Deloitte Tax Services Pty Ltd
ACN 092 223 240

Grosvenor Place
225 George Street
Sydney, NSW, 2000
Australia

Phone: +61 2 9322 7000
www.deloitte.com.au

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International Tax Unit
Corporate and International Tax Division
Treasury
Langton Cres
Parkes ACT 2600

MNETaxIntegrity@treasury.gov.au

Dear Sir / Madam

Submission on interest limitation rules

This submission provides our comments on the Exposure Draft Treasury Laws Amendment (Measures for Future Bills) Bill 2013: **Thin capitalisation interest limitation** (**the ED**), as issued on 16 March 2023.

We will separately provide our detailed comments on the proposed modifications to sections 25-90 and 230-15.

Our comments are in the attached appendix. We would be pleased to discuss any aspect further.

Yours faithfully

David Watkins
Partner
0498 344 000

Mark Hadassin
Partner
0419 970 163

Claudio Cimetta
Partner
0412 321 341

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Appendix

Introductory comments

We are concerned by the overriding approach to the deductibility of interest which is implicit in the ED.

The Explanatory Memorandum (EM) makes numerous references to preventing "excessive deductions" of interest. This is an appropriate policy goal and the 30% of tax EBITDA model is consistent with the OECD best practice and commonly adopted regimes worldwide. However, the ED will not only prevent "excessive deductions" but will in many cases prevent the deductibility of genuine, commercial amounts of interest.

At numerous decision points in the ED, both in respect of policy matters and drafting choices, multiple decisions have been made which unduly and unreasonably narrow the regime.

Whilst the framework proposes three alternative methods, the narrow way in which the Group ratio test (GRT) and External third party debt test (ETPDT) have been drafted, at numerous points, effectively means that these two methods would rarely be genuine alternatives. The approach adopted can be said to deliver a framework that is consistent with the original announcement, however, we submit that this is the case in form but not in substance.

We submit that the ED is overly influenced by a minority of arrangements, is not designed for the majority, and indeed will be unduly harsh on many ordinary commercial arrangements. An appropriate balance needs to be struck between preventing excessive deductions whilst allowing genuine, commercial amounts of interest and establishing the new regime without creating "a more expensive, time consuming and painful experience"[1] for the majority.

Key submission points

We are conscious of the imminent start date and the limited time available for consultation. With that in mind, we set out below what we consider are the highest priority matters to be dealt with in the short term (though many other matters remain important):

1. Sections 25-90 and 230-15: proposed changes to these sections, which reverse longstanding policy and had not previously been announced, would have wide ranging and capricious consequences predominantly for Australian-based multinationals and therefore, should be removed from the current ED process and be subject to a separate consultation;
2. Irrevocable choice per s820-43(8): the annual choice to apply the GRT or ETPDT should be revocable, consistently with the principles of self-assessment;
3. In respect of the Fixed ratio test (FRT) and its application to non-consolidated groups, such as trusts and non-100% owned corporate structures, the FRT earnings limit of an entity should include an ownership based proportional share of any excess of FRT earnings limit over net deductions of associates (appropriately defined);
4. The GRT as drafted will likely not be adopted by most eligible GR groups, even where it is expected that the group ratio may exceed 30%. The cost and effort to perform the required adjustments and computations will likely mean that the costs outweigh the potential benefits.

[1] Although speaking of tax administration and not tax policy formulation and legislative design, this objective was referred to by the Commissioner of Taxation, Chris Jordan AO, in a speech to the IPA National Congress, 23 November 2017. The Second Commissioner, Jeremy Hirschhorn also recently spoke about the objective of "designing for the majority who willingly comply", 15th International Conference Tax Administration, 4 April 2023

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5. The **ETPDT** is defined in an unduly narrow way such that much genuine, commercial debt funding from non-associates will be ineligible. This is due to a number of matters – including the one in, all in mutual choice and the applicable associate entity test, the limited recourse test (s820-61(2)(c)) and the wholly test (s820-61(2)(d)). We encourage Treasury to adopt a more balanced approach to this test which in turn will require a number of policy and / or drafting decisions as compared to the ED. That is, making changes to only one area of ETPDT concern may make limited practical difference to the outcome.

