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Dear David

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

The Property Council welcomes the opportunity to provide comments to the Treasury consultation regarding the exposure draft legislation which amends Australia's thin capitalisation rules, released in March 2023.

The Property Council of Australia champions the industry that employs 1.4 million Australians and shapes the future of our communities and cities. Property Council members invest in, design, build and manage places that matter to Australians: our homes, retirement villages, shopping centres, office buildings, industrial areas, education, research and health precincts, tourism and hospitality venues and more.

We are deeply concerned that the Government's proposed changes to the thin capitalisation regime, as set out in the exposure draft legislation, will severely limit the ability of large multinational groups in the property sector to access debt financing and will deter both debt and equity investment from offshore sources of capital.

As a result, Australia's attractiveness to international capital would be negatively impacted if extensive changes aren't made to the draft legislation. As the economy faces numerous challenges such as housing affordability (driven by a lack of housing supply) and interest rate rises impacting debt availability, enacting policy changes that don't operate as intended would be particularly harmful to the wider economy.

We believe that several key issues need to be resolved in order to enable the changes to operate as intended for the property sector, principally:

- critical policy design issues, focused on enabling common third party financing arrangements in the property context to satisfy the external third party debt test; and
- other important issues and enhancements to the draft legislation that would ensure a fair and equitable outcome in accordance with OECD guidelines.

More details regarding these issues, as well as recommendations to solve these problems, are provided in the document attached to this submission.

If you would like to discuss any aspect of this submission further, please contact Kosta Sinelnikov on 0422 168 720 and ksinelnikov@propertycouncil.com.au or myself on 0484 354 272 and aknep@propertycouncil.com.au.

Yours sincerely



Antony Knep
Executive Director – Capital Markets

Thin capitalisation and financing arrangements in the property sector

This main section of our submission puts forward industry recommendations to help ensure that the proposed thin cap rule changes as set out in exposure draft legislation are consistent with the Government's policy to provide an exception for genuine third party debt, as well as to improve the operations of those rules. This paper is divided into two sections:

- critical issues, focused on enabling common third party financing arrangements in the property context to apply to the external third party debt test
- other important issues and proposed enhancements to ensure a fair and equitable outcome in accordance with OECD guidelines

Critical issues

These issues must be addressed in order for the new thin capitalisation rules to operate as intended for the property sector.

Issue	Why is it a problem?	Proposed solution
External third party debt test (ETPDT) – choice		
An entity can only choose to apply the test if all associate entities that are general class investors also choose to apply it under s820-43(5).	<p>The requirement that all associate entities, based on a 10% TC control interest threshold that are general class investors make the ETPDT choice will make the ETPDT entirely unpractical and will severely limit the availability of the ETPDT. This is because an entity with a 10% TC control interest will not have any actual influence or control, or any visibility or ability to procure information in relation the tax affairs of the other entity.</p> <p>Firstly, relevant associate entities can also include foreign entities that have no Australian debt deductions as well as Australian entities with a common 10%+ unitholder, but that are otherwise unrelated (i.e. "sister" structures). Associate entities may also have different year ends for income tax purposes, and thus there are different deadlines under section 820-43(7) for making the choice. The entity with the earlier date will not have certainty about whether the associate entity will make the choice at the time of preparation of its income tax return and its own election.</p> <p>The one-in all-in requirement will have a wide ranging effect across entirely unrelated structures. For example, assume an investor holds 25% in</p>	<p>The one-in all-in nature of the election should be removed in its entirety.</p> <p>We understand the integrity concern relates to a circumstance where an entity makes the ETPDT election, and an upstream unitholder does not make the election in order to access the fixed ratio test (allowing double gearing, potentially with related party debt upstream).</p> <p>Once the one-in all-in election is removed, and in order to address this integrity concern, where a downstream vehicle makes an election to apply the ETPDT, any upstream entity should be required to calculate their tax EBITDA on a modified basis, excluding taxable income referable to their share of the net income of the downstream fund (or dividends paid by the downstream entity) from its tax EBITDA calculation. This will prevent double gearing of the same income stream. In this</p>

Property Fund A, and also holds 25% in Property Fund B, an unrelated property fund. In order for Property Fund A to make the election, the investor will need to make the election. Once the investor makes the election, Property Fund B will need to make the election. Once Property Fund B (which is unrelated to Property Fund A) makes the election, all other unitholders in Property Fund B holding 10% or more will need to make the election, and so on. The policy rationale for requiring an unrelated investor in an unrelated property fund to make the election is entirely unclear.

