



# Inbound related-party financing for private groups in property and construction

What to consider if you receive funding from an international related party.

## **What you need to know about financing**

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# What you need to know about financing

Basics about inbound related-party financing for privately owned and wealthy groups in property and construction.

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## Who this information is for

This information will help you if you:

- are a member of a privately owned and wealthy group

- receive funding (such as a loan) from an overseas related entity or associate (such as a relative) to acquire or develop property.

If this applies, you need to consider the application of the **transfer pricing** rules because they may affect your tax outcomes.

## **Transfer pricing rules**

The transfer pricing rules apply the **arm's length principle**. This determines terms and conditions (such as pricing) for cross-border arrangements between related entities. These rules also apply to cross-border arrangements between unrelated parties that are not acting at arm's length.

### **Arm's length conditions**

When applying the arm's length principle, you need to consider whether your funding is obtained on arm's length terms and conditions. These are terms and conditions that would be expected if you and the lender were both:

- independent of each other
- acting at arm's length.

For more information on arm's length conditions, see Taxation Ruling *TR 2014/6 Income tax: transfer pricing – the application of section 815-130 of the Income Tax Assessment Act 1997*.

## **Our concerns**

We are concerned that some businesses claim excessive debt deductions and shift profits overseas. They are doing that by setting unrealistic interest charges for funding received from overseas related entities.

We are also concerned when businesses claim interest deductions but incorrectly defer or avoid interest withholding tax.

## **Our expectations**

You need to support the commerciality and arm's length nature of your funding arrangement. To do so, we expect you to:

- [explain your funding arrangements](#)
- [maintain evidence](#)
- [understand and comply with your tax obligations](#).

## **Explain your funding arrangements**

We expect you to explain:

- your consideration of the funding options realistically available to you at the time of entering into an arrangement (and any later refinancing decision)
- the commercial rationale for choosing a particular funding option
- how you structured your funding, including the
  - mix of debt and equity
  - types of debt used
  - amount of debt used.

## **Maintain evidence**

Once you have entered into an arrangement, we expect you to maintain evidence to support the ongoing commerciality and arm's length nature of your arrangement.

## **Understand and comply with your tax obligations**

We expect you to understand and comply with your tax obligations that arise from the arrangement, such as interest withholding tax.

You are at risk of review if your business has:

- significant related-party financing arrangements
- factors that attract our attention
- low tax performance
- thinly capitalised Australian operations.

Practical Compliance Guideline PCG 2017/4 *ATO compliance approach to taxation issues associated with cross-border related party financing arrangements and related transactions* explains which financing arrangements are at greatest risk of review.

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# Our observations on funding arrangements

Funding arrangements we are seeing in the property and construction industry.

**Last updated** 12 February 2025

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## How businesses operate

The following information explains how businesses might approach commercial funding of a project, the types of arrangements we see in our engagements and the practices that concern us.

This content is not intended to provide advice or guidance on the technical interpretation or application of Australia's tax and transfer pricing rules. If you need to know the tax implications of any specific arrangement, we recommend that you seek advice. This could include consulting with tax and legal professionals or one of our **ATO advice** products.

## Funding for property and construction generally

We have been observing third-party funding arrangements for property investments and developments across privately owned,

wealthy groups. These arrangements are:

- project specific
- tailored to the requirements of the investment or development.

Projects are usually funded through a mix of:

- investor or developer equity (capital contributed such as unencumbered funds or cash)
- debt financing (such as loans).

The amount and term of a loan is typically matched to the funding needs of the specific investment or the relevant stage of the development project.

Commercial lenders:


- require equity to be available for a project before lending
- generally try to maximise the value of the security available against their debt.

Developers:

- provide security over property to obtain finance
- generally seek to refinance when circumstances change or a better funding opportunity becomes available
- repay loans as soon as practicable.

## **Development lifecycle**

These are the stages of the development lifecycle and typical funding arrangements we observe in each stage.

 Each stage of the development lifecycle: pre-acquisition; land acquisition; planning, pre-sales and preparation; construction and development activities, exit.

### **Pre-acquisition**

Pre-acquisition costs are generally borne by the investor or developer for activities such as analysis and development feasibility.

### **Land acquisition**

Land acquisition is usually funded with an equity contribution by the investor or developer using unencumbered funds (for example, cash).

