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SUBMISSION

Submission to Treasury: Multinational tax integrity and enhanced tax transparency measures

5 September 2022

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Assistant Secretary
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Federal Treasury
Langton Cres
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Via email: MNETaxIntegrity@treasury.gov.au

5 September 2022

Dear Sir/Madam

Multinational tax integrity and enhanced tax transparency measures

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the Treasury consultation on multinational tax integrity and enhanced tax transparency measures. The submission has been prepared with the support of ASFA's Tax Specialist Advisory Committee.

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $3.3 trillion in retirement savings.

Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing almost 90 per cent of the 17 million Australians with superannuation.

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If you have any queries or comments in relation to the content of our submission, please contact me on (03) 9225 4027 or by email jstannard@superannuation.asn.au.

Yours sincerely

Julia Stannard

Senior Policy Advisor

Executive summary

ASFA supports efforts to improve multinational enterprises (MNEs) tax integrity and tax transparency.

Aspects of the proposed reforms are of particular relevance to the superannuation industry, which represents some of the largest Australian investors in MNEs. Our submission considers these matters in more detail below but, in essence, ASFA's primary concerns in relation to the proposed reforms are as follows:

MNE interest limitation rules - ASFA is supportive of the Government's intention to address base erosion and profit shifting concerns. Given Australian complying superannuation funds are Australian taxpayers and fully subject to Australian tax on their investments, ASFA submits that Australian complying superannuation funds should be exempt from the MNE interest limitation rules. Complying superannuation funds are not the type of entities that the rules are intended to capture. Exempting them would significantly reduce compliance burden while continuing to promote investments in Australia by the superannuation industry, and would not pose a risk to the Australian tax base.

Our submission also supports the retention of the arm's length debt test (ALDT) in its current form, recommends the introduction of a 'public benefit exemption' for infrastructure and property sector assets that provide a net public benefit to the community, grandfathering provisions for existing assets if the ALDT is to be modified, and a 'carry forward or back' rule as part of the fixed ratio rule.

Denying MNEs deductions for payments relating to intangibles and royalties paid to low tax or no tax jurisdictions - ASFA requests that further clarity be provided in relation to the types of 'intangibles' covered by this proposed measure

MNE tax transparency - ASFA is supportive of improvements that could be made to MNE public tax disclosures. However, it is important to ensure that the information disclosed is both of use and useable to investors, and is efficient and sustainable for MNEs to provide. We recommend that the Board of Taxation, which developed Australia's voluntary Tax Transparency Code, is engaged to provide specific recommendations about MNE mandated public reporting disclosures. We also recommend that any change to information disclosure by Australian superannuation funds and their majority and wholly owned managed investment vehicles should be considered in consultation with ASIC and APRA, and not through the current MNE reporting proposals

Our submission also makes recommendations about the application of MNE reporting income thresholds, and the need to take into account, without negative inference, available tax concessions and tax exemptions and differing mechanisms for flow through taxation, when considering global minimum taxation.

General comments

ASFA is pleased to make this submission in relation to the Government's consultation on MNE tax integrity and enhanced tax transparency measures. We have focussed on specific aspects that are of particular relevance to the superannuation industry, which represents some of the largest Australian investors in MNEs.

The Australian superannuation industry – excluding self-managed and small APRA funds - has $2.1 trillion in total investments, with property and infrastructure assets accounting for 16.1% of total investments[1].

1 APRA, Quarterly superannuation performance statistics, June 2022

The superannuation industry typically seeks investments that not only aim to deliver strong long-term returns, but that are sustainable, support employment, foster innovation and contribute to a more productive economy.

Australian superannuation funds invest in ways that have a positive impact within the community. Funds are responsible investors that adhere to a range of environmental, social and governance factors when making investments. The types of investments that Australian superannuation funds invest into include affordable housing, retirement villages, renewable energy, transport (including rail, ports and airports), digital and social infrastructure (including hospitals and water supply facilities).

Comments in response to the consultation paper

Part 1: MNE interest limitation rules

Background

As you may be aware, subject to a limited exemption (in relation to limited recourse borrowing arrangements), there is a general prohibition on complying superannuation funds borrowing. As a result, large complying superannuation funds do not have any debt deductions and the thin capitalisation ('thin cap') rules do not apply at the superannuation fund level.