This also works in reverse where there is a failure to make an election. Assume, for example, that one of the investors in Property Fund B fails to make the election, which may be because they do not claim debt deductions and are not aware that the thin capitalisation regime applies to it. Their failure invalidates the election of Property Fund B, which invalidates the election of the investor in Property Fund B, which invalidates the election of Property Fund A, and so on.

Seeking to resolve this by (for example) increasing the threshold will not resolve the fundamental issue, which is that one unitholder may prevent the Property Fund from making an election in the interests of all of the other unitholders. In addition, that election may be in the interests of unitholders collectively.

To take an example, assume a Property Fund has borrowed solely from external third party lenders, and would have a debt deduction denial of \$1 million under the fixed ratio rule. Further assume that an investor who holds 40% would have a debt deduction denial of \$600,000 if it makes the election. No other unitholders would have a debt deduction denial if they make the election. It is in the interests of that sole unitholder not to make the election (as it would lose \$600,000 of debt deductions, and only gain

scenario, if the only income stream of the upstream unitholder arose from the investment in the fund, there would be no thin capitalisation capacity. Where the unitholder is an associate entity (in our view this should be based on a 20% TC control interest threshold) and applies the fixed ratio test, such distributions (or their share of net income arising from being presently entitled to income) would need to be excluded from Tax EBITDA.

It should be noted that this modified fixed ratio test will need to apply to both direct and indirect unitholders, and will need to be based on taxable income. There will need to be a process for expense allocation.

	<p>40% of \$1 million), notwithstanding that all investors would be collectively better off if the election were made.</p> <p>Finally, it is entirely plausible that a fund will not have any visibility or ability to procure information in relation the tax affairs of the other relevant entities. In practice, this makes making the election impossible.</p> <p>Realistically, therefore, it will often be impossible for an Australian entity to (1) identify all “associate entities” based on a 10% TC control interest threshold, (2) obtain assurance that all such associate entities have (or will) make the election (3) access the ETPDT, due to one or more associate entities seeking to apply the fixed ratio test (FRT) or group ratio test (GRT), even though this does not cause integrity issues (e.g. sister structures).</p> <p>As such, the ETPDT election requirement is currently unworkable.</p>	
Effect of election being invalid or of the ETPDT not providing additional capacity	<p>If an entity makes an election to apply the ETPDT, and the application of the ETPDT is incorrect (e.g., the ATO challenges that position and succeeds), the entity should remain eligible to apply the fixed ratio test as an alternative.</p> <p>In addition, if an election itself is invalid (e.g., as the relevant requirements were not satisfied), the entity should remain eligible to apply the fixed ratio rule.</p>	<p>In a situation where the implications of the ETPDT turn out to be incorrect (e.g., the ATO successfully challenges the position), a fall back to apply the fixed ratio rule should apply. This is similar to how the current rules operate.</p> <p>Where an entity makes an election, but that election is invalid (e.g., because an associate entity has not made an election), and assuming the one-in all-in requirement remains, it should be clarified that the entity making the invalid election remains able apply the fixed ratio rule. This appears to be consistent with the current operation of the election provisions, and so this clarification could be included in the Explanatory Memorandum.</p>

Associate entities may have different year ends for income tax purposes, and thus there are different deadlines under section 820-43(7) for making the choice.	<p>The entity with the earlier date may not have certainty about whether the associate entity will make the choice at the time of preparation of its income tax return and its own election.</p> <p>Consequently, it may make the election based on an expectation that the other entity will make the election (which, if it turns out to be incorrect, will invalidate the election) or, may not make an election where such an election would be required to permit the other entity to make an election.</p>	Remove the one-in all-in requirement, as recommended above.
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ETPDT – conditions

