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

Via Email: MNETTaxIntegrity@treasury.gov.au

**RE: Treasury Laws Amendment (Making Multinationals Pay Their Fair Share-Integrity and Transparency) Bill 2023**

Dear Mr Robinson,

INPEX appreciates the opportunity to make a further submission to the Economics Legislation Committee on the '*Treasury Laws Amendment (Making Multinationals Pay Their Fair Share-Integrity and Transparency) Bill 2023'* (the **Bill**) and associated Supplementary Explanatory Memorandum (**EM**).

It is INPEX's firm view that further significant changes will have to be made to the amending legislation so that it is in accordance with the policy intent. This is particularly relevant to the Debt Deduction Creation Rules (**DDCR**) which is an integrity measure with a policy intent to stop **artificial** debt loading within Australia. The current view on the drafting is that it is so broad that it would effectively render a 0% EBITDA test for inbound groups and require full equity funding of activities in Australia. It also does not allow for any dividends to be paid where you have related party debt still on foot, which is an unworkable proposition for a capital-intensive nation like Australia, where infrastructure costs are high, and which has long payback periods and project lives.

These outcomes are far broader than targeting artificial debt loading and would become a major impediment to foreign investment. Australia is, and will remain, dependent on foreign investment and trade and these rules must be rectified so that they only target arrangements that result in artificial debt loading.

We note the recommendation that we made on the 'Third Party Debt Test' to extend credit support to that required by financial institutions was not actioned, rather a limited Australian support was introduced. It would remain our view that this will have consequences in the longer-term Project Financing market as it relates to infrastructure in Australia, particularly renewable energy infrastructure, but make no further submissions on this point.

INPEX has also had the benefit of reviewing the Corporate Taxpayer Association (**CTA**) submission on the amending legislation. The detailed submission from the CTA highlights just how many unintended issues remain with the proposed legislation and the need for further considered consultation on the drafting of these rules before they are resubmitted into Parliament.

Our detailed comments on the DDCR are set out below.

**Debt Deduction Creation Rules (DDCR)**

INPEX acknowledges that Treasury has addressed some of the issues raised in the previous consultation in its redrafting of the DDCR. However, the draft legislation remains very broad in its potential application and the absence of a purpose test results in genuine commercial and day-to-day transactions being caught in the net of what was suggested to be an anti-avoidance rule by design.

The outcomes detailed below arise where global corporations utilise cash pooling arrangements (or Cash Management Systems (**CMS**)) to efficiently manage cash requirements across a global portfolio from a centralised function. CMS's work such that if an entity has an account in a positive balance at the close of a business day, it will automatically be transferred to the Financial Service Entity's (**FSE**) account and will either offset any borrowings with the FSE or will be deemed an ordinary deposit (whichever is applicable). Conversely, where an entity has an account in a negative balance at the close of a business day, the FSE will transfer an amount to the entity so the balance is equal to zero and this will either reduce any ordinary deposits held by the FSE or be deemed a loan (whichever is applicable).

Cash pooling arrangements are genuine commercial arrangements and will **<u>reduce</u>** interest costs in Australia as the Australian group's 'free cash' is automatically swept up and offset against its debt balances reducing the net amount owing and which interest is calculated on. The cash pool can then be drawn against to meet operating and capital expenditure requirements as needed.

However, the act of drawing down on the cash pool to facilitate the payment of obligations puts the taxpayer within the scope of the DDCR when the funds are paid to a non-resident related party. There are many examples of day-to-day transactions which would fall foul of these rules including expense reimbursements for global insurance policies, personnel secondment reimbursements, technical service charges, service charges for administration functions and acquisition of trading stock to name a few.

Furthermore, because these cash management facilities pool free cashflow of the Australian operations and offset against the intercompany debt facility, the DDCR restricts the taxpayer's ability to choose to repatriate free cashflow to a foreign shareholder as a dividend, as the drawdown from the cash pool would result in a permanent denial of interest deductions for the tranche paid out as a dividend.

In the case of INPEX, the CMS was put in place for the financing of construction projects and is long term in nature as a result. It will take years until the CMS balance shifts to positive (that is, it is in net deposit). However, the DDCR rules would impact the INPEX CMS in the event a dividend is paid. This is an extraordinary outcome given that current earnings would easily allow for dividends to be paid, absent the CMS being in place. To highlight the point by example, INPEX could have $100m in surplus funds capable under the *Corporations Act* of being distributed as a dividend. If it had these in a separate account (not a CMS) then the DDCR rules would not be breached upon payment of a dividend of $100m which could occur anytime. However, if the $100m sweeps into the

CMS at the end of the day, and the next day a dividend is paid out, this would breach the DDCR rules, because a drawdown against a CMS facility would arise – even though this is a straightforward call back of otherwise operating positive cashflow.

