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Outward investing entity (ADI)

There are 5 steps an outward investing entity (ADI) takes to calculate if they have met the thin capitalisation rules.

Step 1: Calculate the adjusted average equity capital

How to calculate the adjusted average equity capital if you're an outward investing entity (ADI).

Step 2: Calculate the safe harbour capital amount

How to calculate the safe harbour capital amount if you're an outward investing entity (ADI).

Step 3: Calculate the worldwide capital amount

How to calculate the worldwide capital amount if you're an outward investing entity (ADI).

Step 4: Calculate the arm's length capital amount

How to calculate the arm's length capital amount if you're an outward investing entity (ADI).

Step 5: Calculate the debt deductions disallowed

How to calculate the debt deductions disallowed if you're an outward investing entity (ADI).

Worked example of calculations for an ADI outward investing entity

The steps an ADI outward investing entity takes to determine whether it will have debt deductions disallowed.

QC 48192

Step 1: Calculate the adjusted average equity capital

How to calculate the adjusted average equity capital if you're an outward investing entity (ADI).

Last updated 24 July 2024

Broadly, the adjusted average equity capital of an outward investing entity (ADI) is the ADI equity capital allocated to its Australian operations. *Table 30: Outward investing entity (ADI)'s step 1* and *Worksheet 24: Outward investing entity (ADI)'s step 1* explain how an outward investing entity (ADI) calculates its adjusted average equity capital.

For more information, see subsection **820-300(3)** of the ITAA 1997.

Table 30: Outward investing entity (ADI)'s step 1

Steps	Comments and instructions
Step 1.1: Calculate the average value, for the income year, of all the ADI's equity capital, other than ADI equity	ADI equity capital is the total value of the entity's equity capital and the total value of all the debt interests issued by

capital attributable to its overseas permanent establishments. Insert this amount at **A** on *Worksheet 24: outward investing entity (ADI)'s step 1*.	the entity. To be included, a debt interest must be on issue for 90 days or more and not give rise to any costs for the issuer. Equity capital (excluding any equity capital attributable to any of the ADI's overseas permanent establishments) includes: • the issue price of each equity interest in the entity that is still on issue less any of the issue price that remains unpaid • the entity's general reserves and asset revaluation reserves • the entity's retained earnings • the entity's current year earnings, net of expected tax and distributions • provisions for distributions.
Step 1.2: Calculate the average value, of all the ADI's controlled foreign entity equity for that year, unless it is attributable to any of the ADI's overseas permanent establishments. Insert this amount at **B** on *Worksheet 24: outward investing entity (ADI)'s step 1*.	ADI equity capital is then reduced by equity invested in controlled foreign entities for which the ADI is an Australian controller. However, disregard any equity investment attributable to any of the ADI's overseas permanent establishment as it has already been excluded in step 1.1.
Step 1.3: Calculate the adjusted average equity capital. This is the result of **A** – **B**.	Adjusted average equity capital represents total equity capital (**A**) less any equity invested in controlled foreign entities (**B**).

Worksheet 24: Outward investing entity (ADI)'s step 1

Steps	$
Step 1.1: Average ADI equity capital	(**A**)_____
Step 1.2: Average controlled foreign entity equity	(**B**)_____
Step 1.3: Adjusted average equity capital (**A** – **B**)	= _____

Now compare the ADI's adjusted average equity capital to its minimum capital amount, which is the least of either:

- the safe harbour capital amount – **step 2**
- the worldwide capital amount – **step 3**
- the arm's length capital amount – **step 4**.

For more information, see **Worked example of calculations for an outward investing entity (ADI)**.

QC 48195

Step 2: Calculate the safe harbour capital amount

How to calculate the safe harbour capital amount if you're an outward investing entity (ADI).

Last updated 24 July 2024

The safe harbour capital amount is a level of equity capital an authorised deposit-taking institution (ADI) must allocate to its Australian operations. This amount is based on the value of net risk-weighted assets and intangible assets comprising of capitalised software expenses that are attributable to the ADI's Australian operations. The safe harbour capital amount is broadly based on the methodology of the capital adequacy requirements prescribed by prudential regulators, for example, the Australian Prudential Regulation Authority (APRA).