### **Planning, pre-sales and preparation**

This stage involves design and approvals, pre-sales, arranging finance, and tendering and contracting. The developer obtains senior debt secured against the land to fund construction. The loan term matches the project duration.

### **Construction and development activities**

From the commencement of construction through to practical completion, interest is payable regularly or capitalised when there is insufficient project cash flow.

Withholding tax is remitted regularly if applicable.

Additional equity may be required to fund construction.

In limited circumstances, short-term subordinated debt may be available to bridge funding gaps in excess of senior debt and equity capital.

### **Exit**

This involves divesting or retaining and managing the property. Loans are repaid upon completion of development activities. Any remaining withholding tax is remitted.

## **What we are seeing in our engagements**

Some taxpayers have cross-border related-party funding arrangements with terms and conditions that differ from third-party arrangements we are observing. This may result in excessive debt deductions through:

- non-arm's length amounts of debt
- loans with higher interest rates.

It can also result in taxpayers claiming interest deductions with deferral of (or non-compliance with) interest withholding tax obligations.

For more information about arrangements that defer interest withholding tax, see Taxpayer Alert [TA 2018/4](#)  *Accrual deductions*

*and deferral or avoidance of withholding tax.*

## **Practices that concern us**

We are concerned with the following practices or behaviours observed in relation to related-party funding arrangements:

- insufficient evidence to support the arm's length nature of funding
- lack of information about or disregard for the commercial borrowing practices of the private group
- undocumented loan arrangements
- conduct that is inconsistent with the related-party loan agreement or stated purpose of the funding
- absence of transfer pricing analysis or evidence to support the arm's length nature of related-party loans (such as analysis of relevant third-party debt arrangements)
- related-party funding arrangements that are not monitored or reviewed throughout the project lifecycle and when circumstances change.

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## **Related-party funding arrangements that attract our attention**

What is attracting our attention with related-party funding arrangements.

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## **Factors attracting our attention**

There are key risk factors of related-party funding arrangements that attract our attention.

Where one or more of these factors are present, the risk of your related-party funding arrangement increases and you are more likely to attract compliance activity.

We expect you to carefully consider the commerciality of your arrangement and maintain documentation and evidence to support your approach.

## **Funding structure**

Factors attracting our attention include:

- no or limited equity (capital) contributed by the investor or developer
- funding that appears to be equity under arm's length conditions, but is treated as debt.

This is a risk because insufficient equity (capital) or excessive debt may result in excessive interest deductions.

## **Debt**

Factors attracting our attention include:

- insufficient evidence to support the arm's length nature of related-party loans
- related-party loans that are priced as subordinated debt including when
  - there is no senior debt at all
  - more reasonable funding options were realistically available such as additional senior debt or equity
  - group funding practices don't demonstrate the use of third-party subordinated debt in comparable circumstances
  - used at the land acquisition stage, or in relation to stabilised assets (for example, existing income-producing property)
- interest expenses on related-party loans that would cause an investment or development to
  - have questionable viability
  - not meet its profitability expectations.

This is a risk because the use of non-arm's length terms and conditions (such as subordination) to justify higher interest rates may result in excessive interest deductions.

## **Amount of debt**

A factor attracting our attention is an amount of related-party debt that exceeds what might be expected between parties acting at arm's length in comparable circumstances.

This is a risk because a non-arm's length amount of related-party debt may result in excessive interest deductions.

## **Currency**

A factor attracting our attention is related-party loans that are not denominated in the operating currency of the Australian borrower. This is typically Australian dollars.

This is a risk because an inconsistent borrowing currency may result in greater deductions to the Australian borrower.

## **Interest payments**

A factor attracting our attention is deferring the payment or crediting of interest when the borrower has financial capacity to meet payment obligations on related-party loans.

This is a risk because deferring the payment or crediting of interest may result in the:

- deferral or avoidance of interest withholding tax
- denial of interest deductions.

## **Term**

Factors attracting our attention include:

- misalignment between the funding needs of the investment or development, and the term of the related-party loan
- unpaid principal and accrual of interest on related-party loans beyond the investment period or project completion
- unpaid principal and accrual of interest beyond the term of the related-party loan.

This is a risk because related-party loans that extend beyond an arm's length term may result in excessive interest deductions.

## **Security**

A factor attracting our attention is related-party loans that are priced as unsecured debt.