   Attachments A and B elaborate on these issues in particular with respect to infrastructure and related investments.

6. Given the complexity of the changes and the compressed timeline, Treasury and the Government should commit to **ongoing post implementation review and monitoring** of the rules and commit to make amendments as required, and not leave taxpayers, advisers and the ATO managing issues that are best dealt with by legislative amendment

Given the many matters that we raise, both key submission points and other points, we have necessarily kept our submission comments brief. We would be happy to discuss any matter further, including proposed ways to deal with areas of concern.

General matters

Irrevocable choice: section 820-43(8)

In our opinion, it is unreasonable and inconsistent with the principles of self-assessment that the annual choice to apply the GRT or ETPDT under section 820-43(3) or (4) cannot be revoked.

We refer to the Treasury Consultation paper, June 2010 dealing with Review of Elections in the Income Tax Law. That report notes at 2.3.1 that there are certain circumstances where making an election irrevocable can be justified, such as where an irrevocable choice "could have adverse effects such as compromising the integrity of the tax system by providing unintended tax advantages". Furthermore, Proposed guideline 4 states that "Explanatory Memoranda should explain why the election needs to be irrevocable". There is no such explanation in the draft EM (rather just noted at paragraph 1.37).

Consider the case where a taxpayer makes a choice under section 820-43(3) or (4), and there is a subsequent change in circumstances such as an amended assessment issued to the taxpayer or a restatement of the financial statements of the GR group. It is unreasonable to prevent the taxpayer adopting an alternative method for determining deductible debt deductions in these circumstances.

Amendment to section 815-140

The proposed amendment to section 815-140 is a significant change and will require taxpayers to undertake a transfer pricing analysis in relation to debt deductions (both quantum and rate) which has previously not been required. This will necessarily take time to undertake a proper analysis, and where necessary, develop and implement an appropriate response.

Appropriate consultation should be undertaken by the ATO, with the goal of producing meaningful guidance on determining the quantum of debt under modified section 815-140.

Definition of debt deduction

The modification of the definition of debt deduction is a significant change. It will likely significantly expand the scope of deductions that come within Division 820, and will also give rise to considerable uncertainty as to the scope of amounts calculated by reference to the time value of money.

We submit that greater clarity is required as to the expanded scope of debt deduction, via the ED, the EM and likely via consultation with and guidance from the ATO.

ATO guidance on Part IVA risks associated with restructures

In connection with the commencement of the hybrid mismatch rules, the ATO issued PCG 2018/7: Part IVA of the Income Tax Assessment Act 1936 and restructures of hybrid mismatch arrangements, "designed to assist taxpayers to manage their compliance risk in these circumstances where their intention is to eliminate double non-taxation outcomes, consistent with the underlying objective of the hybrid mismatch rules".

Appropriate consultation should be undertaken by the ATO, with the goal of producing meaningful guidance to identify low risk arrangements associated with refinancing and other restructures undertaken in order to comply with the new interest limitation rules.

Fixed ratio test

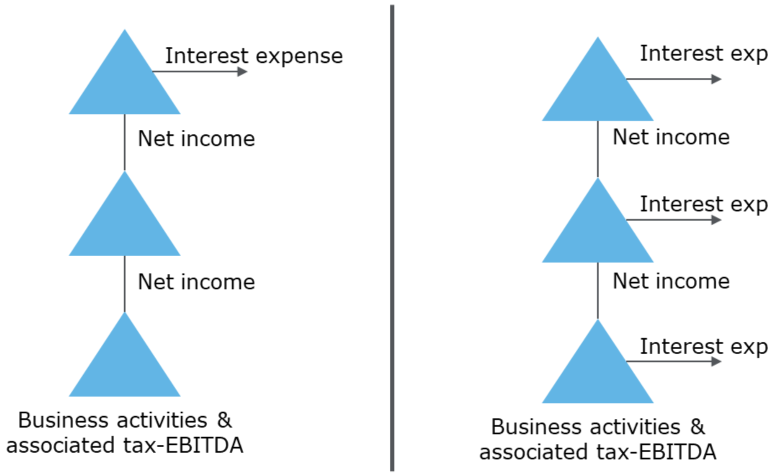
Non consolidated groups

The FRT makes no allowance for non-consolidated group structures such as a chain of trusts or a joint venture company, or other non-wholly owned companies. Rather, each entity is required to address the FRT on a stand-alone basis. This is to be contrasted with the existing Division 820 which includes a concept of associate entity excess amounts.

