AustralianSuper

2/09/2022

Assistant Secretary
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via email: **MNETaxIntegrity@treasury.gov.au**

Dear Sir/Madam,

Submission on the “Multinational tax integrity and enhance tax transparency” Consultation Paper

AustralianSuper is Australia’s leading superannuation fund and is run only to benefit members. Almost 2.9 million Australians are members of AustralianSuper and we invest over $260bn of their retirement savings on their behalf. Our purpose is to help members achieve their best financial position in retirement.

Purpose

We are writing this submission in response to the *Multinational tax integrity and enhanced tax transparency Consultation Paper* (“Consultation Paper”) and in particular the topic of thin capitalisation and interest limitation rules.

AustralianSuper strongly supports the overarching policy intent of the rules and the proposed reforms, being to prevent multinational groups from engaging in base erosion and profit shifting practices (as it relates to deductible debt within the group), by taking advantage of the differences between jurisdictions’ tax systems to minimise overall group tax liabilities.

In doing so we also make suggestions for legislative reform to address an unintended consequence of the current thin capitalisation rules, which has the potential to impede infrastructure investment by Australian superannuation funds and negatively affect investment returns for Australian superannuation fund members.

Overview

Under the current rules, a wholly Australian based asset or business that an Australian complying superannuation fund (“superannuation fund”) controls or sufficiently influences can be brought into the scope of thin capitalisation rules due to the superannuation fund’s unrelated offshore investments. We consider this is an unintended application of the current legislation, as it is inconsistent with the policy aim of the thin capitalisation rules, being to target profit shifting by multinational groups. The current application of thin capitalisation rules for wholly Australian based portfolio investments of superannuation funds means there is a potential for the loss of debt deductions in situations where there is no risk of base erosion or profit shifting between tax jurisdictions. As such, in these specific situations, the thin capitalisation rules should not apply.

Superannuation funds are significant investors in many large Australian infrastructure businesses and assets, as well as a variety of large commercial property and other significant unlisted assets. AustralianSuper is a significant investor in the infrastructure and property sectors, with around $10 billion in equity invested over the 2019 to 2022 financial years across a range of assets in Australia. A recent example is AustralianSuper’s $1.9 billion acquisition of a 70% stake in Australia Tower Network in 2022.[1]

We understand the Government is supportive of measures that encourage investment in large-scale infrastructure projects and other measures to support the Australian economy into the future, which also deliver reliable long-term returns.[2] However as the thin capitalisation rules currently apply to wholly Australian based portfolio investments, they represent an impediment to further investment into Australian infrastructure assets by superannuation funds. A legislative change would remove a hurdle to increased investment into infrastructure assets by superannuation funds,

[1] ATN is Australia’s largest independent telecommunications tower company, with a national network of over 4,000 towers and rooftop sites.
[2] “*Supercharging Superannuation to Build a Better Future*” – Announcement dated 15 December 2021, by Stephen Jones MP (Member for Whitlam and Assistant Treasurer and Minister for Financial Services).

whilst also removing an unintended application of the thin capitalisation rules that potentially erodes returns for Australian superannuation fund members.

We have included comments in respect of the above legislative reform issue in Section 1 below. We have also included specific comments in respect of *Part 1: Multinational enterprise ("MNE") interest limitation rules* of the Consultation Paper (refer Section 2 below) and also *Part 3: Multinational tax transparency* (refer to Section 3 below).

Summary of submission

Section 1 - Application of thin capitalisation rules to wholly Australian based portfolio investments of superannuation funds

- The current application of thin capitalisation rules to wholly Australian based portfolio investments of superannuation funds is an unintended consequence of the rules.
- This represents a potential impediment to investment into Australian infrastructure and other assets by superannuation funds, which may negatively affect investment returns for superannuation fund members.
- We recommend amendment of the rules to address this issue and have provided suggested options to achieve this in a simple and straightforward manner.

