INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

18 May 2026

Board of Taxation

Via email taxboard@taxboard.gov.au

SUBMISSION TO THE BOARD OF TAXATION'S INDEPENDENT REVIEW OF THE TREASURY LAWS AMENDMENT (MAKING MULTINATIONALS PAY THEIR FAIR SHARE – INTEGRITY AND TRANSPARENCY) ACT 2024 (AMENDING ACT).

Infrastructure Partnerships Australia is an independent think tank and executive member network, providing research focused on excellence in social and economic infrastructure. We exist to shape public debate and drive reform for the national interest. As the national voice for infrastructure in Australia, our membership reflects a diverse range of public and private sector entities, including infrastructure owners, operators, financiers, advisers, technology providers and policy makers.

Infrastructure Partnerships Australia draws together the public and private sectors in a genuine partnership to debate the policies and priority projects that will build Australia for the opportunities and challenges ahead.

Please find below a submission to the Board of Taxation, prepared by Infrastructure Partnerships Australia's Tax Policy Taskforce on the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Act 2024* (Cth). Infrastructure Partnerships Australia and its Tax Policy Taskforce look forward to further assisting the Board on this consultation. If you require additional detail or information, please do not hesitate to contact Katie Dempsey, Senior Policy Manager, at katie.dempsey@infrastructure.org.au.

Yours sincerely,

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Chief Executive Officer

Infrastructure Partnerships Australia

INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

Executive Summary

Infrastructure Partnerships Australia's Tax Policy Taskforce is grateful for the opportunity to provide this submission as part of the public consultation process within the independent review of the operation of the amendments made by Schedule 2 of the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2024* (the **New Thin Cap Law**).

The Tax Policy Taskforce acknowledges the Terms of Reference issued by the Board of Taxation, as well as the Consultation Guide released in March 2026 and that the focus of review by the Board of Taxation is:

> *"… whether the Amendments are operating in a manner consistent with their policy intent which is stated to "strengthen Australia's thin capitalisation regime to address risks arising from the use of excessive debt deductions, informed by the OECD's best practice guidance."*

As set out in further detail below, this submission of the Tax Policy Taskforce highlight our principle concern that the drafting issues and associated interpretative guidance from the Australian Taxation Office (**ATO**) result in a thin capitalisation framework that is not fit for purpose for the infrastructure industry and does not accord with the policy intent underlying the amendments.

For the avoidance of doubt, this submission seeks to put forward challenges with the legislation as drafted, and the subsequent interpretation of the legislation in related compliance guidance. This is intended to remove possibilities or risks of inadvertent implications for infrastructure investment arising from the legislation's application and interpretation.

As regards the specific Terms of Reference, our submission focuses in particular on:

- *The overall performance of the amendments in strengthening Australia's thin capitalisation regime to address risks arising from the use of excessive debt deductions.*
- *Any minor and technical drafting changes which are necessary for the practical administration of the laws, with a particular focus on the third party debt test provisions and related undefined legislative terms.*

The Taskforce would welcome the opportunity to meet with the Board to discuss our submission at the earliest possible time.

At various points throughout this submission, the Taskforce refers to previous submissions to Federal Treasury and the ATO, which provide additional clarity on the issues presented in this submission. These earlier submissions are provided in Annexures 3 – 5 at the base of this submission (hyperlinked).

Summary of issues – ongoing technical / interpretative issues

Item	Issue	Overview	Legislative fix	Commercial impact and consequence
TPDT				
1	'All or nothing' approach	The Third Party Debt Test (TPDT) is not structured to apply proportionality. It operates to fully deny debt deductions in relation to a non-compliant debt instrument, irrespective of the extent of the contravention.	a. Insert statutory right to revoke the TPDT election within four years of making the election; b. Expand and clarify carveouts/de minimis rules – e.g., 'minor or insignificant' limb of s. 820-427A(3)(c); and / or, c. Insert overarching proportionate deduction provision for test elements (apart from s. 820-427A(3)(a)).	Projects that otherwise would be eligible for the TPDT may not choose the TPDT where any doubt exists as to its availability. This is translating to significant uncertainty in respect of the tax treatment of debt funding for new and existing infrastructure projects. This uncertainty, and the unwillingness to adopt the TPDT for critical infrastructure projects, that would be otherwise within the scope of the TPDT, result in higher costs to equity investors, consumers and the State counterparties.
2	'Commercial activities'	The legislation has been drafted in such a way that it has resulted in the ATO asserting a narrow view that 'commercial activities' excludes inherently commercial activities such as payment of dividends, distributions and capital returns.	a. Flip the 'commercial activities' test so that it focuses on what is prohibited, i.e., those activities specified in s. 820-427A(3)(d)(i)-(ii) and delete the 'commercial activities' requirement; and / or, b. Clarify that 'commercial activities': i. encompass all economic activities of a business, including the payment of distributions to equity investors; and	The ability to recycle equity funding from one infrastructure project to the next (once debt funding becomes available post operations commencement) is instrumental to the infrastructure industry. The current ATO interpretation prohibits ordinary commercial arrangements.

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			ii. are not limited to those capable of returning a profit, as without this clarification, the conduit financing rules cannot function as intended.	Further, it acts as a disincentive to new greenfield projects compared to existing brownfield projects, hindering rather than promoting critical new infrastructure (particularly new renewable energy projects).
3	Credit support rights	The interpretation of the scope of "credit support rights" as outlined in supporting guidance is unduly broad, encompassing ordinary borrowing arrangements (where equity commitment deeds and/or cost overrun support deeds are a mandatory requirement of a lender) and contractual arrangements which are contingent rights that only arise in the event of a failure to perform.	a. Insert a carve out for performance guarantees and indemnities that wholly relate to the performance of contractual obligations; b. Allow credit support that is entered into by arm's length parties, notwithstanding that the borrower is subject to the thin capitalisation provisions; and / or, c. Introduce a "sole or dominant" purpose test, such that the credit support prohibition only applies where the "sole or dominant" purpose is to increase Australian debt deductions greater than the borrower would have otherwise been entitled to.	The implementation is inconsistent with the policy intent underpinning the TPDT, improperly increasing the cost of debt to infrastructure projects that should otherwise meet the terms of the TPDT. Further, this approach is in direct contradiction to ordinary lending practices that also apply to Australian consortiums that are not subject to Australia's thin capitalisation laws (evidencing that there is no tax mischief). For existing infrastructure projects that have unregulated pricing, these costs may be able to be passed on to consumers. However, for those entities with regulated pricing structures, this would reduce the equity returns to the equity investors and the State counterparties (where there are revenue share arrangements).

Item	Issue	Overview	Legislative fix	Commercial impact and consequence
				New infrastructure projects that are unable to access the TPDT would pass the cost to consumers and the State counterparties. This has extended to ordinary 'phased' deployment of capital, whereby the mere fact of staged equity releases can be seen to be a form of impermissible credit support provided by a foreign associate entity.
4	Development carve out in section 820-427A(5)(a)(iii)-(vi) is ineffective for large scale infrastructure projects delivered by consortia that typically contain foreign headquartered participants	The overriding prohibition of credit support from foreign associate entities in section 820-427A(5)(b) is unduly restrictive and renders the development phase carve out uncertain and unworkable for major infrastructure projects that necessarily include foreign-headquartered equity sponsors and contractors to deliver complex and large-scale infrastructure projects. It is ordinary lending practice for financial sponsors to an infrastructure project (whether Australian or foreign) to be required to stand in for the project through the development phase and does not facilitate debt dumping.	a. Provide a carve out for development phase projects regardless of whether it is provided by Australian or foreign associate entities of the borrower. That is, amend the law so that the development phase carve out in section 820-427A(5)(a)(iii)-(vi) is not restricted by section 820-427A(5)(b); b. Alternatively, if the development carve out must still be limited where credit support is provided by foreign associate entities, amendments should narrow the definition of associate entity for this purpose to a brightline "majority interest" test.	From a policy perspective, credit support during the development phase of a project supports the funding of Australian infrastructure projects using foreign balance sheets, which should be encouraged. The current rules act as a disincentive to new greenfield projects, hindering rather than promoting critical new infrastructure (for example new renewable energy projects). Accordingly, the development phase carve out must remain available to consortia containing foreign headquartered participants whose scale, balance sheet and expertise is typically required to deliver large-scale infrastructure development projects.

Item	Issue	Overview	Legislative fix	Commercial impact and consequence
5	Swaps	Considerable uncertainty as to the treatment of swaps.	a. Switch off 820-427A(2)(b)) for purposes of the conduit financing rules; and b. Overarching fix so that where a conduit entity is operating as a conduit entity (i.e., not making a profit), it should not be denied the use of the TPDT.	The ATO's interpretation has resulted in taxpayers adopting structures that are artificial, contrived and non-commercial. The Taskforce respectfully submits there is no clear policy rationale for such a complex and detrimental framework.
FRT				
6	Excess gearing capacity	Excess gearing capacity is only allowed to investors holding an interest of 50 per cent or more in the project.	Allow any equity investor holding a 10 per cent or more equity interest in an entity should be entitled to include an Excess Tax EBITDA amount in the FRT calculation.	The Taskforce sees no policy rationale for disallowing the sharing of gearing capacity, with the consequence that unnecessary tax planning is required to ensure that debt is entered into in the appropriate level of an investment structure.
Debt Deduction Creation Rules (DDCR)				
7	Refinancing existing related party debt with third party debt	There is uncertainty regarding the circumstances in which the restructuring of related party debt arrangements with third party debt may be impugned under the broad scope of the DDCR integrity rules.	Insert an explicit carve out for third party debt refinancing of related party debt, or at least more clearly prescribe the circumstances in which it may apply.	Prohibiting third party refinancings impedes ordinary commercial arrangements where investors should be permitted to adjust their capital structure within overall thin capitalisation limits.