This aspect of the DDCR rules when applied to a CMS arrangement effectively results in a requirement to have a surplus on a CMS facility to pay a dividend. The notion of requiring debt to be fully repaid prior to a subsidiary being able to make distributions to foreign shareholders is a significant and non-commercial impediment to investment in Australia, particularly for long-term capital-intensive projects.

The examples outlined above are not artificial debt creation schemes. The alternate to utilising the cash pooling arrangement to facilitate these payments would be to utilise a direct bank overdraft facility with a third-party lender, or to quarantine free cashflow from Australian operations in a separate deposit facility in which intercompany payments, including dividends would be paid from. In either of these alternate scenarios, the group's overall cost of funds in Australia would be increased, resulting in outcomes that are economically and commercially nonsensical.

To facilitate refinancing of related party debt it is highly likely that any third-party debt could not be sourced fully from Australia due to the sheer scale of foreign investment, and as a result it is likely that institutional investors would be the lenders. The ramifications of this are that (a) debt gets more expensive; (b) it would be interest withholding tax free, and (c) the lenders are not Australian entities so there is no taxable income in Australia.

The DDCR clearly goes beyond modernising the debt creation rules contained in the now repealed Division 16G of the *Income Tax Assessment Act 1936* and Chapter 9 of the OECD's BEPS Action 4 Report[1] and can and will deny debt deductions for any arrangements involving associates. Division 16G contained several exceptions to limit the impact to what are non-genuine commercial arrangements.

The impact of introducing a broadly drafted integrity rule without an underlying anti-avoidance purpose in its application will unfairly prejudice foreign-owned companies who are bringing critical capital investment into Australia. The impact will be significant and is highly likely to cause major capital funding disruptions and impediments to future investment. No investor can be in a position where it cannot procure trading stock or intercompany services, nor be in a position where it must have no net debt before it can pay out a dividend. Furthermore, CMSs are normal banking arrangements facilitated by third party banks. It seems counter intuitive that these are impacted by the introduction of the DDCR.

INPEX strongly recommends the DDCR is better targeted to the stated policy concerns. It seems analogous to have such a broad reaching integrity rule for a set of circumstances detailed by the Australian Taxation Office (**ATO**) responses to Questions on Notice in the Senate Committee hearings which are limited to cases where non-resident associates were involved in internal restructures or reorganisations, and the ATO was successful in arguing all but one of the cases using existing law. In respect of the one unsuccessful case, the ATO accepted the law applied as intended. There does not appear to be any justifiable policy rationale to enact a law which essentially removes foreign related parties' borrowings from a taxpayer's capital structure.

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[1] Explanatory Memorandum, *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share-Integrity and Transparency) Bill 2023* (Cth), p 2.147

### *Transitional Rules*

While the amended Bill introduces a transitional rule in subsection 820-50 of the *Taxation Administration Act*, the rule is ambiguous in its application. On initial reading, the section would work to prevent the denial of debt deductions where the interest payments arise before 1 July 2024 for financial arrangements that arose before 22 June 2023. However, the new transitional provisions do not appear to affect the denial of debt deductions occurring on or after 1 July 2024, even if they are referrable to payments made before that time.

Further, it is unclear as to whether the integrity rule in section 820-423D should be disregarded before 1 July 2024, with the effect that any restructure or transaction undertaken before that date to ensure that the DDCR does not apply (that would, if undertaken, on or after 1 July 2024 be covered by the integrity rule) is not considered in determining whether any deductions on or after 1 July 2024 are available.

### *Recommendations*

INPEX would recommend the following actions:

1. Ensure that the rules that capture all related party debt on refinancing (as covered in more detail in the CTA submission) are rectified.

2. Introduce an exemption for good and services purchases required to be paid for by debt (as covered in more detail in the CTA submission).

3. Introduce an exemption for CMS facilities to reflect that they are not giving rise to artificial or contrived debt loading as was the intent of the integrity rule.

With regards to (3) above, if the policy intent is to prohibit dividends being paid whilst related party loans exist then Treasury should expressly indicate this is the policy intent. This position would be radically different from the Government's announced legislative intent to change the thin capitalisation laws to an EBITDA approach, and as such needs to be explicitly stated.

Ultimately, it is unacceptable to be deemed to be in breach of future laws due to past genuine and **legal** actions, without any period to rectify this situation to become compliant. As such, the following recommendation must be actioned.

4. Ensure that the transitional rules allow taxpayers to restructure their affairs so that they would be compliant going forward. That is, an amnesty or grace period, as opposed to merely a deferral of the impact (as is the current provision). For clarity, this cannot be at the discretion of the ATO, but must be legislated, and the provisions would need to make clear other anti-avoidance rules would not override the amnesty.

If you wish for a further discussion, please contact me on (08) 6213 6736.

Yours sincerely,

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Ken Ezuka
**Vice President Finance, Treasury and Technology and**
**Public Officer**