

PCG 2025/2 - Restructures and the thin capitalisation and debt deduction creation rules - ATO compliance approach

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Practical Compliance Guideline

Restructures and the thin capitalisation and debt deduction creation rules – ATO compliance approach

📌 Relying on this Guideline

This Practical Compliance Guideline sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow this Guideline in good faith, the Commissioner will administer the law in accordance with this approach.

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What this Guideline is about

1. The *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share—Integrity and Transparency) Act 2024 (Act)* introduces thin capitalisation rules in Division 820 of the *Income Tax Assessment Act 1997 (ITAA 1997)* and the debt deduction creation rules (DDCR) in Subdivision 820-EAA of the ITAA 1997.
2. This Guideline primarily sets out our compliance approach to the restructures¹ carried out in response to the Act.
3. This Guideline provides a risk assessment framework rating on the application of certain anti-avoidance provisions to restructuring in response to the Act.²
4. The risk assessment framework sets out matters that we will take into account in deciding whether or not we will have cause to devote our compliance resources to further examine your restructures. It does not mean that any anti-avoidance provision necessarily applies.
5. This Guideline does not replace, alter or affect our interpretation of the law in any way.
6. All further legislative references in this Guideline are to the ITAA 1997, unless otherwise indicated.

Structure of this Guideline

7. This Guideline is structured as follows:
 - the main body – which sets out the general principles of our risk approach and application of compliance resources and includes
 - a brief summary of relevant changes to the income tax laws in the Act
 - our compliance approach
 - our risk assessment framework
 - schedules – which expand on the general principles in respect of specific examples.
8. The DDCR schedules to this Guideline are:
 - Schedule 1 – which covers examples where the DDCR will need to be considered.
 - Schedule 2 – which covers the compliance risks arising from restructures in response to the DDCR. Some restructures in Schedule 2 to this Guideline build on examples in Schedule 1 to this Guideline and Schedules 1 and 2 should be read as complementary in considering whether to restructure your arrangements.
9. The thin capitalisation schedule to this Guideline, as currently published, is:
 - Schedule 4 – which covers the compliance risks arising from restructures in response to the thin capitalisation rules.

¹ The term 'restructure' encompasses any restructure or refinance, including any change, or reorganisation of group structure, business affairs or financial arrangements. Restructure includes any part of a broader restructure or a restructure that is part-way through and yet to be completed.

² The anti-avoidance provisions covered by this Guideline are Part IVA of the *Income Tax Assessment Act 1936 (ITAA 1936)* and the specific anti-avoidance rule (SAAR) in section 820-423D.

9A. A further thin capitalisation schedule to this Guideline, Schedule 3, currently remains in draft form. When finalised, this Schedule will cover a targeted compliance approach for taxpayers seeking to comply with certain aspects of the third party debt test (TPDT).

10. Schedule 4 to this Guideline should be read in conjunction with 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*.

11. You will need to read and apply the schedules in conjunction with the general principles set out in this Guideline.

Summary of changes in the Act

Thin capitalisation changes

12. The Act introduced 3 thin capitalisation tests in Subdivision 820-AA for general class investors. These tests limit the amount of debt deductions of general class investors for an income year. The TPDT also applies to financial entities that are not an authorised deposit-taking institution (ADI)³ in Subdivisions 820-B and 820-C.

13. The 'fixed ratio test' (FRT) disallows debt deductions where net debt deductions exceed 30% of the entity's 'tax EBITDA'. The FRT is the default test unless a choice to apply one of the other tests is made or is deemed to apply.

14. The 'group ratio test' can be used as an alternative to the FRT. This test limits net debt deductions using a ratio of the net interest expense and EBITDA of the worldwide group (of which the entity is a member) based on the worldwide group's audited financial statements.