Section 2 – Multinational enterprise ("MNE") interest limitation rules

- Arm's length debt test ("ALDT") – We support retaining the ALDT to support infrastructure and other assets that require significant capital outlay and thus tend to be highly leveraged in order to be commercially viable. We support a more compliance friendly version of the ALDT in respect of external debt on the basis that third party debt should, by default, be viewed as arm's length and commercially justifiable.
- Transitional relief – Reasonable transitional relief or, alternatively, full grandfathering for pre-existing assets/projects should be made available. However, where the ALDT is retained, this should not be necessary.
- Carry forward / back of denied deductions – In the context of a fixed ratio rule, the ability to carry forward interest deductions is critical, in particular for infrastructure or property assets during pre-income phases. However, where the ALDT is retained, this should not be necessary.

Section 3 – Multinational tax transparency

- AustralianSuper supports changes to MNE tax transparency that enhance the understandability of disclosures, comparability of disclosures between MNEs, and which can be produced in a cost-efficient manner.

1 Application of thin capitalisation rules to wholly Australian based portfolio investments of superannuation funds

Superannuation funds are significant investors in many large Australian infrastructure businesses and assets, as well as a variety of large commercial property and other significant unlisted assets.

Some superannuation funds also deploy significant capital in offshore unlisted assets and investments, and it is expected that this will grow significantly into the future. Superannuation funds look to diversify their portfolios globally to reduce risk and locate quality investment opportunities in order to maximise member returns. In the case of AustralianSuper, 49% of our portfolio is represented by overseas investments. Overseas investment income of superannuation funds is taxed in Australia. Offshore unlisted portfolio investments are an important investment in this context. However as superannuation funds are treated as 'outward investors', they are subject to the thin capitalisation rules.

Under the current thin capitalisation rules, Australian entities with wholly Australian based assets and/or operations that are 'associate entities' of an Australian superannuation fund that is an 'outward investor' will be subject to thin capitalisation. This means that wholly Australian based investments can effectively be drawn into the scope of the thin capitalisation rules simply by virtue of controlling ownership by superannuation funds. We question whether it is the policy intent of the thin capitalisation regime to capture wholly Australian based portfolio investments in these

situations, noting the role that superannuation funds play in investing in Australian infrastructure and other significant assets in Australia that drive economic growth.

For the reasons outlined below, we consider this to be an inappropriate application of the thin capitalisation provisions.

1.1 Outline of relevant provisions

The outline in this section is based on the application of the thin capitalisation rules to AustralianSuper. This has been done for illustrative purposes only and the rules can apply similarly to other Australian superannuation funds.

AustralianSuper is an 'outward investor (general)' as it is an 'Australian controller' of 'Australian controlled foreign entities'.[3] This is an outcome of AustralianSuper's interests in offshore portfolio investments.

Wholly Australian based portfolio investments that are 'associate entities' of AustralianSuper[4] will also be deemed an 'outward investor (general)' and fall within the scope of thin capitalisation rules. Broadly, this will be the case where AustralianSuper, either directly or indirectly via a wholly owned subsidiary, has a controlling interest or otherwise has relevant sufficient influence over the relevant entity.

These wholly Australian based portfolio investments could be drawn into the thin capitalisation rules purely because of their status as an 'associate entity' of AustralianSuper, even if they only have Australian assets and/or business. We have illustrated some relevant examples below. As discussed in Section 1.2 below, we do not believe this is the policy intent of the regime and is an unintended consequence requiring attention.

We acknowledge that, from a policy perspective, if an Australian portfolio investment would otherwise fall within the scope of the thin capitalisation rules due to other reasons, such as having requisite foreign ownership or control, having foreign subsidiaries, or being an 'associate entity' of an Australian based multinational corporate group, the thin capitalisation rules should rightfully apply in these circumstances.