The application of the provision applies only to debt deductions that are attributable to debt interests (s820-61)	<p>The ETPDT permits debt deductions that are attributable to debt interests as allowable deductions, where the relevant conditions are satisfied.</p> <p>However, as a consequence of the changes to the definition of "debt deduction", there is no longer any requirement that the debt deductions relate to a debt interest – as drafted, it appears that it may (for example) cover interest rate swap payments.</p> <p>If an election is made, the debt deductions in respect of instruments that are not debt interests (such as interest rate swaps) will be denied, notwithstanding they may be arrangements entered into with genuine third parties.</p>	<p>For instruments giving rise to debt deductions where the instrument is not a debt interest, it should be sufficient that the counterparty is not an associate entity of the issuer. Similar provisions for conduit financing need to be included in respect of arrangements that are not debt interests.</p> <p>There should be no requirements in respect of recourse, as most arrangements such as swaps are not secured.</p>
The requirement that recourse can only be to the assets of the borrower (s820-61(2)(c))	Lenders typically require recourse to other entities as a condition of a secured loan. For example, if the debt is borrowed by an asset trust, security would (at least) be taken over the units held by the holding trust in the asset trust. This is not to provide credit support to the bank, but to assist in enforcement and taking of security in the case of default (i.e., as it is easier to exercise security over the units, rather than secure assignments of underlying assets, including assignments of a potentially large number of leases). Conversely, if debt is provided at an upstream level, security would	<p>There should be no integrity concerns where the relevant security (and recourse against entities) is against Australian entities which predominantly hold Australian assets (e.g., by value).</p> <p>With respect to the meaning of 'Australian assets', we note that there is a relevant concept in section 12-383 of Schedule 1 to the <i>Taxation Administration Act 1953</i> (Cth), which refers to assets that are situated in Australia, assets</p>

	<p>typically be provided over the assets of the downstream asset trusts, as well as over the units in the borrowing trust.</p> <p>Consequently, the requirement in the proposed ETPDT that the third party lender only have recourse for payment to the assets of the entity will in almost all common circumstances mean that the ETPDT will not be available. Such an outcome is inconsistent with the express Government announcements regarding there being an exclusion for genuine third party debt.</p>	<p>that are taxable Australian property (i.e., which covers direct interests in land and direct and indirect interests in land rich entities), and assets that are listed for quotation on an approved stock exchange in Australia. We consider that this approach should be appropriate in determining the scope of appropriate security arrangements – that is, it will prevent non-Australian assets or entities providing credit support in order to load additional debt into Australian vehicles.</p> <p>Note that a separate exception is required to deal with construction finance (discussed below), which will often involve a parental guarantee or other form of commitment (e.g. equity commitment), where that parent may be an offshore parent for inbound investors. In the absence of these arrangements, construction finance will not be able to be obtained for inbound groups undertaking development.</p>
<p>Recourse in the context of development assets(e.g., large scale construction activities) (s820-61(2)(c))</p>	<p>In the context of construction finance (i.e., external third party debt provided to partially finance large developments or redevelopments, such as Build-to-Rent developments or commercial office buildings), it is common for external financiers to seek some form of parental guarantee or other support, such as support in the form of an Equity Commitment Letter (whereby the parent agrees to provide equity to the borrowing vehicle in order to meet certain costs, such as (for example) development cost overruns or interest payments).</p>	<p>In order to address integrity concerns around the use of offshore parental support (which we accept raises integrity concerns over the possibility of debt loading into Australia), we would propose that the exception is tightly constrained, as follows:</p> <ul style="list-style-type: none"> Limited to development that is significant (where parental support is required), such as developments with capital expenditure of at least \$20 million. Alternatively, this could be linked to FIRB requirements (e.g., on an asset where FIRB approval was required as part of the acquisition or would have

The rationale for seeking parental support in the context of construction finance is because the underlying asset is not (yet) income earning, and further there are a range of risks associated with undertaking developments.

In the context of inbound investors, the entity of economic substance from which the external financier would typically look for this support is an offshore vehicle.

Based on the current drafting, the provision of a parental guarantee would result in the external financier having recourse against the parent vehicle, which would result in the ETPDT not being available. Even where the proposed changes with respect to the recourse requirements above are made, the parental guarantee would prevent the Australian vehicle from accessing the ETPDT.

To allow inbound investors to continue to access external credit markets to partially finance development in Australia – activities that provide a significant number of jobs to the Australian community as well as boost the value and utility of Australia's real estate assets – additional permissible recourse needs to be included with respect to development assets that permits the provision of offshore parent support.

In some circumstances, the external financier requires other forms of support – either an Equity Commitment Letter or, alternatively, a third party guarantee (such as a Bank Guarantee or Letter of Credit), which may be obtained by the borrower or a holding trust. These arrangements also need to be facilitated.

been required as part of the acquisition if it were to be acquired);

The parental support should only be permitted during a specific time period and where relevant conditions are satisfied, such as:

- A development approval has been obtained;
- The debt interests issued under the construction finance facility are to undertake development activities (including funding lease incentives) consistent with that development approval;
- Parental support may be in place up to the time that the development asset achieves stabilisation (which, generally, would be 80% of the net lettable area being subject to leases). Alternatively, this could be based on the conditions in the construction finance facility around the meaning of stabilisation or when the facility converts or is required to be refinanced.