For more information, see **section 820-310** of the ITAA 1997.

Table 51: outward investing entity (ADI)'s step 2 and *Worksheet 43: outward investing entity (ADI)'s step 2* explain how to work out the safe harbour capital amount.

You will need copy of the prudential standards to work out the safe harbour capital amount.

Table 31: Outward investing entity (ADI)'s step 2

Steps	Comments and instructions
Step 2.1: Calculate the average value, for the income year, of all the ADI's net risk-weighted assets and intangible assets comprising of capitalised software expenses that are not: • attributable to the ADI's overseas permanent establishments • assets that represent equity invested in controlled foreign entities; that is, amounts shown at **B** in *Worksheet 24: Outward investing entity (ADI)'s step 1* • assets in respect of which prudential capital deductions must be made, other than assets attributable to the ADI's overseas permanent establishments. Insert this amount at **C** on *Worksheet 25: outward investing entity (ADI)'s step 2*.	The first step is to work out the average value of the ADI's net risk-weighted assets and intangible assets comprising of capitalised software expenses that are attributable to the ADI's Australian operations. If the ADI is foreign controlled and there is at least one foreign entity with a TC control interest of at least 40%, the ADI's risk-weighted assets are its risk exposures determined in accordance with the prudential standards of the country in which that foreign entity is a resident. Otherwise, its risk-weighted assets are its risk exposures determined in accordance with Australian prudential standards. To isolate the Australian assets, disregard assets attributable to overseas permanent establishments and equity invested in controlled foreign entities. Prudential capital deductions are amounts that must be deducted under the prudential standards when

	calculating either eligible tier 1 capital or the sum of eligible tier 1 and tier 2 capital.
Step 2.2: Multiply the amount at **C** by 6%. Insert the result at **D** on *Worksheet 25: outward investing entity (ADI)'s step 2*.	The average value of Australian risk-weighted assets is then multiplied by 6%.
Step 2.3: Calculate the average value of all the ADI's tier 1 capital prudential deductions for that year, other than the value of tier 1 prudential capital deductions attributable to any of the ADI's: • overseas permanent establishments or controlled foreign entities for which the ADI is an Australian controller • goodwill or intangible assets relating to any excess of the net market value of an interest in a subsidiary over the net amount of the subsidiary's assets and liabilities to the extent that the excess is referrable to the value of business in force (VBIF) • intangible assets comprising capitalised software expenses. Insert this amount at **E** on *Worksheet 25: outward investing entity (ADI)'s step 2*.	Tier 1 capital is composed of core capital, which primarily consists of common stock and disclosed reserves or retained earnings. It may also include non-redeemable non-cumulative preferred stock. Tier 1 prudential capital deductions are amounts that must be deducted under the prudential standards when calculating eligible tier 1 capital. Prudential capital deductions are made in respect of assets like goodwill and intangibles. VBIF is the value of business in force at the time of acquisition of the relevant subsidiary. VBIF is taken to be nil unless the value of VBIF at the time of acquisition of the relevant subsidiary was worked out by an actuary. Software capitalisation involves the recognition of internally-developed software as fixed assets. They are capitalised on the basis that the expenses will result in a future economic benefit to the entity.
Step 2.4: Calculate the ADI's safe harbour capital amount by	The safe harbour capital amount represents 6% of the

adding the amounts at **D** and **E**.	ADI's Australian risk-weighted assets and intangible assets comprising of capitalised software expenses, increased by any tier 1 capital prudential deductions.

Worksheet 25: Outward investing entity (ADI)'s step 2

Steps	$
Step 2.1: Average Australian risk-weighted assets and intangible assets comprising capitalised software expenses	(**C**) _____
Step 2.2: C × 6%	(**D**) _____
Step 2.3: Average tier 1 prudential capital deductions	(**E**) _____
Step 2.4: Safe harbour capital amount (**D** + **E**)	= _____

This is the ADI's safe harbour capital amount.