Summary of issues – structural policy issues

Item	Issue	Overview	Legislative fix	Commercial impact and consequence
TPDT				
1	TPDT is practically unavailable to outward investing entities	Any group of entities that have a foreign asset that is not of minimal or nominal value will never be able to satisfy the conditions of the TPDT, irrespective of whether the foreign asset has been used to secure a higher level of debt in Australia than would otherwise have been the case.	Arm's length debt test be made available to outward investing entities for the purposes of determining the amount of allowable debt deductions for third party debt only (i.e. the third party arm's length debt test (TPALDT). This could be achieved by removing the limitation to Australian assets in paragraph (c) of section 820-427A(3).	Arbitrarily increases tax costs for outward investing entities and encourages the migration of capital to comparable jurisdictions that have favourable interest limitation rules for infrastructure (i.e. Canada, US, UK etc). Distortionary tax practices and rules that arbitrarily reduce competition, without sound policy reasons, will have, over the long run, an adverse impact on productivity and cost to consumers. Keeping Australian capital within Australia will result in greater overall collection of tax revenue.
2	'One-in, all-in'	This deemed TPDT election applies to where an entity is a 20 per cent associate entity of a borrower that has made the TPDT election and is: (a) a member of the same Obligor Group of that borrower; or	a. Increase the "associate entity" threshold for the purposes of the deeming rule to above 20 per cent (ideally to at least 50 per cent); and b. Allow flexibility for stapled group members to individually choose whether to elect into the TPDT.	Due to the scale of capital required, infrastructure projects are often undertaken on a consortium basis such that projects are held in unconsolidated, standalone project vehicles. As the TPDT is an 'all or nothing' test, the deemed election rule provides a disincentive for co-investment into Australia because of the risk of investors' group entities being grouped into the

Item	Issue	Overview	Legislative fix	Commercial impact and consequence
		(b) is part of a "cross staple arrangement" where one of the entities in the stapled group has made the TPDT election. In the case of (a), this can impede parties from entering into joint venture funding arrangements. In relation to (b), this is a relatively blunt rule that can result in inappropriate outcomes.		TPDT. The TPDT is designed to, among other things, facilitate investment into Australia. This rule undermines that policy intent. Stapled groups are also effectively unable to apply the TPDT on one side of the staple, but not the other, despite there being genuine commercial reasons for adopting a stapled structure and different funding objectives.
DDCR				
3	Delinking the TPDT with the DDCR	The TPDT election carve-out from the DDCR turns on making the TPDT election rather than on whether the third party debt conditions are in fact satisfied, producing inappropriate outcomes for taxpayers who have not elected to apply the TPDT for commercial reasons and have widely-used conduit financing structures where the debt is traceable third party debt and on back-to-back terms.	Insert a carve-out for arrangements which are substantively compliant with relevant TPDT conditions.	The current operation of the TPDT election carve-out from the DDCR effectively penalises infrastructure groups and other capital-intensive taxpayers that have genuinely borrowed from third party lenders and on-lent on back-to-back terms within their group, disallowing otherwise permissible debt deductions because a procedural election to apply the TPDT has not been made. This increases the cost of capital for Australian infrastructure investment and discourages efficient group treasury arrangements that do not pose a debt dumping risk.

Infrastructure context

Infrastructure by its nature is a capital-intensive industry sector with debt being a critical component of the capital structure of all infrastructure projects. The ability for such taxpayers to claim a tax deduction on all of their external debt is crucial to the financial viability of these projects.

As the financial returns over the life of the project are typically stable, the net investment and financing decisions are usually made at the commencement of the project. These decisions take into account financial projections over the life of the investment on a net present value basis. Consequently, the financial decisions made at the inception of the project to invest capital in the form of debt or equity can be impacted by subsequent regulatory changes.

The Taskforce respectfully submits that, in drafting the New Thin Cap Law, key features of infrastructure businesses have been unintentionally impacted, particularly for the Third Party Debt Test (**TPDT**) which was designed as a bespoke piece of law for such taxpayers.

It is submitted that the need for legislative reform to the New Thin Cap Law is clear. Many of the issues in this submission were raised during the extended Treasury consultation process prior to enactment of the New Thin Cap Law, including in the two Senate reviews.

In attempting to be narrow in application, taxpayers are now left with a set of rules under the TPDT that do not contain due regard to economic policy, equity and efficiency. In order to access the TPDT, taxpayers in the infrastructure sector are forced to adopt a very specific and narrow type of structure that does not adequately reflect the complexities and economic considerations that are important to investment decisions in that sector.

This is likely to have a real distortionary impact on Australia's ability to attract infrastructure capital. Taxpayers with the same set of economic circumstances may have significantly different tax implications under the TPDT, depending on whether they are owned by non-residents, wholly owned by superannuation funds or by other types of domestic investors. Given that the market for infrastructure investment in Australia is competitive, any economic advantage afforded to one type of investor will lead to other investors looking elsewhere to invest their capital. This is likely to have a significant impact on the cost of infrastructure delivery and services for Australian governments and end users.

As noted above, representatives of the infrastructure sector and adjacent sectors have engaged extensively with the ATO to have the issues outlined in this submission addressed through public guidance, however, uncertainty remains. With now more than two and a half years passing since the rules took effect, this uncertainty underlines the need for urgent and positive legislative reform to ensure that the rules operate as intended and do not unduly impede the sourcing of efficient debt financing and Australia's ability to attract private capital, both of which are critical to meeting Australia's infrastructure needs.

TPDT

The TPDT was drafted by Treasury as an alternative test for taxpayers in the infrastructure to the earnings-based tests under the New Thin Cap Law. This was on the basis that the capital-intensive nature of such industries rendered the earnings-based tests unworkable given lower EBITDA margins than other sectors, higher levels of gearing, or no revenue being generated in the development phase of infrastructure projects, which can be significant with large-scale infrastructure projects.

However, as currently drafted, the TPDT is overly prescriptive yet still uncertain, including in its operation for many basic project financing arrangements, such that the test is, in certain respects, not practical or commercially functional. Importantly, in the Taskforce's view, the test, as it is currently drafted and applied by the ATO, has departed from the policy intention that it "operates effectively as a credit assessment test, in which an independent commercial lender determines the level and structure of debt finance it is prepared to provide an entity."[1] This is an industry-wide concern for taxpayers in the infrastructure sector.

This outcome is at odds with the original intention of the TPDT, which was designed to be a "simpler and more streamlined test" than its predecessor, the arm's length debt test.[2] The TPDT has instead implemented conditions that are unduly burdensome and in many ways are open to interpretation resulting in a significant lack of certainty for taxpayers. Common financing structures representing genuine commercial arrangements are unable to satisfy certain of the strict and onerous conditions of the TPDT. Accordingly, the TPDT is not fit for purpose as it is currently drafted and implemented. Without amendment, this will discourage foreign capital which is critical in developing and operating infrastructure projects. In the absence of sufficient foreign capital inflows, a considerable proportion of infrastructure projects will become unviable or will simply not be commenced at all. For existing infrastructure projects which previously relied upon the ALDT, this change in law could result in significant amounts of genuine external debt being denied deductibility for tax purposes. Reverting to the Fixed Ratio Test (FRT) does not alleviate this issue given these projects typically operate at low margins and will have the same level of gearing for significant periods of time meaning there will never be EBITDA "capacity" under the FRT to recoup these carried forward deductions.

This inadvertent outcome occurs against the backdrop of an infrastructure sector struggling to meet energy transition objectives. It is therefore imperative that the TPDT is designed to operate effectively so that infrastructure taxpayers can source and apply third party debt optimally in situations where there is no base erosion or profit shifting mischief.

Without legislative amendment, the Taskforce puts forward there will be a detrimental impact on Australia's productivity and competitiveness in the longer term, not just in the infrastructure sector, but with flow on consequences to the broader Australian economy.

To this end, this submission suggests that a number of amendments to the TPDT should be introduced. While these are not a complete list of all the amendments considered to be warranted in order to remedy

[1] Explanatory Memorandum, *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Bill 2023* (**EM**), para. 2.90.
[2] Ibid, para. 2.91.

the deficiencies in the TPDT, these suggested legislative amendments reflect what the Taskforce considers to be the most critical in order to make the TPDT more workable for infrastructure taxpayers, and to do so in a way that is consistent with the policy intent that underpins the TPDT.

The Taskforce contends that these amendments should make the TPDT operate as it was set out to achieve – a balance between protecting the tax integrity of the Australian revenue base by preventing 'debt dumping' by multinationals, while promoting investment in Australia in order to support the development of necessary projects to meet the demands of a growing Australia.

Without these amendments, the approach adopted in the legislation and the ATO's interpretation of that legislation, will ultimately preclude the TPDT from being workable for the very taxpayers the rules were intended to accommodate. This adverse outcome is not limited to infrastructure taxpayers; excessive debt deduction denials may also indirectly trigger increased cost to governments and end users of the infrastructure (e.g. through higher charges for use of the infrastructure to both end users and government).

Residual concerns with the FRT and DDCR

While the primary focus of this submission is the application of the TPDT to the financing of Australian infrastructure projects and businesses, there remain residual issues in circumstances where the project is required to rely on the FRT. It is important that these issues are addressed to ensure that the FRT provides fair and consistent outcomes for participants in consortia undertaking these projects that are in line with policy.

Detailed submissions

ONGOING TECHNICAL / INTERPRETATIVE ISSUES

1. "All or nothing" approach

Overview

The TPDT does not apply proportionality in its application. It operates to fully deny debt deductions in relation to a non-compliant debt instrument, irrespective of the extent of the contravention, such that, for example, failing one condition for one day will deny debt deductions for the whole income year.

