



# Understanding the debt deduction creation rules (DDCR)

Work out if the DDCR applies to your entity and your related party financing arrangements.

## Debt deduction creation rules

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# Debt deduction creation rules

Learn the debt deduction creation rules (DDCR) for certain related party financing arrangements.

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## About the rules

The debt deduction creation rules (DDCR) disallow debt deductions relating to certain related party financing arrangements. They apply to assessments for income years starting on or after **1 July 2024**.

A debt deduction is a cost or expense that an entity incurs which is otherwise deductible if Division 820 of the *Income Tax Assessment*

Act 1997 (ITAA 1997) is disregarded. It includes:

- interest
- an amount in the nature of interest
- any other amount that is economically equivalent to interest
- any other amount covered by paragraph 820-40(1)(a) or subsection 820-40(2) of the ITAA 1997.

The DDCR is contained in Subdivision 820-EAA of the ITAA 1997.

## Who is affected by the DDCR

For any given income year, the DDCR applies to all or part of a debt deduction for any of the following entities:

- an entity that is a general class investor
  - this includes non-ADI and non-financial entities which are
    - foreign entities that operate in Australia
    - foreign controlled Australian entities, or
    - Australian controlled Australian entities that control a foreign entity or carry on business at or through an overseas permanent establishment, including private businesses and privately owned groups
- an outward investing financial entity (non-ADI)
- an inward investing financial entity (non-ADI).

Entities that are exempt from the thin capitalisation rules under section 820-37 and private and domestic assets and non-debt liabilities under section 820-32 of the ITAA 1997 are **not** excluded from the DDCR.

### Assets threshold test

Section 820-37 of the ITAA 1997 (the assets threshold test) excludes certain outward investing entities from the thin capitalisation rules for an income year. These entities are subject to the DDCR.

### Private or domestic assets test

Section 820-32 of the ITAA 1997 excludes the following from the thin capitalisation rules:

- assets used (or held for use) wholly or principally for private or domestic purposes
- non-debt liabilities that are wholly or principally of a private or domestic nature.

These assets and liabilities are **not** excluded from the DDCR.

## Who is not affected by the DDCR

For any given income year, the following entities will **not** be subject to the DDCR:

### ADI

An entity that is an (inward or outward) authorised deposit-taking institution (ADI).

### Debt deductions under \$2 million

An entity whose debt deductions, together with the debt deductions of its associate entities, are \$2 million or less for the income year under section 820-35 of the ITAA 1997.

### Australian plantation forestry entity

An Australian plantation forestry entity which solely or predominantly carries on a business of establishing and tending trees for felling in Australia. Refer to section 146 of the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share – Integrity and Transparency) Act 2024*.

### Securitisation vehicle

An entity that is a securitisation vehicle under subsection 820-942(2) of the ITAA 1997 where all the following apply:

- It is established for the purposes of acquiring, funding and holding securitised assets.
- It has acquired the securitised assets from another entity (the originator).

- The acquisition of the securitised assets is wholly funded by the issuing of debt interests by the entity.
- In issuing the debt interest, the entity does not receive any guarantee, security or other form of credit support from any of its associate entities, the originator or any associate entity of the originator.
- It has not issued debt interests for any purpose other than for the purpose of funding the acquisition of the securitised assets.
- There is no debt interest issued to the entity by any of the entity's associate entities, the originator or any associate entity of the originator, and
- Any arrangements the entity has with any of its associate entities, the originator or any associate entity of the originator are those that would reasonably be expected to have been entered into by parties dealing at arm's length with each other.

## Special purpose entity

Certain special purpose entities under section 820-39 of the ITAA 1997 where all the following apply:

- The entity is established for the purposes of managing some or all of the economic risk associated with assets, liabilities or investments.
- The total value of debt interests in the entity is at least 50% of the total value of the entity's assets, and
- The entity is an insolvency remote special purpose entity according to the criteria of an internationally recognised rating agency that are applicable to the entity's circumstances. That entity does not have to have been rated by a rating agency.

## How the DDCR interacts with other rules

### The DDCR and Division 7A of the ITAA 1936

Complying loans under Division 7A of the *Income Tax Assessment Act 1936* (ITAA 1936) are **not** excluded from the DDCR.