If the ADI's adjusted average equity capital is equal to or more than the safe harbour capital amount, the ADI is not disallowed any debt deductions under the thin capitalisation rules. You do not have to complete any more calculations.

If the ADI's adjusted average equity capital is less than the safe harbour capital amount, you can choose to calculate the ADI's worldwide capital amount, but only if the ADI is not foreign controlled (see **step 3**) or an arm's length capital amount (see **step 4**). If you do not want to calculate a worldwide capital amount or an arm's length capital amount, you can use your safe harbour capital amount as your minimum capital amount and debt deductions will be disallowed on this basis (see **step 5**).

For more information, see **Worked example of calculations for an outward investing entity (ADI)**.

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Step 3: Calculate the worldwide capital amount

How to calculate the worldwide capital amount if you're an outward investing entity (ADI).

Last updated 24 July 2024

A foreign-controlled authorised deposit-taking institution (ADI) cannot apply the worldwide capital test. If the ADI is foreign-controlled, go directly to **step 4**.

The worldwide capital test is available to an outward investing entity (ADI) that is not also foreign controlled. This test allows an ADI with foreign investments to fund its Australian investments with a minimum capital ratio equal to 100% of the Tier 1 capital ratio of the worldwide group. The worldwide group consists of the Australian ADI and the controlled foreign entities for which the ADI is an Australian controller.

For more information, see **section 820-320** of the ITAA 1997.

Table 32: Outward investing entity (ADI)'s step 3 and *Worksheet 26: Outward investing entity (ADI)'s step 3* explain how to work out the worldwide capital amount.

You will need a copy of the prudential standards to work out the worldwide capital amount.

Table 32: Outward investing entity (ADI)'s step 3

Steps	Comments
Step 3.1: Calculate the average value of the eligible tier 1 capital (within the meaning of the prudential standards) for the worldwide group of which the ADI is a member. Insert this amount at **F** on *Worksheet 26: outward investing*	This is the average value of eligible tier 1 capital (within the meaning of the prudential standards) of the worldwide group of which the ADI is a member. Tier 1 capital is also calculated in accordance with the prudential standards.

entity (ADI)'s step 3.	
Step 3.2: Calculate the average value of the worldwide group's risk-weighted assets. Insert this amount at **G** on *Worksheet 26: Outward investing entity (ADI)'s step 3*.	This is the average value of the worldwide group's risk-weighted assets. Risk-weighted assets are calculated in accordance with the prudential standards.
Step 3.3: Divide the amount at **F** by the amount at **G.** Insert the result at **H** on *Worksheet 26: Outward investing entity (ADI)'s step 3*.	Dividing the worldwide group's tier 1 capital by the worldwide group's risk-weighted assets establishes the capital ratio of the worldwide group.
Step 3.4: Calculate the average value of the ADI's risk weighted assets that are not: • attributable to the ADI's overseas permanent establishments • assets that represent equity invested in controlled foreign entities; that is, amounts shown at **B** in *Worksheet 26: outward investing entity (ADI)'s step 1* • assets in respect of which prudential capital deductions must be made, other than assets attributable to the ADI's overseas permanent establishments. Insert the result at **I** on *Worksheet 26: Outward investing entity (ADI)'s step 3*.	This is the average value of the ADI's risk-weighted assets attributable to its Australian operations.
Step 3.5: Insert the result of step 3.3 (**H**) at **J** on *Worksheet 26: Outward investing entity (ADI)'s step 3*.	This is the same amount calculated in step 3.3.
Step 3.6: Multiply the amount at **I** by the amount at **J**.	This applies the worldwide capital ratio to the ADI's