This is a risk because we haven't observed unsecured third-party debt for property investments or developments. The absence of security to justify higher interest rates may result in excessive interest deductions.

## **Repayment or refinancing**

Factors attracting our attention include:

- related-party loans for property investments that are not repaid after the property has been sold

- related-party loans for development projects that are not repaid when the project has generated sufficient cash flow
- related-party loans that are not refinanced as soon as practicable when circumstances change or when a better funding opportunity is available (such as refinancing to a stabilised loan facility)
- moving funds from a completed project to another project or entity without repaying the loan.

This is a risk because it may result in excessive interest deductions.

## Other issues that attract our attention

For more information on other behaviours, characteristics and tax issues that attract our attention, see [Privately owned and wealthy groups – What attracts our attention including international transactions that attract our attention](#).

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## Practical related-party funding scenarios

Some funding scenarios that we are seeing in the property and construction industry.

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## Using these scenarios

If you receive funding from an overseas related entity or associate to acquire or develop property, these scenarios provide guidance. They show funding arrangements and behaviours including what we consider to be low risk and high risk scenarios.

These scenarios use companies to illustrate various funding scenarios, but the same principles apply to other entities such as trusts.

If you adopt funding arrangements and behaviours with higher risk factors, you are more likely to attract compliance activity.

## **Low risk scenario**

### **Scenario 1**

#### **Project details**

An Australian resident private company connected to a foreign individual investor was undertaking a residential development in Australia. The company acquired land for the development and sale of medium-rise residential apartments. The development project had a construction period of 2 years.

#### **Funding**

The company received funding in the form of equity (additional shares were issued to its shareholders) to fund the land acquisition. To fund construction and other development costs, they obtained external senior debt funding from a local Australian bank. The external debt was secured by a first (senior) ranking mortgage over the property. They had additional senior debt capacity available at the time.

During construction, the company obtained a loan from a foreign related party to fund the balance of construction costs. The total amount of debt obtained didn't exceed the senior debt capacity that was available. The terms and conditions of the external debt and related-party loan were comparable and included the following features:

- The pricing of the related-party loan was the same as the external senior debt.
- The loans were denominated in Australian dollars.
- Interest was

- payable regularly
- only capitalised into the principal amount during the construction period when there was insufficient cash flow from the project.
- The term of the loans aligned with the proposed duration of the development project.
- The loans were repaid from net sales proceeds soon after the completion of the development.

## **Documentation and compliance**

The commercial nature of the funding structure and gearing levels were documented and could reasonably be explained. The related-party loan was contemporaneously formalised in a written and executed loan agreement. The agreement:

- set out the key terms and conditions
- reflected the substance of the arrangement.

The company assessed its compliance with Australia's transfer pricing rules. It maintained transfer pricing documentation and evidence. This was to support the arm's length nature of the related-party loan. It did so before lodging its tax return. The documents included transfer pricing analysis that:

- addressed Subdivision 815-B of the *Income Tax Assessment Act 1997*
- met the requirements of Subdivision 284-E of Schedule 1 to the *Taxation Administration Act 1953*.

The company monitored and reviewed its funding arrangements throughout the project lifecycle and as business circumstances changed. They kept contemporaneous records of all realistically available funding options they considered.

## **Conclusion**

We consider this scenario low risk because:

- the company used equity (cash) to fund the land acquisition
- as they had senior debt capacity available, they didn't take on related-party debt on less favourable terms than it could have otherwise obtained using external senior debt

- they maintained evidence to support the commerciality of the funding structure including a combination of equity, external debt and related-party debt
- the pricing of their related-party loan was comparable to its external secured debt
- the form of the related-party loan as a debt interest was consistent with its substance.

## High risk scenarios

### Scenario 2

#### Project details

An Australian resident company was undertaking a residential development in Australia. They acquired land for the development and sale of medium-rise residential apartments. The development project commenced one year after the land was acquired and had a construction period of 2 years.

#### Funding

The company obtained funding for the land acquisition from a foreign related party. The funding was treated as a subordinated and unsecured loan. They had no other funding facilities at the time and didn't consider other options realistically available, such as the use of equity or senior debt funding.

To fund construction and development costs, the company:

- obtained external senior debt from a local Australian bank secured over the property
- increased the loan from its foreign related party.