15. The TPDT limits an entity's gross debt deductions to its 'third party earnings limit'. The third party earnings limit is broadly the sum of each debt deduction attributable to a debt interest issued by the entity that satisfies the third party debt conditions in subsection 820-427A(3). Debt deductions attributable to any other debt interests (such as related party debt) do not count towards the third party earnings limit.⁴

16. Debt deductions disallowed under the FRT over the previous 15 years may be utilised in a later year in certain circumstances, provided the entity continues to apply the FRT.⁵ If an entity chooses to use the group ratio test or TPDT in a future year, the balance of any debt deductions that may be so utilised is reduced to nil.

Debt deduction creation rules

17. The Act introduced the DDCR in Subdivision 820-EAA. The DDCR operates to disallow debt deductions arising on certain related party arrangements.

18. The DDCR applies to 2 types of arrangements.

Type 1 – acquisition case

19. For Type 1 arrangements, the DDCR may disallow debt deductions where an entity (acquirer) acquires a CGT asset or a legal or equitable obligation from one or more associate pairs (each an associate disposer).

³ An ADI entity is a body corporate that is an authorised deposit-taking institution for the purposes of the *Banking Act 1959*.

⁴ Subsection 820-427A(1).

⁵ Section 820-56.

20. Type 1 rules apply to debt deductions of a 'relevant entity', which may be:
- the acquirer
 - an associate pair⁶ of the acquirer (including an associate disposer)
 - an associate pair of an associate disposer.⁷
21. The debt deductions must be:
- wholly or partly in relation to the acquisition or holding of the CGT asset, or legal or equitable obligation⁸
 - referable to an amount paid or payable (directly or indirectly) to an associate pair of the relevant entity, acquirer or an associate disposer.⁹
22. Type 1 rules apply to all acquisitions except acquisitions of:
- membership interests in an Australian entity or foreign company that have not previously been held by any entity¹⁰
 - a depreciating asset (other than an intangible asset) that the acquirer holds immediately after its acquisition and at the time of the acquisition
 - it is reasonable to conclude that the acquirer expects to use the CGT asset for a taxable purpose within Australia within 12 months
 - the CGT asset has not been installed ready for use, or previously used for a taxable purpose, by the acquirer, an associate disposer or an associate pair of the acquirer¹¹
 - debt interests issued by an associate pair of the acquirer that have not previously been held by any entity.¹²
23. Debt deductions are disallowed to the extent that they are incurred in relation to the acquisition or holding of the CGT asset or legal or equitable obligation.¹³

Type 2 – payment or distribution case

24. For Type 2 arrangements, the DDCR may disallow debt deductions where an entity (payer) uses a financial arrangement to fund, or facilitate the funding of, one or more relevant payments or distributions.
25. Type 2 rules apply to one or more payments or distributions that are:
- made to any entity (an associate recipient) that is an associate pair of the payer
 - prescribed payments or distributions.¹⁴
26. The prescribed payments or distributions are a:
- dividend, distribution or non-share distribution

⁶ See paragraph 36 of this Guideline for the definition of 'associate pair'.

⁷ Paragraph 820-423A(2)(c).

⁸ Paragraph 820-423A(2)(d).

⁹ Paragraph 820-423A(2)(e).

¹⁰ Subsection 820-423AA(1).

¹¹ Subsection 820-423AA(2).

¹² Subsection 820-423AA(3).

¹³ Subsection 820-423B(1).

¹⁴ Subparagraphs 820-423A(5)(b)(iii) and (iv).

- distribution by a trustee or partnership
 - return of capital, including a return of capital made by a distribution or payment made by a trustee or partnership
 - payment or distribution in respect of the cancellation or redemption of a membership interest in an entity
 - royalty, or a similar payment or distribution for the use of, or right to use, an asset
 - payment or distribution that is wholly or partly referable to the repayment of principal under a debt interest if both of the following apply
 - the debt interest is issued by the payer, and
 - the debt interest is a financial arrangement that satisfies paragraphs 820-423A(5)(a), (b) and (c)
 - payment or distribution of a kind similar to a payment or distribution mentioned in the list points in this paragraph
 - payment or distribution prescribed by the regulations.¹⁵
27. Type 2 rules apply to debt deductions of a 'relevant entity', which may be:
- the payer
 - an associate pair of the payer (including an associate recipient)
 - an associate pair of an associate recipient.¹⁶
28. The debt deductions must be:
- wholly or partly in relation to the financial arrangement¹⁷
 - referable to an amount paid or payable (directly or indirectly) to an associate pair of the relevant entity, payer or an associate recipient.¹⁸
29. Debt deductions are disallowed to the same extent that the financial arrangement was used to fund, or facilitate the funding of, one or more prescribed payments or distributions made to an associate recipient.¹⁹

