



Ruling compendium – TR 2025/2

❗ Relying on this Compendium

This Compendium of comments provides responses to comments received on draft Taxation Ruling TR 2024/D3 *Income tax: aspects of the third party debt test in Subdivision 820-EAB of the Income Tax Assessment Act 1997*. It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

All legislative references in this Compendium are to the *Income Tax Assessment Act 1997*.

Issue number	Issue raised	ATO response
1	Subsection 820-427A(2) and cross currency and interest rate swaps A 'conventional interest rate swap' covers any hedging arrangement that is covered by a standard International Swaps and Derivatives Association Master Agreement and has a component of the swap that relates to interest rate risk (for example, a cross currency and interest rate swap (CCIRS)). The final Ruling should clarify what 'debt deductions' arise under a CCIRS.	We note this submission, however no change has been made in the final Ruling. A 'conventional interest rate swap' refers to an interest rate swap only. A CCIRS is not an example of a conventional interest rate swap. Consideration of what 'debt deductions' a CCIRS gives rise to is outside the scope of this Ruling.
2	Paragraph 820-427A(2)(a) The final Ruling should clarify the specific provision of section 820-40 referred to in paragraph 19 of the draft Ruling that brought the relevant debt deductions within the definition of 'debt deduction'.	We agree. In the final Ruling, paragraph 19 has been clarified to include specific reference to subparagraph 820-40(1)(a)(i).

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3	Example 1 of the draft Ruling Any debt deductions paid by Project Trust to Fin Co under the On-swap will satisfy paragraph 820-427A(2)(b) if those debt deductions are 'passed-on' to an entity that is not an associate entity of Project Trust. Example 1 of the draft Ruling implies that the conduit financing rules are satisfied and should include discussion of the conduit financing rules.	We note this submission, however no change has been made in the final Ruling. The final Ruling clarifies that the relevant debt deductions do not satisfy paragraph 820-427A(2)(b), even if those debt deductions are 'passed-on' to an entity that is not an associate entity of Project Trust. In the final Ruling, footnote 27 has also been included to clarify the scope of Example 1. The 'conduit financing' rules are outside the scope of the Ruling.
4	Timing of satisfaction of paragraphs 820-427A(3)(a) and (b) The final Ruling should provide further guidance on the time at which the tests in paragraphs 820-427A(3)(a) and (b) are applied and the outcome if unrelated parties become associate entities (and vice versa) after the debt interest was issued.	We note this submission, however no change has been made in the final Ruling. The final Ruling does not consider all possible factual circumstances. Guidance on the timing of satisfaction of paragraphs 820-427A(3)(a) and (b) is set out at paragraphs 30 to 33 of the final Ruling.
5	Recourse The final Ruling should provide guidance on the characterisation of certain contingent rights held by the borrower. An unsecured creditor does not have 'recourse' to any assets. Paragraph 42 of the draft Ruling should be explicitly stated to apply to membership interests. The application of the recourse condition to trustees and trust assets should be clarified to reflect that a trust is not a legal person and cannot issue a debt interest (that is, it cannot owe a debt) and the ways in which a lender to a trustee can satisfy or recover an amount from trust assets.	We agree in part with these comments. The Ruling does not consider all possible factual circumstances. Guidance on the assets the holder of the debt interest has 'recourse' to is set out at paragraphs 36 to 64 of the final Ruling, including Example 4, concerning an unsecured creditor. In the final Ruling, paragraph 42 has been updated to clarify that it applies equally to membership interests.
6	Example 5 of the draft Ruling The depiction of the obligor group in Example 5 of the draft Ruling is incorrect and should be removed.	We agree. In the final Ruling, the obligor group box in Example 5 has been removed.