The company did not invest any equity for the project including the land acquisition or development. There was no evidence to support a conclusion that:

- the financing arrangement was on commercial terms
- independent parties acting at arm's length would have entered into an arrangement like this.

The related-party loan:

- had a term of 3 years
- attracted a higher fixed interest rate than the external debt.

During the development, interest was capitalised into the loan principal amount. The additional interest expense from the related-party loan caused the project to have poor expected profitability at the time of entering into the loan. The company didn't review the related-party arrangement throughout the project lifecycle.

All loans were repaid soon after the conclusion of the development.

## **Conclusion**

We consider this scenario high risk because:

- the company invested no equity (such as unencumbered funds or cash) during the land acquisition or development
- the related-party funding for the land acquisition was treated as a subordinated and unsecured loan, despite the company having no senior ranking debt and the availability of security at the time
- the company was unable to demonstrate the commercial nature of its approach to funding the project (including the timing and amount of its subordinated debt)
- the interest rate charged on the related-party funding was higher than the interest rate on the external debt without justification for the arm's length nature of the approach
- the company didn't review the related-party arrangement to ensure the transfer pricing treatment was appropriate each year.

## **Scenario 3**

### **Project details**

An Australian resident company connected to a foreign privately owned group undertook a residential development in Australia. They acquired land for the development and sale of medium-rise residential apartments. The development project had a construction period of 2 years.

### **Funding**

The company contributed its own funds to acquire the land. To fund construction and development costs, it obtained a 2 year external senior debt facility and additional funding from a foreign related party. The related-party funding was treated as an interest-bearing loan with a term of 9 years. There was no evidence to support a conclusion that the 9-year term was appropriate. Nor was there evidence that independent parties acting at arm's length would have entered such a loan given the:

- purpose of the funding
- proposed construction period at the time of entering into the related-party arrangement.

After the conclusion of the development, the company didn't repay the related-party loan. Interest accrued beyond project completion. The company used the net proceeds from the sale of properties to:

- repay the external bank loan
- fund another development project undertaken by an associated entity.

The company didn't review the related-party arrangement throughout the project lifecycle or once the properties were sold.

## **Conclusion**

We consider this scenario high risk because:

- the term of the related-party loan was significantly longer than the duration of the external debt and development project
- the conduct of the parties was inconsistent with the purpose of the loan as
  - the related-party loan remained unpaid beyond project completion and sales
  - interest and deductions continued to accrue.
- the company didn't review the related-party arrangement to ensure the transfer pricing treatment was appropriate
  - each year
  - when business circumstances changed including once the properties were sold.

## **Scenario 4**

### **Investment details**

An Australian resident company was part of a privately-owned property investment group operating in Australia. They acquired a commercial investment property to earn rental income and generate capital growth. They intended to hold the asset for 5 years.

### **Funding**

The company invested capital and obtained funding from a foreign associate to acquire the property. The funding from its associate was treated as an interest-bearing loan. A fixed interest rate was payable monthly for a term of 5 years. The loan was subordinated and provided without security to justify the high interest rate charged. They documented the terms and conditions of the related-party loan in a written loan agreement.

The company had no other funding facilities at the time. They didn't consider other options realistically available, such as the use of equity or senior debt funding. There was no evidence to support the commerciality of the funding structure.

The company generated sufficient cash flow from rental income to meet interest payment obligations. They claimed interest as a deduction as it accrued. However, they didn't pay the interest when it was due and payable.

After 5 years, they sold the property. However, they didn't repay the amounts owing on the loan at that time. Interest continued to accrue on the loan. They used the proceeds from the sale of the property to acquire another property. They didn't review the related-party arrangement throughout the investment period or once the property was sold.

### **Conclusion**

We consider this scenario high risk because:

- the company was unable to explain and demonstrate the commercial nature of its funding structure
- the related-party loan was priced as subordinated debt even though the company had no senior ranking debt

- the related-party loan was priced as unsecured debt even though security (the property) was available
- the company didn't meet interest payment obligations despite its ability to service the related-party loan from cash
- the company claimed interest deductions but deferred payment, contrary to the lender's entitlement to the interest under the agreement
- the company didn't review the arrangement to ensure the transfer pricing treatment was appropriate
  - each year
  - when business circumstances changed including once the property was sold
- the conduct of the parties was inconsistent with the terms and conditions of the loan as
  - the related-party loan principal remained unpaid
  - interest continued to accrue and was deducted beyond the documented term of the loan.