Third party debt test choice

30. Both Type 1 and Type 2 cases do not apply if the relevant entity has made a choice under subsection 820-46(4) to use the TPDT for the income year.²⁰

Indirect Type 1 and Type 2 arrangements

31. Type 1 and Type 2 cases also apply to indirect arrangements.²¹

32. In the case of Type 1 arrangements, the DDCR may apply in relation to an indirect acquisition by an entity through one or more interposed entities.²² In determining whether

¹⁵ Subsection 820-423A(5A).

¹⁶ Paragraph 820-423A(5)(c).

¹⁷ Paragraph 820-423A(2)(d).

¹⁸ Paragraph 820-423A(2)(e).

¹⁹ Subsection 820-423B(2).

²⁰ Paragraphs 820-423A(2)(g) and 820-423A(5)(f).

²¹ Paragraph 820-423A(2)(a), subsections 820-423A(3A) and (6).

²² Paragraph 820-423A(3A)(a).

an acquisition occurs indirectly through one or more interposed entities, it is sufficient if acquisitions exist between each entity and it is not necessary that these occur in series.

33. A Type 1 indirect acquisition through one or more interposed entities may occur even if an acquisition in the series is covered by the exceptions in section 820-423AA.

34. In the case of Type 2 arrangements, the relevant prescribed payments of distributions may be made directly, or indirectly through one or more interposed entities before, at, or after the time the relevant payer enters into or has the financial arrangement which funds or facilitated the funding of those payments or distributions. The recipient may be the entity that the payer has the financial arrangement with, or another entity.²³

35. 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, and 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.²⁴

Associate pairs

36. An entity is an associate pair of another entity if either or both of the following conditions are met:

- the entity is an associate of the other entity, or
- the other entity is an associate of the entity.²⁵

Section 820-37 and the debt deduction creation rules

37. An entity that satisfies section 820-37 will still need to apply the DDCR.

38. Section 820-37 generally operates so that the thin capitalisation rules will not apply to an entity for an income year if that entity meets the assets threshold (known as the 90% Australian assets threshold).

39. Section 820-37 only applies to:

- outward investing financial entities (non-ADI) and outward investing entities (ADI) that are not also an inward investing financial entity (non-ADI) or inward investing entity (ADI)
- general class investors that would meet the above condition (if they were financial entities).

Application of the debt deduction creation rules

40. The DDCR applies to assessments for income years that commence on or after 1 July 2024.

41. Accordingly, the DDCR applies in relation to:

- arrangements entered into before 1 July 2024 if debt deductions continue to arise from the historical arrangements in income years commencing on or after 1 July 2024
- new arrangements entered into on or after 1 July 2024.

²³ Paragraphs 820-423A(6)(a) and (b).

²⁴ Paragraphs 820-423A(7)(a) and (b).

²⁵ Subsection 995-1(1).

Specific anti-avoidance rule in section 820-423D

42. Section 820-423D contains the DDCR specific anti-avoidance rule (SAAR) which directly targets schemes entered into to avoid the operation of the DDCR. For the DDCR SAAR to apply, the following criteria must be satisfied:

- it is reasonable to conclude that one or more entities 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 any of the following results
 - subsection 820-423A(2) does not apply in relation to a debt deduction
 - subsection 820-423A(5) does not apply in relation to a debt deduction(whether or not the debt deduction is a debt deduction of any of the participants and whether or not any of them carried out the scheme or any part of the scheme), and
- the scheme has achieved, or apart from this section would achieve, that purpose.