However, wholly owned (and majority owned) investment vehicles of superannuation funds, typically wholly owned unit trusts, can borrow and the thin cap rules do apply to these investment vehicles.

Application of the thin cap rules to Australian superfunds generally – request for general exemption

As outlined in the consultation paper, from a tax policy perspective, the interest limitation rules are designed to limit the debt deductions of MNE entities that seek to minimise Australian tax paid and move the incidence of tax from a higher tax jurisdiction to a lower tax jurisdiction.

Given that Australian superannuation funds are Australian taxpayers (and are not foreign owned), and invest predominantly in Australian assets, any debt deductions that exist in wholly owned vehicles are not deliberately designed to minimise tax in Australia.

ASFA submits that there should be a general exemption for Australian superannuation funds from the thin cap rules (including their wholly owned and majority owned Australian investment vehicles).

We understand the intention of the Government tightening the thin cap rules is to address base erosion and profit shifting. However, unlike Australian corporates that invest overseas in circumstances where the returns on their investment may be treated as non-assessable non-exempt income, Australian superannuation funds do not benefit from this treatment. As such, the returns from their investments will be brought back to be taxed in Australia.

Changes to the thin cap rules may encourage a reduction of the overall gearing of foreign investments held by Australian superannuation funds. This is likely to result in higher foreign taxes paid on foreign investments (for example, dividend withholding rates are typically higher than interest withholding tax rates) and higher foreign income tax offsets claimed by Australian complying superannuation funds. This would lead to a reduction of Australian taxes collected.

Further, as the debt obtained by a superannuation funds (through its associates, for example, wholly-owned vehicles) for its investments is usually with third parties and not related parties, ASFA considers there is no mischief in the debt deductions claimed indirectly by Australian superannuation funds - superannuation funds (and their associates) are not the types of entities that the thin cap rules are intended to capture[2].

ASFA submits that a general exemption for Australian complying superannuation funds from the thin cap regime (including their wholly owned and majority owned Australian investment vehicles) would significantly reduce compliance burden for the superannuation funds, continue to promote investments in Australia by the superannuation industry and does not pose a risk to the Australian tax base.

Australian superannuation funds are generally not subject to the thin cap rules as their assets are predominately Australian based, therefore falling under the 'assets threshold exemption' in section 820-37 of the *Income Tax Assessment Act 1997*. However, there is great complexity in applying this test to superannuation funds. This complexity relates to the reference of 'associate' in the asset threshold exemption. ASFA submits that, if a specific exemption is not provided for Australian superannuation funds, the assets threshold exemption should be retained. We further submit that the definition of 'associate', particularly with respect to trust arrangements, should be clarified in the context of the asset threshold exemption for the superannuation industry. This would increase certainty of tax treatment for the industry and minimise compliance costs, particularly as the number of investments held by Australian superannuation funds is growing at significant pace.

In addition, due to income fluctuations, in particular from foreign currency hedging gains and losses designed to reduce investment risk and which can be quite extreme in some years, some form of averaging over a multi-year period should be considered if a direct approach is adopted. The current indirect approach of capping interest deductions based on debt levels does not present the same problem.

Arm's length debt test (ALDT)

As noted above, whilst Australian superannuation funds generally qualify for the asset threshold exemption, there are instances where the thin cap rules are relevant to the superannuation funds through consortium investments.

The ALDT is most commonly relevant for the infrastructure and property sectors due to the high capital requirements for these projects.

These projects are typically funded through a 'project financing' arrangement from unrelated third-party financiers (a non-recourse or limited-recourse financial structure where the entity pays back the debt used to finance the project from the cash flow the project generates). These types of projects may not satisfy the safe harbour test, at least in the initial phases of the project, and would rely on the ALDT as project financing is typically a highly leveraged transaction.

ASFA submits that the ALDT should be preserved in its existing form.

Removal or tightening of the ALDT rules could prevent access to debt deductions for infrastructure and property projects, which can put the viability of these projects at risk. If these projects are not able to access the ALDT and it is necessary to reduce their gearing, the increased cost could make them uneconomical.

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2 Per the Explanatory Memorandum to the *New Business Tax System (Thin Capitalisation) Act 2001*, the objective of the thin cap regime is to ensure that MNEs do not allocate an excessive amount of debt to their Australian operations.