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## Evidence to support your funding arrangements

Documents and other evidence you need to support your funding arrangements as a privately owned and wealthy group.

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## What you need

If you obtain funding from an overseas related entity or associate for the purpose of acquiring or developing property, it is important that you have appropriate documents and other evidence to support your arrangement and tax positions.

Good contemporaneous record-keeping practices are desirable should we seek to verify information including the arm's length nature of your funding arrangement. If we review your funding arrangements, we will seek to understand your particular facts and circumstances.

See [Overview of record-keeping rules for business](#).

## Details about the project

You need details about the property investment or development project. These include timeline, initial feasibility assessments, project plans, cash flow projections, project budgeting and valuations, pre-sales levels, and project financials including projected and actual profitability (or commercial reasons for losses).

## Funding structure

You need evidence of the ongoing commercial nature of your funding structure. These include:

- the equity you have contributed
- internal and external debt funding
- source of the funds
- your consideration of the funding options realistically available to you throughout the investment or development lifecycle

- details of group funding practices including how you and your associates have funded other property investments or development projects.

## **Loan documentation**

You need:

- related party and third-party loan agreements and terms sheets
- records of loan accounts, schedules and workpapers
- evidence of payments to international related parties and associates including interest and repayments of debt and equity capital.

For more information on documenting your related-party funding arrangement – see **Documenting genuine loans from related overseas entities**.

## **Transfer pricing analysis**

You need transfer pricing analysis that you or your adviser have undertaken to support the arm's length nature of your related-party funding arrangement. This includes how the terms and conditions of your related-party loan compare with your external debt or other relevant third-party arrangements that you or your associates are party to.

Include details such as the commencement date, loan amount, debt ranking, security, maturity, currency, timing of payment or capitalisation of interest, repayment terms, obligations, type of interest and interest rate.

For more information on transfer pricing documentation, see Taxation Ruling TR 2014/8 *Income tax: transfer pricing documentation and Subdivision 284-E*.

## **Risk assessment**

Keep a record of the risk rating of your related-party financing arrangement in accordance with PCG 2017/4 including supporting analysis and explanations.

## Simplified record-keeping options

If you are eligible to apply the low-level inbound loans option in accordance with Practical Compliance Guideline PCG 2017/2 *Simplified transfer pricing record-keeping options*, your record-keeping requirements will be minimised, but we may seek to verify your eligibility.

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## Compliance for private groups in property and construction

What you need to know to ensure you meet your compliance obligations.

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## Meet your compliance obligations

Review your transfer pricing position annually before lodging your tax return and keep records of this.

Comply with your reporting and lodgment obligations, such as disclosing:

- loan balances and interest expenses in the International Dealings Schedule with your annual tax return
- interest paid to non-residents in the PAYG withholding from interest, dividend and royalty payments paid to non-residents – annual report

Ensure you meet your **interest withholding tax** obligations including remitting interest withholding tax as interest is paid, credited or capitalised to the loan.

## **Do your research**

Monitor developments in the law and public advice and guidance to ensure your ongoing tax compliance.

For more information on your tax obligations if you buy, sell, rent, invest property or land including income tax, CGT and GST, see **Property guide**.

Read the latest updates on tax at our **Business bulletins newsroom**. You can use keywords to search for recent interesting articles and you can subscribe to our fortnightly newsletters.

Learn about our **subscriptions services and how to sign up** to our newsletters, RSS news feeds or email subscriptions.

## **Other tax considerations**

Other potential tax considerations with your related-party funding arrangement include the:

- characterisation of the funding as **debt or equity** for tax purposes
- deductibility of interest under section 8-1 and TOFA
- **thin capitalisation rules**
- **hybrid mismatch rules**
- **Division 7A loans and Debt deduction creation rules and Division 7A.**

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## **Our commitment to you**

We are committed to providing you with accurate, consistent and clear information to help you understand your rights and entitlements and meet your obligations.

If you follow our information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take.

Some of the information on this website applies to a specific financial year. This is clearly marked. Make sure you have the information for the right year before making decisions based on that information.

If you feel that our information does not fully cover your circumstances, or you are unsure how it applies to you, contact us or seek professional advice.

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