43. Paragraphs 1.43 and 1.44 of the Supplementary Explanatory Memorandum to the Treasury Laws Amendment (Making Multinationals Pay Their Fair Share—Integrity and Transparency) Bill 2023 relevantly state the following regarding the intended operation of section 820-423D:

1.43 Schemes that seek to exploit the related party debt deduction condition to artificially locate or 'debt-dump' third-party debt in Australia will be subject to the anti-avoidance rules in section 820-423D and Part IVA of the [Income Tax Assessment Act 1936]. For example, such schemes may involve third party debt (and the associated debt deductions) being located in Australia, whilst the proceeds of the debt are ultimately used for business activities outside Australia. Such schemes may have a sophisticated commercial guise or may be embedded into genuine commercial activity.

1.44 The anti-avoidance rules in section 820-423D may also apply to any avoidance schemes relating to the debt deduction creation rules. However, these rules are not intended to apply to schemes where a taxpayer is merely restructuring, without any associated artificiality or contrivance, out of an arrangement that would otherwise be caught by the debt deduction creation rules. The application of section 820-423D will ultimately depend on the facts and circumstances of each case.

Date of effect

44. This Guideline applies to restructures entered into on or after 22 June 2023 (the date the Act was introduced into parliament).

Compliance approach

45. It is recognised that the Act will result in different tax outcomes compared to those under the previous thin capitalisation rules. We expect taxpayers will need to consider the impact of these changes on their affairs and whether it is appropriate to restructure their arrangements that give rise to debt deductions.

46. This Guideline sets out our compliance approach to restructures by providing a risk assessment framework. You can assess the risks associated with restructuring in response to the Act in accordance with this Guideline.

47. By following this Guideline, you can understand the compliance risks associated with restructures being contemplated or already undertaken. If your restructures are low risk, you can have confidence that we will not have cause to allocate resources to intensive examinations beyond verifying your self-assessment. Similarly, it provides certainty on areas of higher compliance risk that are likely to result in further and more intensive examinations.

48. As our engagement with affected taxpayers and our compliance activity increases with our implementation of the Act, this Guideline may be updated. We will consult on any proposed material changes.

Risk assessment framework

49. Where taxpayers restructure in response to the Act, we will also consider the application of the DDCR SAAR or Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) (concurrently with other provisions of the income tax law).

50. This risk assessment framework is designed to explain how to assess the compliance risks of your restructuring with respect to the Act. This risk assessment framework applies as follows:

- If you have undertaken a restructure in response to the DDCR, apply this risk assessment framework in conjunction with Schedule 2 to this Guideline.
- If you have undertaken a restructure in response to the thin capitalisation rules, apply this risk assessment framework in conjunction with Schedule 4 to this Guideline.
- If you have not undertaken a restructure in response to the Act in an income year, this risk assessment framework does not apply to you.

51. Your risk rating will influence our engagements with you, including the intensity of assurance activities or whether we are likely to engage with you to review your restructure. We generally prioritise our resources and undertake more intensive investigations to address higher risk restructuring.

Table 1: Risk assessment framework

Risk zone	Risk level
White	Further risk assessment not required
Yellow	Compliance risk not assessed
Green	Low risk
Red	High risk

52. As we continue to implement the Act, we expect to revisit these zones to ensure that they continue to be an accurate reflection of our understanding of the risks associated with such restructures. We will consult on any proposed material changes.

White zone

53. You are in the white zone if all of your restructures in response to the Act are in the following categories.

- There is a settlement agreement between you and the ATO entered into since enactment of the Act on 8 April 2024, where the terms of the

settlement cover the Australian tax outcomes, including under the Act, related to the arrangement for the current year, and you have met the conditions of the agreement.

- There is a court decision in relation to the Australian tax outcomes of the arrangement, including under the Act, where you were a party to the proceeding.
- We have conducted a review or audit of your restructure and provided you with a 'low-risk' rating (or 'high assurance' under a Justified Trust review).