Supporting analysis

As currently drafted, the TPDT is an "all or nothing" test. That is, where any of the TPDT conditions are not satisfied (whether partially or inadvertently), the consequence is a full denial of debt deductions in relation to the non-compliant debt instrument. This results in outcomes that do not reflect the extent to which the funds are otherwise used for 'compliant' purposes. This can have severe outcomes for taxpayers that rely on debt deductions to make their projects financially viable.

This outcome is, in turn, exacerbated by several factors:

1. The TPDT is complex and open to interpretation in many areas, with the result being its implementation for certain matters to be unduly narrow.
2. Taxpayers may contravene one of the TPDT conditions inadvertently, or only to a minor degree, with no difference in denial outcome to those that arise under flagrant or complete contraventions of the TPDT.
3. Taxpayers will be denied deductions for a debt interest for the whole of the income year where it fails the test for just a single day in the income year, lacking proportionality.
4. A taxpayer who elects into the TPDT, but then fails to meet the TPDT conditions, does not automatically default to the application of the FRT or GRT.[3] The TPDT was designed as a particular measure for taxpayers in the infrastructure for whom the earnings based tests (i.e. the FRT and GRT) are unworkable.[4] This means that even if these tests were automatically applied as a fall-back in the event of non-compliance with the TPDT, this would be of little practical benefit for affected taxpayers.
5. Due to the scale of infrastructure projects, debt deductions on debt interests are often substantial. Debt deduction denial may therefore impact the economic viability of entire projects and the cost of essential infrastructure services to end users and government.

The Taskforce acknowledges that the TPDT was designed to operate as a "narrow" test that is "simpler and more streamlined to apply and administer" than its predecessor, the arm's length debt test.[5] Parliament's

[3] Noting there are issues with accessing the Commissioner's discretion to revoke a choice to apply the TPDT – it is beyond the scope of this submission to address these in further detail.
[4] EM, p. 83.
[5] EM, paras. 2.91-2.92.

reference to the "narrow" design of the TPDT is that it is intended to "accommodate only genuine arrangements relating only to Australian business operations."[6]

The Taskforce submits that that these objectives would withstand a "to the extent" approach to the operation of the TPDT. A "to the extent" approach to deductibility is capable of being narrow in the sense of only permitting genuine commercial arrangements. Such an approach is also widely used for other provisions and would ameliorate the potential gravity of minor or inadvertent breaches of the TPDT conditions, without compromising its intended design.

Without any legislative amendment, the "all or nothing" approach also means that, in practice, taxpayers will not be willing to adopt the TPDT where there is any uncertainty in its application. A taxpayer could not challenge the view of the Commissioner or adopt a contrary position that is reasonably arguable on an element of the test without risking the full debt deductions in relation to the debt arrangement in question. This significantly undermines the principle of self-assessment. Taxpayers should be permitted to take positions that are reasonably arguable in the context of complex laws and financial arrangements.

This issue is amplified in the conduit financing context, where the failure of one element of the TPDT could result in duplication of denials in the lending chain.

Legislative fix

Given the above, the Taskforce submits that the TPDT be amended to include the following:

(i) *Revocation of TPDT election*

It is submitted that taxpayers should have the statutory right to revoke the TPDT election within four years of making the election. Currently, the TPDT can only be revoked at the discretion of the Commissioner, which cannot be challenged under Part IVC of the *Taxation Administration* Act *1953*.

The TPDT is accessed by making an annual irrevocable election by the time the entity lodges its income tax return for the year. The election can only be revoked where the Commissioner is satisfied that it is fair and reasonable and application for revocation is made within a limited four-year period.

The complexity of project financing arrangements, combined with the prevailing uncertainty regarding the proper application of the TPDT, has placed an unfair burden on affected taxpayers who have been required to make an irrevocable election in that context.

If the elective nature of the TPDT is to be retained, it is submitted that the choice should be made freely revocable within the income tax return amendment period applicable to the taxpayer for the relevant income year. It is submitted that this eliminates the uncertainty and unnecessary administrative burden on taxpayers and the Commissioner while still achieving the policy objective of ensuring that taxpayers only seek to rely on the TPDT where there is a reasonable basis.

[6] EM, para. 2.92.

Another alternative is to have an automatic default to the FRT for each year that there is a contravention of the TPDT.

(ii) *Expansion and clarification of carveouts/ de minimis rules*

To assist with the ability of taxpayers to satisfy the TPDT, there should be legislative clarification to the minor or insignificant limb of the test so that, for example – if the quantum of debt that is able to be borrowed is not increased by an asset that is included in the security net (domestic or otherwise), that asset is necessarily considered minor or insignificant.

(iii) *Insertion of overarching proportionate deduction provision*

To overcome the challenges presented by the provision whereby a deduction is denied if even one of the provisions is only breached for a single day in the income year, there should be an insertion of a new overarching provision providing that, other than in respect of s. 820-427A(3)(a), a taxpayer is able to establish a proportionate level of allowable debt deductions having regard to the degree of compliance with the TPDT conditions.

That is, for part year satisfaction, proportionate to the period that each of the conditions were satisfied. For example, where all conditions are satisfied for half a year, but all conditions are failed for the other half year of the income year, this should result in half of the debt deduction pool being allowable. It is appreciated that this will introduce complexity where, for example, different conditions are satisfied for different periods of the year, however, this complexity also arises due to the current all or nothing approach in the TPDT. The burden will be on taxpayers to document and establish a fair and reasonable degree of proportionality.

2. 'Commercial activities'

Overview

The legislation has been drafted in such a manner that it has resulted in the ATO interpreting and proposing a view of "commercial activities" which excludes the payment of dividends, distributions and capital returns – all of which are inherently commercial activities. Rather than focusing the test on whether commercial activities are "in connection with Australia", the test has been effectively rendered unworkable because the focus has shifted from multinational debt dumping to restricting the scope of "commercial activities" to corporate actions which directly earn a profit. The Taskforce puts forward, this is not the intent of the "credit assessment test" that the TPDT is intended to operate as, it prohibits genuine commercial arrangements and not well aligned with the policy of the law to the point that it effectively renders the TPDT unworkable for infrastructure taxpayers.

Supporting analysis

The Taskforce submits that, as currently drafted, the legislation does not sufficiently clarify that "commercial activities" extends to the full range of activities relevant to infrastructure activities that rely upon the TPDT. As a consequence, the meaning of "commercial activities" has been narrowed in its implementation to such an extent that for many infrastructure projects the TPDT becomes unworkable.

Specifically, the ATO asserts the view that for the purposes of s. 820-427A(3)(d), "commercial activities" does not include "the payment or distribution of dividends or capital returns".[7] The Taskforce respectfully puts forward this offers a limited compliance approach which contemplates a rare fact pattern that is highly unlikely to occur in practice.[8]

The issues stemming from this can be summarised that the payment of dividends, distributions and capital returns is an inherently commercial activity, as discussed in detail in the Taskforce's February 2025 Submission (Annexure 3 – item 4, p. 10 – 18). Furthermore, the practice of replacing equity with debt financing (also known as regearing) is common in infrastructure projects and allows equity investors to obtain a return of some of their investment after having financed the riskier early stages of a project. Replacing equity with third party debt in this manner allows the less-costly debt to finance the less-risky ongoing operation of the asset – thereby reducing the ongoing cost of providing infrastructure services to customers and government.

The legislation, as drafted, enables "commercial activities" to "be regarded as those operations of trade or business capable of returning a profit."[9] It is further considered that the payment of dividends or capital returns do not return a profit. However, the view that commercial activities require a profit be made is at odds with the mechanical requirements of the Conduit Financing Conditions in s.820-427C. These broadly require the costs incurred by a Conduit Financer to be passed on to the Borrower on back-to-back terms (i.e. if the Conduit Financer is going to meet the Conduit Financing Conditions it is not permitted to make a profit on its financing activities).

As such, if the position of requiring profit-making activities was accepted, then no financing vehicles would be able to satisfy Conduit Financing Conditions as well as the "commercial activities" condition in s. 820-427A(3)(d). This would contradict the reason why the conduit financing rules were introduced in the first place and make it impossible for them to be used.

As a matter of policy, the legislation's intention was that the TPDT operate as a "credit assessment test"[10] and "accommodate only genuine commercial arrangements".[11] As part of any financing transaction, independent lenders make a credit assessment of a prospective borrower's debt capacity. This is the case even when the funds are used to replace securityholder equity. Such capital management activities are factored in by lenders as part of their credit assessment when determining the terms of genuine commercial financing arrangements. Therefore, no 'mischief' arises as part of such activity. Accordingly, in the

[7] TR 2025/2, para. 125.
[8] PCG 2025/2, Example 34. This fact patterns entails the use of a debt facility to pay annual trust distributions. The compliance approach requires, in broad terms, that the trust only make annual distributions of less than 10% of the available balance of the debt facility, and unwind that policy by ceasing to pay such distributions and repaying the debt facility out of Australian business revenues. The threshold of 10% of the balance of a given debt facility will often represent a very insignificant amount of debt used to fund a distribution. Practically, therefore, the fix suggested in the Guidance would be highly unlikely to occur in practice as very few arrangements would fall within these narrow parameters.
[9] TR 2025/2, para. 120.
[10] Refer EM, para. 2.90.
[11] Ibid., para. 2.92.

Taskforce's view, one cannot reconcile the ATO's interpretation of "commercial activities" with the 'mischief' intended to be addressed via the New Thin Cap Law. The impact of this interpretation is that the time at which debt is introduced into a project becomes relevant as to its deductibility under the TPDT. It would appear debt on financial close of a project is acceptable but debt introduced at practical completion to a project 100 per cent equity financed during construction is not. There is no clear rationale as to why these two scenarios should be treated differently.