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7	Example 6 of the draft Ruling The depiction of the obligor group in Example 6 of the draft Ruling is incorrect and should be amended to exclude the 'Property'. Example 6 should be amended to explain that Head Trust is not a member of the obligor group because of the operation of subsection 820-49(3). The reference to the assets out of which Head Co agrees to satisfy its obligations under its guarantee to Assets Trust is irrelevant to the Example and should be removed.	We agree. In the final Ruling: • The depiction of the obligor group in Example 6 now excludes 'Property'. • A paragraph has been added to Example 6 to explain why Head Trust is not a member of the obligor group (see paragraph 60 of the final Ruling). • The reference to the assets out of which Head Co agrees to satisfy its obligations under its guarantee to Assets Trust has been removed. This reference was relevant to Example 18 in the draft Ruling, which has also been clarified (see Example 21 of the final Ruling).
8	Minor or insignificant assets The interpretation of 'minor or insignificant' in the draft Ruling is overly narrow. Suggested alternatives include that the expression is not a composite phrase, relative value tests, impact on credit assessment, and thresholds higher than 1% of total assets or \$1 million. The final Ruling should include further examples of what are 'minor or insignificant assets'.	We note this submission, however no change has been made in the final Ruling. Guidance on 'minor or insignificant assets' is set out at paragraphs 65 to 80 of the final Ruling, including Examples 8, 9 and 10.
9	Example 8 of the draft Ruling The depiction of the obligor group in Example 8 of the draft Ruling is incorrect and should be amended to exclude Foreign Sub Co.	We agree. In the final Ruling, the depiction of the obligor group in Example 8 now excludes Foreign Sub Co.
10	Australian assets Further guidance is requested on the meaning of 'Australian assets', including in relation to intangible assets (including membership interests and rights against foreign residents), physical assets in transit to Australia, and real property. Alternative tests suggested include: • alignment with section 820-37 • alignment with section 820-680	We agree in part with these comments. The final Ruling does not consider all possible factual circumstances. In the final Ruling, we have: • expanded the guidance on 'Australian assets' (at paragraphs 81 to 112) • removed an earlier qualification that Australian real property will 'generally' constitute 'Australian assets'

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	- whether the asset generates assessable income - for membership interests - the place of incorporation of the entity - the tax residency of the entity - shares in Australian entities with foreign permanent establishments should be considered to be 'Australian assets'. Australian real property should always constitute 'Australian assets'.	added a new example (Example 12) dealing with the classification of membership interests as 'Australian assets' where an underlying minor or insignificant non-Australian asset is involved. We maintain the view that the 'Australian assets' test is not aligned with section 820-37 or section 820-680, and that shares in Australian entities with foreign permanent establishments do not qualify as 'Australian assets' (see Example 15 of the final Ruling).
11	Paragraph 820-427A(4)(b) In the final Ruling, the interaction between 'minor or insignificant' and paragraph 820-427A(4)(b) should be explained.	We agree. A new example (Example 13) has been included in the final Ruling to demonstrate the interaction between 'minor or insignificant' and paragraph 820-427A(4)(b).
12	All or substantially all The expression 'all, or substantially all' covers more than just minimal or nominal amounts. It is a relative test (for example, a 90-10 rule or an 80-20) rule. The example at paragraph 103 of the draft Ruling about borrowing fees is inappropriate because they are invariably 'commercial activities in connection with Australia'.	We agree in part with these comments. We maintain our view that 'substantially all' is synonymous with 'nearly all' or 'almost all' (see paragraph 118 of the final Ruling). The final Ruling now clarifies this point by removing the reference to a 'minimal or nominal amount'. In the final Ruling, the reference to 'borrowing fees' has been removed. The reference addressed only the interpretation of the phrase 'all, or substantially all'. It did not address whether the use of the proceeds of issuing a debt interest to fund the payment of borrowing fees satisfies paragraph 820-427A(3)(d), which depends on the particular facts and circumstances. We maintain our view that such fees are not invariably covered by paragraph 820-427A(3)(d), and that the 'all, or substantially all' concession has the practical effect of ensuring that qualifying fees would not need to be tested.