However, to the extent that the ALDT is modified, we propose that there should be a 'public benefit exemption' for infrastructure and property sector assets that provide a net public benefit to the community. This would allow Australian superannuation funds that typically invest in these assets in Australia not to be disadvantaged by having debt deductions in these investments denied under the thin cap rules, thereby increasing the cost of funding and reducing returns that are fully subject to tax in Australia. This is especially the case when the debt obtained on these projects is provided for by third party lenders.

We would also request a grandfathering of the existing rules for existing assets to allow sufficient time to restructure debt arrangements. Lack of such an arrangement could have a detrimental valuation impact to assets. We consider that the public benefit exemption should be available for Australian infrastructure and social infrastructure projects including affordable housing, retirement villages, public infrastructure (such as roads and communications infrastructure assets), critical infrastructure (such as renewable energy, water and digital infrastructure assets), and transport (such as rail, airports and ports). The absence of a public benefit exemption would cause Australian projects that have a public benefit to effectively be more expensive than those in other jurisdictions that that have a public benefit or similar exemption (for example, US and UK). This would reduce the projects' competitiveness and discourage domestic and foreign investments in Australia.

Fixed ratio rule

ASFA also requests that, with the introduction of the fixed ratio rule, a 'carry forward or back' rule is also introduced to allow the ability to carry forward (or back) denied interest deductions and excess debt capacity. This would be critical for the infrastructure and property sectors where interest costs arise from the beginning of the investment, but earnings only arise later (for example, at construction completion). Otherwise, there may be a loss of deductions for interest in those early years and excess debt deduction capacity in later years, resulting in higher net taxes overall. This would also impact on the valuations of these assets held by superannuation funds, ultimately adversely affecting the outcome for fund members.

Without a carry forward or back rule in place, there would be an increased number of outcomes where property and infrastructure assets would have to rely on the ALDT. This would in turn increase complexities and compliance costs annually for taxpayers and the Australian Taxation Office.

Recommendations – MNE interest limitation rules

- There should be a general exemption for Australian superannuation funds (including their wholly owned and majority owned Australian investment vehicles) from the thin cap rules.
- ASFA does not consider it is in Australia's best financial interests to impose any interest deduction limitation on managed investment vehicles held by Australian complying superannuation funds (either wholly owned or majority owned). However, in the event that interest deduction limitations are to be applied:
  - the ALDT should be preserved in its existing form
  - carry-forward and carry-back rules should be included
  - any direct interest deduction limitation rule should consider multi-year averaging of the underlying earnings parameter, due to volatility in that parameter, in particular due to currency hedging gains and losses from exchange rate movements. This could be achieved by introducing the carry forward or back of denied interest deductions and excess debt capacity.
- To the extent that the ALDT is modified, there should be a 'public benefit exemption' for infrastructure and property sector assets that provide a net public benefit to the community.

Part 2: Denying MNEs deductions for payments relating to intangibles and royalties paid to low tax or no tax jurisdictions

ASFA requests that clarity be provided that the reference to 'intangibles' covered by this proposed measure is restricted to royalties as defined in section 6(1) of the *Income Tax Assessment Act 1936* and relevant double tax treaties.

ASFA recommends that this measure is not extended to other intangibles, such as foreign tax reclaims and dividend and interest distribution entitlements. Nor does ASFA consider it desirable to require Australian complying superannuation funds to dissect administration and management services contracts to artificially identify a royalty.

Recommendation – Denial of deductions

- Make clear that this proposed measure is restricted to royalties as defined in section 6(1) and double tax treaties and does not require dissection of administration and management fees that Australian complying superannuation funds (and their wholly and majority-owned investment vehicles) pay.

Part 3: Multinational tax transparency

ASFA considers that tax transparency can contribute to investor value through its contribution to the encouragement of sustainable tax practices within MNEs and through its contribution to the ability of investors to make informed decisions about tax risk and sustainable value in their investment processes.

On this basis, ASFA is supportive of improvements that could be made to MNE public tax disclosures.

For tax transparency information to contribute to investor value in this manner, ASFA considers it important that the information disclosed is both of use and useable to investors, and is efficient and sustainable for MNEs to provide.

To achieve this purpose, ASFA is of the view that:

- **Information disclosed should be simple and understandable** and should not be overly detailed and voluminous as this can add to the cost of the investor analysis and can confuse or unnecessarily add to requests for further information.

