

April 11, 2023

International Tax Unit
Corporate and International Tax Division
Treasury
Langton Cres
Parkes ACT 2600

Dear International Tax Unit,

RE: Canada Pension Plan Investment Board (CPP Investments) response to the Treasury's consultation on *Multinational Tax Integrity – strengthening Australia's interest limitation (thin capitalisation) rules (16 March 2023 – 13 April 2023)* ("Consultation")

On behalf of the Canada Pension Plan Investment Board (CPP Investments), we wish to thank the Treasury for the opportunity to provide comments in response to the abovementioned Consultation, including the proposed amendments to Australia's thin capitalisation regime contained in the "*Treasury Laws Amendment (Measures for Future Bills) Bill 2023: Thin capitalisation interest limitation*" ("Thin Capitalisation Bill").

About CPP Investments

CPP Investments is a leading global professional investment management organization that invests the assets not needed by the Canada Pension Plan (CPP) to pay current benefits. At December 31, 2022, the CPP fund reached C\$536 billion (~A\$579 billion), making it Canada's largest single-purpose pension fund and ranking among the 10 largest retirement funds worldwide. We are a committed, patient capital investor in Australia, with C\$14.6 billion (~A\$15.8 billion) invested across infrastructure, real estate, public and private equities, funds and credit. Our investments are anchored by our strong local presence, including our office in Sydney and network of business partners. CPP Investments' long investment horizon allows us to act as an important provider of capital for projects with public interest benefits, including in real estate, infrastructure and sustainable energies. We also actively integrate responsible investing considerations into our investment activities and have committed our portfolio to net-zero greenhouse gas emissions across all scopes by 2050.

Introduction of the Thin Capitalisation Bill

We are mindful that the Australian Government, through its economic and fiscal policies, is working appreciably to navigate the headwinds of complex global macroeconomic conditions and inflationary pressures, to mitigate their near-term impacts on Australia's economy and society, while also aiming to position your country for more innovative and sustainable economic growth going forward. Indeed, as a long-term investor, we have invested in Australia's ongoing economic success story and are appreciative of its longstanding welcome of foreign investors like CPP Investments. We also

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acknowledge that the proposed thin capitalization rules are designed to bring Australia's tax system more closely into line with Organisation for Economic Cooperation and Development ("OECD")'s best practice guidance.

However, we respectfully submit below several areas of concern regarding the Thin Capitalisation Bill, and note the potential unintended consequences of the new rules, including an increase in the cost of capital in sectors such as real estate, infrastructure and energy which are key to Australia's economic productivity, growth, supply chain resilience, energy sustainability and social wellbeing.

1. Need for predictability and consistency

For a global long-term investor like us, the stability and predictability of regulatory and taxation frameworks, including the consistent and transparent application of tax laws, are important considerations when undertaking significant capital deployments in any jurisdiction, including Australia.

While we appreciate that the changes are intended to be aligned with the OECD's best practice guidance, the Thin Capitalisation Bill represents a departure from the policy settings that have been in place for our investments into Australia (which is further explained below). CPP Investments has invested in Australia on the basis of the existing regime that allows for **commercial** levels of debt funding.

Further, as Australian-based investors generally do not fall within the thin capitalization regime, foreign investors like us are disproportionately impacted and can be competitively disadvantaged. It is important to maintain a more certain and level playing field in the Australian capital market to enable future investments by foreign investors.

2. Practical challenges with the third-party lender test

The proposed changes to the third-party lender test represent a clear policy shift from the existing arm's length debt test originally in place and under which we undertook significant investments. Practically the current drafting of the third-party lender test does not allow for genuine third-party debt to be deductible in most scenarios due to the requirements for all 'associate entities' to elect to apply the third-party lender test.

For many large real asset investors like CPP Investments, it is extremely challenging to identify every 'associate entity' in order to elect into the external third-party lender test and this is further complicated where investments are made alongside a joint venture partner or a consortium, where there is minimal visibility of all associate entities. Therefore, in practice, it may be impossible to determine whether the election requirement is met.