It is submitted that the approach of the ED creates winners and losers as between groups of entities whose arrangements are the same in substance but not in form, for example where interest expense is incurred in a holding trust, tax EBITDA will consist of taxable distributions from the subsidiary trust, which is not grossed-up for depreciation deductions. It also appears that the approach of the ED potentially permits multiple rounds of interest deductions to be tested as against the same underlying profits.

It is submitted that where there is a sufficient level of common ownership as between entities, the FRT earnings limit of an entity should include an ownership based proportional share of any excess of FRT earnings limit over net deductions of associate entities.

Examples of potentially affected arrangements are depicted below:



Tax EBITDA (s820-49)

We submit that:

- The adjustment in respect of depreciation should be expanded so as to include all Division 40 capital allowances;

- Carry forward capital losses that are applied to reduce (including to zero) a net capital gain in an income year should also be added back similar to income tax losses;
- it should be clarified that the tax losses referred to in paragraph (d) should be those tax losses taken into account in paragraph (a), being the computation of taxable income disregarding the operation of Division 820. That is, the actual amount of prior year tax losses deducted will not be known at this stage (as it depends upon the operation of Division 820), but in any event, the object of the exercise at this stage is to remove the effect of the tax losses taken into account in paragraph (a).
- The Tax EBITDA of a trust should be based on s95 net income, grossed up for any CGT discount. Trusts do not determine taxable income.

FRT disallowed amounts

We submit that:

- It is unreasonable that FRT disallowed amounts be forfeited if in a particular year the taxpayer adopts the GRT or the ETPDT. Rather, the balance should be notionally decreased (if applicable) and otherwise remain subject to the 15 year time limit;
- Taxpayers should be able to elect to establish an opening balance of FRT disallowed amounts at the commencement of these new rules. The absence of such a transition unduly affects taxpayers emerging from a high debt / low EBITDA phase at the same time as these new rules commence;
- FRT disallowed amounts should be subject to a same business type test, as well as a continuity of ownership test, consistent with tax losses; and
- FRT disallowed amounts should be able to be cancelled for ACA tax consolidation purposes similar to tax losses.

Group ratio test

The GRT as presently drafted will not be a realistic option for many eligible GR groups. Consider a global group, not headquartered in Australia, which could have hundreds or even thousands of entities in various jurisdictions and which has sizeable operations in Australia. On a group level, the group is highly leveraged via external debt. The FRT can be applied to the Australian operations in a relatively straightforward manner, both as to time and cost. On the other hand, the various modifications required to the group financial accounts, including the identification of any and all entities with negative entity EBITDA, practically mean that such a group simply will not contemplate the GRT. It is an illusory alternative.

GR group net third party interest expense (s820-53))

The requirement to adjust the financial statement net third party interest expense of a GR group to include amounts in the nature of interest or any other amount calculated by reference to the time value of money is subjective and potentially very broad. Examples could include income by reference to deferred payment terms or other time value amounts.

From a compliance and certainty perspective, interest should be determined based on the financial statements, noting that there is already a requirement that these statements be prepared under recognised accounting standards with an unqualified audit. Accounting standards already adopt a broader concept of interest than for tax purposes (e.g. leasing standard).

Refer also our comments below regarding the 10% threshhold for association: we submit that section 820-53(5) should be amended from 10% to 25%.

Drafting observations:

- s820-53(4) refers to ”net interest expense”, which is not defined. Is that instead meant to be referring to some other concept?
- s820-55(2)(b) refers to ”GR group’s adjusted net third party interest expense” which is not defined

Negative entity EBITDA (s820-55(3))

The requirement to determine if any GR group member has negative entity EBITDA and to exclude this from GR group EBITDA is very onerous and impractical.