54. Your restructure will be in the white zone as long as there has not been a material change in the arrangement since the time of the agreement or decision, or the circumstances which informed the basis of our risk or assurance rating in the review or audit.

55. Your restructure will also be in the white zone for an income year if section 820-35 applies to you (that is, Division 820 does not apply to you as the total debt deductions of you and all your associate entities for that year are \$2 million or less). This '*de minimis*' provision also corresponds with reduced ATO reporting obligations (for example, in the International Dealings Schedule).

56. If your restructure is in the white zone, you do not need to apply the risk assessment framework. We will not have cause to apply compliance resources beyond verifying that you can substantiate that the conditions for the white zone have been met.

57. It is not anticipated that many taxpayers will have restructures in the white zone early in the implementation of the Act.

Yellow zone

58. You are in the yellow zone if you have undertaken one or more restructures (including any part of a restructure) in response to the Act in the income year that are not in the green or red zones. That is, restructures that are not covered by examples in Schedules 2 and 4 to this Guideline.

59. If your restructure is in the yellow zone, we may engage with you to understand the compliance risks of your restructure.

Green zone

60. You are in the green zone if all of your restructures in response to the Act in the income year are:

- covered by low-risk examples in Schedules 2 or 4 to this Guideline, and
- exhibit the features set out in paragraph 202 of this Guideline.

61. If your restructure is in the green zone, we will generally only have cause to devote our compliance resources to tax risks in scope of this Guideline to obtain comfort and verify your self-assessment.

Red zone

62. You are in the red zone if any of your restructures in response to the Act are in the following categories:

- Your restructure (including any part of a restructure) in response to the Act in the income year is covered by a high-risk example in Schedules 2 and 4 to this Guideline.
- We have conducted a review or audit of your restructure and provided you with a 'high risk' rating (or 'low assurance' under a Justified Trust review).

63. If your restructure is in the red zone, we will prioritise our resources to review your arrangement. This may involve commencing a review or audit. The red zone is a reflection of the features that we consider indicate greater risk, however, it is not a presumption that the DDCR SAAR or Part IVA of the ITAA 1936 necessarily apply.

64. We will generally tell you if we intend to commence an examination involving the DDCR SAAR or Part IVA of the ITAA 1936. As part of our examination, we will consider information available to us and may request further information from you. We will have regard to the relevant facts and circumstances, including evidence in relation to contended commercial or non-tax rationales, when we review your restructure.

Reporting your self-assessment

65. It is generally voluntary to apply this Guideline to assess your restructures, although doing so is best practice. If you do not apply this Guideline, we may apply resources to understand your arrangements consistent with the red zone.

66. You may be required to report your risk rating. For example, you may have disclosure requirements if you are required to complete a reportable tax position schedule.

Commissioner of Taxation

20 August 2025

SCHEDULE 1 – Debt deduction creation rules

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Scope of this Schedule

67. The DDCR applies to debt deductions arising in income years starting on or after 1 July 2024, regardless of whether those debt deductions are connected to arrangements arising prior to, or after, the start of such an income year.

68. This Schedule provides you with guidance on:

- examples where the DDCR will need to be considered
- records and evidence relevant to such considerations, including tracing and apportionment of funds.

69. The examples in this Schedule provide guidance to assist taxpayers considering whether to restructure. The examples do not consider the DDCR SAAR or any other provision.

70. Schedule 2 to this Guideline provides examples of restructures in response to the DDCR, some of which build on the examples in this Schedule.

