

To: Australian Taxation Office

Re: Practical Compliance Guidance PCG2017/4DC2

12 October 2020

Introduction

AMEC appreciates the opportunity to comment on the ATO's proposed Schedule 3 Guideline dealing with interest-free loans between related parties, as part of the three-year review post-implementation in 2017.

About AMEC

The Association of Mining and Exploration Companies (AMEC) is a national industry body representing over 325 member companies across Australia.

The mining and exploration industry make a critical contribution to the Australian economy, employing over 255,000 people. In 2018/19, these companies collectively paid over \$39 billion in royalties and taxation, invested \$36.1 billion in new capital and generated more than \$283 billion in mineral exports. In 2019/20, \$2.8 billion was spent on minerals exploration, representing an 18% increase from the previous year.

PCG 2017 Schedule 3

General Feedback

AMEC appreciates the ATO's release of the draft risk-guidance detailing the determination of transfer pricing risk of outbound interest free-loans between Australian taxpayers and related international parties. We welcome the ATO's acknowledgement of the unique nature of financial arrangements in the mining and mineral exploration industry, by providing specific examples relating to the industry.

Consistent with current guidance, as per the new schedule, outbound interest-free loans will be considered by the ATO to be a high risk factor, essentially placing pricing risk scores in the high risk zone, solely on the nature of the loan, regardless of mitigating factors.

The guidance acknowledges that outbound interest-free loan arrangements may be consistent with arm's-length conditions, providing a welcome framework to review and substantiate positions, that was not previously available. However, the guidance can be interpreted as subjective and particularly complex, with a significant burden on taxpayers to provide satisfactory evidence and their own substantial analysis in order to be considered in a lower risk zone.

Risk zone scoring

As outlined in Schedule 1, outbound interest-free loan arrangements continue to be viewed as an automatic high risk, without consideration of any other characteristics of the financial arrangement. This supports the ATO's position that loans are generally not provided by independent parties on an interest-free basis, incurring an automatic allocation of 10 points. Regardless of other factors, a score

of 10 or more will result in the transaction immediately falling into the ATO's amber or red zone classification.

AMEC welcomes the acknowledgement by the ATO that interest-free loans made to a mining subsidiary in the development phase might be appropriately considered as low risk¹. However, the evidentiary requirements and self-assessment of the taxpayer to qualify for the lower risk rating should be commensurate with the actual level of risk posed, rather than perceived risks.

Under Schedule 3, taxpayers have an opportunity to self-assess a lower score based on relevant factors of arm's-length conditions outlined in the draft guidance document.

Currency of the debt

The currency of the debt is one such factor. While inbound funding is expected to be in the operating currency of the borrower, the ATO does not expect outbound funding to be in the operating currency of the borrower, where the funding is not in the borrower's currency, but is denominated in an Australian lender's accounting and tax functional currencies².

This indicates the foreign exchange impact on Australian taxpayers raises concerns with the ATO, resulting in a high risk score. Industry is concerned that the ATO may seek to review and challenge tax deductions for foreign exchange losses that arise from interest-free outbound funding to related parties, that would not have previously been considered.

Sovereign risk of the borrower

The modified table in the draft Schedule outlining sovereign risk raises concern. It appears that the ATO will consider outbound interest-free financing from jurisdictions with a lower sovereign credit rating lower risk (0 score for B onwards), but will consider financing higher risk if it is to a jurisdiction with a higher sovereign credit rating (10 score for AAA).

The application of this scoring could result in inappropriate risk scores being allocated to funding from high sovereign rating jurisdictions. This example is particularly relevant to the mining and mineral exploration industry, as mineral exploration companies who are reliant on capital raising to fund their activities as they do not generate income, would have little prospect of raising interest-bearing debt without outbound financing, regardless of the sovereign credit rating of the jurisdiction of the borrower.

We welcome the ATO's acknowledgment that in this situation, it would be even more challenging to borrow from an arm's-length transfer arrangement. As mineral exploration companies generally do not have access to debt markets at arm's length, interest free loans to them should be considered low risk by the ATO, with other factors including the currency of the loan or the borrower's jurisdiction's sovereign rating not bearing on the risk rating.

To potentially be subject to a high-risk score by what is essentially default, would add additional requirements and costs to these companies, where the administrative burden is not commensurate to

¹ <https://www2.deloitte.com/content/dam/Deloitte/au/Documents/tax/deloitte-au-tax-interest-free-loans-ato-releases-draft-guidance-140820.pdf>

² <https://taxnews.ey.com/news/2020-2102-australian-taxation-office-issues-compliance-guidelines-for-outbound-interest-free-related-party-loans>

the actual risk posed. Industry questions if there is an alternate approach, which will not require significant evidentiary burden from taxpayers, for further assessment by the ATO.

Interpretation of the guidance

While the application of tax rulings and requirements generally requires specialist knowledge, the level of analysis and requirement to demonstrate evidence for consideration under Schedule 3 and other associated documents is extensive. The requirements to demonstrate lower risk levels, particularly by smaller mining and mineral exploration companies, will likely increase red and green tape, resulting in further delays and financial burden to meet requirements, disproportionate to the actual level of risk posed.

AMEC is supportive of measures that will not disadvantage junior companies who do not have experience with these processes, or adequate resourcing to address the extensive evidentiary burden for taxpayers to support positions that may be reasonable from a transfer pricing perspective³.

Increased requirements for taxpayers

As previously highlighted, the Schedule 3 draft amendments will require further significant demonstration from taxpayers to support their positions. This supporting evidence, due to the nature of loans especially in the mineral exploration and mining industry, is often highly subjective. Industry is concerned there may be a lack of consistency in the assessment of applications, or there will be over-regulation in an already heavily regulated area to account for subjective interpretations.

From a legal perspective, it has been found that “in our experience, objective factual evidence gathered at or near the commencement of the loan is generally more reliable, easy to obtain and persuasive in the event of a later audit”⁴.

The use of early, objective measurables will provide more consistency and transparency into decision making for taxpayers and assessors alike.

Timeframes and capacity to assess

AMEC notes the absence of a proposed date of effect within the draft Schedule, as well as specific details as to the extent of the new Schedule’s requirements. If retrospective outbound interest-free loans will be subject to the proposed Schedule 3 changes, this will create substantial work for relevant parties and assessors.

Due to the significantly greater level of detail and materials required for all assessments, industry is concerned their applications will be subject to delays if the ATO does not have sufficient capacity to meet expected increased demand.

Final comments

AMEC appreciates the opportunity to engage with the ATO and welcomes further consultation on reforms which will have significant, ongoing impacts on the mining and mineral exploration industry.

³ <https://www.pwc.com.au/tax-alerts/guidance-cross-border-related-party-interest-free-loans.html>

⁴ <https://www.kwm.com/en/au/knowledge/insights/ato-related-party-financing-guidance-an-update-20200820>

We are supportive of reforms that reduce red tape and streamline processes, to reduce the cost of minerals projects operating in Australia, whilst complying with legislative requirements.

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