Where DDCR conditions are satisfied, the DDCR will apply to disallow debt deductions for interest paid or payable under a complying Division 7A loan. This is where the loan has been used to acquire or fund a relevant related party arrangement.

For more information, see [Debt deduction creation rules and Division 7A](#).

## **The DDCR and thin capitalisation rules**

Under section 820-31 of the ITAA 1997, the DDCR will apply to the following 3 kinds of entities before the thin capitalisation rules apply to the entity:

- general class investors
- outward investing financial entities (non-ADI)
- inward investing financial entities (non-ADI).

Where a debt deduction is disallowed under the DDCR, you disregard that debt deduction when applying the following provisions to the entity for the income year:

- Subdivision 820-AA of the ITAA 1997 (thin capitalisation rules for general class investors)
- Subdivision 820-B of the ITAA 1997 (thin capitalisation rules for outward investing financial entities (non-ADI))
- Subdivision 820-C of the ITAA 1997 (thin capitalisation rules for inward investing financial entities (non-ADI)).

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## **How the DDCR works**

Learn the types of arrangements where the debt deduction creation rules (DDCR) apply to an entity.

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## Types of arrangements

The debt deduction creation rules (DDCR) apply to the following 2 types of arrangements.

### Type 1 DDCR: Acquisition case

In the Acquisition case, the DDCR will operate to disallow an entity's debt deductions referable to an amount paid, directly or indirectly, to an 'associate pair' to the extent they are in relation to the acquisition or holding of a CGT asset, or a legal or equitable obligation, directly or indirectly, from an 'associate pair'.

This is covered in subsection 820-423A(2) of the *Income Tax Assessment Act 1997* (ITAA 1997).

For more information about a CGT asset, see [What is a CGT asset?](#)

### Type 2 DDCR: Payment or distribution case

In the Payment or distribution case, the DDCR will operate to disallow an entity's debt deductions referable to an amount paid, directly or indirectly, to an 'associate pair' in relation to a financial arrangement to the extent the arrangement is used to fund or facilitate funding of prescribed types of payments or distributions to an 'associate pair'.

This is covered in subsection 820-423A(5) of the ITAA 1997.

## Timing

The rules apply to debt deductions arising in income years starting on or after **1 July 2024**. This includes debt deductions in relation to arrangements entered into before or after 1 July 2024.

The rules do not apply to an entity for an income year that has made a choice (including a deemed choice) to apply the third-party debt test for the income year.

## Domestic and cross-border transactions

The rules disallow debt deductions for certain arrangements involving associates, including arrangements between Australian entities.

## Tracing and apportionment

You and your 'associate pairs' must obtain sufficient information to trace the use of related party debt or financing arrangements covered by subsections 820-423A(2) and (5) of the ITAA 1997. These include indirect related party arrangements.

Apportionment does not replace tracing. However, apportionment may be appropriate where it is not possible to trace. For instance, where funding from various sources that were used for different purposes are refinanced into a single debt interest.

For example, apportionment will be necessary to determine the debt deductions disallowed by the DDCR for a debt facility where a payment or distribution covered by subsection 820-423A(5A) is funded by related party debt that is refinanced into a single debt facility with other debt used for different purposes.

For more information on tracing and apportionment, see *PCG 2024/D3 Restructures and the new thin capitalisation and debt deduction creation rules – ATO compliance approach*.

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## Type 1 DDCR: Acquisition case

When to apply the Type 1: Acquisition case under the DDCR.

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## When Type 1: Acquisition case applies

The Type 1: Acquisition case disallows all or part of a debt deduction of an entity for an income year if all of the following conditions are satisfied:

- An entity (the 'acquirer') acquires a CGT asset, or a legal or equitable obligation, either directly or indirectly, through one or more interposed entities, from one or more other entities (each of which is a 'disposer').
- One or more of the disposers is an 'associate pair' of the acquirer.
- The entity (*relevant entity*) that incurred the debt deduction is any of
  - the acquirer
  - an 'associate pair' of the acquirer
  - an 'associate pair' of an 'associate disposer'.
- The relevant entity's debt deduction is wholly or partly in relation to any of
  - the acquisition of CGT asset, or a legal or equitable obligation
  - the acquirer's holding of the CGT asset, or legal or equitable obligation.
- The relevant entity's debt deduction is referable to an amount paid or payable, either directly or indirectly, to an 'associate pair' of the relevant entity, acquirer or associate disposer.
- The acquisition is not covered by an exception in **section 820-423AA**.
- The entity has not made a choice under **subsection 820-46(4)** to use the third-party debt test for the income year.

