September 12, 2022

Assistant Secretary
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600
MNETaxIntegrity@treasury.gov.au

RE: Consultation Paper, “Government election commitments: Multinational tax integrity and enhanced tax transparency”

Dear Treasury:

We are writing in response to Treasury’s August 2022 Consultation Paper, “Government election commitments: Multinational tax integrity and enhanced tax transparency”.

OMERS is one of Canada’s large public pension plans with 541,000 members and over 1,000 employers. We invest C$121 billion in net assets to generate an investment return that, in turn, is used to pay pensions of Ontario police officers, fire fighters, school board employees, municipal employees and more. Our investments are diversified across different asset classes and geographies.

CDPQ is an institutional investor that manages funds primarily for Quebec’s public and para public sector pension and insurance plans. CDPQ’s overall portfolio includes high-quality assets of all classes which reflects our strategy to create long-term value for our Depositors. It is one of the largest institutional fund managers in North America, with net assets of C$392 billion as at June 30, 2022. CDPQ is also the second largest institutional infrastructure investor and one of the 10 largest real estate asset managers in the world.

OMERS and CDPQ have invested extensively in critical Australian real property and infrastructure, with combined Australian AUM of over A$12 billion. OMERS Australian investments include Port of Melbourne and Transgrid, and a recently announced transaction to purchase certain tower assets from TPG. CDPQ owns Port of Brisbane, Transgrid, Westconnex, and is a significant investor into social infrastructure assets as part of a partnership with Plenary Group, including Footscray Hospital, Victorian Comprehensive Cancer Center, Casey Hospital and Melbourne Convention Center to name a few.

We are writing to provide our comments on the consultation paper’s proposal to limit the deductibility of interest in computing taxable income to 30% of EBITDA. While we continue to support the implementation of the OECD’s Base Erosion and Profit Shifting (BEPS) Pillar 2 framework, we respectfully request that Treasury consider revising certain elements of the proposed interest deductibility limitation to enhance certainty for international investors and to encourage further investment in Australian real estate and infrastructure and maintain the country’s competitiveness for capital relative to other jurisdictions.

Please find below our three submissions regarding the proposed rules.

Grandfathering and Transitional Period

Like many investors, OMERS and CDPQ have made investment decisions based on the existing legislative and regulatory frameworks. We acknowledge and accept Treasury's ability to make changes to that framework, but believe in the interest of maintaining a stable and predictable investment climate, the provisions related to new limits on interest deductibility should only impact debt issued after the date on which the proposals were announced in Treasury's August 2022 consultation paper.

In particular, we believe interest expense relating to debt issued prior to August 2022 should be grandfathered and not impacted under the proposal to implement a fixed ratio test at 30% of EBITDA. Despite the 30% EBITDA limit being noted under OECD/G20 guidance, it is critically important to note that the Australian corporate tax rate at 30% is higher than many of its jurisdictional peers (for example, UK is 19%, US is 21%), as such the adverse impact of a fixed ratio test could be more significant, particularly in the higher interest rate environment.

Should the legislation ultimately not include a grandfathering provision, we believe the implementation should allow for a transitional period of up to 15 years for existing arrangements in place prior to the enactment of the legislation. This aligns with the transitional periods previously granted for legislative changes affecting foreign sovereign and pension funds, including amendments to the treatment of stapled structures, withholding tax exemption for superannuation funds with foreign residents and sovereign immunity exemption as outlined in *Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australian and Other Measures) Bill 2019*.

Further, our view is that a grandfathering rule for existing arrangements is particularly appropriate given the changes in the ATO's guidance on the application of the arm's length debt test for purposes of the current thin capitalization rules. Stability is important for investors like us, and the combination of these changes can impact future investment decisions.

Arm's Length Debt Test

The consultation paper proposes to add an interest deductibility limit of 30% of EBITDA but does not modify the current rule which requires shareholder loans to bear interest at an arm's length rate in order for the related interest expense to be deductible. Based on our experience with our existing Australian investments, the arm's length debt test requires a high level of analysis, documentation and in practice a high compliance cost, despite the ATO's guidance framework under Practical Guideline PCG 2020/7.

We respectfully submit that our experience around the world suggests that Australia's application of the arm's length standard is one of the most rigorous we have seen. if the interest deductibility limitation of 30% of EBITDA is implemented as agreed amongst OECD countries, the requirement for related party debt to bear interest at an arm's length rate should also be aligned with practices and standards recommended by the OECD, such as by implementing appropriate legislation to frame the methodology to be applied by the ATO or eliminating the requirement altogether given that the potential tax benefit will be capped in any event. These approaches would avoid putting Australia at a competitive

disadvantage as compared to other countries by having a higher tax rate with comparatively lower tax permissible tax deductions, and would enhance certainty for long-term investors such as OMERS and CDPQ by eliminating subjectivity in the determination of whether shareholder loan interest is deductible for tax purposes.

Exemptions from Interest Deductibility Limitation

Infrastructure and real estate projects require significant capital investments that are typically financed substantially with debt. Our experience is that commercial banks do not use the Interest to EBITDA ratio to determine the borrowing capacity for real estate and infrastructure projects. As a result, arm's length banks will often permit financing for infrastructure and real estate entities to utilize much higher leverage ratios and therefore interest expense in excess of 30% of EBITDA should be considered arm's length for these industries.

The consultation paper proposes to address this issue by permitting a multinational enterprise (MNE) to deduct third party interest expense to the extent that its Australian interest-to-EBITDA ratio does not exceed the MNE's consolidated interest-to-EBITDA ratio (the "arm's length debt test" or the "worldwide gearing test"). While we understand that this carve out is intended to be relieving, its impact is less advantageous for sovereign wealth and pension fund (SWPF) investors that are typically less highly leveraged than other real estate and infrastructure investors. In general, SWPF investors are limited in the amount of debt they are permitted to carry on their balance sheet, either because of local regulations in their home jurisdictions or because of more conservative investment approaches. Consequently, the proposed group ratio rule results in SWPF investors becoming less competitive in the Australian market. We propose two potential solutions to this:

- Provide an exemption from the interest deductibility limitation for SWPF investors, or

- Provide a carve-out from the interest deductibility limitation for real estate and infrastructure investments which would continue to be governed by the arm's length debt test.

With respect to the second solution, in the US tax reform passed in 2017, Congress provided a safe harbour rule that allows certain real estate and eligible infrastructure businesses to elect out of the American interest deductibility limitations.[1] To continue to encourage investment in Australian real estate and infrastructure, we believe Australia should follow the path set by the United States and exempt debt associated with investments in real estate and infrastructure from any new interest deduction limits.

Conclusion

Thank you for the opportunity to participate in the consultation process regarding these important tax changes.

Should we be of any assistance to you as you consider our proposals, please contact us at lmurphy@omers.com for OMERS and sbosse@cdpq.com for CDPQ.

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[1] Rev. Proc. 2018-59 permits certain infrastructure trades or businesses to elect to be treated as a real estate trade or business for purposes of Internal Revenue Code, Section 163(j)(7)(B).

Sincerely,

Elizabeth Murphy
OMERS Global Head of Tax

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VP Finance & Tax - CDPQ