt et placement du Québec (**CDPQ**), British Columbia Investment Management Corporation (**BCI**) and the Ontario Teachers' Pension Plan (**OTPP**) (together, the **Canadian Investors**), with assistance from Ashurst.

The Canadian Investors previously provided submissions in respect of the Bill when it was referred to the Committee for inquiry on 22 June 2023. The Canadian Investors' submission dated 21 July 2023 sets out details of each of the Canadian Investor's investments in Australia. In short, the Canadian Investors have collectively invested over A$35 billion in Australia, comprising investments in key Australian real property and infrastructure assets.

As a result of the Committee's report dated 22 September 2023, technical amendments were released by Treasury on 18 October 2023 in respect of the Bill (**Exposure Draft Legislation**). The Canadian Investors further consulted with Treasury on the Exposure Draft Legislation and provided written submissions to Treasury. On 24 November 2023, the Government introduced the Amendments in the Senate. The Amendments broadly reflect the Exposure Draft Legislation with some modifications. The Amendments represent an improvement on the Bill as introduced into Parliament on 22 June 2023.

However, there are a number of critical changes required to avoid unnecessarily deterring foreign investment in Australia, noting that this will have a marked impact on Australia's infrastructure pipeline (including, in particular, the **renewable infrastructure sector and the investment required to deliver Australia's energy transition**, and the **housing sector**). Because the Bill and the Amendments are intended to ensure deductibility of debt deductions arising on genuine third party debt arrangements, **it is important that standard commercial arrangements clearly satisfy the statutory third party debt conditions**. Statutory third party debt conditions that do not reflect standard third party debt arrangements will materially increase the cost of capital for Australian entities. The critical changes that are required are set out in the table below.

In addition to the changes set out in the table below, the operation of the Bill **must be deferred to income years commencing on or after 1 July 2024**. Presently, it is intended that the Bill (other than the debt deduction creation rules) operates from income years commencing on or after 1 July 2023. Given the timing of the Committee's report and expected subsequent developments, this is likely to mean that three quarters of the first income year will have passed before there is any certainty regarding the thin capitalisation measures. Taxpayers who make quarterly distributions of income have been required to anticipate the ultimate form of the rules in order to ensure that they do not over or under withhold, and this problem becomes more urgent for each quarterly distribution (as there are fewer remaining opportunities in future distribution periods for the first year to correct any over or under withholding). Given these difficulties, it is important for the measures not to apply with retrospective effect, and to take effect for income year commencing on or after 1 July 2024. We also recommend, consistent with the current proposed staggering of the measures, that **the debt deduction creation rules should apply for income years commencing on or after 1 July 2025**.