In applying the above conditions, you **disregard** the following paragraph (b) of the definition of 'acquire' in subsection 995-1(1) of the *Income Tax Assessment Act 1997* (ITAA 1997):

an entity does not acquire an item of intellectual property merely because a licence relating to a patent, design or copyright is surrendered to the entity.

The test time of an associate pair condition is when the acquisition occurs. The manipulation of the test time may trigger consideration of the specific anti-avoidance rule contained in section 820-423D.

## Debt deductions disallowed under Type 1

Debt deductions referable to an amount paid or payable (directly or indirectly) to an associate pair are disallowed under Type 1 to the extent they are in relation to the acquisition or holding of the relevant CGT asset or legal or equitable obligation acquired from an associate pair.


### Example 1: Type 1 – acquisition of a CGT asset

Finance Co lends \$100 to Acquisition Co, an associate pair of Finance Co.

Acquisition Co uses the loan proceeds to acquire a CGT asset from Disposal Co, which is an associate pair of both Acquisition Co and Finance Co.

In the current income year, Acquisition Co pays an interest expense of \$5 to Finance Co in relation to the \$100 debt.

The DDCR will apply to disallow debt deductions for the \$5 interest expense incurred by Acquisition Co. This is because the debt deductions are in relation to the acquisition of the CGT asset from Disposal Co, the associate disposer.

 DE-70232 - Understanding the DDCR - Example 1 Type 1.png

## Excepted CGT assets for Type 1

The following 3 kinds of acquisitions of CGT assets are excluded from the DDCR under section 820-423AA:

- acquisition of a newly issued membership interest in either

- an 'Australian entity'
- a foreign entity that is a company
- acquisition of certain qualifying new tangible depreciating assets
- acquisition of certain debt interests issued by an **associate pair**.

### **Example 2: acquisition of excluded CGT assets**


Entity 1, an Australian company, borrows \$100 from Lend Co, an associate pair of Entity 1.

Entity 1 uses the proceeds of the borrowing to acquire \$100 of shares in Entity 2, an Australian company. The shares had not previously been held by any entity.

In the current income year, Entity 1 pays an interest expense of \$5 to Lend Co under the \$100 related party borrowing.

Type 1 DDCR does not apply to disallow Entity 1's debt deductions for the \$5 interest expense as those debt deductions are:

- in relation to the acquisition of an excluded CGT asset (new membership interests in an Australian company)
- not in relation to the acquisition or holding of a non-excluded CGT asset or legal or equitable obligation that was acquired from an associate pair.

 DE-70232 - Understanding the DDCR - Example 2 Type 1.png

## **Indirect acquisition covered by Type 1**

Type 1 DDCR also applies to 'indirect' acquisitions of CGT assets. In this regard:

- In determining whether an acquisition(s) occurs indirectly through one or more interposed entities
  - it is sufficient if the acquisition(s) exists between each entity
  - it is not necessary to demonstrate that each acquisition in a series of acquisitions happened before the next acquisition.

- Type 1 DDCR may apply to disallow debt deductions in relation to the indirect acquisition by an entity of a CGT asset through an interposed entity. This is even if the indirect acquisition involves the direct acquisition by the first entity of an excepted CGT asset.

### **Example 3: indirect acquisition of CGT asset subject to Type 1 DDCR**

Aus Co A borrows \$1,000 from Lending Co, an associate pair of Aus Co A.


Aus Co A uses the proceeds of the borrowing to acquire 100% membership interest in Aus Co B, an associate pair of Aus Co A.

Aus Co B acquires a CGT asset from Aus Co C, an associate disposer of Aus Co B, for a consideration of \$1,000.

Aus Co A, Aus Co B and Aus Co C will all be associate pairs of each other as Aus Co B is an associate of Aus Co A and of Aus Co C under section 318 of the *Income Tax Assessment Act 1936* (ITAA 1936).