From a policy perspective, the exclusion of payments of distributions, dividends or capital returns from "commercial activities" is distortionary and discourages exactly the type of investment that the TPDT is designed to protect. Lenders are typically less likely to lend to new infrastructure assets that do not have an established revenue history. To manage the availability and pricing of debt for new greenfield developments, equity investors subscribe for equity upfront and, over time, replace this equity with debt. Put simply, new greenfield infrastructure assets have higher levels of equity at the earlier "risky" phase and higher debt funding during the later established phase.

This view of "commercial activities" is distortionary as it encourages investment in established infrastructure assets in the secondary market (i.e. brownfield assets), as these can be geared on acquisition. Newly-built assets (i.e. greenfield assets) are actively discouraged as the debt is deemed non-deductible to the extent that they are used to fund the return of the initial equity contributed by the investors. As it would not be possible to fund greenfield assets upfront with the level of debt that they could later support, the practical implication of the ATO's approach is that greenfield assets will be largely funded via non-deductible debt as compared to brownfield assets which will likely be funded by deductible debt (if the TPDT were to be elected).

From an equity investor perspective, the returns on established assets will be higher in comparison to new greenfield assets, thereby skewing investment and / or increasing cost to government and society overall. Please refer to the illustrative example of the kinds of common commercial regears which may trigger debt deduction denials for greenfield investments under the 'commercial activities' condition, set out at Annexure 1. Having regard to the examples set out in Annexure 1, the indicative outcomes under the ATO's current interpretation would be as follows:

- Example 1: new lower cost Senior Debt should be non-deductible;
- Example 2: interpretation is unclear; and
- Example 3: new lower cost Senior Debt should be deductible.

The Taskforce submits that there is no clear policy rationale for the above outcomes to differ between those three examples.

For greenfield projects this interpretation of "commercial activities" creates two issues:

1. <u>The timing of when third party debt is introduced into a project</u>

The current interpretation of "commercial activities" in effect encourages greenfield projects to be debt financed from day one, as such debt will be deductible, subject to other conditions, from the outset. In contrast, an identical greenfield project that is 100 per cent equity financed during construction, with the introduction of debt on commencement of operations, will be adversely impacted if that debt is used to

replace equity. In such a case, both projects could have identical long-term debt/equity ratios but one project will have 100 per cent deductible debt and the other, based on the current interpretation, 0 per cent deductible debt.

2. The funding/financing needs of that project over its life

The second issue caused by the current interpretation of "commercial activities" is that projects that have material cost bases will be able to introduce debt during the life of the project, whereas those with little operational or capital expenses will not. It is common in the infrastructure industry for projects to increase their level of gearing once that project has an understood revenue profile. For projects with high operational expenditure/ capital expenditure needs, based on the legislation's current interpretation, debt can be raised to fund those activities[12] with in effect cash flow from revenue used to repay equity. This is to be contrasted with, for example, a renewables project that may have minimal capital expenditure or operational expenditure. Such a project cannot regear as it cannot trace the debt to a source of expenditure. Both projects may have identical gearing ratios but one project is penalised due to it having minimal capital expenditure and operational expenditure.

Similarly, by viewing certain economic activities as being "commercial" (i.e. repaying debt) while categorising other economic activities as being uncommercial (i.e. returning equity) – this distorts the choices of an economically rational business. If this interpretation was to remain in place, a business may choose sub-optimal outcomes, such as retaining cash in a bank account or investing in certain low productivity activities if the tax advantages of doing so outweigh the more productive alternatives, all else being equal. When taxes cause mutually beneficial trades to be abandoned, this invariably causes a reduction in economic efficiency and surplus and increases deadweight cost to society.

Furthermore, the current interpretation of the legislation effectively incorporates DDCR concepts into the TPDT. The DDCR is intended to address related party funding that facilitates, among other things, a distribution. By importing that rule by interpreting "commercial activities" to exclude the payment of dividends and distributions, the DDCR is effectively duplicated in the TPDT. This is inappropriate given that the legislation explicitly provides an exemption from the DDCR for entities that are subject to the TPDT.[13]

Given the lack of a "to the extent" rule in the TPDT (refer item 1 above), the impact of a contravention of this condition in the TPDT is exacerbated given a breach of the requirements would deny all debt deductions arising under the debt interest, not merely those arising only from the portion of the borrowed funds that have been used to fund dividends or distributions.

Illustrative example 1 – IRR impact of regears being non-deductible

By way of illustration, the Taskforce refers to a worked example of modelling enclosed at Annexure 2. That example illustrates the impact of the aforementioned interpretation of 'commercial activities' by modelling changes to the internal rate of return (**IRR**) of a greenfield asset under a scenario whereby regears are not available as deductions under the TPDT. That example assumes a 20-year greenfield project life with an

[12] TR 2025/2, paras. 122 – 124.
[13] Section 820-423A(2)(g) and 820-423A(5)(f),

initial capital outlay of $150 million geared to 20 per cent, and two regears during the project life increasing gearing to 40 per cent and 60 per cent respectively. Further assumptions are set out in the "Assumptions" tab of the workbook.

Applying these assumptions, the example demonstrates an IRR of 9.21 per cent where the regears are deductible, compared to an IRR of 8.90 per cent where they are not (and the workbook includes a switch at cell B10 in the "Model" tab which can be toggled to model the two scenarios). To that end, the example illustrates how funding of an infrastructure project is considered and the negative impacts that arise where equity proceeds are not able to be released to financial sponsors following replacement with debt financing through various stages of the life of an infrastructure asset.

Legislative fix

The Taskforce submits that the commercial activities requirement should be removed (given thin capitalisation is only relevant if a deduction is already available), such that the test is flipped so that it focusses on what *is* prohibited.

Option A:

(d) the entity uses all, or substantially all, of the proceeds of issuing the debt interest ~~to fund its commercial activities in connection with~~ in Australia, and ~~that~~ does not include:

*(i) any * business carried on by the entity at or through its * overseas permanent establishments; and*

*(ii) the holding by the entity of any * associate entity debt, * controlled foreign entity debt or * controlled foreign entity equity;*

Option B:

(d) the entity does not use~~s~~ all, or substantially all, of the proceeds ~~of issuing the debt interest to fund its commercial activities in connection with Australia that do not include~~ in relation to:

*(i) any * business carried on by the entity at or through its * overseas permanent establishments; and*

*(ii) the holding by the entity of any * associate entity debt, * controlled foreign entity debt or * controlled foreign entity equity;*

[*Proposed amendments highlighted in red*]

Alternatively, the Taskforce submits that a legislative amendment is required to clarify that the concept of "commercial activities" encompasses all economic activities of a business, including the payment of distributions to equity investors. This is on the basis that making distributions to investors is an inherently commercial transaction, as are regearing transactions as described above. The Taskforce also submits that the legislative amendment must make it clear that "commercial activities" are not limited to those capable of returning a profit, as without this clarification the conduit financing rules cannot function as intended.

3. Credit support rights

Overview

The interpretation of the scope of "credit support rights" as outlined in the supporting guidance is unduly broad, encompassing contractual arrangements which are contingent rights that only arise in the event of a failure to perform. Such arrangements are necessary in an infrastructure context to provide assurance for delivery of contracted services. Prohibiting them does nothing to address the 'mischief' intended to be caught by the TPDT. Once again, such arrangements have no bearing on the TPDT as a "credit assessment test" and have the effect of making the TPDT unworkable for the very taxpayers it was designed to accommodate.

Supporting analysis

The interpretation as to the scope of credit support rights is excessively broad.

The intent of Parliament in introducing a prohibition on credit support rights (with certain targeted carve outs) was to prevent multinationals from exploiting "an unfettered ability to fund their Australian operations with third party debt."[14] This effectively means that the rules are aimed at preventing taxpayers from using more debt in Australia by reference to a foreign entity's balance sheet than may have otherwise been accessible. It was not intended to catch ordinary commercial arrangements that merely support contractual commitments to perform made to the borrower or the obligor group and that remain wholly contingent unless and until there is a breach of that contractual commitment.

The current legislative drafting enables overreach in finding that credit support extends to contingent rights that only arise in the event of a failure to perform, e.g. failure to:

(i) contribute equity;
(ii) make lease payments; or,
(iii) deliver contracted services.

This means that as it currently stands, the legislation can be interpreted in a way that credit support rights may include arrangements such as cost overrun support deeds, [15] equity commitment deeds, [16] and performance guarantees. [17] In published guidance on the former arm's length debt test, the ATO acknowledged that the existence of a commercial arrangement undertaken at arm's length should not necessarily be taken to indicate the existence of credit support.[18] This inconsistency further supports the need for legislative clarification to ensure that the TPDT operates as intended.

The Taskforce points to its February 2025 Submission, attached as Annexure 3 for further details.[19] However, for convenience, key areas of concern are summarised below.

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[14] EM, para. 2.99.
[15] TR 2025/2, Example 22, and PCG 2025/2, Example 31.
[16] TR 2025/2, Example 7.
[17] TR 2025/2, Example 19.
[18] Refer to paragraph 69 of Practical Compliance Guideline PCG 2020/7.
[19] Pages 23 -28

Equity contributions (cost overruns/ equity commitment deeds)

The ATO has set out in its published guidance a compliance approach entailing a trust amending the terms of its cost overrun support deed to be limited to the development phase, with no such rights applying to the operational phase.[20] However, the legislation does not provide sufficient guidance to determine when the construction period ends (e.g., whether this is intended to be when a project achieves its commercial operation date). In practice, lenders will typically require arrangements for equity contributions to cover cost overruns to remain in place for a longer period of time, until such point as the project asset has stabilised.