Diagram #1 – Superfund owning 100% of portfolio investment

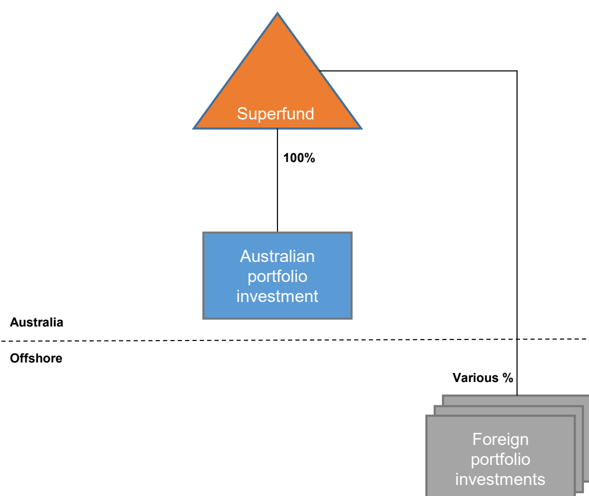
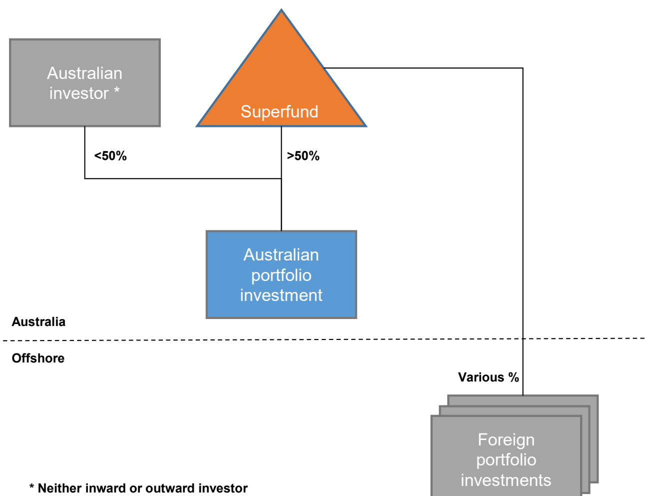


Diagram #2 – Superfund owning greater than 50% of portfolio investment – plus an Australian investor



[3] Section 820-85(2)(b), table item 1, Income Tax Assessment Act 1997 ("ITAA 97")
[4] Section 820-85(2)(b), table item 3, ITAA 97

Diagram #3 – Superfund owning greater than 50% of portfolio investment – plus a foreign investor

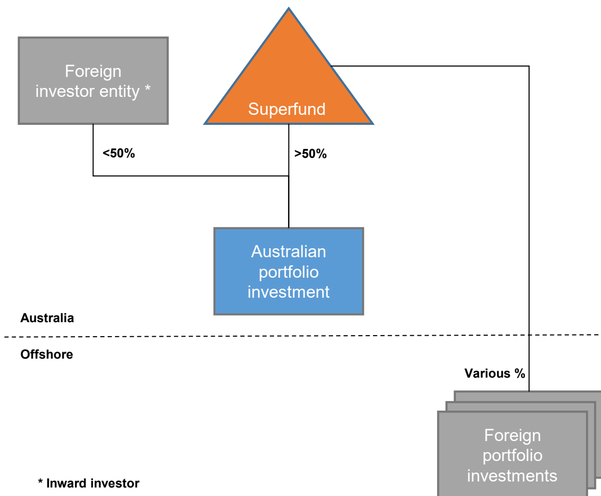
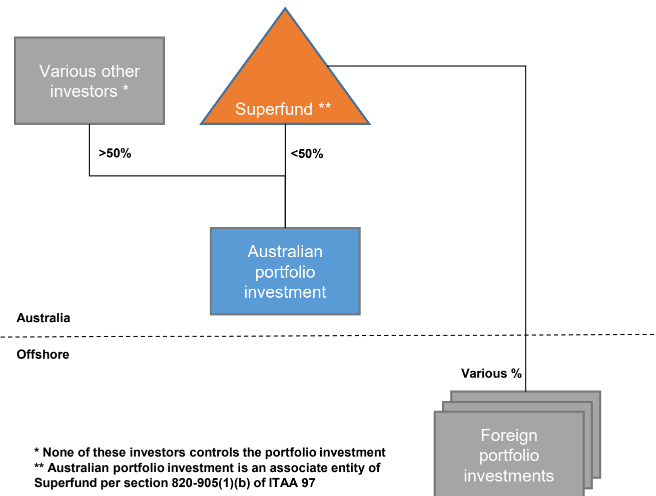


Diagram #4 – Superfund owning less than 50% of portfolio investment, but with sufficient influence



1.2 Policy intent of thin capitalisation rules

The overarching policy intent of thin capitalisation rules is to prevent multinational groups from engaging in base erosion and profit shifting practices, as it relates to deductible debt within the group, by taking advantage of the differences between jurisdictions' tax systems to minimise overall group tax liabilities.