In the current income year, Aus Co A pays an interest expense of \$33 under the \$1,000 borrowing from Lending Co.

The DDCR will apply to disallow Aus Co A's debt deductions for the \$33 interest expense since the debt deductions are in relation to the indirect acquisition of the CGT asset from Aus Co C.

 DE-70232 - Understanding the DDCR - Example 3 Type 1.png

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## **Type 2 DDCR: Payment or distribution case**

When to apply the Type 2: Payment or distribution case under the DDCR.

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## **When Type 2: Payment of distribution case applies**

The Type 2: Payment or distribution case disallows all or part of a debt deduction of an entity for an income year if all the following conditions are met:

- An entity (the 'payer') enters into or has a financial arrangement with another entity.
- To the extent the payer uses the financial arrangement to fund or facilitate the funding of one or more payments or distributions
  - the payer makes to an 'associate recipient' that is an associate pair of the payer
  - that are a [prescribed payment or distribution](#).
- The entity (the 'relevant entity') is any of
  - the payer
  - an associate pair of the payer
  - an associate pair of an associate recipient.
- The relevant entity's debt deduction is wholly or partly in relation to the financial arrangement mentioned above.
- The relevant entity's debt deduction is referable to an amount paid or payable, either directly or indirectly, to any of
  - an associate pair of the relevant entity

- an associate pair of the payer
- an associate pair of an associate recipient.
- The entity has not made a choice to use the third-party debt test for the income year.

A recipient of the payments or distribution described above may be the entity with whom the payer enters into or has the financial arrangement, or another entity.

## Prescribed payments or distributions

Prescribed payments or distributions include:

- dividends, distributions or non-share distributions
- distributions by a trustee or partnership
- returns of capital, including returns of capital made by a distribution or payment made by a trustee or partnership
- cancellations or redemptions of a membership interest
- royalties (or similar payments or distributions for the use of, or right to use, an asset)
- repayment of principal under a debt interest issued by the payer if the debt interest satisfies paragraphs 820-423A(5)(a), (b) and (c)
- payments or distributions of a similar kind to any of the above
- a payment prescribed by the regulations (no regulations currently exist).

Debt deductions referable to an amount paid or payable (directly or indirectly) to an associate pair are disallowed under Type 2 to the extent the relevant financial arrangement was used to fund, or facilitate the funding of, the prescribed payments or distributions.


### **Example 1: Type 2 – financial arrangement used to fund a prescribed payment or distribution**

Pay Co borrows \$1,000 from Fin Co, an associate pair of Pay Co.

Pay Co uses the proceeds of borrowing to pay dividends to its offshore parent entity, Foreign Co, which is an associate pair of Pay Co.

In the current income year, Pay Co pays an interest expense of \$50 in relation to the \$1,000 associate borrowing from Fin Co.

The DDCR will apply to disallow Pay Co's debt deductions for the \$50 interest expense since the debt deductions are in relation to the funding of a prescribed payment or distribution.

 DE-70232 - Understanding the DDCR - Example 1 Type 2.png

### **Example 2: Type 2– refinancing a debt interest that originally funded a prescribed payment or distribution**

On 1 July 2022, Pay Co borrows \$1,000 from Fin Co, an associate pair of Pay Co.


Pay Co uses the proceeds of borrowing to pay dividends to its offshore parent entity, Foreign Co, which is an associate pair of Pay Co.

On 6 July 2024, Pay Co refinances the \$1,000 related party borrowing from Fin Co with a new \$1,000 related party borrowing from Treasury Co, an associate pair of Pay Co.

In the 2025 income year, Pay Co pays an interest expense of \$60 in relation to the \$1,000 associate borrowing from Treasury Co.

The DDCR will apply to disallow Pay Co's debt deductions of the \$60 interest expense. This is because:

- The new \$1,000 related party borrowing is used to fund a repayment of principal to an associate pair under a debt interest issued by Pay Co that was subject to the DDCR.
- The original \$1,000 related party debt which the new debt refinanced funded a prescribed payment or distribution (dividends) to its offshore parent, Foreign Co.