If entity A has two activities which on a combined basis produce positive EBITDA of a particular amount, it is not clear why the application of the GRT should be any different, or what the relevant integrity concerns are if those two activities are instead undertaken in entity A (which has a positive EBITDA) and entity B (which has a negative EBITDA)?

Audited consolidated financial statements (s820-53(1))

Reference is made to audited consolidated financial statements, which is defined in existing s820-935, which is focussed on overseas accounting standards. It is not clear that this definition includes audited consolidated financial statements prepared under Australian IFRS, which is relevant in the case of an Australian group applying the GRT.

External third party debt test

The ETPDT is presently drafted in such a way that much existing, genuine debt will not meet the external third party debt conditions (ETPD conditions). Even where debt restructures are contemplated or new debt is being raised, it will often not be possible to meet the strict ETPD conditions, or it will be impractical, time consuming and expensive. Furthermore and given the current interest rate cycle, this is not an ideal time for borrowers to be renegotiating loan terms.

“Mutual choice” and modified associate entity test

It is submitted that the “mutual choice” (s820-43(5)) and the modified associate entity test (s820-43(6)) as drafted are unreasonable and effectively render this choice redundant. We note the reference to integrity concerns at paragraph 1.33 of the EM, which seems to imply that the concerns may arise for structures involving multiple tiers of entities in the ownership of a particular business, where each tier is subject to a separate application of the thin capitalisation rules.

Associate entity test: The setting of the associate entity test in such a way means that the associate entity net is cast very broadly, and in many cases, it will not practically be possible to confirm that all possible associate entities have been identified. In any event, it will often be the case that different associates will have different preferences under these rules so that it is not possible to reach a mutual choice. This is a particular concern where entirely separate businesses may be associated with one another (on the very broad definition) merely because there is an investor with an interest in both businesses.

To address the integrity concerns, but to also allow some room for the ETPDT to apply in practice, section 820-43(5) should be amended so that where an investee entity has made a choice to apply the ETPDT under subsection (4), and an investor entity is an associate entity with a **direct or indirect thin capitalisation control interest** of greater than zero in the investee, then the investor is either:

- Prevented from taking into account taxable income attributable to that entity when applying the FRT (the preferred option); or

- Deemed to have elected to apply the ETPDT itself if the preferred option is not considered appropriate.

This will cast the net widely, but then should also mean that the one-in all-in requirement will only apply to economic groups that are connected by vertical equity interests in the same underlying business.

Refer **Attachment A** for a discussion of the issue and suggested solutions.

The proposed 10% threshold for association in section 820-43(6) (and also in section 820-61(9)) is exceptionally low and should be increased to 25% to be consistent with the OECD's best practice recommendations.

Mutual choice: where associates have different year end dates and different tax return lodgement dates, the entity with the earlier date will not have certainty as to whether all later lodging associates will make the same choice.

Drafting comment: Is the intended policy correctly expressed in section 820-43(5)(a)(ii)? We read this to say that you cannot make this choice if Subdiv 820-AA does **not** apply to an associate because of say s820-35 ($2 million threshold). That is, the associate is effectively **excluded or exempted** from the thin capitalisation / interest limitation rules, and yet this choice is not available if such an (excluded or exempted) associate does not also so choose to apply the ETPDT.

The EM at paragraph 1.32 (second bullet) states that the choice cannot be made if "those associate entity are **not** exempt from the thin capitalisation rules" (emphasis added). We presume that the policy is correctly stated in the EM, and it is the statutory language in section 820-43(5)(a)(ii) that needs to be amended.

Limited recourse: "only to the assets of the entity" (s820-61(2)(c))

This is an unduly narrow test that does not accord with commercial reality, which will typically see third party lenders seeking to maximise security, including by way of security over equity in the borrower, security over assets of related entities, contingent equity, guarantees and cross-collateral arrangements.

Permitted recourse should be extended to assets of any associate entities that are mutually choosing to apply the ETPDT, and in this way, any integrity concerns should be alleviated.

From a drafting perspective query whether this is intended to require that the lender has recourse over:

- all of the assets of the borrower; or
- some of the assets of the borrower

Where it can include only some assets of the borrower, this should be clarified in the legislation or EM.