Agreements such as cost overrun deeds and equity commitment deeds should, in the Taskforce's view, be permissible under the TPDT. These agreements do not facilitate debt dumping by multinationals. Ordinary finance deals for development projects typically include such agreements so that a financial sponsor can provide assurance to a lender by providing equity. This induces the lender to finance the project because it instils confidence that the project will continue through the development phase. This facilitates infrastructure taxpayers in undertaking new projects. The prohibition on cost overruns/ equity commitment deeds precludes genuine commercial arrangements.

Lease payments

In the Taskforce's view, there is no clear policy basis for making the guarantee of a lease obligation impermissible – as implied by the ATO in TR 2025/2, Example 19 – given this does not support a bank loan. Practically, it is also unclear how a bank could have recourse to a guarantee of lease obligations unless and until there was a breach of the lease obligations.

Performance guarantees/ bonds/ indemnities

Performance guarantees provide additional contractual protection common in arm's length service arrangements in order to ensure that critical infrastructure can continue to operate effectively, or to enable project construction to continue in the event of non-performance by a service provider to deliver or acquire goods or services.

These are typically provided in the form of a performance bond, guarantee or indemnity provided by the service provider's parent. Regardless of their form, they are arm's length commercial arrangements that are standard in the contracting arrangements for large scale infrastructure development and operational services contracts.

These do not secure additional debt from a third party lender than would have otherwise been offered in their absence. Rather, such guarantees are rooted in the equitable doctrine of specific performance to provide the procurer with a contractual remedy that is fit for purpose. This is clearly distinct from the operation of a "credit assessment test", which is the intended operation of the TPDT.

Legislative fix

To that end, the Taskforce submits that legislative amendments should be made to clarify that rights under the following arrangements are not impermissible forms of credit support:

[20] PCG 2025/2, Example 31.

(i) cost overrun support deeds;
(ii) equity commitment deeds; and,
(iii) performance guarantees.

Such arrangements are necessary commercial agreements for taxpayers in the infrastructure sector that provide necessary assurance regarding the delivery of contracted services. Prohibiting such agreements will impede investment without addressing the mischief intended to be caught by the TPDT.

Legislative fixes include:

4. A carve out for performance guarantees and indemnities that wholly relate to the performance of contractual obligations. This could include contractual obligations to provide services (e.g. an O&M contract) or contractual obligations to pay for services delivered (e.g. a lease or offtake agreement),

5. Allowing credit support that is entered into by arm's length parties, notwithstanding that the borrower is subject to the thin capitalisation provisions. This would allow genuine commercial lending arrangements for a borrower subject to the thin capitalisation provisions on equal footing with an Australian-only consortium that is not subject to the thin capitalisation provisions.

6. Introducing a "sole or dominant" purpose test, such that the credit support prohibition only applies where the "sole or dominant" purpose is to increase Australian debt deductions greater than the borrower would have otherwise been entitled to. Where a lender requires the borrower to enter into an equity commitment deed, as it would for other borrowers, that is comparable to a market standard arrangement. This strikes a balance between allowing genuine commercial activities whilst addressing concerns on the ability of multinationals to "debt-dump".

4. **Development carve out in section 820-427A(5)(iii)-(vi) is ineffective for large scale infrastructure projects delivered by consortia that typically contain foreign headquartered participants**

Overview

The Taskforce proposes that the policy objective of preventing foreign investors from inappropriately accessing the credit support carve out has not been appropriately balanced with allowing infrastructure projects to advance past the high risk development phase of a project with the benefit of support from a foreign headquartered equity sponsor or contractor.

This is due to the overriding prohibition of credit support that provides direct or indirect recourse to foreign associate entities. This prohibition is unduly restrictive and prevents the development carve out being applicable for many large scale infrastructure projects delivered by consortia including foreign headquartered equity participants and contractors.

This issue is amplified by the uncertainty and breadth of the "sufficient influence" test used to identify associate entities of the borrower for these purposes, which has been interpreted to be met where there is merely negative control (e.g., a veto board vote). This is a low threshold with veto rights being an essential protective right for minority equity sponsors.

Support from equity sponsors in infrastructure consortia, such as in the form of an equity guarantee and construction performance guarantees, is critical during a project's high-risk construction phase because it provides a crucial safety net against cost overruns, delays, and other unforeseen issues that could prevent project completion. According to S&P Global's rating methodology, credit agencies view such parental support as a significant credit enhancement that directly mitigates construction risk. When a parent company or another entity provides guarantees for construction obligations and potential funding shortfalls, the rating agency may substitute the guarantor's stronger credit quality for the project's standalone risk profile during the construction phase. This support allows funding sources like deferred equity contributions to be treated as 'Certain,' which strengthens the project's financial assessment and reduces the likelihood of default.

Ultimately, an unconditional and irrevocable guarantee from a creditworthy parent can elevate the project's final credit rating to a level that reflects the guarantor's financial strength, instilling lender confidence and ensuring the project is adequately funded through to completion. This is the case whether support is provided by local or foreign equity sponsors. Such support provided through the development phase of the project is intended to secure project delivery rather than facilitate debt dumping in Australia.

Supporting analysis

The carve outs included in the TPDT for permissible credit support provided to projects during the high risk development phase are critical to the successful financing of large scale Australian infrastructure projects.[21] Consortia involved in delivering these projects will often include one or more foreign headquartered equity

[21] Refer section 820-427A(5)(a)(iii)-(vi).

investors whose scale, balance sheet and expertise is required to successfully fund and develop the project until it reaches a stable operations phase.

However, under section 820-427A(5)(b), that carve out is excluded where the credit support is provided by an entity that is a foreign resident associate entity of the borrower – which requires broadly that either:

- The foreign resident investor holds a 50 per cent or more interest in the borrower – which is a "bright line stake test"; or
- That the borrower is "sufficiently influenced" by the foreign resident investor – which is a test open to differing interpretations that require a detailed analysis of governance arrangements existing between the relevant entities.

While it may be arguable that a bright line stake test is appropriate to avoid project financing of Australian projects being inappropriately supported by foreign assets, the practical reality is that new developments require some degree of credit support to commence, and this should not be prohibited merely because of foreign investment during the development phase.

Further, the inclusion of a sufficient influence test is far more problematic and should be reconsidered for the reasons outlined below.

It is generally the case that the stake held by a minority equity investor in a consortium will be sufficient to allow the appointment of at least one director that may be afforded limited veto rights. That is, the director will have the ability to block certain board resolutions in order to protect the minority investment held by the investor. While it should be arguable that this should not amount to sufficient influence, the ATO has previously indicated that such an investor may be considered to sufficiently influence the borrower for these purposes as the director it appoints may be expected to act in accordance with the wishes of that investor in all matters. It follows from this view, that the minority investor, who may only hold a 10 to 20 per cent stake in the project, risks being an associate entity of the borrower.

Simply put, this means that the financing for a large-scale infrastructure project that depends on credit support provided by a foreign investor during the high-risk development phase of a project is, based on current legislative interpretation, likely to fail the TPDT. This risks materially undermining the financeability of projects and in many cases the denial of deductions will render the project unviable. Furthermore, the project is only likely to remain viable where the significant additional cost can be passed on to end users or government.

This is notwithstanding that the TPDT included specific carve outs for permissible credit support precisely to facilitate the financing of the development of Australian projects. It is submitted that a better balance can be struck between this policy objective and the need to prevent the unwarranted leveraging of foreign balance sheets by investors.

Legislative Fix

In light of Australia's infrastructure requirements for the energy transition, the Taskforce considers that there are sound arguments to allow the carve out for development phase projects in all cases, including where there is support provided by foreign headquartered equity sponsors and contractors that may be considered

associate entities of the borrower. The carve out would allow the risky development phase of projects to be funded by lower cost third party debt supported by all consortia members – including foreign sponsors. Once the project is derisked and achieves stable operations the development carve out would no longer apply.

This would involve the following amendment to section 820-427A(5)(b):

> (5) This subsection covers a right under or in relation to a guarantee, security or other form of credit support, other than a right that:
>
> …
>
> (b) disregarding rights covered by any of section 820-427A(a)(iii)-(vi) above, assuming that the holder of the right exercised the right, the right would *not* reasonably be expected to allow, directly or indirectly, the holder or another entity to have recourse for payment of the debt mentioned in paragraph (3)(c) of this section against a * foreign entity that is an * associate entity of the entity that issued the * debt interest.
>
> [*proposed amendment highlighted in red*]

Alternatively, or in addition, the definition of "associate entity" for these purposes should be limited by removing the "sufficient influence" test so that a foreign entity should only be considered an associate entity of the borrower where it has a majority interest in the borrower.

5. Swaps

Overview

Hedging debt arrangements via swaps is a commonly used tool by investors to manage exposures to interest rate and foreign currency risk. However, as a result of legislation that does not enable clear and direct interpretation of its policy intent, uncertainty has risen in the application of the TPDT. Taxpayers and industry require certainty and clarity in Australia's taxation system to ensure they can make informed project-level decisions, particularly in circumstances where the TPDT is an all or nothing test.

Supporting analysis

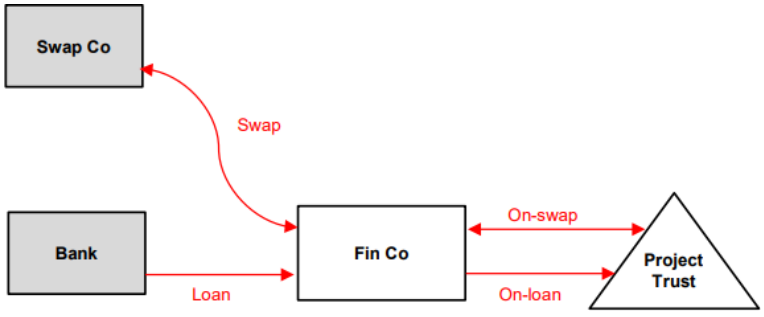
In the Taskforce's view, there remains uncertainty in the application of the TPDT conditions with regard to the treatment of swaps. Further, the legislation enables its interpretation to unduly narrow the availability of the TPDT and adopt a form over substance approach to the treatment of such instruments.