* * * *

Section	Issue	Description	Solution
820-427A(2); 820-427C	Deductions referable to common commercial swap arrangements with third parties may not be available due to technical gaps in the drafting of the third party debt test and conduit financing regime.	In the third party debt test (subsection 820-427A(2)), entities are prevented from entering into back-to-back swap arrangements with associate entities, because: • the cost associated with the payment under the swap would be referable to an amount paid or payable directly or indirectly to an associate entity, failing paragraph 820-427A(2)(b); and • the cost associated with the back to back swap is not disregarded under the conduit financing modifications, as those modifications only apply to the debt interest (and not swap arrangements which hedge interest rate risk on the underlying debt interest). From a policy perspective, **a back to back swap should be treated the same as a back to back borrowing** (i.e., on-lending on the same terms by a conduit financier). If this treatment does not prevail, taxpayers will be forced to close out existing swap arrangements and renegotiate new swaps, in a (likely) higher interest rate environment, which is likely to increase debt deductions claimed over the next several years. It will also lead to significant compliance costs for no particular policy reason. In addition, the treatment of cross-currency interest rate swaps is ambiguous, and **it is not clear that cross-currency interest rate swaps meet the requirements for deductibility in section 820-427A(2).** In particular, a cross-currency interest rate swap hedges exposure to an interest rate denominated in a foreign currency, and may also hedge exposure to foreign exchange fluctuations. It is not clear to what extent these arrangements give rise to debt deductions (with respect to the foreign currency part), and that (if they do) the cross-currency interest rate swap is "directly associated with hedging or managing interest rate risk in respect of the debt instrument", as they hedge two potential fluctuations. As drafted, **it appears that debt deductions on swaps with third parties will only be available where they can be shown to only manage interest rate risk, such that cross-currency interest rate swaps would fail** (as they manage two types of risk – interest rate risk, and foreign exchange risk).	We recommend that changes are made to ensure that debt deductions associated with hedging or managing risk (not just interest rate risk) in respect of one or more debt interests should be allowable, provided that the debt deductions are not referrable to an amount paid: • directly to an associate entity, unless the amount is paid indirectly to an entity that is not an associate entity; or • indirectly to an associate entity. To clarify the treatment of cross currency interest rate swaps, the language in section 820-427A(2) should be amended to include a legislative note to clarify that cross-currency interest rate swaps give rise to an allowable debt deduction to the extent they satisfy the requirements above. If such a legislative note is not included, the Supplementary Explanatory Memorandum should include an example of how the rules allow debt deductions arising on cross-currency interest rate swaps.
820-427A; 820-427A(5); 820-427A(6)	The Amendments will continue to discourage investment in development assets, including (in particular) certain **renewable energy infrastructure, developments** and development assets more generally.	Subsection 820-427A(5) of the Amendments does not cover non-land infrastructure assets in a comprehensive manner (other than certain offshore renewable energy infrastructure) and, consequently, **certain infrastructure assets would remain ineligible for the development asset concession.** This effectively excludes assets that are not considered to be real property or land. **Many renewable energy projects, that should be (and are) considered by the Government to be critical infrastructure projects, would be ineligible for the development asset concession as these infrastructure assets often do not qualify as interests in land** (e.g., because they arise from license arrangements or they are investments in assets that are not fixtures), and **are not moveable property relevant to the income producing use of the land** (as they are often held separately to the land). More generally, **the development asset concession will adversely impact a number of investments in real estate and infrastructure developments, where those assets are majority-owned by a non-resident.** We are unable to discern the policy	Amend subsection 820-420A(5) to expand the development asset concession to non-land development assets that are (or will be) economic infrastructure facilities within the meaning of subsection 12-439(5) of Schedule 1 to the *Taxation Administration Act 1953* (Cth). Remove subparagraph 820-427A(5)(b), which will permit non-residents to provide guarantees, security or other forms of credit support in respect of development