Insert the result at **K** on *Worksheet 26: Outward investing entity (ADI)'s step 3*.	Australian risk-weighted assets.
Step 3.7: Calculate the average value of all the tier 1 prudential capital deductions for that year, other than the value of tier 1 prudential capital deductions attributable to any of the ADI's overseas permanent establishments or controlled foreign entities for which the ADI is an Australian controller. Insert the result at **E** on *Worksheet 44: outward investing entity (ADI)'s step 3*.	This is the average value of the ADI's tier 1 prudential capital deductions. Tier 1 prudential capital deductions are amounts that must be deducted under the prudential standards when calculating eligible tier 1 capital. Prudential capital deductions are made in respect of assets like goodwill and intangibles.
Step 3.8: Calculate the ADI's worldwide capital amount by adding the amounts at **K** and **E.**	This is the ADI's worldwide capital amount.

Worksheet 26: Outward investing entity (ADI)'s step 3

Steps	$
Step 3.1: Worldwide group's average tier 1 capital	(**F**) _____
Step 3.2: Worldwide group's average risk-weighted assets	(**G**) _____
Step 3.3: F ÷ G	(**H**) _____
Step 3.4: ADI's average risk-weighted assets attributable to its Australian operations	(**I**) _____
Step 3.5: Transfer result from **H**	(**J**) _____
Step 3.6: I × J	(**K**) _____

Step 3.7: ADI's average tier 1 prudential capital deductions	(**E**) _____
Step 3.8: Worldwide capital amount (**K** + **E**)	= _____

Worksheet 26: outward investing entity (ADI)'s step 3

If the ADI's adjusted average equity capital is equal to or more than the worldwide capital amount, the ADI is not disallowed any debt deductions under the thin capitalisation rules. You do not have to complete any more calculations.

If the ADI's adjusted average equity capital is less than both the worldwide capital amount and the safe harbour capital amount, you can choose to calculate an arm's length capital amount for the ADI – see **step 4**. If you do want to calculate an arm's length capital amount, you can use your worldwide capital amount as the minimum capital amount and debt deductions will be disallowed on this basis – see **step 5**.

For more information, see **Worked example of calculations for an outward investing entity (ADI)**.

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Step 4: Calculate the arm's length capital amount

How to calculate the arm's length capital amount if you're an outward investing entity (ADI).

Last updated 24 July 2024

On this page

How to apply step 4

If the ADI's adjusted average equity capital is less than both its safe harbour capital amount and its worldwide capital amount (outward investing entities that are also foreign controlled cannot use the worldwide capital amount), it can choose to adopt an arm's length capital amount as its minimum capital amount. It would generally do so only if the arm's length capital amount is less than the capital amount calculated under the other tests.

The arm's length capital test focuses on the ADI's Australian business. The arm's length capital amount is determined by conducting an analysis about certain factual assumptions and relevant factors. The factual assumptions include some conditions that actually exist during the income year and some conditions that replace what happened during that period.

The result of the analysis is a notional amount of capital that represents what would reasonably be expected to have been the ADI's minimum capital amount throughout the year in relation to its Australian business. The Australian business is treated as if it were a separate entity, independent and operating at arm's length from the other parts of the ADI.

Broadly, the assumptions are that the ADI's:

- commercial activities are those of its Australian business – Australian business has a wide meaning
- Australian business was independent of any guarantee, security or other support provided by any of the entity's associates or using the assets that are attributable to the entity's overseas permanent establishments.

Relevant factors

Certain factors, outlined below, must be considered when doing the analysis. All the factors must be considered and must be considered in the context of the above assumptions. The factors should not be considered in isolation from each other. The weight given to each

factor in analysing a particular ADI may vary, depending on the facts and circumstances of each case.

The factors are:

- the functions performed, the assets used and the risks assumed in relation to the ADI, and the ADI's Australian business throughout the year
- the ADI's credit rating and the effect of that rating on the ADI's ability to borrow in relation to its Australian business, the interest rate of such a borrowing and the gross profit margin in relation to that business
- the capital ratios of the ADI, the ADI's Australian business and the ADI's associate entities that engage in commercial activities similar to the Australian business of the ADI
- the ADI's purpose of entering the loan arrangements in relation to itself and its Australian business throughout the year
- the profitability of the ADI and the ADI in relation to its Australian business
- commercial practices adopted by independent parties dealing with each other at arm's length in the industry in which the ADI operated its Australian business throughout the year, whether in Australia or in comparable markets elsewhere
- the way in which the ADI financed its foreign activities throughout the year
- the general state of the Australian economy throughout the year
- any other relevant factors that must be considered as set out in the regulations made for the purposes of the arm's length capital amount test.