In cases where recourse extends to the assets of foreign subsidiaries of an Australian based multinational group, we submit that instead of completely disqualifying such debt, the test should allow the amount that would be lent if recourse were limited only to the assets of the Australian borrower.

Wholly (s820-61(2)(d))

This matter clearly interacts with the position adopted with respect to section 25-90 (noting that is the subject of a separate submission), however we note the following:

By way of preliminary comment:

- The drafting of this rule could be improved:
  - It is awkwardly split between s820-61(2)(d) and s820-61(3), which could be simplified;
  - It refers to "Australian operations" which does not appear to be relevantly defined; and
  - It requires that the funds be used to **wholly** meet **two** conditions: that is, used to fund subsection (3) investments **and** Australian operations. Technically this has the result that if the proceeds are

used wholly to fund subsection (3) investments but not Australian operations (or vice versa), the debt interest would not meet the ETPD conditions.

- The condition specifically requires that the proceeds of issuing the debt interest are used to fund particular investments and operations. On one view (although hopefully not the intended view), where a debt interest that meets all the ETPD conditions is refinanced, the proceeds of the refinanced loan may not be taken to relevantly fund the investments / operations, but may instead be taken to repay the original borrowing. It is submitted that the test should align to more common tax concepts: that the debt deduction be incurred in gaining or producing assessable income.

Subject to the above:

- Based on the current ED, the effect of this provision is that where there is a single debt interest with a mixed use (funds used for both Australian operations and non-Australian operations), the debt interest does not meet the ETPD conditions, and the interest expense is wholly non-deductible per this test, notwithstanding that a part of the debt can be traced to use in Australian operations. That is a punitive outcome with respect to interest that is incurred in gaining or producing assessable income and is otherwise deductible.
- The extreme position above is evidenced by the alternative scenario of two separate debt interests:
    - one debt interest is wholly used to fund non-Australian operations: this debt interest does not meet the ETPD conditions
    - another debt interest is wholly used to fund Australian operations: this debt interest meets the ETPD conditions and is wholly deductible per this test
- We submit that the wholly test should be removed and the debt interest should be taken to meet the ETPD conditions **to the extent** that the funds are relevantly used in the Australian operations.

Conduit financing (s820-61(5))

See our specific comments in **Attachment B** that relate to conduit financing arrangements in the context of infrastructure projects.

The ED has made an attempt to deal with the case where a conduit financer issues an external debt interest and uses the proceeds to on-lend to other entities. This is another example of where the policy decisions and / or the drafting effectively make this test most unlikely to be of any practical use:

- The terms of the on-lending are required to be “the same” as the terms of the ultimate debt interest (external borrowing), other than the terms as to the amount of the debt. Even leaving aside the amount, it is most unlikely that all of the terms of the external borrowing will be adopted in the terms of the on-lending, and in some cases, certain terms that are drafted with respect to the particular circumstances of the conduit financer will not be relevant or applicable to the entity to whom the funds are on-lent.
- s820-61(5)(f) requires that s820-61(2)(d) is met: if the conduit financer is a non-resident (e.g. in the context of a multinational group with an in-house financing entity), it will not be possible to meet s820-61(2)(d).
- The combined operation of s820-61(5)(b) and (c) is to the effect that it first identifies a number of entities: one or more entities that are associates of each other, and then requires that **each** of those entities issues a debt interest. One reading of this is that the conduit financing rules cannot apply unless the conduit financer on-lends to a particular entity and **all** of the associates of that entity.
- The combined operation of s820-61(5)(f)(i) and s820-61(5)(g) should be clarified. s820-61(5)(g) requires that the ultimate lender has recourse **only** to certain assets (assets of each borrower and each asset of

the conduit financer being a debt interest issued by a borrower), and yet s820-61(5)(f)(i) contemplates that s820-61(2)(c) is met which relevantly requires that the ultimate lender has recourse **only** to different assets (being assets of the conduit financer). Presumably it is policy consistent if the ultimate lender has recourse to the identified assets of the conduit financer **and** the identified assets of the borrower.

