INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

19 December 2023

Committee Secretary
Senate Standing Committee on Economics
PO Box 6100 Parliament House
Canberra ACT 2000
Via Email: economics.sen@aph.gov.au

Dear Committee Secretary,

SUBMISSION TO THE SENATE ECONOMICS LEGISLATION COMMITTEE ON THE TREASURY LAWS AMENDMENT (MAKING MULTINATIONALS PAY THEIR FAIR SHARE - INTEGRITY AND TRANSPARENCY) BILL 2023

Infrastructure Partnerships Australia is an independent think tank and executive member network, providing research focused on excellence in social and economic infrastructure. We exist to shape public debate and drive reform for the national interest. As the national voice for infrastructure in Australia, our membership reflects a diverse range of public and private sector entities, including infrastructure owners, operators, financiers, advisers, technology providers and policy makers.

Infrastructure Partnerships Australia draws together the public and private sectors in a genuine partnership to debate the policies and priority projects that will build Australia for the opportunities and challenges ahead.

Background and Content

Infrastructure Partnerships Australia would like to acknowledge the significant improvements that were made to the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share—Integrity and Transparency) Bill 2023* (**the Bill**) released on 28 November 2023. The Bill contained a number of important changes that had been requested by industry through numerous rounds of previous public consultation.

However, there remain a number of outstanding issues in the Bill that are particularly relevant to the infrastructure sector. Therefore, Infrastructure Partnerships Australia welcomes this further opportunity to provide an additional submission to the Senate Economic Legislation Committee (**the Committee**) on these further matters.

For a more comprehensive understanding of our input into the design of the policy package, and the subsequent drafting of the Bill, we refer the Committee to our previous submissions to Treasury, including:

- Submission to Treasury on the Government Election Commitments: Multinational Tax Integrity and Enhanced Tax Transparency, dated 2 September 2022
- Submission to Treasury on the Multinational Tax Integrity Package – Amending Australia's Interest Limitation (Thin capitalisation) Rules, dated 9 January 2023

- Submission to Treasury on the Multinational Tax Integrity– Strengthening Australia's Interest Limitation (Thin capitalisation) Rules 2023 Exposure Draft, dated 13 April 2023
- Submission On Treasury Laws Amendment (Measures For Future Bills) Bill 2023: Thin Capitalisation Interest Limitation, dated 21 July 2023, and
- Submission to the Treasury on the Multinational Tax Integrity – Strengthening Australia's Interest Limitation (Thin Capitalisation) Rules Exposure Draft, dated 30 October 2023.

Please find an attached submission on the Bill below, developed by Infrastructure Partnerships Australia's Tax Policy Taskforce.

Further contact

We appreciate the opportunity to provide this submission and would be happy to discuss it further should you wish.

Infrastructure Partnerships Australia looks forward to further assisting the Treasury in this matter. If you require additional detail or information please do not hesitate to contact Mollie Matich, Head of Policy and Research at [redacted]

Yours sincerely,

[redacted]

Adrian Dwyer
Chief Executive Officer
Infrastructure Partnerships Australia

APPENDIX

Provide taxpayers with an election to defer application of the measures by one income year

Infrastructure Partnerships Australia's Tax Taskforce makes an initial comment that it remains highly undesirable that the effective date of the thin capitalisation measures included in the Bill remains 1 July 2023, yet the final legislation will not be substantively debated in Parliament until at least 5 February 2024 (when the Committee is scheduled to release its report).

With the measures already applying to many taxpayers, the lack of final legislation continues to create significant uncertainty, including among fund managers preparing interim tax distribution statements for investors and other taxpayers entering into financing for new transactions or refinancing existing assets.

In this regard, while the measures were announced in October 2022, there has been an unusual amount of uncertainty and change in the substance and form of the measures in the meantime. This has made it difficult for many taxpayers to prepare for the introduction of the measures with any level of confidence.

The Tax Taskforce accepts that this may be an issue that may affect taxpayers differently and some taxpayers have already done substantial work in preparing for the introduction of the measures on the basis of a 1 July 2023 start date. Therefore, rather than a wholesale deferral of the thin capitalisation measures, the Taskforce considers that it would be appropriate to provide taxpayers with the choice to defer the application of the measures for one income year.