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13	Commercial activities in connection with Australia The final Ruling should provide further guidance on 'commercial activities in connection with Australia'. 'Commercial activities in connection with Australia' should encompass all capital management activities. The payment of dividends and returns of capital should be covered. The proceeds of issuing the debt interest are used to fund 'commercial activities in connection with Australia' if debt deductions are deductible outside Division 820. 'Commercial activities in connection with Australia' takes the same meaning as in the former arm's length debt test. Paragraph 820-427A(3)(d) does not require the tracing of the 'use' of funds, including through each subsequent redeployment of the funds. The final Ruling should clarify that paragraph 820-427A(3)(d) will be satisfied where the proceeds of issuing a debt interest are used to fund the refinancing of a debt interest that satisfied paragraph 820-427A(3)(d).	We agree in part with these comments. In the final Ruling: - further guidance on 'commercial activities in connection with Australia' has been included at paragraphs 119 to 130, and - the reference to 'capital management activities' has been removed. We maintain the view that the payment of dividends and returns of capital do not constitute 'commercial activities in connection with Australia' for the purposes of paragraph 820-427A(3)(d) (see paragraph 125 and Example 18 of the final Ruling). We do not agree that: - the proceeds of issuing the debt interest are necessarily used to fund 'commercial activities in connection with Australia' if debt deductions in relation to the debt are deductible outside Division 820 'commercial activities in connection with Australia' takes the same meaning as in the former arm's length debt test. Paragraph 122 of the final Ruling confirms our view that paragraph 820-427A(3)(d) functions as a tracing rule. Paragraph 124 of the final Ruling confirms that refinancing debt that was used to fund commercial activities in connection with Australia will satisfy paragraph 820-427A(3)(d), provided the nexus to those activities is maintained.
14	Credit support rights Credit support rights should not include rights unrelated to the third-party borrowing. The final Ruling should clarify the meaning of 'other credit support rights'.	We note this submission, however no change has been made in the final Ruling. We maintain the view that credit support rights covered by subsection 820-427A(5) are not necessarily limited to those in relation to the debt interest. While the Ruling does not consider all possible factual circumstances, guidance on 'credit support rights' is provided at paragraphs 133 to 138.
15	Subparagraph 820-427A(5)(a)(i) Examples 6 and 18 of the draft Ruling, when taken together, suggest that if an associate subsidiary and member of the	We agree. In the final Ruling, the discussion of subparagraph 820-427A(5)(a)(i) has been updated (see paragraphs 139 to 142).

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	obligor group were to provide credit support to the borrowing entity, that this right would not meet subparagraph 820-427A(5)(a)(i), even if the credit support right provides recourse directly or indirectly only to Australian assets that are covered by subsection 820-427A(4) and not 820-427A(5).	Example 18 of the draft Ruling has been replaced with Example 19 in the final Ruling.
16	Subparagraph 820-427A(5)(a)(ii) and paragraph 820-427A(5)(b) The final Ruling should provide further guidance on the meaning of 'directly or indirectly' as it appears in subparagraph 820-427A(5)(a)(ii) and paragraph 820-427A(5)(b), as well as the implications of recourse against 'entities' as contrasted to assets.	We note this submission, however no change has been made in the final Ruling. The Ruling is not intended to cover all interpretative questions that arise under the third party debt test. Guidance on these provisions is provided at paragraphs 148 to 155, and paragraphs 175 to 177, respectively of the final Ruling.
17	Development concessions The final Ruling should include further guidance on the scope of the 'development concession' exceptions in subparagraphs 820-427A(5)(iii), (iv), (v) and (vi).	We note this submission, however no change has been made in the final Ruling. The Ruling is not intended to cover all interpretative questions that arise under the third party debt test. Guidance on these provisions is provided at paragraphs 156 to 177 of the final Ruling.
18	Conduit financing conditions The final Ruling should include guidance on the conduit financing conditions.	We note this submission, however no change has been made in the final Ruling. The conduit financing rules are outside the scope of this Ruling.
19	Interaction with Division 230 The final Ruling should consider the interaction between the taxation of financial arrangement provisions, including their relevance to section 820-40 with respect to the treatment of interest rate swaps.	We note this submission, however no change has been made in the final Ruling. The interaction between Division 230 and the new thin capitalisation provisions is outside the scope of this Ruling.
20	Recourse in a tax consolidated group The final Ruling should clarify the interaction between the recourse requirements and tax consolidated groups.	We note this submission, however no change has been made in the final Ruling. The interaction between the recourse requirements and tax consolidated groups is outside the scope of this Ruling.

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21	Section 820-427D The final Ruling should provide guidance on section 820-427D.	We note this submission, however no change has been made in the final Ruling. Section 820-427D is outside the scope of this Ruling.

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