While the Taskforce succinctly proposes its primary submissions below, please also refer to the February 2025 Submission (Annexure 3) in relation to the need for guidance on the treatment of on-swaps (Item 5, p. 18-23), and guidance on the bifurcation of hedging costs under cross currency interest rate swaps (item 6, p. 23).

Guidance on the treatment of on-swaps

Swaps are derivative instruments, typically entered into over-the-counter (OTC), under which parties agree to exchange cash flows arising from different financial instruments over an agreed period. They are commonly used by institutional investors to manage exposures to interest rate and foreign currency risk, including through arrangements that exchange fixed-rate payment obligations for floating-rate obligations.

There is currently a lack of clarity regarding the deductibility of on-swaps (or back-to-back swaps) under the TPDT and the conduit financing conditions as a result of the interpretation of the legislation. The following diagram from Example 1 of TR 2025/2 illustrates a typical on-swap arrangement:



In this Example, Fin Co and Project Trust are associate entities, and the Bank and Swap Co are unrelated to Fin Co and Project Trust. Fin Co will borrow at the best rate possible in global debt markets; the currency and interest rate (whether floating or fixed) being dependent on market conditions and borrowing power of

Fin Co, amongst other factors. In order to manage exposure to interest rate and foreign currency risk, Fin Co will enter into hedging arrangements with the type of hedging arrangements being dependent on market conditions (pricing, availability, credit rating). The types of arrangements that are entered into include interest rate swaps, FX swaps and cross currency interest rate swaps.

Such arrangements are commonplace in infrastructure projects. Where both the on-loan and on-swap are on back to back terms with the external arrangements (such that the Fin Co is a 'break-even' entity), the outcomes for Fin Co and the Project Trust are completely consistent with the objects of the TPDT and the conduit financing provisions.

Practically, the manner in which the swaps are passed on to the Project Trust is largely dependent on the underlying agreement the Project Trust has with the relevant government authority for the operation of the infrastructure asset. Certain government authorities do not want exposure to foreign currency risks or swaps / hedges and require that any on-loans to Project Trust be denominated in AUD. This is on the basis that, in the event that the project defaults, the government authority may be required to step into the shoes of Project Trust. In these circumstances, the swap must be embedded into the on-loan arrangement itself, with the cost of the on-loan reflecting the combined cost of the external debt and the external swap (i.e. the "all-in cost") to which the on-loan relates. In other cases, the government authority is indifferent to the form of the hedging and the swap may be passed on back-to-back terms to Project Trust (i.e. on-swapped).

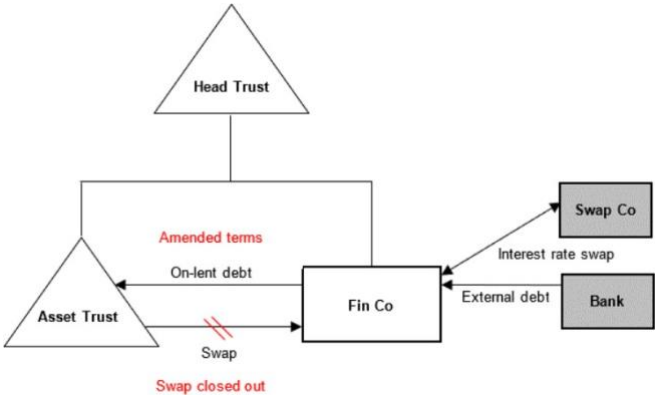
In its guidance, the ATO takes the view that costs paid on interest rate swaps to an associate entity (even if those costs are back-to-back with external swaps) do not satisfy the TPDT,[22] broadly on the basis that s 820-427A(2)(b) provides that the debt deduction under the swap must not be referable to an amount paid or payable, directly or indirectly, to an associate entity. On this view, arguably, payments on the on-swap are not deductible, notwithstanding that Fin Co does not make any margin and economically all interest and hedging costs are ultimately paid to third-party entities.

The ATO's guidance states that instead of entering into the back-to-back swap, the terms of the swap should be embedded into the terms of the on-loan.[23] While practically, the two ATO examples (TR 2025/2, Example 1 and PCG 2025/2, Example 37) put Finance Co in a net break-even position, the current legislation and the ATO's interpretation preclude debt deductions for the costs associated with the on-swap, but do not deny deductions where the effect of the external swap is effectively on-charged via amendment of the terms of the on-loan – despite the fact that both types of arrangement result in exactly the same economic outcomes. The legislation, and its subsequent interpretation, do not provide clear rationales for why these should present differing results, particularly when considering that these outcomes are consistent with the overarching objectives the TPDT and conduit financing provisions seek to achieve. In addition, further clarity is required on the treatment of other types of swap arrangements (such as cross currency interest rate swaps and FX swaps).

ATO guidance on restructuring on-swap arrangements

[22] TR 2025/2, Example 1.
[23] PCG 2025/2, Example 37.

As noted above, the scenario depicted by the above diagram is a common arrangement. Thus, in Example 37 of PCG 2025/2, the ATO has issued guidance to taxpayers seeking to close out such swap on-swap arrangements in order to comply with the new thin capitalisation rules. The ATO depicts this compliance approach in Example 37 with the diagram reproduced below:



Under this compliance approach, the ATO proposes that "*Fin Co and Asset Trust amend the terms of the on-lent debt so that Asset Trust's interest expenditure is equal to what its payments would have been under the on-lent debt and back-to-back internal swap. At the same time, the back-to-back internal swap is closed out.*" [24]

In order to implement the ATO's proposed solution, closing out the existing swap would likely give rise to realising a taxable swap gain in one entity, and a swap loss in the other entity (with those gains and losses unable to be offset against each other as they arise in different entities).

However, the ATO suggests that under its compliance approach, "[the ATO] *will not apply compliance resources for the purposes of determining whether the costs under the on-lent debt and back-to-back internal swap are included in the third party earnings limit, other than to verify…the gain or loss from closing out the back-to-back internal swap is not included as assessable income or deductible expenditure of Fin Co or Asset Trust.*" [25] While the publication of a clear compliance approach is welcome, industry is concerned that in this instance, it is suggested that taxpayers intentionally omit the swap gain from their assessable income. The Taskforce submits that the legislation, in its current form, poses potential challenges in that the compliance approach is predicated on a contestable view which entails the taxpayer disregarding a taxable event that is recognised under the existing tax law.[26]

Guidance on hedging costs under cross currency interest rate swaps and FX swaps

[24] PCG 2025/2 paragraph [331]
[25] PCG 2025/2 paragraph [332]
[26] There is also a gap in the existing guidance given that the two examples above contemplate a taxpayer availing itself of the conduit financing rules, but neither example specifically confirms that either structure would satisfy the conduit financing rules.

Unlike interest rate swaps, there is currently a lack of clarity in relation to compliance methods for passing on-swap costs through conduit entities as regards acceptable methods of passing through cross-currency interest-rate swaps or FX swaps to the ultimate borrower.

This includes regarding the extent to which payments under cross currency interest rate swaps are considered a "debt deduction" for the purposes of the New Thin Cap Law (i.e. within the definition in s. 820-40), and also the extent to which cross currency interest rate swap payments can be taken to be "directly associated with hedging or managing interest rate risk" for the purposes of s 820-427A(2).

It is also unclear whether on-charging of FX swaps or other types of instruments (other than interest rate swaps) that manage the financial risks associated with external borrowing in the manner contemplated by the ATO in Example 37 would be permitted under the conduit financing principles. This is on the basis that the terms of the on-loan, to the extent that the terms relate to the costs incurred by the Asset Trust would not be the same as the terms of the ultimate debt interest, to the extent that those terms relate to such costs incurred by the Fin Co in relation to the bank debt (section 820-427C). The ultimate swap arrangements do not form part of the debt instrument issued by Fin Co.

The TPDT is designed to promote investment into Australia. This implicitly requires the attraction of foreign capital. Cross-currency interest rate swaps and FX swaps are, in turn, a critical means of managing risk on foreign currency denominated debt. It is therefore not only appropriate, but critical, that the TPDT appropriately clarify and accommodate the treatment of cross currency interest rate swaps and FX swaps within the TPDT.

Legislative fix

The Taskforce sees no policy basis for distinguishing one type of derivative instrument over another. This simply impedes economic activity for no clear societal or economic benefit.

The Taskforce submits that legislative amendments be made to the conduit financing conditions to expressly provide that payments of hedging gains or losses of any kind to associate entities are deductible to the extent that the hedging arrangement is back-to-back with an external hedge, and the arrangement hedges financial risk associated with the external borrowing or the on-lent amount that complies with the conduit financing conditions.

This legislative amendment should be comprehensive so as to cover instruments such as interest rate swaps, cross-currency interest rate swaps, FX swaps and any other similar instruments. It should also be more commercially workable, in contrast to the legislation's current interpretation to contend contestable views which, in the Taskforce's view, is unduly narrow (in particular, in relation to s. 820-427A(2) and s. 820-427C).

The Taskforce submits that legislative amendment is required in order to clarify the application of the TPDT in such a way as to support its policy intent.

Specific legislative fixes could include:

(i) Switching off 820-427A(2(b)) for purposes of the conduit financing rules; and,
(ii) Overarching fix so that where a conduit entity is operating as a conduit entity (i.e., not making a profit), it should not be denied the use of the TPDT.