Note that these parameters are broadly consistent with the terms traditionally included in a construction finance facility.

With respect to Equity Support Letters (or equivalent), these typically provide that a parent vehicle will provide equity to the borrower in order for it to meet certain costs (such as cost overruns or interest payments). These

		<p>arrangements are consistent with the policy intent of the thin capitalisation regime, which is to encourage the provision of equity to Australian vehicles. In addition, the ability to call on the commitment in the letter generally constitutes an economic asset of the borrower. It should be clarified (in the Explanatory Memorandum) that these arrangements are acceptable.</p> <p>On third party guarantees (such as Bank Guarantees or Letters of Credit), these support arrangements should also be permissible, noting they are third party arrangements. Note that bank guarantee arrangements may be facilitated by the parent vehicle (i.e., the parent may obtain the guarantee).</p>
The requirement that debt must be used to wholly fund Australian investments and operations (s820-61(2)(d))	<p>The relevant debt must only fund Australian investments and operations. If there are any investments or operations outside of Australia that are undertaken by the group, it would be practically impossible to prove that <u>none</u> of the debt was used to fund such investments and operations, particularly where debts have been in place for a number of years. It is also unclear whether the requirement in s820-61(2) can be satisfied in respect of the re-financing of funding for such Australian investments or operations (e.g. re-financing of a loan or directly replacing equity funding with third party loan funding).</p> <p>The provision (as drafted) is not proportional because if a single dollar were used to fund foreign operations, all of the debt deductions would be denied under the ETPDT.</p>	<p>Given the proposed repeal of section 25-90 and existing scope of section 25-90 (i.e. not allowing a deduction for amounts incurred that are costs in relation to a debt interest, where those costs are incurred in deriving foreign sourced income that is non-assessable non-exempt income), the requirement in s 820-61(2) creates unnecessary additional tracing requirements and should be removed. In addition, the tracing requirements operate as a cliff (i.e., any dollar amount spent on foreign operations results in all debt deductions being denied), in contrast to the section 25-90 repeal position.</p> <p>An alternative solution is to have a pro rata reduction in the extent to which interest is deductible under the ETPDT to the extent that the entity's total income (i.e., assessable income and non-assessable non-exempt</p>

		income) is assessable income (or to the extent of Australian assets compared to non-Australian assets).
The requirement in s820-61(3) that the Australian investments relate only to assets that the entity holds for the purpose of producing assessable income	This requirement is overly restrictive as it could result in the ETPDT not being available where an entity derives any non-assessable non-exempt income, even if these are Australian sourced (for example cash flow boost payments).	S820-61(3) is overly restrictive and should be removed from the legislation.
Discretion in satisfying the ETPDT	It is possible that elements of the ETPDT could be failed for a small part of an income year, or alternatively could be failed on a highly technical basis, where (substantively) the debt is clearly third party debt. In these circumstances, it should be possible for the Commissioner to have discretion to treat the third party conditions as being satisfied.	A broad discretion should be included for the Commissioner to treat any of the third party debt conditions as being satisfied where the Commissioner considers that it is fair and reasonable in the circumstances.
ETPDT – conduit financier		
Conduit financing requirements are too restrictive and are not able to be satisfied in common financing scenarios.	It is not possible to on-lend on the same terms, as typically the third party financier will take security over the assets of the entity to which the funds are on-lent. Accordingly, if the on-lending arrangements were to be secured (which it typically would not be), any security would need to be a second ranking security (and, therefore, not the same).	Only require the same or substantially similar terms with respect to interest rate, tenor, and payment terms. Substantially similar should include a safe harbour for a small margin – e.g. a 50 basis point margin.
On-lending by the conduit financier to other entities is required to be on the “same terms” as the external debt	There are a range of other terms that may differ, such as agency or majority lender provisions. The relevant integrity concerns relating to the terms of the on-lending relate primarily to the interest rate (i.e., whether it is the same as the rate	Similar terms should also allow accounting for hedging arrangements (e.g., reflect an all-in cost of the relevant arrangements).