Section	Issue	Description	Solution
		objective behind the fact that a non-resident who holds less than 50% can provide a guarantee, security or other form of credit support in respect of a development asset, but a non-resident who holds 50% or more providing a guarantee would result in the failing of the third party debt conditions. Guarantees are a standard part of sourcing third party debt for development assets, as the asset is subject to development risk and earns no income. The approach in the Amendments will produce illogical outcomes. For example, a single member of the Canadian Investors cannot provide a guarantee in respect of a wholly-owned development asset, but collectively, the Canadian Investors as a consortium (each holding less than 50%) can. Further, an Australian entity may provide a guarantee, security and other form of credit support that would not result in the failing of the third party debt conditions, even if that Australian entity only held foreign assets (i.e., and the foreign assets provided comfort to the bank that the guarantee was from an entity of substance). Finally, the development asset concession will cease to apply upon completion of the development of the relevant asset. Standard guarantee (or equivalent) arrangements extend beyond completion through to the stabilisation of the income arising from the development asset. This guarantee will then fall away at stabilisation and the third party debt conditions may be able to be satisfied – but it is not clear why for that short period of time (e.g., 12 to 18 months), there should be a failure of the conditions.	assets, where that non-resident holds a 50% or more membership interest in the borrower. Amend paragraph 820-427A(4)(a) to permit the period to extent for a period beyond development – e.g., for 12 or 18 months following the completion of the development. This will allow assets that previously qualified for the development asset concession to continue to qualify during a period of income stabilisation (i.e., the period of time post-development in which external lenders would continue to require a guarantee).
820-49; 820-427A(3) ; 820-427A(5)	The recourse requirements in the third party debt conditions remain problematic, as : • there is no safe harbour as to what constitutes a minor or insignificant asset; • in a non-conduit financing scenario, they will be failed if there is recourse for payment of the debt against a foreign resident having granted specific security only over membership interests in a member of the obligor group that is not the borrower.	Prior to the Amendments, entities granting all asset security would have resulted in the failing of the recourse requirements where that security encompassed a single foreign asset, irrespective of its materiality. The Amendments have introduced the concept of "minor or insignificant" assets, which are disregarded for the purposes of determining whether a debt interest satisfies the third party debt conditions. While this is positive, **it is not clear what constitutes a minor or insignificant asset.** The Supplementary Explanatory Memorandum notes this exception is intended to prevent the failing of the third party debt conditions for inadvertent or superficial reasons. "Inadvertent" or "superficial" are equally ambiguous. For example, it is not clear if it is measured by reference to the total value of the asset, the value of the asset compared to the value of all assets of the entity, or the value of the asset compared to the quantum of debt. Furthermore, it is not clear if an asset that would otherwise be significant by value may nonetheless be minor or insignificant because it is only temporarily a foreign asset – e.g., if material funds from drawing down debt issued in a foreign market is deposited into a foreign bank account (a foreign asset), before being transferred into an Australian bank account (an Australian asset). Finally, **it should be permissible for a foreign entity to grant specific security over the membership interests in an obligor entity, as this form of specific security does not give the lender access to assets it could not obtain through exercise of its general security interest.** In this sense, granting specific security over membership interests is not (in substance) credit support. However, the rules prevent a non-resident granting specific security over membership interests in an entity within the obligor group who is not the borrower (in a non -conduit financing scenario), with the consequence that the third party debt conditions would not be satisfied in standard third party arrangements. This is illogical as, in both cases, there is (in substance) no credit support.	With respect to disregarding minor or insignificant assets, the Amendments should include a safe harbour, which deems foreign assets that collectively represent less than 15% (by value) of the total assets of the entity (by value) to be minor or insignificant assets. On minor or insignificant assets more generally, guidance in the Explanatory Memorandum should be updated to include examples or minor or insignificant assets, and these examples should confirm that an asset can be minor or insignificant by reference to time (i.e., even if it is material in value, but if the foreign asset only exists for a limited period of time). Finally, permissible recourse should be expanded to allow specific security over membership interests in a member of the obligor group, even in a non-conduit financing scenario. This should encompass ancillary rights attaching to those membership interests, such as the right to distributions.