- With respect to section 820-61(5)(g), we refer to our comments above relation to s820-61(2)(c).

Miscellaneous drafting observations

- The three methods identify the maximum permitted amount of debt deductions as the fixed ratio earnings limit (s820-47(1)) group ratio earnings limit (s820-47(2)) and external third party earnings limit (s820-61): we suggest that the words "earnings" be removed so that these limits are simply described as the fixed ratio limit, group ratio limit and external third party limit (or fixed ratio deduction limit, group ratio deduction limit and external third party deduction limit).

- References are made to "third party" and "third-party". This should be standardised.

- The term "external third party debt test" could be simplified to external debt test or third party debt test.

- In computing the amount of a special deduction (s820-57), it is necessary to determine "the excess mentioned in paragraph (1)(b)" (refer section 820-57(2)(a)). It would be helpful to define this excess as "unused capacity" or similar, noting that the BEPS Action 4 report refers to this attribute as "unused interest capacity".

- Paragraph 1.124 of the EM is incomplete.

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Attachment A

“Mutual choice” and modified associate entity test

For the ETPDT to be available for any taxpayer all “general class investors” that are associate entities of that taxpayer (other than exempt entities) must elect to apply to use the test. Further, the associate entity definition has been modified to include an associate that has a 10% or greater TC control interest.

This is a very wide definition and because of the “all in” requirement in the proposed test, means that a taxpayer may be reliant on many unrelated “associate entities” also making the election. This is particularly the case for trusts because of the way in which the “associate” test applies in section 318(4) of the ITAA 1936 to trusts as all entities that benefit under the trust are associates of the trust (regardless of their interest held in the trust or the control/influence over the trust).

As currently drafted, the existence of a single 10% common investor in two or more projects or businesses will mean that all the investors and entities across those projects will be required to make the election to apply the ETPDT even though there projects may be otherwise unrelated but for the common investor.

To provide an example of where this can occur in using structures that are commonplace in the Australian infrastructure sector:

- There is a significant degree of cross ownership of infrastructure assets in Australia, meaning that most project vehicles will have at least one 10% or more investor that has also invested in another otherwise unrelated project.
- For example, Investor A has a 10% investment in a toll road operator and a 10% investment in an electricity distribution company. There are no other common stakeholders in the businesses.
- As currently drafted, each of the toll road operator, the electricity distribution company and their 10% or more investors will need to make the external third party debt election even though they are not economically integrated, not commonly held and not subject to the same governance arrangements.
- Furthermore, there would be a consequential effect where Investor B has a 10% interest in the electricity company and a 10% interest in a renewables project. All of the project entities and investors in the renewables project would also need to make the relevant election for the election to be available for the electricity distribution entities, even though there is no cross ownership between the two businesses.

This is an inappropriate outcome as an electricity distribution company will typically have higher external leverage than a toll road operator because of their different risk / return profiles of the investments, however, the two economic groups will be forced to apply the same method simply because Investor A has a 10% or more investment in each.

Further the test currently requires all the associate entities to make the election even if they do not have an interest in the relevant project vehicle. Given the reduction of the threshold ownership interest for associate entity status to 10%, it is unlikely either project vehicle, or their investors would be able to obtain the information necessary to determine whether this requirement has been met.

We understand that the test has been drafted in this way because of the Government’s concern that certain entities in the same “economic group” may gain an unintended advantage by applying different thin capitalisation methods with respect to their investment in the same underlying business or revenue stream. For example, an underlying trust may apply the ETPDT but investor trust applies the 30% EBITDA test to distributions by the underlying trust. However, requiring all of Project Trust's associate entities to also apply the ETPDT goes much further than required to deal with this concern. In fact, it will have the practical effect of preventing most (if not all) infrastructure project entities being able to make the election.

To address the integrity concerns, but to also allow some room for the ETPDT to apply in practice, section 820-43(5) should be amended so that where an investee entity has made a choice to apply the ETPDT under subsection (4), and an investor entity is an associate entity with a **direct or indirect thin capitalisation control interest** of greater than zero in the investee, then the investor is either:

- Prevented from taking into account taxable income attributable to that entity when applying the FRT (the preferred option); or
- Deemed to have elected to apply the ETPDT itself if the preferred option is not considered appropriate.