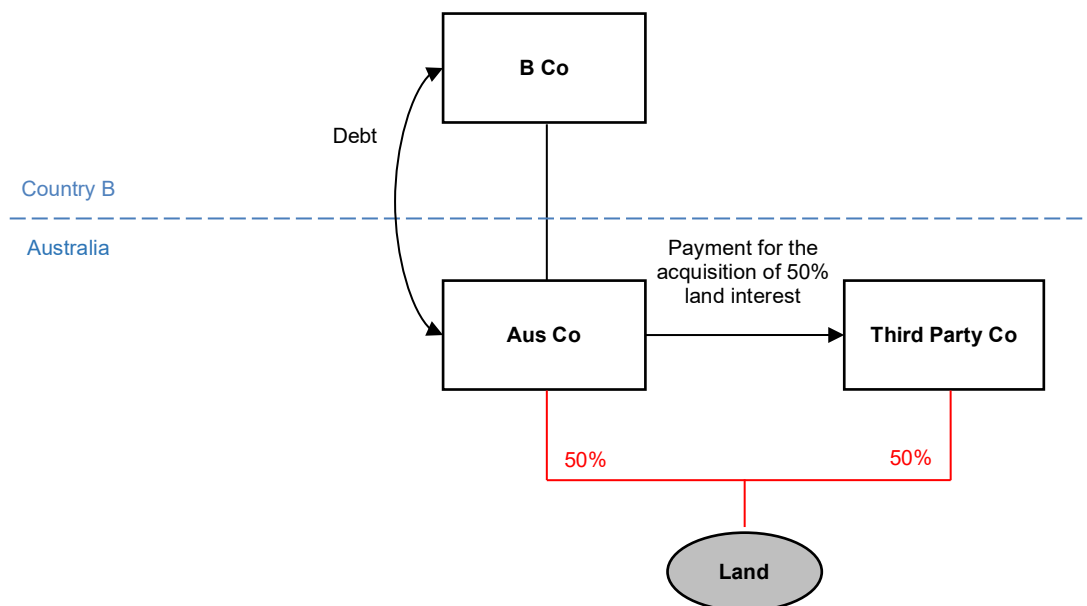
Examples where the debt deduction creation rules will need to be considered

71. The DDCR will need to be considered in the following examples. In each example, information and documentation would need to be obtained where the taxpayer wants to determine if the DDCR (and whether an exception in section 820-423AA) applies to the arrangement.

72. If the DDCR needs to be considered, in the course of compliance activity we would ordinarily expect to have cause to allocate resources to ensure that the correct amount of debt deductions were disallowed.

Example 1 – timing and the ‘associate pairs’ conditions

Diagram 1: Timing and the ‘associate pairs’ conditions



73. *Aus Co is an Australian tax resident and general class investor wholly owned by B Co, which is a tax resident of Country B.*

74. *Aus Co acquires a 50% interest in land from Third Party Co, an unrelated Australian company. Aus Co borrows from B Co to fund the acquisition of its 50% interest in the land.*

75. *Aus Co and Third Party Co hold their respective shares in the land as tenants in common.*