6. FRT

Overview

Consortia investments in large scale infrastructure projects are typically non tax consolidated as each investor holds a stake in the joint venture project entity. In circumstances where the TPDT is not available or appropriate to apply to a project financing, the default FRT will generally apply to financing obtained at both the project and investor level. In these circumstances, it is important that the FRT applies a consistent approach to allowing investors to leverage any excess gearing capacity at the project level. However, under the current FRT, this ability is only allowed to investors holding an interest of 50 per cent or more in the project – unfairly prejudicing minority investors. This leads to arbitrary outcomes with no apparent policy basis and is a significant departure from equivalent provisions under the former safe harbour debt test.

Legislative Fix

To restore fairness and prevent arbitrary outcomes in applying the FRT to non consolidated consortium investments, it is submitted that any equity investor holding a 10 per cent or more equity interest in an entity should be entitled to include an Excess Tax EBITDA amount in the FRT calculation.

7. DDCR

Overview

The exclusion of the DDCR from arrangements subject to the TPDT means that the provisions should not have wide application to debt financing arrangements within the infrastructure sector. However, final ATO public guidance has created uncertainty regarding the circumstances in which the restructuring of related party debt arrangements with third party debt may be impugned under the broad scope of the DDCR integrity rules.

As a general proposition, it is untenable that refinancing of existing related party debt with third party debt could be considered to give rise to “debt dumping” in Australia or otherwise be considered to be avoiding the operation of the DDCR.

Legislative Fix

The DDCR integrity rules should include an explicit carve out for third party debt refinancing of related party debt or at least more clearly prescribe the circumstances in which it may apply.

STRUCTURAL POLICY ISSUES

1. TPDT is practically unavailable to outward investing entities

Overview

As stated above, the policy intent of the TPDT is that it "operates effectively as a credit assessment test, in which an independent commercial lender determines the level and structure of debt finance it is prepared to provide an entity."[27]

One of the conditions under the TPDT is that the holder of the debt has recourse for payment of the debt only to Australian assets, unless the asset is minor or insignificant (section 820-427A(3)(c)). This, together with the other TPDT conditions, is to ensure that the TPDT "only captures genuine third party debt which is used to fund Australian business operations".[28]

In TR 2025/2, the ATO expresses its views as to the relevant factors that may be taken into account in determining whether tangible and intangible assets constitute "Australian assets" for the purposes of the TPDT.

In determining whether a membership interest in an Australian entity is an Australian asset, the ATO takes a "look through" approach. The implication of this is that, in the ATO's view[29]:

- Where all of the underlying assets held by the group are Australian assets, the membership interests in the entities in the group will themselves be Australian assets; and
- Where not all of the underlying assets held by the group are Australian assets, the membership interests in entities in the group will not qualify as an Australian asset.

When taken in conjunction with the ATO's interpretation that the exclusion for minor or insignificant assets in section 820-427A(3)(c) only covers assets of minimal or nominal value,[30] this has the effect that any group of entities that have a foreign asset that is not of minimal or nominal value will never be able to satisfy the conditions of the TPDT, irrespective of whether the foreign asset has been used to secure a higher level of debt in Australia than would otherwise have been the case. That is, this approach does not have regard to the legislative policy that the rules are designed to prevent debt dumping into Australia from offshore.

As detailed in our submission dated 12 February 2025 (annexure 3), the TPDT is intended to be applied by all general class investors and it is not intended to be limited to inward investing entities only. From the legislative context in which the rules were introduced, it is evident that the purpose and intent of the TPDT is to replicate an objective streamlined credit assessment that a third party lender would consider when providing debt to an entity.

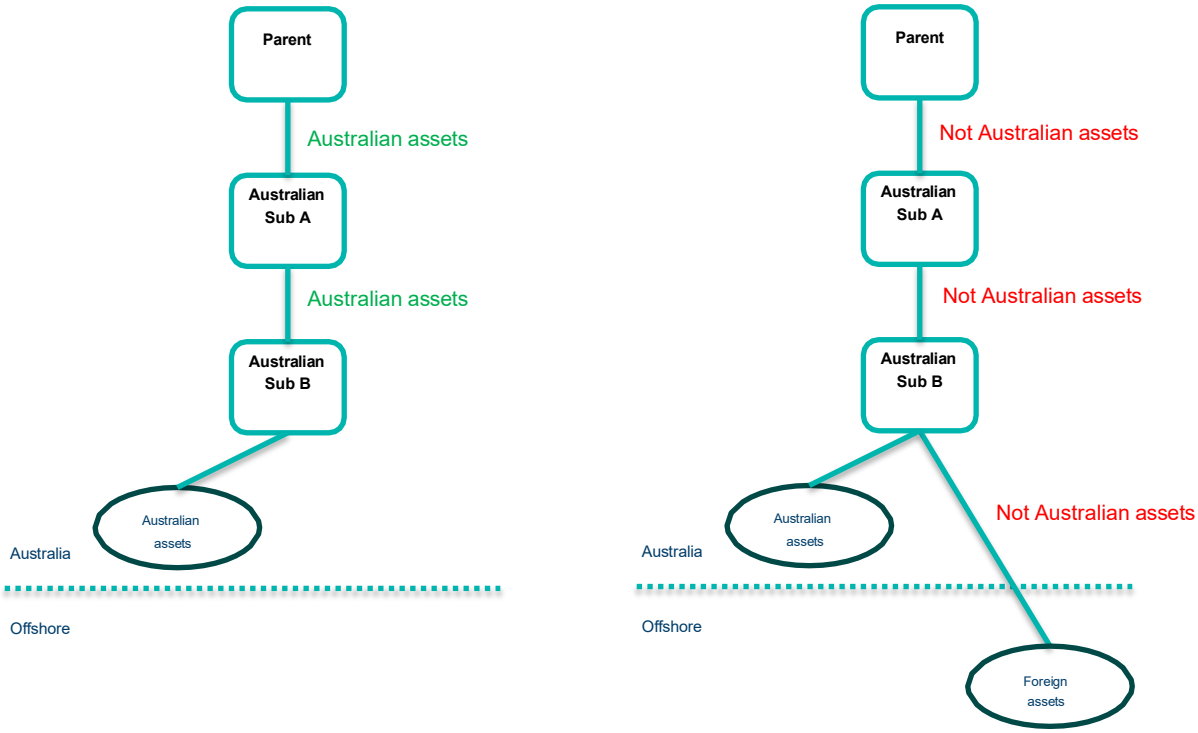
The Taskforce submits that the ATO's interpretation of the term "Australian assets" has the effect of precluding outward investing entities from accessing the TPDT. This approach disadvantages outward

[27] Refer EM, para 2.90.
[28] Refer EM, para 2.97.
[29] Refer to Example 13 in TR 2025/2.
[30] Para 65, TR 2025/2.

groups as these groups, by their very nature of being outbound, will have subsidiary entities or establishments that are offshore.

The existence of foreign subsidiaries or offshore permanent establishments will cause the membership interests in an Australian domiciled tax resident entity to be classified as not being Australian assets. This will mean that if these shares are used to secure the third party debt, this will cause a failure of the third party debt conditions.

The following diagram illustrates the position adopted by the ATO:



This approach does not take into account:

- The extent to which non-Australian assets held in foreign countries economically support the relevant third party debt;
- The rights that a lender has against foreign assets (and whether the foreign assets are secured against other debt offshore); and
- The ownership percentage in the membership interest (whether portfolio or non-portfolio).

This can be contrasted to foreign inbound groups who can quarantine their borrowing against Australian assets in relation to their Australian investment. This creates an "unequal playing field" between inward investing entities and outward investing entities.

Over the long run, there appears to be no clear policy rationale for disincentivising Australian investment in Australian infrastructure by Australian-owned multinational groups in favour of foreign organisations. Australian outbound multinational groups will be limited to the fixed ratio test and the group ratio test whilst foreign inbound multinational organisations can access the more concessional TPDT for infrastructure investment.

This gives rise to the risk of Australian outward groups exiting the infrastructure sector or taking their capital offshore in the long term. This can negatively impact on Australia's goals to build wealth in Australia. In addition, the Taskforce proposes it may have a detrimental impact to the Australian revenue base as Australian entities are generally taxed at the 30 per cent tax rate, whereas non-resident investors may be taxed at a lower withholding tax rate.

This risk was considered by the Senate Economic Committee in its February 2024 report.[31] Submissions were made to the Committee calling for changes to be made to the TPDT on the basis that the existing drafting "creates an impractical and seemingly unfair outcome for Australian MNE Groups in comparison to foreign headquartered multinational groups operating in Australia through a local subsidiary" and that it "will potentially result in foreign investors that are geared offshore being more competitive than Australian bidders in the context of acquisitions of multinational groups".

Legislative Fix

The Taskforce submits that the risk to revenue of debt dumping into Australia can be readily dealt with through existing mechanisms contained in the tax law.

The below fix could achieve the same equitable outcome for outward investing entities as having access to the TPDT:

- Arm's length debt test be made available to outward investing entities for the purposes of determining the amount of allowable debt deductions for third party debt only (i.e. the third party arm's length debt test (**TPALDT**). This could be achieved by removing the limitation to Australian assets in paragraph (c) of section 820-427A(3).

This fix will result in Australian-owned outward investing entities being able to claim a tax deduction for genuine third party debt used to finance major Australian infrastructure.

To the extent the Board considers other integrity risks to be relevant, these could be managed on a case-by-case basis.

[31] The Senate Economics Legislation Committee report dated February 2024 on the Government Amendments to Treasury Laws Amendment (Making Multinationals Pay Their Fair Share-Integrity and Transparency) Bill 2023, paras 2.33 and 2.34.