Section	Issue	Description	Solution
820-52; 820-55; 820-60	Allow upstream entities to pick up downstream entity excess thin capitalisation capacity in all circumstances where they are required to exclude dividends and distributions from their tax EBITDA calculation, to ensure the rules apply consistently and in a principled way.	The control threshold to enliven the Excess Tax EBITDA rule discriminates against upstream entities that hold a 10% or more interest but less than a 50% interest. Upstream entities holding an interest of 10% or more are required to exclude from their tax EBITDA income arising from holding an interest in the downstream entity. In other words, their tax EBITDA is depressed as they hold interests in income producing assets indirectly, rather than directly. This issue is resolved for upstream entities that hold 50% or more in the downstream entity, as these entities are entitled to pick up excess thin capitalisation capacity from downstream entities. Accordingly, **upstream entities holding non-portfolio non-controlling interests (i.e., between 10% and 50%) are unfairly treated compared to those holding portfolio interests (<10%) or those holding controlling interests.** **This will have a material impact on institutional investment in large assets (e.g., infrastructure, energy projects and material real estate assets)**, where it is extremely common to hold interests of less than 50% but more than 10%. These entities will, in effect, be denied access to the default fixed ratio test, as they are likely to have limited, or no, tax EBITDA.	Amend paragraph 820-60(2)(a) to require that the TC control interest threshold is 10% or more, equal to the threshold to be associate entities in subsection 820-52(9). This will facilitate greater participation in partnerships for the development and operating of critical infrastructure assets, including those infrastructure assets required to deliver Australia's energy transition.
820-427C	Where an entity borrows from a conduit financer on back-to-back terms, and uses those funds to subscribe for equity in a downstream Australian entity, that is permitted by the conduit financing regime. However, if those funds are used to provide quasi equity to a downstream entity in the form of non-interest bearing debt, the conduit financing conditions will be failed.	In conduit financing structures, the ultimate borrower may apply borrowed funds to subscribe for equity in downstream Australian entities, which is permitted. However, it is also extremely common for the ultimate borrower to provide quasi equity to the downstream vehicles, in the form of non-interest bearing debt. This is often commercially preferred if the funds are only needed by the downstream entity for a short period of time (e.g., to pay expenses). More generally, common genuine commercial arrangements often involve funds initially being provided by way of non-interest bearing loans within a group of entities. These non-interest bearing loans may subsequently be capitalised at regular intervals (i.e., converted into equity) resulting in the initial loaned amount ultimately representing an equity interest. Under the rules as currently drafted, **these arrangements will be classified as "relevant debt interests", and will result in a failure of the third party debt conditions as a result of them being non-interest bearing** (and therefore failing the same terms requirement). **It is inconsistent with the underlying policy objective of the regime for non-interest bearing on-lending to result in a failure of the conduit financing conditions**, which indirectly impacts the availability of debt deductions on external debt issued to third parties. Non-interest bearing loans do not give rise to the mischief of increased debt deductions, nor do they present any anti-avoidance risk associated with that debt interest being capitalised (as that capitalised equity interest will also not give rise to future interest deductions).	The concept of "relevant debt interest" should expressly exclude associate entity equity (as currently defined in section 820-915 of the ITAA 1997) which imposes specific requirements for a debt interest to be classified as associate entity equity (e.g., that the debt interest gives rise to no debt deductions).
820-423A(5); 820-423A(5A)	The debt deduction creation rules will apply to very common intragroup arrangements, notwithstanding there is no mischief in these scenarios.	There remain material issues with the debt deduction creation rules in respect of intragroup funding, where non-consolidated entities require funds for genuine commercial reasons (i.e., third party expenses and costs) that may be incurred by upstream or downstream entities in instances where the third party debt test does not apply. It is very common in such instances for intragroup funding to occur by way of non-interest bearing loans. To take an example, Entity A borrows from a related party, and on-lends to Entity B on a non-interest bearing basis (the on-lending constitutes a financial arrangement). Entity B subsequently borrows from a conduit financer (on a back to back basis), and uses the proceeds to repay the original non-interest bearing debt owing to Entity A, and Entity A repays the related party. This repayment of principal would appear to result in debt deductions on the debt from Entity B (for the subsequent debt) being denied, notwithstanding the total value of debt had not increased (i.e., there is in fact no debt creation). Further, the debt deduction creation rules would appear to apply where external debt financing is obtained (through a conduit financer), and is used to make equity investments within the group. To take an example, if Entity A borrows externally and on-	The following key changes should be made: • A conduit financing exemption should be incorporated, such that where funding is sourced externally (and on-lent on back to back terms), the debt deduction creation rules cannot apply to the on-lending (notwithstanding that the third party debt test election may not have been made). • Make it clear that payments arising in respect of debt interests that are classified as associate entity equity are excluded from the debt deduction

Section	Issue	Description	Solution
		lends on back to back terms to Entity B, and Entity B subscribes for equity in Entity C, the subscription for equity would constitute a "financial arrangement". If Entity C uses some of those funds to make a royalty payment (even to an Australian entity, which is treated as assessable income) or to pay an intragroup dividend, (or another payment within section 820-423A(5A)), it appears that Entity B's debt deductions on the related party borrowing could be adversely impacted (notwithstanding it is ultimately sourced from a third party).	creation rule contained in subsection 820-423A(5). This could be achieved by amending subsection 820-423A(5)(a) to read "… with another entity <u>that gives rise to a debt deduction</u>". • Inclusion of a purpose test – i.e., that the totality of the arrangements are designed to give rise to debt deductions. • Remove the reference to payments of a "similar kind", and allow regulations to be made prescribing particular payments that are identified as problematic (as there is uncertainty about whether a payment may be of a similar kind to other payments).