This will cast the net widely, but then should also mean that the one-in all-in requirement will only apply to economic groups that are connected by vertical equity interests in the same underlying business.

Attachment B

Conduit financer & recourse requirements

The recourse limitation in section 820-61(2)(c) and the conduit financer rules in section 820-61(5) are inflexible and based on our experience with the types of financial arrangements that are typically entered into by taxpayers, unworkable.

In summary, the rules provide that for a debt from a third party lender to qualify, the lender can only have recourse against: the assets of the borrower(s) and assets of a conduit financer (i.e., where the third party debt has been on-lent) (see section 820-61(5)(g)).

Further, for the conduit financing rules to apply requires that the on-lent debt is on the same terms as the third-party debt and that the third party debt is only on-lent once (i.e., the on-lending of third-party debt multiple times, even where it is within the same economic group will not qualify as conduit financing) (see sections 820-61(5)(a) and 820-61(5)(e)).

To illustrate the issues associated with these requirements in the context of typical financing arrangements in the infrastructure space, third party financers that have lent to an infrastructure project typically require security over the assets of the project entities as well as security over share/units of the relevant investor entities. The ETPDT as currently drafted would not be available in this circumstance as recourse (security) has been provided by a broader range of entities than the borrower and conduit financers.

We understand that the purpose of these restrictions is to ensure that credit support from outside of the relevant economic group (and outside of Australia) cannot be used to boost the borrowing capacity and therefore external third party debt capacity of the group. However, as currently drafted the rule are so restrictive that it is unlikely that any typical financing structure that is used in the Australian infrastructure sector would meet the requirements without complex restructuring that will likely require consent of third parties, which may not be possible in the short timeframes until the new rules are operative, if at all.

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To make the "recourse" requirement more flexible and able to work with the types of third party financing arrangements that are seen in practice, we suggest the requirement can be satisfied where recourse is limited to entities that are general class investors and have elected to apply the ETPDT. As outlined above, this will include the project entities and the investor's entities that are within the scope of the thin capitalisation rules. To the extent that recourse is outside of this group then the current restriction continues to apply and the ETPDT is not available.

To compliment this, we suggest that groups have the option to elect for additional entities to be able to apply the ETPDT. The purpose of this expansion would be to accommodate situations where "recourse" is external to the group established by the third party debt test election. This would not be available to non-Australian entities and so if credit support is provided from offshore then the ETPDT should not be available.

Further, it is relatively common in practice for debt to be on-lent more than once within an economic group. This can often comprise the third-party debt being lent from a Finco to an Asset Trust and then from an Asset Trust to a Project Trust. We suggest that the "conduit arrangements" could then be relaxed so that the external third-party debt test can be applied where the conduit arrangements are within the group that has been formed by the entities that have made the election.

Finally, in respect of the requirement that the on-loan has the same terms as the third-party debt in section 820-61(5)(e), as currently drafted we understand this requirement to mean that the on-loan has exactly the same terms. For obvious reasons having exactly the same terms is not possible (as, for example, the security granted in respect of the third party debt cannot be a feature of the on-lent debt).

Even if that is not a requirement of the test, the requirement may not be workable as it is often the case that a FinCo will have multiple external borrowings and it would be unnecessarily administratively burdensome to have mirroring on-loans for each tranche of external debt that is on-lent.

We understand that integrity concern with this requirement is to prevent taxpayers from using margins on on-loans to allocate net interest margin and so we would propose that the limitation on the terms of the on-loan is such that the interest rate and associated costs is equivalent to the third party debt and related arrangements so that there is no (or small) net financing margin.

If the on-lending is limited to a group that must apply the ETPDTor has elected to apply it) then there should be no integrity concern. This should mean that there is flexibility to have multiple on loans within the group to the extent the on-loans are attributable to the external debt against which the "group" assets have been pledged as security. The third-party debt test election means that the entities within that "group" can only apply the third-party debt test and so the integrity concern outlined above in respect of the ability of taxpayers to choose to use different tests does not apply.