<p>(other than the amount on-lent).</p>	<p>applicable to the external borrowing), the payment terms (i.e., do payment obligations align, or could interest be calculated over different periods), and also the tenor (could certain deductions or income be accrued over different periods).</p> <p>We would suggest that only the interest payment terms should be the same, or substantially the same, to balance any potential substantial re-characterisation integrity concerns . It is common to charge a small margin in certain conduit financing arrangements, either to cover administration costs of the conduit financier (e.g., tax return preparation, audit), or because there may need to be a margin to meet arm's length requirements in the current thin capitalisation regime (see definition of associate entity debt).</p> <p>Further issues with a 'same terms' approach include:</p> <ul style="list-style-type: none"> • There may be several external loans within the conduit financier, and the on-lending by the conduit financier may reflect the blended interest cost across the external loans. • The conduit financier may hedge its loan position (e.g., may enter into interest rate swaps), and on-lend based on the hedged position. For example, a conduit financier may borrow at (say) BBSW +150 bps, and hedge that exposure to a fixed rate of (say) 7%. It may then on-lend at 7%. <p>There are a range of other issues, as follows:</p> <ul style="list-style-type: none"> • Section 820-61(4) also refers only to the "debt interest". As mentioned above, debt deductions may now arise in respect of financial instruments which are not debt interests (e.g., swaps). 	<p>It should be noted that the recourse for payment needs to be amended to reflect our comments above in respect of the non-conduit financier ETPDT. In addition, the conduit financier will typically provide security over all of its assets, not just the assets comprising on-lent debt.</p> <p>With respect to the other issues identified, our proposed solutions are as follows:</p> <ul style="list-style-type: none"> • Section 820-61(4) should be broadened to cover any arrangement giving rise to a debt deduction; • The associate requirement should occur in respect of the relationship between the conduit financier and the entity to which it has on-lent, and not between the entities to which it has on-lent; <p>The external debt interest should be covered by the conduit financier rule, as it will not satisfy the requirements in subsection (2) as security will be granted by other entities.</p> <p>An alternative approach would be to look to adopt the test in s832-730 (back-to-back arrangements for the purposes of the hybrid mismatch targeted integrity rule), including adopting the guidance contained in LCR 2021/1, with appropriate changes being made to reflect the scheme and purpose of the conduit financier provisions.</p>
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	<ul style="list-style-type: none"> • There is a requirement that the entities to which it on-lends are associate entities (i.e., that the entities that have borrowed are associate entities, not that the entities are associate entities of the conduit financier). While the entities may be expected to be associate entities of the conduit financier, they may not be associates of each other (e.g., in some stapled structures). • The conduit financing rule does not treat the external debt interest as satisfying the ETPDT, it only applies to the on-lending arrangements. This is made clear by section 820-61(4), which refers only to the "relevant debt interests", which are the debt interests issued by the entities to which the funds are on-lent (and not the debt interests issued by the conduit financier). 	
<p>A third party cannot have recourse for payment to the assets of any entity other than an entity to which the conduit financier has lent or the assets of the conduit financier consisting of the relevant loan.</p>	<p>For the purposes of ss 820-61(5), where the ultimate lender has recourse to the membership interests in the borrower (i.e., the ultimate borrower), the recourse requirement would not be satisfied as this is not an asset held by a borrower or a relevant debt interest held by the conduit financier.</p> <p>In addition, s820-61(5)(g) requires that the ultimate lender has recourse for payment to the assets of each borrower which raises the question of whether all borrowers are required to provide security.</p> <p>More generally, the same issues as highlighted above arise in relation to this requirement. It would be common for the third party lender to have recourse to all the assets of the conduit financier, the membership interests in the conduit financier, all assets of the ultimate borrower(s) including any entity that is permitted to become a borrower (generally being members of the obligor group), membership interests in the ultimate borrower(s) (including members of the obligor group, which may not be held directly by</p>	<p>The recourse should be permitted to include:</p> <ul style="list-style-type: none"> • all the assets of the conduit financier; • membership interests in the conduit financier; • all assets of the borrowers (including entities that the conduit financier is permitted to on-lend to, typically referred to as the obligor group); • membership interests in the borrowers (including entities that the conduit financier is permitted to on-lend to, typically referred to as the obligor group). <p>A requirement (i.e. a requirement negotiated by the third party lender) for an associate entity – based on a 10% TC control interest test – to contribute additional equity, or</p>

