

13 April 2023

Mr Marty Robinson
First Assistant Secretary
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

(via email: MNETaxIntegrity@treasury.gov.au)

Dear Mr Robinson,

RE: Strengthening Australia's interest limitation (thin capitalisation) rules

The Australian Petroleum Production & Exploration Association (**APPEA**) is the peak national body representing companies actively engaging in oil and gas exploration and production in Australia. APPEA welcomes the opportunity to make a submission to Treasury on the *Treasury Laws Amendment (Measures for Future Bills) Bill 2023: Thin capitalisation interest limitation* Exposure Draft (**ED**) and accompanying Explanatory Memorandum (**EM**).

APPEA has had the opportunity to review the submission by the Corporate Tax Association (**CTA**) dated 13 April 2023. We support and endorse the commentary and recommendations contained in within the CTA submission. It is critically important the policy settings and legislative frameworks are designed to attract investment in Australia. Potential changes and the signals being sent need to be reviewed in the context of broader policy considerations currently being addressed by the industry and the Government. Specific to this industry, this includes measures that cap the price of wholesale gas supply, costs associated with meeting emissions reductions under the safeguard mechanism and as publicly noted by the Treasurer, potential changes to the Petroleum Resource Rent Tax regime.

The benefits of attractive and stable policy and regulatory settings are evident. A decade of legislative and regulatory stability underpinned much of Australia's social and economic success through the investment of more than A\$400 billion in the development of oil and gas projects, the employment of 160,000 Australians, and spent billions of dollars on local goods and services.

It has also delivered A\$69 billion of taxes, rents and royalties have been paid directly to state and federal governments with Australia's LNG industry to contribute more than A\$13.8 billion to government revenues in 2022-23. This has delivered local benefits through the provision of secure, reliable, and affordable energy to Australian homes and businesses and enabled investment in housing, hospitals, schools and critical infrastructure.

Further, it will be Australia's oil and gas industry that will accelerate Australia's energy transformation to a net zero 2050 economy. The industry has the skills, knowhow and ability to deliver large-scale capital-intensive projects with APPEA members already investing heavily to support economy-wide policy to drive down emissions by committing more than \$20 billion to achieving Australia's lower emissions future.

As a capital importing nation, it is important that Australia re-establishes its reputation as an attractive investment destination. We are concerned that the mechanics of the ED and EM put at risk Australia's reputation as an attractive destination to attract capital and the economic and social benefits that flow as a result. As such it is imperative that we make the following observations:¹

- If implemented as is, Australia will have one of the most restrictive interest limitation regimes that will diminish Australia's investment attractiveness. It will stall Australia's energy transformation and a low emissions future as much of the trillion-dollar spending required to develop renewable energy, hydrogen and low emissions technologies such as carbon capture and storage will require foreign debt.
- The ED and EM does not reflect the policy intent of the government announcement and includes proposed changes to section 25-90 that have not been consulted on and beyond the scope of the government announcement. The proposal is short-sighted in terms of impact on investment and disregards changes introduced in 2013 that introduced deregulatory measures that removed the need for tracing.
- Earnings Before Interest, Tax, Depreciation and Amortisation (**EBITDA**) is a measure of earnings which excludes key non-cash expenses to provide an indication an entity's ability to meet its interest obligations. There does not appear to be any policy reason to exclude all division 40 deductions other than subdivision 40-B amounts from the meaning of depreciation and amortisation for the purposes of determining tax EBITDA. This seems to be an oversight in the ED. All Division 40 amounts that are deductible over time are non-cash deductions and would typically be included within depreciation and amortisation in an accounting context.
- In addition to being inconsistent with other jurisdictions, the External Third-Party Debt Test (**ETPDT**) will disincentivise foreign companies from co-developing projects and infrastructure with superannuation funds that will put at risk the project financing required in Australia's energy transformation. Project Financing is the most common means of financing renewable power generation assets, however the limitations in the provision due to the definition of 'associates' and the exclusion of guarantees (a key feature during construction periods of project financing) will render the ETPDT as unable to be utilised by entities with project financing arrangements. This will directly impact the ability of renewables projects to be funded and developed, a situation counter intuitive to the Governments stated energy and climate policy.
- The ETPDT is at odds with the Federal Budget announcement that the Arm's Length Debt Test (**ALDT**) would be retained albeit with some restrictions on related party debt. We note that the ALDT was subject to rigorous testing by the Board of Taxation and there has been inadequate reasoning provided by Treasury as to why the ETPDT – a test that is unworkable in any event - should replace the ALDT.

¹ All legislative references are to the *Income Tax Assessment Act 1997* unless otherwise stated.



- It is unclear as to why the ETPDT disallows debt deductions to the extent that they exceed the entity's deductions attributable to external third-party debt struck under arm's length commercial terms. This does nothing more than build on Australia's growing reputation that it is anti-business and suggest it is removed.
- The thin capitalisation rules already determine a taxpayer's maximum allowable quantum of debt. Many taxpayers that will become "General class investors" under the proposed new thin capitalisation rules, have existing related party debt arrangements that were entered into having regard to the safe harbour debt amount. A transitional rule should be available to taxpayers who have relied on the current rules. The result of these measures will only increase Australian investment uncertainty and the added burden on the taxpayer in additional compliance costs from seeking external expert and lead to additional court disputes with the ATO on valuation methodologies and contentious interpretations.

If you require further information or would like to discuss the comments above, please do not hesitate to contact me on 0403 152 157, or at sstaples@appea.com.au.

Yours sincerely

A handwritten signature in blue ink that reads "Simon Staples".

Simon Staples
Director – Policy & Capital Markets