The Taskforce considers that similar considerations apply to the debt deduction creation rules. On that basis, there should also be a deferral of the effective date of the debt creation rules (DCR) until 1 July 2024 for all arrangements to which it will apply

Arrangements to which the 'debt deduction creation rules' (DCR) will apply

The Taskforce further submits that the DCR only apply to debt created from the date the legislation is enacted, however, if Treasury must have the DCR rule applying to debts existing at the date of the commencement of the legislation, then the DCR should only apply to debts first created during the prior five income years from 1 July 2024 ("the look back period"). This application limit should also apply to a debt that is created during the lookback period for the primary purpose of refinancing a debt created prior to the lookback period. The five years is broadly equivalent to the period in which a taxpayer's tax returns would reasonably be open for amendment, and therefore the period during which reasonable records from which to undertake the details DCR analysis would most likely be available.

The Taskforce submits this as the DCR is different to the other thin capitalisation changes, as the DCR requires detailed analysis of matters at the time the debt is put in place (for example, was a lender a related party at the time the debt was created), rather than simply considering the status and characteristics of the debt during the relevant income year for which deductibility is being tested. Such analysis will often require detailed information

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which may not be retained or available today. Relying on the existing period for tax return lodgement and review is a clear and not unreasonable historical time for which records would likely be available.

Fixed Ratio Test

a. Address arbitrary outcomes arising under the 'Excess Tax EBITDA Amount' rule

Particularly for non-consolidated multi-entity financing structures common in the infrastructure sector, the ability for upstream parent entities to utilise surplus gearing capacity of underlying projects held in associated entities has been a critical part of Australia's thin capitalisation rules for decades.

The October Bill included a very limited measure that allowed a trust holding at least 50 per cent interest in another trust to utilise a proportion of any surplus gearing capacity under the Fixed Ratio Test (referred to as the excess Tax EBITDA amount).

The Taskforce welcomes the expansion of the excess Tax EBITDA measures beyond trusts to companies and partnerships in the current Bill. The Taskforce considers that expanding access to this measure significantly reduces the potential for arbitrary and unintended outcomes.

However, the Taskforce considers there remains a significant potential for arbitrary outcomes due to the fact that an investor obtains no gearing capacity for investments of between 10 per cent - 49.9 per cent held in subsidiary entities.

The Taskforce submits that investors should be able to utilise a proportion of the excess gearing capacity of underlying investments where they hold 10 per cent or more in the relevant subsidiary entity. This would result in a more coherent approach that would see investors adopt the following treatment depending the stake held in a subsidiary entity:

Investments below 10 per cent:	Include distributions from the investment in the calculation of the investor's Tax EBITDA.
Investments of 10 or more per cent:	Investor disregard distributions received from an investment and include that percentage proportion of any excess Tax EBITDA in its Fixed Ratio Test calculation.

Third Party Debt Test

Subsection 820-427A(3) prohibits recourse to the third party debt test where the strict conditions are not satisfied.

Although some of the proposed amendments to subsection 820-427(3) are welcome, significant uncertainty still exists in relation to the intended application of the provisions. In particular:

a. <u>Clarification of the definition of 'Obligor group'</u>

The current definition of obligor group in section 820-49(b) includes any entity that has one or more assets to which the creditor has recourse.

In the case that a borrower receives a right of credit support from another entity (the **credit support provider**), it could be considered that the creditor has recourse (indirectly) to the assets of the credit support provider.

While it may be inferred that this indirect credit support is not the type of recourse intended to be covered by section 820-49(b) this is not clear based on the current drafting.

This potential area of confusion could be resolved by a note included in section 820-49(b) that recourse for these purpose does not recourse that may be obtained by a creditor through the exercise a right under or in relation to a guarantee, security or other form of credit support as that term is used in section 820-427A(5).

b. <u>Expansion of credit support carve out for development projects</u>

The Taskforce welcomes the expansion of the credit support carve out contained in section 820-427A(5)(a)(iii)-(vi) and the helpful clarification included in the Explanatory Memorandum regarding its application to a renewable energy project.

Noting the unprecedented requirement to fund Australia's energy transition, the Taskforce agrees that it is critical that the third party debt test appropriately accommodate the standard project financing arrangements that generally apply to these types of projects.