If an ADI is relying on an arm's length capital amount, it must keep records documenting the application of the factual assumptions and relevant factors. These records must be prepared before the entity lodges its tax return.

If the ADI has not appropriately considered the factual assumptions and the relevant factors to calculate the arm's length amount, we have the power to substitute a different arm's length amount that we consider to better reflect those assumptions and relevant factors.

For more information, see **section 820-315** of the ITAA 1997.

Once you have worked out the ADI's arm's length capital amount, compare it to the ADI's adjusted average equity capital.

If the ADI's adjusted average equity capital is equal to, or more than, the arm's length capital amount, the ADI is not disallowed any debt deductions under the thin capitalisation rules. You do not have to complete any more calculations.

If the ADI's adjusted average equity capital is less than the arm's length capital amount, its safe harbour capital amount and its worldwide capital amount, you must complete **step 5**.

QC 48182

Step 5: Calculate the debt deductions disallowed

How to calculate the debt deductions disallowed if you're an outward investing entity (ADI).

Last updated 24 July 2024

The ADI's minimum capital amount is the least of the:

- safe harbour capital amount from **step 2**
- worldwide capital amount from **step 3**
- arm's length capital amount from **step 4**.

You do not necessarily have to calculate all 3 amounts. For example, you can use the safe harbour capital amount as the minimum capital amount if you do not want to calculate either a worldwide capital amount or an arm's length capital amount.

If the ADI's adjusted average equity capital is less than its minimum capital amount, a proportion of its debt deductions cannot be deducted. *Table 53: outward investing entity (ADI)'s step 5* and *Worksheet 45: outward investing entity (ADI)'s step 5* work out the proportion disallowed.

For more information, see **section 820-325** of the ITAA 1997.

Table 33: Outward investing entity (ADI)'s step 5

Steps	Comments
Step 5.1: Calculate the amount by which the ADI's adjusted average equity capital is less than its minimum capital amount (the capital shortfall). Insert this amount at **L** on *Worksheet 27: Outward investing entity (ADI)'s step 5*.	The proportion of debt deductions disallowed depends on the amount by which the ADI's adjusted average equity capital from step 1 is less than its minimum capital amount.
Step 5.2: Calculate the ADI's average debt. Insert this amount at **M** on *Worksheet 27: Outward investing entity (ADI)'s step 5*.	The average value for the income year of the ADI's debt capital that gives rise to debt deductions in that year or any other income year. However, it does not include debt capital attributable to any of the ADI's overseas permanent establishments.
Step 5.3: Divide the amount at **L** by the amount at **M.** Insert the result at **N** on *Worksheet 27: Outward investing entity (ADI)'s step 5*.	This step works out what proportion to apply to the ADI's debt deductions to calculate the amount disallowed.
Step 5.4: Calculate the ADI's debt deductions for the income year. Insert this amount at **P** on *Worksheet 27: Outward investing entity (ADI)'s step 5*.	The calculation is applied to all the ADI's debt deductions for the year. Do not include any debt deductions attributable to any of the ADI's overseas permanent establishments.
Step 5.5: Multiply the amount(s) at **N** by the amount at **P**. This is the amount of debt deductions disallowed.	This calculates the amount of debt deduction disallowed. The debt deductions that would be allowed, but for thin capitalisation, are each reduced proportionately.