This policy is outlined in the Explanatory Memorandum to the relevant legislation introducing the current thin capitalisation rules:[5]

> *The objective of the thin capitalisation regime is to ensure that multinational entities do not allocate an excessive amount of debt to their Australian operations. This is to prevent multinational entities taking advantage of the differential tax treatment of debt and equity to minimise their Australian tax.*[6]

Further, as outlined in the OECD report *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 2015 Final Report* ("OECD Report"):

> *"Base Erosion and Profit Shifting (BEPS) risks in this area may arise under three scenarios:*
>
> - *Groups placing higher levels of third party debt in high tax countries.*
> - *Groups using intragroup loans to generate interest deductions in excess of the group's actual third party interest expense.*
> - *Groups using third party or intragroup financing to fund the generation of tax exempt income."*

We believe the policy intent is not directed to capturing a wholly Australian based portfolio investment of an Australian superannuation fund, purely as a result of unrelated offshore investments of the superannuation fund. In particular, we consider this to be the case for the reasons explained below.

Taxable on all income in Australia

Superannuation funds are subject to tax in Australia on their offshore income, ultimately at a rate of 15%, and their beneficiaries are individual Australian members. Moreover, superannuation funds do not benefit from several income exemptions available to Australian multinational corporate groups.[7]

[5] New Business Tax System (Thin Capitalisation) Bill 2001
[6] "General outline and financial impact" section
[7] For example, section 768-A, 23AH, 768-G.

Separately managed unlisted investments

Superannuation funds invest in a diversified range of unlisted portfolio investments across various asset classes which reflects a superannuation fund's role in acting as the manager of the funds of its members.

Relevantly, each unlisted portfolio investment is both invested and managed separately such that, other than from a portfolio construction and member option perspective, there is effectively no commercial connection or integration between the unlisted investments managed by a superannuation fund. This separation also flows through to accounting policies and financial statements. Unlike multinational groups, portfolio investments (including wholly or majority owned portfolio investments) of superannuation funds are not consolidated for accounting purposes. Instead, such investments are recorded and carried in financial statements at fair value.

Superannuation funds not permitted to borrow

Unlike multinational corporate groups, regulated superannuation funds are not permitted to borrow money[8]. Coupled with the commercial separation of investments as noted above, this invariably means any external borrowing relating to unlisted portfolio investments will be project/asset financing to fund or refinance a particular investment, with security provided over only that investment to the external financiers.

No tax incentive for shareholder loans

There is no Australian tax incentive for superannuation funds to use shareholder loans to fund unlisted portfolio investments. As noted above:

- superannuation funds are taxable in Australia on all income at 15%, which includes dividends, net income or income distributions (from partnerships and trusts) and interest; and
- due to being legally established as trusts, superannuation funds are not able to benefit from the suite of income exemptions available to corporate entities such as the treatment of dividends from foreign subsidiaries as non-assessable, non-exempt income.

In addition, superannuation funds' entitlement to refundable franking offsets also means that a 15% effective tax rate can still be achieved for any tax paid (at 30%) by an Australian portfolio company.

We note that superannuation funds will hold shareholder loans, but it will generally be driven by foreign investors or fund managers with foreign capital within a consortium investor group. In such cases, superannuation funds need to also hold shareholder loans to ensure they have equivalent rights to all other consortium members across both the investor equity and debt tranches.