2. "One-in, all-in"

Overview

The current TPDT structure can make certain entities subject to its parameters, without those entities directly electing to be subject to the TPDT. This can apply via a deemed election that gives rise to what can be termed the "one-in, all-in" rule.

This deemed election applies to make entities subject to the TPDT where an entity is a 20 per cent associate entity of a borrower that has made the TPDT election and is also:

(a) a member of the same Obligor Group of that borrower; or
(b) is part of a "cross staple arrangement" where one of the entities in the stapled group has made the TPDT election.

In the case of (a), this can impede parties from entering into joint venture funding arrangements, and in particular may affect whether a participant decides to provide security to the lender or become part of the Obligor Group.

In relation to (b), this is a relatively blunt rule that can result in inappropriate outcomes. For instance, it is not uncommon in the infrastructure sector for one side of the stapled group to enter into passive investment in real estate, whereas the other engages in active business activities such as tolling activities in relation to infrastructure asset development. In such situations, each entity in the stapled group will have diverging debt strategies. In this context, it is not always appropriate to apply the "one in, all in" rule to render both entities subject to the TPDT.

As currently drafted, the "one-in, all-in" rule makes the TPDT unworkable for many stapled groups. Such taxpayers (where they are not a member of a consolidated group for income tax purposes), would suffer full denials on debt deductions under the TPDT on cross-staple or other related party loans (where those cross-staple loans are not funded from third party debt and on-lent on terms that satisfy the conduit financing provisions), including in circumstances where one of the stapled entities had intentionally not made a TPDT election.

In the infrastructure sector, projects are often undertaken by a consortium and projects are held in unconsolidated, standalone project vehicles. These factors make it likely for the "one-in, all-in" deeming rule to apply. Given other issues in the TPDT (refer e.g., item 1 above), this is likely to stifle investment into Australia by impeding investors from undertaking infrastructure investments due to the potential to be brought into the TPDT in circumstances where this is not preferred.

This outcome would cause a policy failure of the New Thin Cap Law, given the TPDT was specifically designed in order to accommodate taxpayers in the infrastructure.[32]

[32] Refer, for e.g., EM, p. 86.

Legislative fix

The Taskforce submits that legislative amendments be made to:

(a) increase the "associate entity" threshold for the purposes of the deeming rule to above 20 per cent (ideally to at least 50 per cent); and,
(b) allow flexibility for stapled group members to individually choose whether to elect into the TPDT.

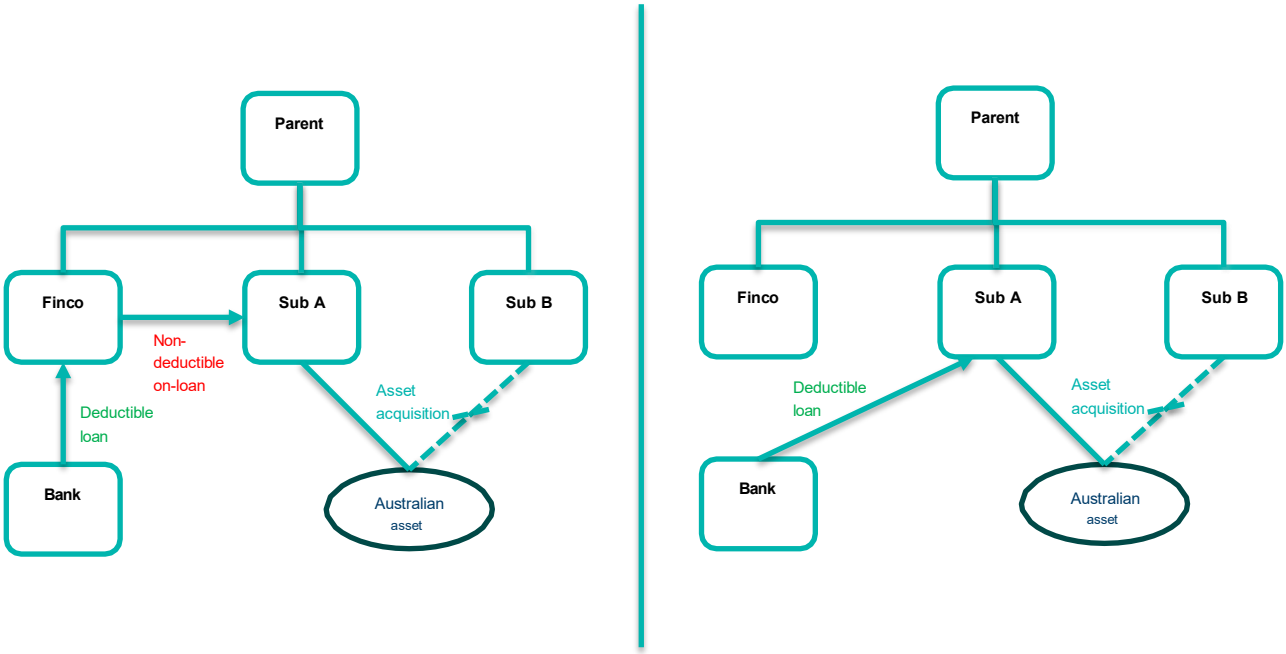
3. Delinking the TPDT with the DDCR

Overview

Broadly, the DDCR as currently drafted disallows debt deductions relating to related party financing arrangements where they are incurred:

- In relation to the acquisition or subsequent holding of an asset or an obligation from an associate; or
- To fund certain payments or distributions to an associate.

The DDCR is intended to apply only to "internally generated" related party debt deductions.



The EM provides the following policy rationale for the introduction of the DDCR:

- "The strengthened thin capitalisation rules will play an important role in limiting excessive debt deductions. However, they do not address the risk of excessive debt deductions for debt created in connection with an acquisition from an associate entity or distributions or payments to an

associate entity. Such debt deductions may only ever indirectly, and at most, be partially limited by the thin capitalisation rules.

> ***New Subdivision 820-EAA seeks to directly address this risk by disallowing debt deductions to the extent that they are incurred in relation to debt creation schemes that lack genuine commercial justification.***"[33] (emphasis added)

- "Subdivision 820-EAA disallows debt deductions in two cases. ***These cases represent integral parts of schemes where artificial interest-bearing debt is created within a multinational group.*** Over time, this interest-bearing debt effectively allows for profits to be shifted out of Australia in the form of tax-deductible interest payments."[34] (emphasis added)

- "Broadly, an entity that chooses the third party debt test for the income year will effectively be exempt from the debt deduction creation rules for that income year. ***This exemption recognises that such entities are subject to the third party debt conditions in Subdivision-EAB. These conditions are intended to ensure that an entity's debt deductions are only allowed where they are attributable genuine third party debt that is borrowed against Australian assets and is used to fund Australian operations.***" [35] (emphasis added)

This is notwithstanding that the provisions apply irrespective of whether the related party financing is on back-to-back terms with third party debt.

For a group of taxpayers where a dedicated financing entity has raised third party debt and on-lent it to other entities in the group on back-to-back terms, which is very common in the infrastructure sector, they will be caught by these rules unless they have made an election to apply the TPDT (refer to section 820-423A(2)(g) and 820-423A(5)(f)).

It is clear from the above that the legislature did not intend for the DDCR to apply to debt deductions that are attributable to genuine third party debt that satisfies the conditions of the TPDT. The Taskforce respectfully submits that it is a flaw in the legislative drafting in s820-423A(2)(g) and s820-423A(5)(f) that provides an exemption from the DDCR only where the relevant entity has made a choice to apply the TPDT in section 820-46(4).

The Taskforce submits that it should be irrelevant whether a choice has been made to apply the TPDT. There may be genuine commercial reasons as to why a group of entities has decided not to make an election to apply the TPDT for a particular income year. Not electing to apply the TPDT does not mean that on-loans have artificially been created to allow profits to be shifted out of Australia.

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[33] Refer EM, paras 2.145 – 2.146.
[34] Refer EM, paras 2.149.
[35] Refer Supplementary EM, para 1.45.

In our view, the actual making of the election should not be conflated with a loan being sourced from third party debt. So long as the debt can be traced to third party debt and the third party debt has been merely on-lent within a group, the DDCR rules should not apply.

Legislative Fix

The Taskforce submits that the exemption from the DDCR be conditional upon the satisfaction of the following TPDT and conduit financing conditions rather than on the taxpayer making a TPDT election:

- The ultimate debt interest is an interest issued to an entity that is not an associate entity (section 820-427C(1)(a));
- The ultimate debt interest is not held at any time in the income year by an associate entity (section 820-427A(3)(b));
- The terms of the relevant debt interest, to the extent that they relate to the cost of the debt interest, are the same as the terms of the ultimate debt interest (section 820-427C(1)(d)), having regard to section 820-427C(2).

INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

ANNEXURE LIST

Annexure	Document Title	Issue reference	Submission p. #
1	*Annexure 1 – Illustrative Example of commercial activities condition – greenfield investments (attached to submission email)*	2 – Commercial activities	13
2	*Annexure 2 – Illustrative Regearing Example (attached to submission email)*	2 – Commercial activities	14
3	*Annexure 3 - February 2025 - Infrastructure Partnerships Australia Submission - ATO Consultation on Thin Capitalisation Guidance - final draft* (as hyperlinked)	2 – Commercial activities 3 – Credit support rights 5 – Swaps 1 – Outward investing entities	12 16 20 25
4	*Annexure 4: Infrastructure Partnerships Australia Submission – ATO Thin Capitalisation targeted consultation – July 2024* (as hyperlinked)	General reference	N/A
5	*Annexure 5: Infrastructure Partnerships Australia Submission – Submission to the Treasury on the Treasury Laws Amendment Bill 2023 Exposure Draft* (as hyperlinked)	General reference	N/A