AustralianSuper

30/10/2023

Kathryn Davy
Assistant Secretary
International Tax Branch
The Treasury
Langton Crescent, Parkes ACT, 2600

Via email to **mnetaxintegrity@treasury.gov.au**

Dear Kathryn,

AustralianSuper submission to Multinational Tax Integrity – strengthening Australia's interest limitation (thin capitalisation) rules exposure draft amendments

AustralianSuper welcomes the opportunity to provide a written submission in relation to the draft amendments to the Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023. We appreciate Treasury's engagement on this bill, recognising that it represents a significant and complex reform with a range of stakeholders.

AustralianSuper is Australia's largest superannuation fund and is run only to benefit members. AustralianSuper has over 3.2 million members and manages over $300 billion of members' assets. AustralianSuper's vision is to be Australia's leading superannuation fund, in the world's best system for members.

As Australian superannuation funds grow in size and sophistication, they continue to look to diversify their portfolios globally to reduce risk and locate quality investment opportunities in pursuit of maximising returns for their Australian membership. Accordingly, foreign investment is and will continue to be a critical component of Australian superannuation funds' investment portfolios. In the case of AustralianSuper, approximately half of the portfolio is represented by overseas investments.

Debt attributable to overseas permanent establishments

Our primary comment is in relation to the Bill's continued omission of the exclusion for debt that is attributable to an overseas permanent establishment from the general class investor rules. The parliamentary amendments should include an amendment to introduce that exclusion within the new provisions.

Unlike in the existing thin capitalisation provisions, an exclusion for debt that is attributable to an overseas permanent establishment has not been included within the general class investor rules in the Bill. It is of note that, under the Bill, this exclusion remains available for 'financial entities'.

We are concerned that this change will negatively impact the way Australian superannuation funds can invest in overseas private market assets (especially in key investment markets such as the US) and further disadvantage Australian superannuation funds in the way they can invest overseas compared to Australian corporate taxpayers. This will also impact Australian superannuation funds when competing for foreign

assets with other global investors, including global pension and sovereign wealth funds that are not taxable in their country of residence.

We are also concerned that such a fundamental and asymmetrical change to thin capitalisation policy was not referred to in a government announcement. Moreover, the change is not remarked on in the explanatory memorandum to the Bill nor in other stages of the consultation process, such as the consultation paper. Neither is the rationale for the differential treatment of different classes of investors made clear.

We submit that the type of debt which would be subject to the exclusion does not pose an integrity risk for Australia and should continue to be excluded.

Detailed comments on this issue are provided in the Attachment.

If you require further information, please do not hesitate to contact me, Gina Maio, Head of Tax (**gmaio@australiansuper.com**) or Nick Coates, Head of Government Relations and Public Policy (**ncoates@australiansuper.com**).

Regards

Peter Curtis
Chief Operating Officer

Attachment: Detailed Comments

Debt attributable to overseas permanent establishments

We recommend that an exclusion for debt attributable to an overseas permanent establishment be included in the general class investor provisions. This would align with the existing outward investor provisions and the provisions that will continue to apply to 'financial entities' under the proposed new provisions. The exclusion should apply to each of the fixed ratio test, group ratio test and external third party debt test.

Australian superannuation funds are significant investors in key Australian infrastructure and commercial property assets and this will continue to be the case. Relevantly, as the Australian superannuation industry continues to mature, increased investment in private market assets outside of Australia will be necessary for superannuation funds to deliver strong returns for members into the future.

When investing offshore, Australian superannuation funds may seek to invest via transparent structures (where available or feasible to do so) in order to prevent double taxation on foreign income. Superannuation funds are taxable in Australia on their global income but, unlike corporate taxpayers, are not able to benefit from exemptions that prevent double taxation of foreign income and gains. Examples include the exemption for foreign non-portfolio dividends[1], the exemption for capital gains from the disposal of shares in a foreign company[2] and the foreign branch income exemption[3]. This lack of access to double taxation relief on foreign income incentivises superannuation funds, where possible and feasible, to invest in foreign assets using transparent investment structures for both Australian and foreign income tax purposes (e.g. foreign limited partnerships that are treated as foreign hybrid limited partnerships for Australian income tax purposes).