	the conduit financier), or for another entity to provide a guarantee or commitment to subscribe for additional equity.	guarantee payments, should be specifically allowed (e.g. deemed to be an asset of the borrower only). Also refer to comments above regarding recourse.
Offshore entities with a loan to an Australian subsidiary do not meet the 'conduit financier' definition	As the ultimate debt interest issued by the conduit financier needs to meet the external third party debt conditions, the conduit financier cannot be an offshore entity with a loan to an Australian subsidiary as the requirement in s820-61(2)(d) would not be satisfied, even if all the other requirements are met (such as meeting the same terms, meeting the recourse requirements, etc.). It is unclear why cross border back-to-back loans should be excluded in this regard. Also a common structure for foreign bond issuance is an ex-Australian issuance entity that on-lends to an Australian finance entity.	As recommended above, we believe that s820-61(2) should be removed. In this case, the conduit financier is not claiming any Australian debt deductions.
Borrowers are defined in s820-61(5) as one or more associate entities of each other, and there is no requirement that the entity is actually issuing a debt interest to the conduit financier.	In this case the ETPDT cannot apply unless the conduit financier on-lends to an entity and all of its associate entities.	We believe that this is a drafting error and that borrowers should instead be defined as associate entities, each of which have issued debt interests to the conduit financier.
Trust groups		
Where external lending is to a trust that does not directly hold the real estate asset (e.g., a holding trust or the head trust of a trust group), the trust's tax EBITDA does	This potentially creates a significant reduction in borrowing capacity for a holding trust with external third party debt. Borrowing at a holding trust level is extremely common, including in the following scenarios: <ul style="list-style-type: none"> The holding trust is borrowing in respect of a portfolio of assets (i.e., the holding trust holds a number of property trusts, and it wants to 	The introduction of a rule to pick up the impact of depreciation in sub-trusts (and other entities less than 100% owned). One possibility would be to simply add to tax EBITDA the relevant share of tax depreciation in the sub-trust.

<p>not include the downstream depreciation, meaning its calculation is (economically) not based on its EBITDA (i.e., it is after depreciation)</p>	<p>borrow in respect of the entire portfolio rather than borrowing at an asset trust level in respect of each property). It is often possible to secure lower interest rates on borrowing at a portfolio level, because there is lower risk of default (e.g., even if an asset performs poorly, there are other assets in the portfolio).</p> <ul style="list-style-type: none"> • The holding trust has acquired the downstream trust in a third party transaction, and has used external third party debt to partially finance the acquisition. <p>We note that this outcome does not arise for tax consolidated groups – if a tax consolidated group borrows at an intermediate or holding level, it is still able to add back the depreciation (as a consequence of the tax consolidation regime). Accordingly, trusts are at a disadvantage compared to tax consolidated groups.</p> <p>There may be a similar outcome for other non-tax consolidated groups (e.g., if they have not formed a tax consolidated group or if the tax consolidated group holds interests in non-wholly-owned vehicles).</p>	<p>However, where the sub trust has borrowed debt, this may result in double counting of the depreciation amount. Accordingly, an adjustment should be made to reflect the gearing level of the sub trust.</p>
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Other important issues and enhancements

Issue	Why is it a problem?	Proposed solution
Fixed ratio test		
The definition/calculation of Tax EBITDA	The current Tax EBITDA definition does not work for trusts as, first, it refers to taxable income (and it should refer to either taxable income or net income), and second because net income only includes 50% of the capital gain (in certain circumstances).	The definition should be updated to reflect that trusts calculate their net income (not their taxable income). To ensure trusts and companies are treated equivalently, the CGT discount should be reversed in the calculation of net income.
Permanent loss of carry forward excess deductions if switching from the fixed ratio test to the ETPDT or the group ratio test.	This is a material problem, as a potential dispute with the ATO around the availability or application of the ETPDT could result in debt deductions being denied under the ETPDT, and a loss of carried forward deductions as a consequence of the election.	Carried forward deductions should remain available provided you are applying (in any given year) the fixed ratio rule. In other words, carried forward deductions should not be able to be used in any year a taxpayer relies on the ETPDT or the group ratio rule, but should be able to be used if the taxpayer subsequently reverts to the fixed ratio rule.
Other issues		
Definition of "debt deductions"	<p>The removal of the requirement that debt deductions arise in relation to debt interests creates significant uncertainty, noting the breadth of the terms used in the definition (such as amounts that are calculated by reference to the time value of money).</p> <p>The 2016 OECD report did not recommend asymmetric treatment between debt deductions and assessable income, but only recommends broadening debt deductions beyond costs incurred in relation to a debt interest to capture financing costs that do not relate to a debt interest. If the policy intent is to follow the OECD</p>	<p>In order to eliminate any uncertainty, we suggest not removing the following words from the definition of debt deduction: 'in relation to a debt interest issued by the entity'. Instead, the definition should be expanded to include specific types of debt deductions (not related to debt interests issued by the entity) that are intended to be included in the definition (per OECD guidance).</p> <p>We are also seeking clarity on whether "debt deductions" should extend to legal and other costs incurred in relation to financial arrangements per TD 2019/12 (specifically paragraph 3).</p>