Worksheet 27: Outward investing entity (ADI)'s step 5

Steps	$
Step 5.1: Capital shortfall (minimum capital amount minus adjusted average equity capital)	(**L**) _____
Step 5.2: Average debt	(**M**) _____
Step 5.3: L ÷ M	(**N**) _____
Step 5.4: Debt deductions for the income year	(**P**) _____
Step 5.5: N × P This is the total debt deductions disallowed	= _____

This is the amount of debt deductions the outward investing entity (ADI) is not allowed to deduct under the thin capitalisation rules.

For more information, see **Worked example of calculations for an outward investing entity (ADI)**.

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Worked example of calculations for an ADI outward investing entity

The steps an ADI outward investing entity takes to determine whether it will have debt deductions disallowed.

Last updated 12 October 2023

The five steps an ADI outward investing entity takes to calculate if they have met the thin capitalisation rules are:

- Step 1: Calculate the adjusted average equity capital
- Step 2: Calculate the safe harbour capital amount

- Step 3: Calculate the worldwide capital amount
- Step 4: Calculate the arm's length capital amount
- Step 5: Calculate the debt deductions disallowed.

This worked example goes through each of these steps.

See also:

- Thin capitalisation

Worked example

Bank Oz is an Australian ADI that carries on an international banking business through Australian entities, foreign permanent establishments and through foreign entities it controls.

Bank Oz has total assets (adjusted for risk) of $570 million, of which $100 million is attributable to its overseas permanent establishments. Bank Oz has debt capital of $530 million (all interest-bearing), $80 million of which is attributable to its overseas permanent establishments.

Bank Oz has equity capital of $35 million. Its total prudential capital deductions are $10 million, of which $6 million is goodwill (a tier 1 prudential capital deduction) and $4 million is an equity investment in a funds management subsidiary that is not consolidated for capital adequacy purposes. Both assets relate to its Australian operations. It has controlled foreign entity equity of $10 million and equity attributable to its foreign branches of $4 million. Its controlled foreign entities have, between them, retained earnings of $4 million and risk-weighted assets of $50 million.

All figures stated are average values.

Bank Oz's debt deductions are $30 million.

Step 1: Calculate Bank Oz's adjusted average equity capital

Worksheet 1: Bank Oz's step 1

Steps	$m

Step 1.1: Bank Oz has $35m of equity capital less the equity capital attributable to its overseas permanent establishment of $4m. Its average equity capital is $31m	Average ADI equity capital	(**A**)	31
Step 1.2: Bank Oz has invested $10m equity in its controlled foreign entities	Average controlled foreign entity equity	(**B**)	10
Step 1.3: Bank Oz's adjusted average equity capital is $21m	Adjusted average equity capital (**A** – **B**)	=	21

Bank Oz's adjusted average equity capital is $21 million. This is now compared to Bank Oz's minimum capital amount, which is the least of its:

- safe harbour capital amount
- worldwide capital amount
- arm's length capital amount.

Bank Oz can calculate these amounts in any order it chooses and does not necessarily have to calculate all three amounts.

Step 2: Calculate Bank Oz's safe harbour capital amount

Worksheet 2: Bank Oz's step 2

Steps			$m
Step 2.1: The average value of Bank Oz's risk-weighted assets is $570m. This is reduced by the $100m attributable to its overseas permanent establishment, the $10m of risk weighted assets comprised by the	Average Australian risk-weighted assets	(**C**)	450

controlled foreign entity equity, and $10m of assets in respect of which prudential capital deductions must be made. Bank Oz's Australian net risk-weighted assets are $450m			
Step 2.2: Multiply the amount at **C** by 6%	**C** x 6%	(**D**)	27
Step 2.3: Bank Oz must make a tier 1 capital prudential deduction of $6m. For the goodwill, the $4m investments in the unconsolidated funds management subsidiary does not have to be deducted from tier 1 capital – see Prudential Standard APS 111	Average tier 1 capital prudential deductions	(**E**)	6
Step 2.4: Bank Oz's safe harbour capital amount is $24m	Safe harbour capital amount (**D** + **E**)	=	33

Bank Oz's safe harbour capital amount is $33 million and its adjusted average equity capital is $21 million. As its adjusted average equity capital is less than its safe harbour capital amount, Bank Oz can choose to calculate the worldwide capital amount or the arm's length capital amount, though neither amount may be less than the safe harbour capital amount.

