

International Tax Unit
Corporate and International Tax Division
Treasury

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13 April 2023

Dear Sir/Madam

Multinational Tax Integrity – strengthening Australia’s interest limitation (thin capitalisation) rules

CPA Australia is Australia’s leading professional accounting body and one of the largest in the world. We represent the diverse interests of more than 170,000 members in over 100 countries and regions. We make this submission in response to the [Treasury Laws Amendment \(Measures for Future Bills\) Bill 2023: Thin capitalisation interest limitation Exposure Draft](#) (the ED) and accompanying [Explanatory memorandum](#) (EM) on behalf of our members and in the broader public interest.

In our September 2022 [submission](#) in response to the Treasury [consultation paper](#) on multinational (MNE) tax integrity, we expressed our broad support for efforts to align Australia’s thin capitalisation (TC) rules with OECD guidance and approaches in other jurisdictions. We emphasised that the proposed rules should be designed so as not to constrain arm’s length commercial activity nor affect the viability of investments in Australia.

The fixed ratio of 30 per cent, while towards the top of the OECD’s recommended range, is tailored for the composition of the Australian economy, while the availability of three alternative tests provides practical flexibility for taxpayers. The introduction of the ‘general class investor’ is a useful simplification, while the ability to change tests from year to year is pragmatic and helpful.

The commencement date from 1 July 2023 and the lack of transitional rules may create significant challenges for affected MNEs to reorganise or refinance debt, particularly longer term arrangements or where investments are contingent on a particular cost of capital. To minimise disruption to investments we recommend that further consideration be given to transitional rules, such as the inclusion of a grandfathering clause similar to that contained in the [EU Anti-Tax Avoidance Directive 2016/1164](#) (ATAD).

The TC control interest threshold, at 10 per cent, is extremely low. In our view, this is significantly below well-established thresholds for ‘control’ or ‘influence’ and is inconsistent with the recommendations and reasoning contained in the OECD report, [Limiting Base Erosion Involving Interest Deductions and Other Financial Payments ACTION 4: 2015 Final Report](#), upon which the ED provisions are based. We suggest that the rules use, at a minimum, either the 20 per cent threshold for associates (as used for financial reporting¹) or the 25 per cent threshold for ‘associated enterprise’ used by the European Union (EU).

With the removal of the current safe harbour provisions, in combination with the proposed 10 percent TC control interest threshold, total associate inclusive interest may very quickly exceed the \$2 million debt deduction threshold requiring smaller MNEs to demonstrate that the debt is arm’s length, in order to claim any interest deduction. We

¹ OECD (2015), ‘Notes’, Chapter 7. Group Ratio Rule, Limiting Base Erosion Involving Interest Deductions and Other Financial Payments ACTION 4: 2015 Final Report, p.66

reiterate our view that the de minimis debt deduction threshold should be set at \$5 million to better align with the EU threshold and to avoid unnecessarily impacting smaller subsidiaries with low related party debt amounts.

The inclusion of a 15-year carry forward rule is positive. However, the availability of the deduction is subject to the continuity of ownership test (COT). We suggest that consideration be given to also making deductions available under the business continuity test (BCT), as the EM does not propose its exclusion.

At a practical level, the group ratio (GR) calculations may be challenging, particularly with the 10 per cent threshold for TC control interest. Calculation of net third party interest expense will require knowledge of the interest payments to, and receipts from, '10 per cent associates'. Similarly, disregarding entities with negative EBITDA from the GR group EBITDA calculation will require knowledge of all group entities' results. This may require considerable investment to upgrade business systems.

We note that the OECD's proposed approach suggests using the financial statements disclosures as the starting point, keeping any adjustments to a minimum and, even then, that the information should be taken from the financial statements. We recommend that Australia's adoption of the OECD's guidance should be consistent with that guidance, to align Australian rules with global rules and those of our major economic partners.

The external third party debt test is intentionally very narrow, however, it is unlikely to be available to more than a handful of taxpayers or arrangements. It is also unclear how smaller MNEs might satisfy the requirements, particularly where current practices such as parental letters of support, which often reduce the cost of debt for these subsidiaries, would breach the recourse requirement of the 'external third party debt conditions'.

The inclusion of conduit financier arrangements is a positive design feature as it maintains Australian entities' ability to access an MNE's group borrowings. However, the level of documentation and tracing required to demonstrate compliance is unclear. It may be challenging for Australian subsidiaries of MNEs to obtain such data or to influence the MNE's global processes.

The one-in, all-in rule requiring all associates to adopt the chosen test could make it practically difficult to apply. An associate at the 10 per cent TC control threshold has limited influence and no control over entities with over 50 per cent control, or vice versa. Similarly, if a 10 per cent TC control entity that has no other interest in the group does not agree to the chosen test, then the entire group is denied access. We recognise the restriction on choice for integrity purposes, however, the introduction of the low 10 per cent TC control threshold appears to result in incongruous outcomes.

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Yours sincerely,



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