However, the Taskforce is concerned that the requirement that the relevant project "be" Australian land (including an interest in land situated in Australia) or moveable property situated on that land will mean that a significant number of infrastructure projects – most notably large-scale transmission and distribution projects - will not be eligible for this carve out. In this regard, the Taskforce considers that section 820-427A(5)(a)(iii) regarding assets that are moveable property can be interpreted to mean that the taxpayer must hold an 'interest in the land' on which the moveable property is situated.

Electricity transmission and distribution infrastructure is developed on large corridors of land comprising a patchwork of legal land tenures – including freehold, leasehold, licences, rights of way, easements and other forms of access rights. From a legal perspective, a licence or right of way is merely a contractual right between the transmission/distribution entity and the relevant landowner rather than an 'interest in land'. Given the intent of the development carve out evidenced in the Bill and Explanatory Memorandum the exclusion of such projects from the carve out appears an unintended oversight.

The Taskforce submits that this oversight could be addressed by the following amended wording in section 820-427A(5)(a)(iii):

> a right that relates wholly to the creation or development of a *CGT asset that is, or is reasonably expected to be, land situated in Australia (including ~~an interest~~ a quasi ownership right held over ~~in~~ land, if the land is situated in Australia)

A 'quasi ownership right over land' is a well understood concept used in subdivision 40-B and Division 43 and, it is submitted, provides the appropriate 'connection' to land situated in Australia to maintain the intent and integrity of the provision.

c. Expand development carve out to permit credit support provided by a foreign associate entity of the borrower.

Again, noting the unprecedented requirement for funding infrastructure critical to Australia's energy transition, the Taskforce submits that the development carve out should not be limited by section 820-427A(5)(b) which currently maintains the prohibition on credit support provided by a foreign entity that is an associated entity of the borrower.

It is a simple fact that the amount of external bank financing required for the development of large-scale greenfield infrastructure projects can often only be obtained by foreign controlled Australian groups with significant credit support from foreign parent entities. The provision of credit support in these circumstances increases access of the project to relatively lower cost external third party debt capital that lowers the cost of the project and, in turn, lowers that cost to end users. In the case of infrastructure critical to Australia's energy transition, this means lower costs to Australian energy consumers including businesses and household consumers.

In this context, the Taskforce submits that a strictly limited extension to the development carve out to permit credit support from foreign associate entities of the borrower only during the development phase of an otherwise qualifying project is a pragmatic and sensible approach to this issue.

d. Meaning of "minor or insignificant"

There is no practical guidance as to how to apply the "minor or insignificant" carve-out. The Supplementary Memorandum to the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share—Integrity and Transparency) Bill* 2023 (**New Thin Cap Bill**) provides at paragraph 1.30 as follows:

> *"Recourse to minor and insignificant ineligible assets (i.e., assets which are not mentioned in the paragraph immediately above, such as an asset which is not an Australian assets) is disregarded. This allowance is intended to prevent paragraph 820-427A(3)(c) being contravened for inadvertent and superficial reasons. Determining whether recourse to ineligible assets is minor and insignificant will generally require a*

consideration of the ineligible assets to which recourse for payment of the debt can be had and whether those ineligible assets are of a minor and insignificant nature."

How this should be applied in practice is uncertain. For example, it is unclear if foreign assets comprise five per cent of the secured assets should be considered 'minor' or 'significant'. The same uncertainty applies for 10 per cent, etc.

e. <u>Meaning of "Australian assets"</u>

The meaning of "Australian assets" is not defined. The Explanatory Memorandum to the Bill provides as paragraph 2.98:

> *"'Australian assets" is intended to capture assets that are substantially connected to Australia. The following assets are not intended to be Australian assets:*
>
> - *Assets that are attributable to the entity's overseas permanent establishments.*
> - *Assets that are otherwise attributable to the offshore commercial activities of an entity."*

This key term is also not defined. For example, does it require an active business to be undertaken in Australia? What about passive investments?

f. <u>All or nothing test</u>

As drafted, the Third Party Debt Test is an "all or nothing" test. To the extent the conditions are partially satisfied, it is unclear why the law should not allow the debt to satisfy the Third Party Debt Test, that is, "*to the extent*" to which the conditions are satisfied? Such an approach would still be in line with the policy objectives and better align to the approach taken globally.

Review operation of the measures after 12 months

The Taskforce submits that Treasury should commit to an ongoing and real time post implementation review as there remain many issues and uncertainties and it is expected that further issues will arise. It is not appropriate to leave such matters to the ATO and taxpayers to resolve where a legislative response is more appropriate.