Step 3: Calculate Bank Oz's worldwide capital amount

Worksheet 3: Bank Oz's step 3

Steps			
Step 3.1: The average value of the eligible tier 1 capital	Worldwide group's	(**F**)	$39m

for the worldwide group of which Bank Oz is a member is $39m. Bank Oz has eligible tier 1 capital of $35m and its controlled foreign entities have tier 1 capital – the retained earnings – of $4m	average tier 1 capital		
Step 3.2: The value of the risk-weighted assets of the worldwide group is $620m. Bank Oz has risk-weighted assets of $570m – this includes the $100m attributable to its overseas permanent establishment – and its controlled foreign entities have risk-weighted assets of $50m	Worldwide group's risk-weighted assets	(**G**)	$620m
Step 3.3: Bank Oz's worldwide capital ratio is calculated by dividing the amount at **F** by the amount at **G**	**F** / **G**	(**H**)	6.29032%
Step 3.4: The average value of Bank Oz's risk-weighted assets is $570m. This is reduced by the: • $100m attributable to its overseas permanent establishment • $10m of risk weighted assets comprised by the	Bank Oz's risk-weighted assets	(**I**)	$450m

controlled foreign entity equity • $10m of assets in respect of which prudential capital deductions must be made Bank Oz's Australian net risk-weighted assets are $450m			
Step 3.5: The worldwide capital ratio is the amount at **H**	**H**	(**J**)	6.29032%
Step 3.6: The capital ratio is applied to Bank Oz's Australian risk-weighted assets by multiplying the amount at **C** by the amount at **J**	**I** x **J**	(**K**)	$28.30644m
Step 3.7: The value of Bank Oz's tier 1 prudential capital deductions has already been calculated at **E** on worksheet 2 and is $6m	Average tier 1 prudential capital deductions from **E** on worksheet 2	(**E**)	$6m
Step 3.8: Bank Oz's worldwide capital amount is $34,306,440	Worldwide capital amount (**K**) + (**E**)		$34.30644m

Bank Oz's worldwide capital amount is $34,306,440. This is more than its safe harbour capital amount. Bank Oz can calculate an alternative amount under the arm's length capital test. Bank Oz could also choose to not calculate an arm's length capital amount (as this may also be more than the safe harbour capital amount) and calculate what debt deductions are disallowed on the basis that the safe harbour capital amount is its minimum capital amount.

Step 4: Calculate Bank Oz's arm's length capital amount

For the purposes of this exercise, assume Bank Oz chooses not to calculate an arm's length capital amount.

See also:

- Thin capitalisation

Step 5: Calculate Bank Oz's debt deductions disallowed

Bank Oz's minimum capital amount is $33 million, the safe harbour capital amount, being the least of the safe harbour and worldwide capital amounts. As Bank Oz's adjusted average equity capital ($21 million) is less than its minimum capital amount, a proportion of its debt deductions will be disallowed.

Worksheet 5: Bank Oz's step 5

Steps			
Step 5.1: Bank Oz's average equity capital is $21m and its minimum capital amount is $33m	Capital shortfall ($33m – $21m)	(**L**)	$12m
Step 5.2: Bank Oz's average debt capital that gives rise to debt deductions (in Australia) is $450m	Average debt capital	(**M**)	$450m
Step 5.3: Divide the amount at **L** by the amount at **M** to get the proportion to be applied to Bank Oz's debt deductions	**L** /**M** ($12m / $450m)	(**N**)	0.026667
Step 5.4: Bank Oz's debt deductions for the income year are $30m	Debt deductions	(**P**)	$30m

Step 5.5: The amount of debt deductions disallowed is calculated by multiplying the amount at **N** by the amount at **P**	**N** X **P** (0.026667 × 30m)	=	$800,000

Bank Oz cannot deduct $800,000 of its debt deductions.

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