	<p>recommendation, then this should be included in the EM together with the OECD examples.</p> <p>For example, if a supply arrangement provides for a discount if payments are made early or a late payment penalty, the payments that are made are calculated by reference to the time value of money and therefore may be included as a debt deduction.</p> <p>Or, given the changes that were made to the lease accounting standard, are the notional finance elements of an operating lease debt deductions for the lessee?</p> <p>There are many examples where the operation of the revised definition of debt deduction, and the new definition of net debt deduction, are entirely uncertain.</p>	<p>In addition, we suggest the EM includes clarification and examples of what is intended/not intended to be captured by “any other amount that is calculated by reference to the time value of money” as this is very broad. For example, would this include Div 250 deemed notional interest or late completion penalties?</p>
<p>Repeal of s25-90 – this provision currently allows entities to claim debt deductions incurred in earning non-assessable non-exempt foreign income (i.e. income from foreign subsidiaries)</p>	<p>The amendment to s25-90 is problematic for outbound multinationals as it will increase the compliance burden of tracing what are fundamentally fungible items (i.e. finance).</p> <p>Under the current thin capitalisation rules, “assets” for the purposes of determining the asset-based restriction excludes foreign equity interests. A similar outcome results under the tax EBITDA test as taxable income does not in many cases include income from such investments (which is non-assessable non-exempt income).</p> <p>In addition, the repeal of the rule will require tracing on a retrospective basis, and external finance may have been borrowed many years ago. As records may no longer be</p>	<p>Noting that this proposed repeal has never previously been flagged in the Government's budget announcements, in the discussion document, or in consultation, we recommend that this section is not repealed.</p> <p>We note that section 25-90 was inserted on the basis that the thin capitalisation rules themselves provided sufficient integrity in this regard – i.e., because the level of permissible gearing for tax purposes was determined under the thin capitalisation rules, and because the safe harbour debt amount did not allow foreign assets to be included in determining the safe harbour debt amount (see the adjustments for controlled foreign entity equity and debt in determining the safe harbour debt amount), it was considered permissible to gear up to the safe harbour debt amount.</p>

	<p>kept in respect of that financing (noting that the period within which records are required to be kept may have expired), it may now be impossible to trace the use of funds. In this case, it will result in all debt deductions on instruments with multiple uses being denied.</p>	<p>As a consequence of the proposed changes, we consider there is even greater integrity in this regard.</p> <p>Under the fixed ratio rule, non-assessable non-exempt income is not included in tax EBITDA (such that foreign sourced dividends on non-portfolio interests will not ordinarily be included). Consequently, foreign income streams will not be able to be geared for tax purposes under the fixed ratio rule. Moreover, the fixed ratio rule will generally result in lower debt capacity, again constraining the capacity to gear.</p> <p>Under the ETPDT, the potential for tax deductions on interest expense that relates to foreign investments is eliminated by the requirement that debt must only relate to Australian assets. As noted above, this is unworkable.</p> <p>Thus we believe that there is no potential double up in the implied situation that warrants the repeal of s25-90.</p> <p>Given these changes, the integrity risks are significantly lower, and there is no rationale for the repeal.</p> <p>Alternatively, if the repeal is to proceed, a transitional rule should be implemented, noting that it may now be impossible to trace funds borrowed historically. We suggest the transitional rule should deem all existing debt as at the date of effect of the legislation change to have been used to fund assets that generate assessable income (i.e. Australian assets).</p>
90% Australian asset test	<p>It is clear from para 1.113 of the EM that the $\geq 90\%$ Australian assets exemption is intended to apply to general class investors.</p>	<p>Amend Section 820-37 to include the new general class investors in the 90% Australian assets exemption.</p>