1.3 Implications of current application

The current application of thin capitalisation rules for wholly Australian based portfolio investments of superannuation funds means there is a potential for the loss of debt deductions in situations where there is no risk of base erosion or profit shifting between tax jurisdictions. As such, in these specific situations, the thin capitalisation rules should not apply.

Where there is a denial of debt deductions in these situations, it represents an actual cost that could negatively impact the valuation of superannuation fund assets and thus returns for their members. The need to comply with these rules in these situations also presents unnecessary additional cost and burden for superannuation funds.

As the Australian superannuation fund industry continues to grow in size and sophistication as an investor, stakes acquired in unlisted assets will also grow thereby increasing the likelihood of controlling interests or increased governance rights. Accordingly, this issue is likely to become more prevalent in future years.

[8] Section 67 of *Superannuation Industry (Supervision) Act 1993*

1.4 Recommendation

We recommend the thin capitalisation rules be amended so that wholly Australian based portfolio investments of superannuation funds are not drawn into the scope of thin capitalisation rules purely through being an associate entity of a superannuation fund that is an 'outward investor'.

Making this change would not undermine the policy intent of the proposed fixed ratio rule. The overarching purpose of the fixed ratio rule is to discourage debt arrangements which are designed to minimise tax and profit shifting by multinational groups in order to take advantage of the differences between jurisdictions' tax systems to minimise their tax paid. As explained, there is limited scope (if any) for profit shifting in these situations by superannuation funds.

Our recommendation for amendment does not extend to situations where a portfolio investment of a superannuation fund would otherwise fall within the scope of the thin capitalisation rules.

Option 1: Update definition of 'associate entity' (recommended)

The recommended solution would be to update the definition of 'associate entity' (as defined in section 820-905, ITAA 97) to exclude wholly Australian based portfolio investments from being an 'associate entity' of a superannuation fund. This could be done by excluding interests and other relevant rights held by complying superannuation funds (or their wholly owned subsidiaries) in the test for an associate entity in each of paragraph (a) and (b) of section 820-905.

As the concept of 'associate entity' is limited to the thin capitalisation provisions within Australian tax laws, any updates should be self-contained such that it should be possible to do this without requiring broader amendments to other areas of the tax legislation.

Option 2: Update Australian assets threshold exemption test (alternative)

An alternative solution would be to amend the Australian assets threshold exemption test (as outlined in section 820-37, ITAA 97) so that, when calculated for a wholly Australian based portfolio investment that is only an 'outward investor' due to ownership by a superannuation fund, only the assets of the portfolio investment are included in the calculation as opposed to the assets of the portfolio investment and all of its associates. This could be done by specifically excluding relevant interests held by complying superannuation funds (or their wholly owned subsidiaries) for the purposes of applying the test.

There is more complexity to implementing Option 2 as the test formula utilises the broader definition of 'associates', rather than the narrower definition of 'associate entity'.

2 MNE interest limitation rules – specific comments

We make the following comments in response to issues raised in Part 1 (MNE interest limitation rules) of the Consultation Paper.

Arm's length debt test (ALDT)

Assets such as large infrastructure and commercial property require significant capital outlay and thus tend to be highly leveraged in order to be commercially viable. Moreover, these types of assets generally support higher levels of debt by having high certainty of cash flows over long periods. Applying an EBITDA test for these assets/projects will likely result in significant denial of debt deductions, especially during the development and ramp-up phases, thus potentially acting as a barrier to investment in such assets/projects.

Accordingly, we submit that the current 'standalone entity' ALDT should be preserved to supplement the proposed bright line fixed ratio rule but, in order to overcome any broader integrity concerns around limiting deductibility to commercially justifiable amounts, be restricted to external debt only. If the ALDT is limited to external debt, we further submit a more compliance friendly approach be considered on the basis that third party debt should, by default, be viewed as arm's length and commercially justifiable.

In addition, whilst we do not have any in principle objections to the introduction of a targeted ALDT (to support higher gearing for defined classes of assets only, e.g. core infrastructure), it needs to be balanced against the risk of creating further uncertainty, complexity and thus compliance and administration costs for taxpayers and the ATO through the

introduction of various new concepts and definitions within tax legislation. Retaining and utilising current ALDT framework and concepts as much as possible should be preferred.