  In this regard, ASFA does not consider that data provided in its current form to revenue authorities in accordance with OECD BEPS Action 13 (country-by-country reporting) would achieve this purpose as the data is not designed for public or investor use.

  Rather, information disclosed should be targeted to provide understandable information to assist the purpose of investors regarding the sustainable tax practices of investee or potential investee MNEs.

- **Information disclosed should be consistent** such that it allows for comparability of information disclosed between MNEs and has consistency and comparability with tax transparency information that may be disclosed or required to be disclosed by MNEs globally.

  Information that can be compared increases the potential use for investors, provided that the information disclosed is not sensitive to competitiveness such that if disclosed it may harm value or detract from investor value.

- **Information disclosed should be efficient** such that it may be produced by MNEs without incurring overly burdensome compliance costs that can harm investor value if disproportionate to the investor value that the information itself may create. This will also ensure that information provided is sustainable for MNEs to continue to produce and maintain.

ASFA recognises the challenges in the balance of the above areas.

ASFA also recognises that the Board of Taxation has performed work to date on this topic, having developed Australia's voluntary Tax Transparency Code. In this regard, ASFA suggests the Government might consider directing the Board of Taxation to review and provide specific recommendations that may best ensure that any requirements that may be introduced by the Government are appropriately consistent to achieve the key purposes described above. ASFA would be pleased to contribute to such a process if required.

As a more general comment, given fluctuation in earnings data, any application of the MNE reporting proposals should only apply from the second consecutive year that relevant thresholds are exceeded. For example, foreign currency hedging (which is designed to decrease risk to currency fluctuations) can, depending on exchange rate movements, cause one-off large revenue profits in some years. Such large revenue profits can be unexpected, and the entity concerned may not have been prepared in advance to collect and retain the appropriate records needed for the reporting.

In terms of reporting by superannuation funds themselves, superannuation funds are subject to an extensive mandatory disclosure regime that requires information to be provided regarding key features, costs, benefits and risks (which would include tax risks), amongst other things. ASFA considers that the potential imposition of any additional mandated disclosure for superannuation is a matter that should be considered in consultation with ASIC and APRA. On this basis, we submit that Australian superannuation funds and their majority and wholly owned managed investment vehicles should be carved out of the current MNE reporting proposals.

In accordance with specific concessions and exemptions in Australian taxation law enacted by the Australian Government specifically to encourage individuals to hold their retirement savings investment through Australian complying superannuation funds, those funds effectively pay 10% tax on long-term capital gains and no tax on retirement-phase pension income. Accordingly, ASFA does not concur with any assumption or suggestion that an entity that pays less than 15% tax on its income or gains is somehow necessarily acting in an untoward manner.

Managed investment vehicles into which Australian superannuation funds invest, such as managed investment trusts and foreign limited partnerships, are typically 'flow through' vehicles that do not themselves pay tax either. Typically withholding tax is instead deducted in the source country by the paying entity and final income tax is paid in the country of residence of the ultimate investor (that is, in Australia by the superannuation fund), but there is no tax in the intermediate country where the 'flow though' managed investment vehicle is located. So, if anything, interposing the managed investment vehicle (whether in a so-called tax haven or elsewhere) results in double tax compared to direct investment, as opposed to tax avoidance. And in this respect, a managed investment entity that is a 'flow through' vehicle versus formally exempt should not in principle be distinguished – this is important to recognise since many so-called tax haven countries adopt an exemption approach instead of a flow through approach for managed investment vehicles.

Recommendations – Multinational tax transparency

- Consultation about MNE mandated public reporting disclosures be referred to the Board of Taxation to provide specific recommendations having regard to the principles of:
  - (i) simplicity/understandability
  - (ii) consistency/comparability
  - (iii) cost/benefit efficiency in preparing and disclosing information.

- Any application of MNE reporting income thresholds should only apply from a second consecutive year that the thresholds are met, so that only entities that consistently meet the thresholds are required to report.
- The potential imposition of any additional mandated disclosure for Australian superannuation funds (and their majority and wholly owned managed investment vehicles) should be considered in consultation with ASIC and APRA rather than through the current MNE reporting proposals.
- Available tax concessions and tax exemptions, as well as differing mechanisms for flow through taxation, should be taken into account without negative inference when considering global minimum taxation. The investment should be viewed holistically. Seeking to identify potentially harmful tax practices should rather focus on transactions with jurisdictions that are not party to Exchange of Information agreements.