This is particularly the case for US infrastructure investments and the US is a primary jurisdiction where Australian superannuation funds deploy capital for foreign investment. By using transparent investment structures, superannuation funds may be entitled to an Australian foreign income tax offset on any foreign income tax paid, thus potentially neutralising any double taxation outcome. This would not be the case where superannuation funds invest into foreign assets via opaque investment structures (e.g. a US company) that incur entity level taxation in the foreign country. The use of transparent investment structures to preserve the ability to claim foreign income tax offsets (to relieve double taxation outcomes) also ensures Australian superannuation funds and their members are not placed at a competitive disadvantage when competing for quality foreign assets with other global investors, including global pension funds that are non-taxable in their residence country.

Where transparent investment structures are utilised for foreign investments then, without the exclusion for debt attributable to an overseas permanent establishment, debt borrowed by foreign entities that wholly relates to commercial activities outside of Australia would be brought within the scope of Australian thin capitalisation provisions under the general class investor rules. Also, the third party debt test will not be available in such circumstances as it requires strict 'Australian' requirements to be met (e.g. Australian resident borrower, substantially all of the debt must be used to fund Australian business operations). This

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[1] Subdivision 768-A – Income Tax Assessment Act 1997 ("ITAA 97")

[2] Subdivision 768-G – ITAA 97

[3] Section 23AH – ITAA 97

means that, practically, debt deductibility in these scenarios will be limited to the fixed ratio test only which may result in debt deductions being denied, especially in the context of large infrastructure or commercial property assets that commonly require higher levels of gearing to be commercially viable.

From a policy perspective, we submit that there is no apparent reason for not carrying the exclusion for debt attributable to an overseas permanent establishment into the general class investor rules. For example, in circumstances where debt is borrowed by a foreign entity and relates to commercial activities and/or assets located wholly outside of Australia, the deductibility of costs relating to such debt should not pose any base erosion or integrity risk to Australia. *Moreover, in such circumstances, the exclusion for debt attributable to an overseas PE enables there to be symmetry in the Australian debt deductibility outcome as it relates to either transparent or opaque foreign investment structures*. In this regard, applying the above example but assuming the foreign investment is held using an opaque investment structure (e.g. via a foreign company), the Australian tax provisions do not in any way limit debt deductions within that foreign entity, including via Australian controlled foreign company ("CFC") provisions[4].

Additionally, if Treasury now considers there to be an integrity concern with the exclusion for debt attributable to an overseas permanent establishment, such a concern would presumably apply equally with respect to financial entities and thus the proposed asymmetry in application between general class investors and financial entities is also unclear.

Impact on Australian superannuation funds

A change in the treatment of debt attributable to an overseas permanent establishment of an Australian entity will negatively impact direct offshore investment by Australian superannuation funds as it may result in interest deductions being denied in respect of such debt, thus increasing Australian taxable income. This produces double taxation outcomes for relevant offshore investments. This detracts from members' returns and places Australian superannuation funds at a disadvantage when competing for foreign assets with other global investors, including global pension funds that are not taxable in their country of residence.

This change will have a disproportionate impact on Australian superannuation funds, as compared to Australian corporate groups (which shouldn't be impacted). This is because, due to provisions such as Subdivision 768-A (non-portfolio dividend exemption), section 23AH (foreign branch income/gains exemption), Subdivision 768-G (non-portfolio interest exemption) and the ability to access tax consolidation (all of which are unavailable to Australian superannuation funds), corporate groups will be able to achieve a lower overall effective tax rate on an equivalent investment as compared to Australian superannuation funds. It will also result in an additional compliance burden for Australian superannuation funds when compared to Australian corporate groups investing offshore through corporate structures.

Recommendation:

We recommend that an exclusion for relevant deductions relating to debt that is attributable to an overseas permanent establishment be included within the general class investor provisions. This could be achieved by introducing relevant wording within the operative provisions of Subdivision 820-AA, namely at section 820-46(1) and through section 820-50 of the *ITAA 97*.

[4] Per section 389 of the *Income Tax Assessment Act 1936*, Division 820 is disregarded when calculating the attributable income of a CFC.