Transitional relief

A reasonable transitional relief (e.g. to enable refinancing) or, alternatively, full grandfathering, for pre-existing assets/projects should be made available. Fundamentally, investment decisions for existing assets/projects have already been made based on specific investment return metrics and hurdle rates, which includes underlying assumptions around debt quantum and interest deductibility.

Any changes that further restrict debt deductibility for existing investments made by superannuation funds is likely to negatively impact their valuation and undermine returns for members.

Carry forward/back of denied deductions

In the context of a fixed ratio rule, the ability to carry forward interest deductions denied is critical. In particular, this would be the case for infrastructure or property assets during pre-income phases (i.e. early-stage development or construction) as during this period income shall be de minimis or nil.

As such, carry forward/back rules for denied interest deductions are necessary to ensure there is an opportunity to claim these deductions in future income years when these assets have matured and are income generating.

Even with the introduction of a carry forward/back rule, for highly leveraged assets/projects such as large infrastructure and commercial property, there is still a risk that interest denied in early pre-income years could never be claimed under the fixed ratio rule due to limited or no excess capacity in future years to claim carry forward/back deductions (this will ultimately depend on the design of such rules). If this were the case, it could negatively impact the valuation of such assets for superannuation funds and their members. This reinforces the need to retain an appropriate ALDT to supplement the proposed fixed ratio rule.

Where ALDT is retained, in conjunction with the replacement of the existing safe harbour test with a fixed ratio test, we do not consider transitional relief or grandfathering provisions to be necessary. AustralianSuper is unable to borrow at a fund level, and our portfolio investments utilise asset level third party external debt. Our view is that as long as there are provisions in place that effectively allow for debt deductions in respect of external debt, we are comfortable that the thin capitalisation rules will generally not operate to the detriment of our members.

3 Multinational tax transparency

We make the following comments in response to issues raised in Part 3 (Multinational tax transparency) of the Consultation Paper.

AustralianSuper believes that sustainable tax practices of MNE’s supports sustainable investment value for investors. AustralianSuper also believes that disclosures made by MNE’s can help encourage sustainable tax practices of MNE’s and can help investors make informed investment decisions which also contributes to value for investors.

AustralianSuper accordingly supports improvements that could be made to MNE tax transparency. AustralianSuper believes that tax transparency information is of most use to investors in this context where the information disclosed is understandable and is comparable or able to be compared between MNE’s.

To assist this purpose, information disclosed should not be overly voluminous and should be supported by qualitative information, both of which contributes to assisting investors in achieving efficient and meaningful use of the information disclosed.

Information disclosed should also be consistent where possible with tax transparency information that is required to be provided by MNE’s globally. This will assist in the information disclosed being comparable and more efficient and sustainable to produce. Such an approach would also assist in ensuring that information provided does not include inappropriate disclosures that may adversely impact competitive positions of MNE’s which could detract from value for investors.

AustralianSuper also acknowledges that it is important that tax transparency information is able to be provided by MNE's in a cost-efficient manner such that it may be produced by MNEs without incurring overly burdensome compliance costs that can detract from value for investors.

AustralianSuper acknowledges the challenges in the above areas in respect of multinational tax transparency and would be pleased to consult further on this topic if required

4 Conclusion

Thank you for the opportunity to comment on these important policy reforms. As we said at the beginning of our submission, AustralianSuper strongly supports rules that prevent multinational groups from engaging in base erosion and profit shifting practices, and reform that contributes to these policy goals.

However, we believe there are some unintended consequences of the operation of the current thin capitalisation rules that may impede investment by superannuation funds into Australian infrastructure and other significant assets, and that erode the returns of Australian superannuation fund members.

We look forward to working with you to find solutions that are consistent with the policy intention of the proposed reforms and we would be happy to make available our internal tax experts. If you have any questions or would like to arrange a discussion, please contact Nick Coates, Senior Manager External Affairs on **ncoates@australiansuper.com** .

Yours sincerely

Sarah Adams
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