3. Applicability of the rules to trust structures

The proposed rules are drafted from the perspective of corporate entities and do not adequately account for the common unit trust investment structures through which long-term investors like CPP Investments undertake capital deployments in capital-intensive sectors, such as the infrastructure and real property sectors. The new rules require security to be granted by only the borrowing entity and do not allow for circumstances where security is granted by another entity in the wholly owned economic group. Where external debt is raised to fund the activities of entities within its economic group, this can result in denials of genuine third-party debt in many instances such as when a holding trust borrows from third parties where the loan is secured against both the units in the subsidiary trust as well as the assets of the subsidiary trust.

4. Restrictive rules on effective grouping

Given the difficulty in applying the external third-party debt test, the only available methodology is the Fixed Ratio Test. However, there are a number of issues with the Fixed Ratio Test which do not make it fit for purpose for infrastructure and real estate investments.

The Fixed Ratio Test does not include the ability to claim excess capacity that may be available from associate entities. This produces an adverse result compared to the current rules under which entities within the same economic group can rely on the concept of sharing of excess interest deduction. This is particularly important where the borrowing entity is not the asset-owning entity, which is very common for property and infrastructure investments, as this will inadvertently result in lower thin capitalisation capacity.

5. Compressed timeline with no transitional relief or carve outs

The Thin Capitalisation Bill was released with limited time for consultation and with little lead-time, coming into force on July 1, 2023. As highlighted above, there are a number of important issues that need to be addressed in order to ensure that the external third-party debt test and Fixed Ratio Test can apply to property and infrastructure investments in a manner consistent with the policy intention. We look forward to working with the Treasury but, at the same time, are concerned that there is insufficient time to properly address and resolve the issues based on the current proposed timetable.

Further, there is no flexibility for grandfathering or transitional relief for taxpayers. This does not give investors adequate time to restructure their Australian investments or provide comfort that the Australian Tax Office (ATO) will not raise any integrity concerns with taxpayers restructuring their arrangements in response to these changes and compounds uncertainty in light of the issues identified above. Certain other jurisdictions have adopted mitigating safeguards such as carve-outs and / or concessions for sectors that would otherwise have been impacted by comparable tax adjustments. For instance, the United Kingdom has provided a specific carve-out for the infrastructure sector as part of its Corporate Interest Restriction rules.

Recommendations

In light of the concerns outlined above, we respectfully recommend the Treasury to consider the following:

1. Ensuring the changes are in line with the policy intent and, in particular, where genuine third-party debt is provided to trust groups and is secured against the assets of that economic group, such arrangement should qualify for the external third-party debt test.
2. The integrity concerns that require all associate entities to elect to apply the external third-party debt test could be addressed in the following manner:
 - a. consider having all entities within a wholly owned group electing to apply the external third-party debt test as opposed to the 10% common ownership test; or
 - b. exclude distributions by trusts that elect to apply the external third-party debt test from the calculation of tax EBITDA under the Fixed Ratio Test.
3. The Fixed Ratio Test to include the ability to claim an excess capacity that is available from associate entities. As an integrity measure, consider restricting excess capacity for entities applying the external third-party debt test.
4. Consideration be given to providing transitional relief to the property and infrastructure sectors given the complexities of the rules and the important issues identified.

Investment capital from global long-term investors like CPP Investments has played, and can continue to play, a critical role going forward in Australia's economic success. We continue to look at potential opportunities across sectors in the Australian market, noting that the Government has underscored Australia's significant needs and laudable ambitions with respect to the energy transition and the growth of its renewables generation and affordable housing sectors as well as in other infrastructure classes. Foreign inbound investments, notably from long-term investors, will play an essential role in supplying the capital that will be needed to realize these ambitions. A strong and balanced investment framework for inbound investors remains key to maintaining a stable and competitive market for established investments and for the funding of future investments, which in turn will benefit Australia.

Through our long investment presence and consideration of future opportunities in Australia, CPP Investments has endeavoured to be prudent in our approach to tax structuring in recognition that our investments are long-term and that it is in our best interest to invest using structures that are both acceptable and sustainable, such as those impacted by the new thin capitalization rules.

We want to thank you for your consideration of the perspectives shared in this submission, and would welcome the opportunity to engage further, including with respect to any queries you may have.

Sincerely,

A handwritten signature in blue ink, appearing to read "John Graham". The signature is fluid and cursive, with a large initial "J" and "G".

John Graham
President and Chief Executive Officer