 DE-70232 - Understanding the DDCR - Example 2 Type 2.png

## Indirect payments or distributions covered by Type 2

Type 2 also applies to relevant prescribed payments or distributions made 'indirectly' through one or more interposed entities. In determining whether a payment or distribution is made indirectly through one or more interposed entities:

- it is sufficient if payments exist between each interposed entity
- it is not necessary to demonstrate that each payment in a series of payments funds the next payment or is made after the previous payment.

### Example 3: indirect royalty payment subject to Type 2 DDCR


Aus Co A borrows \$1,000 from Lending Co, an associate pair of Aus Co A.

Aus Co A uses the proceeds of the borrowing to acquire \$1,000 of shares in Aus Co B, an associate pair of Aus Co A.

Aus Co B pays a royalty of \$1,000 to Foreign Co, an associate pair of Aus Co A.

In the current income year, Aus Co A pays an interest expense of \$40 under the \$1,000 borrowing from Lending Co.

The DDCR will apply to disallow Aus Co A's debt deductions for the \$40 interest expense since the debt deductions are in relation to the \$1,000 related party borrowings used to fund a prescribed payment (that is, royalty payment) which Aus Co A indirectly makes to its associate pair.

 DE-70232 - Understanding the DDCR - Example 3 Type 2.png

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## The DDCR anti-avoidance rule



See how the DDCR anti-avoidance rule applies to debt deductions.

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The debt deduction creation rules (DDCR) include a specific anti-avoidance rule in **section 820-423D** of the *Income Tax Assessment Act 1997* (ITAA 1997).

Under this rule, the Commissioner of Taxation may determine that Type 1 DDCR or Type 2 DDCR applies to relevant debt deductions if the Commissioner is satisfied that it is reasonable to conclude that one or more entities ('participants') entered into or carried out a scheme for the principal purpose of, or for more than one principal purpose that included the purpose of, achieving the result that either

- **Type 1: Acquisition case** does not apply in relation to a debt deduction
- **Type 2: Payment or distribution case** does not apply in relation to a debt deduction.

This is the case whether or not:

- the debt deduction is a debt deduction of any of the participants of the scheme
- any of the participants carried out the scheme or any part of the scheme
- the scheme has been or is entered into or carried out in Australia or outside Australia, or partly in Australia and partly outside Australia.

This means that if the Commissioner is satisfied that a principal purpose of one of the participants in the scheme was to avoid the application of the DDCR, it does not matter where the scheme was entered into or carried out.

If an entity is dissatisfied with the Commissioner's determination in relation to the application of this anti-avoidance rule, they can request a review under **Part IVC** of the *Taxation Administration Act 1953*.

# DDCR concepts and terms

Check concepts and terms, including associate pairs and modified definitions, when applying the DDCR.

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## Associate pairs

An 'associate pair' is a new term introduced for the **debt deduction creation rules** (DDCR).

It uses the pre-existing definition of **associate** in **section 318** of the *Income Tax Assessment Act 1936* (ITAA 1936).

An entity is an 'associate pair' of another entity if any of the following conditions are met:


- The entity is an associate of the other entity.
- The other entity is an associate of the entity.

The definition of 'associate pair' only requires that **one** of the entities is an associate of the entity. It is not necessary to test whether both entities satisfy the definition of associate.


For example, if an Entity A is an associate of an Entity B, it follows that Entity A and Entity B are both an associate pair of one another.

### Example: associate pair

If Entity A is an associate of Entity B, then Entity A and Entity B are associate pairs regardless of whether Entity B is also an associate of Entity A.

 DE-70232 - Understanding the DDCR - Associate Pair 1.png

If Entity D is an associate of Entity C, Entity C and Entity D are associate pairs regardless of whether Entity C is also an associate of Entity D.

 DE-70232 - Understanding the DDCR - Associate Pair 2.png

If Entity E is an associate of Entity F, and Entity F is also an associate of Entity E, Entity E and Entity F are associate pairs of each other.

 DE-70232 - Understanding the DDCR - Associate Pair 3.png

## Modified meanings or definitions

### Modified meaning of 'associate pair' for certain unit trusts

Section 820-423E of the *Income Tax Assessment Act 1997* (ITAA 1997) modifies the definition of 'associate pair' for certain purposes when applying the DDCR.

### Modified definition of 'associate' for unit trusts where CGT event E4 or E10 apply

This modified definition applies to a unit trust if CGT events E4 or E10 are capable of applying to all of the units and interests in the trust.

