

30 October 2023

Mr Marty Robinson
First Assistant Secretary
Corporate and International Tax Division
Treasury
Parkes ACT 2600

By email: mnetaxintegrity@treasury.gov.au

Dear Mr Robinson

Thin Capitalization and Debt Deduction Creation Exposure Draft Parliamentary Amendments Bill

The Minerals Council of Australia (MCA) welcomes the opportunity to consult in relation to the exposure draft Parliamentary Amendments to the Thin Capitalization and Debt Deduction Creation rules.

The MCA is the peak industry body representing Australian mining companies. We represent Australia's largest company taxpayers and the industry pays around one third of all the company tax collected. In addition, the industry supports more than 1.1 million jobs, pays the highest average wages and is Australia's largest export earner.

The focus of this submission is the debt deduction creation rules. As you are aware, these rules were not flagged by the government in their multinational enterprises tax change commitments announced in 2022. Indeed, the rules were not in the initial treasury draft bills released for consultation in late 2022. This has resulted in inadequate time to consider the impact of the proposed rules on commercial activity.

We understand that the purpose of the debt creation rules is to "...disallow debt deductions to the extent that they are incurred in relation to debt creation schemes that lack genuine commercial justification (per the EM to the original bill)". Notwithstanding that Australia now has robust integrity rules determining the amount of tax-deductible debt via the revised thin capitalization rules, we acknowledge the reason for the debt creation rules. It is, however, very important that this additional overlay of measures applicable to determining tax deductible debt only applies as intended to schemes that lack genuine commercial justification. In that regard, that purpose should be explicitly stated in the legislation.

Many of Australia's largest mining companies and mining projects have relied upon foreign direct investment. These projects have generated immense wealth for Australia. In order for Australia to develop the next generation of critical minerals projects, significant amounts of foreign direct investment will be required.

We outline below instances where commercial arrangements are adversely impacted by the proposed rules. In this regard we also refer you to the detailed submission made by the Corporate Tax Association in relation to this exposure draft. We have had the opportunity to provide input to the CTA submission and endorse the specific examples and recommendations outlined in that submission.

Refinancing Related Party Debt

As currently drafted, the only way to ensure that a refinancing of an existing foreign related party loan is not subject to the debt creation rules is to replace the related party debt with external non-related debt. The proposed rules apply EVEN IF the amount of the existing debt is not increased and the only change is for the existing debt to be refinanced (ie term extended and interest rates changed to reflect current rates). No additional debt has been created!

The refinancing of an existing related party debt is not a debt creation scheme that lacks genuine commercial justification. Multinational enterprises establish centralized treasury companies that employ banking and capital management experts to manage group liquidity, cash flows, interest rate and currency risk, group borrowing and lending, relationships with banking organisations and dividend flows. It is inconsistent with ordinary commercial practice to require the Australian operating company to borrow externally to refinance a borrowing from the centralized foreign resident treasury company. Yet, that is what the proposed rule requires in order for the Australian borrowing entity not to fall within the debt creation rules.

Funding business operations with debt whilst paying dividends

The intent of the debt creation rules is to apply to a borrowing from a foreign related party to fund dividends. The problem is that the proposed wording is very broad in application and will apply, or will be used by the ATO, to apply to commercial arrangements where a company borrows funds, operates a mining business, makes additional capital and project development investments and ALSO pays dividends. A portion of the borrowing is clearly at risk of being captured by the debt creation rules. The company should not be at risk of application of the debt creation rules when it borrows to use funds in the ordinary business operations and also subsequently pays a dividend.

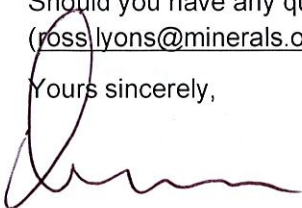
This inappropriate outcome arises because the exposure draft wording states that the provisions apply where the borrowing "facilitates the funding of, or increases the ability of any entity to make the dividend distribution...".

It is normal commercial activity for large mining organisations to have regular borrowing activities, large cash inflows from sales of commodities, large cash outflows in relation to operating costs and capital expenditure as well as pay dividends during the year of income. The debt creation rules should only apply when the company borrows specifically to pay a dividend. The draft anti-avoidance provision should be relied upon to apply when a company attempts to disguise a borrowing made to pay a dividend through use of different accounts or fund movements. The basic rule should not be drafted so broadly to capture ordinary commercial transactions. It must be remembered that the thin capitalization rules always apply to limit the tax-deductible debt and the overlay of the debt creation rules should be confined to instances that lack commercial justification. The rule should be written to apply to borrowings specifically made to fund or partially fund the dividend.

Finally, the rules in effect have retrospective application to borrowings that are in place and the payment of dividends in the future.

Should you have any questions in relation to this submission, please contact Ross Lyons (ross.lyons@minerals.org.au).

Yours sincerely,



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