It operates to treat the trust as if it were a company when determining whether:

- The trust is an associate of another entity
- Another entity is an associate of the trust.

### Modification of 'sufficient influence' test for unit trusts

Section 820-423E also modifies the application of the 'sufficient influence' test for a unit trust, as follows:

- The unit trust is treated as sufficiently influenced by another entity or other entities if the unit trust is accustomed or under an obligation (whether formal or informal), or might reasonably be expected, to act in accordance with the directions, instructions or

wishes of the other entity or other entities (whether those directions, instructions or wishes are, or might reasonably be expected to be, communicated directly, or through interposed companies, partnerships or trust.

- Another entity or other entities are taken to hold a majority voting interest in the unit trust if either of the following percentages is not less than 50%
  - the percentage of the income of the unit trust represented by the share of the income to which the other entity or other entities are entitled, or that the other entity or other entities are entitled to acquire
  - the percentage of the corpus of the unit trust represented by the share of the corpus to which the other entity or other entities are entitled, or that the other entity or other entities are entitled to acquire.
- Disregard the operation of paragraphs 318(6)(b) and (c) of the ITAA 1936.
- Sufficient influence is not taken to exist in relation to a unit trust merely because of a breach by any entity of the terms of a debt interest issued by, or held by, the unit trust if there are reasonable grounds to believe that the breach occurred only to protect the interests of secured creditors in relation to the debt interest.

## **Modified definition of 'Australian entity'**

An 'Australian entity' is defined in section 336 of Part X of ITAA 1936 as one of an:

- Australian partnership
- Australian trust
- entity (other than a partnership or trust) that is a Part X Australian resident.

A 'Part X Australian resident' is an entity which is resident of Australia, excluding any entity treated solely as a resident of another country under a double-taxation agreement between Australia and that country.

## Modifications to definition of Australian entity under the DDCR

Section 337 of the ITAA 1936 is disregarded for the purpose of determining whether an entity is an Australian entity for applying the DDCR.

Under the DDCR, a partnership is treated as an Australian entity where at least a 50% direct participation interest is held in the partnership by either:

- Australian residents
- Australian trusts.

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## Reporting and guidance on the DDCR

See how to report on the debt deduction creation rules (DDCR) using an IDS or RTP.

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## IDS 2024 – restructuring

An entity is required to complete an international dealings schedule (IDS) 2024 if it has written an amount or 'Y' (for 'yes') at any relevant

labels (or trigger points and questions) in its tax return. For more information, see **Who must complete an IDS**.

Question 39a of the IDS 2024 requires an entity to provide information if it undertakes or implements a restructure or replacement of an arrangement during the 2024 income year in anticipation of the debt deduction creation rules (DDCR).

This covers information about the restructure or replacement of an arrangement that would have satisfied the conditions for **Type 1: Acquisition case** or **Type 2: Payment or distribution case** if the arrangement had not been restructured or replaced and had still been in place after 1 July 2024.

For more information, see **Section D: Thin capitalisation**.

## **IDS 2025**

As the DDCR will apply from income years starting on or after 1 July 2024, specific questions in relation to the DDCR are included in the IDS 2025. This includes information in relation to any restructure or replacement of an arrangement that would have satisfied the conditions for **Type 1: Acquisition case** or **Type 2: Payment or distribution case** if the arrangement had not been restructured or replaced and had still been in place until after the DDCR was applicable.

## **PCG 2024/D3**

We published Draft Practical Compliance Guideline **PCG 2024/D3** *Restructures and the new thin capitalisation and debt deduction creation rules* on 9 October 2024. This follows the enactment of the *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share—Integrity and Transparency) Act 2024* on 8 April 2024, which introduced the DDCR.

The draft guideline includes the Commissioner's practical compliance approach to restructures carried out in response to the DDCR. It provides a risk assessment framework for **affected taxpayers**.

We will update this page once Draft PCG 2024/D3 has been finalised.

## **Reportable tax position (RTP)**

Refer to the RTP Schedule and Instructions for information on Question 47.

This question requires disclosure of a taxpayer's risk assessment of restructures undertaken in response to the DDCR consistently with PCG 2024/D3.

For additional information, see RTP schedule 2025 instructions.

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