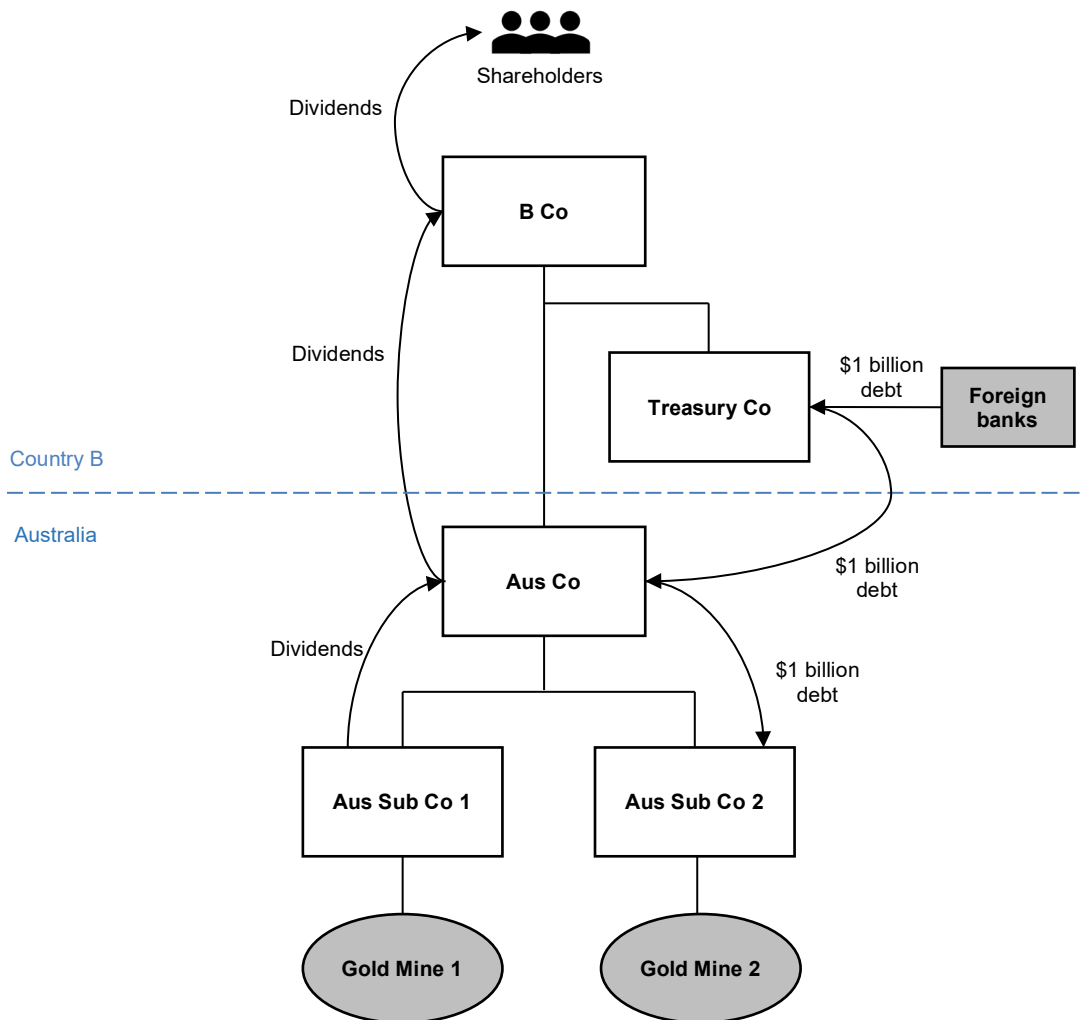
76. Aus Co and Third Party Co subsequently enter into a joint venture arrangement to develop the land for residential purposes. Aus Co and Third Party Co become associate pairs.

77. Aus Co will not need to consider the application of the DDCR for this arrangement as Aus Co and Third Party Co were not associate pairs at the time Aus Co acquired its interest in the land from Third Party Co. We are unlikely to apply compliance resources in this example.

78. There is no need to test at a later point in time unless there are factors indicating contrivance or artificiality in relation to the timing of entering into the acquisition or the borrowing.

Example 2 – funding capital expenditure with related party debt

Diagram 2: Funding capital expenditure with related party debt



79. Aus Co is an Australian tax resident and general class investor that is a holding company with 2 Australian subsidiaries (Aus Sub Co 1 and Aus Sub Co 2).

80. Aus Co is a subsidiary of B Co, a multinational enterprise which is tax resident in Country B.

81. *Aus Sub Co 1 owns and operates a gold mine in Australia (Gold Mine 1). It does not have any borrowings and regularly pays dividends to Aus Co from its retained earnings. In turn, Aus Co regularly pays dividends to B Co.*

82. *The board of B Co resolves to use Aus Sub Co 2 to mine gold in Australia from a separate mining lease (Gold Mine 2) recently acquired from an unrelated third party.*

83. *Aus Sub Co 2 does not carry on any other business.*

84. *B Co's subsidiary, Treasury Co, which is resident in Country B, issues \$1 billion of interest-bearing debt interests to foreign banks for the specific purpose of funding Gold Mine 2's development. The borrowed funds are lent through Aus Co to Aus Sub Co 2 on back-to-back terms. Aus Co has no other borrowings.*

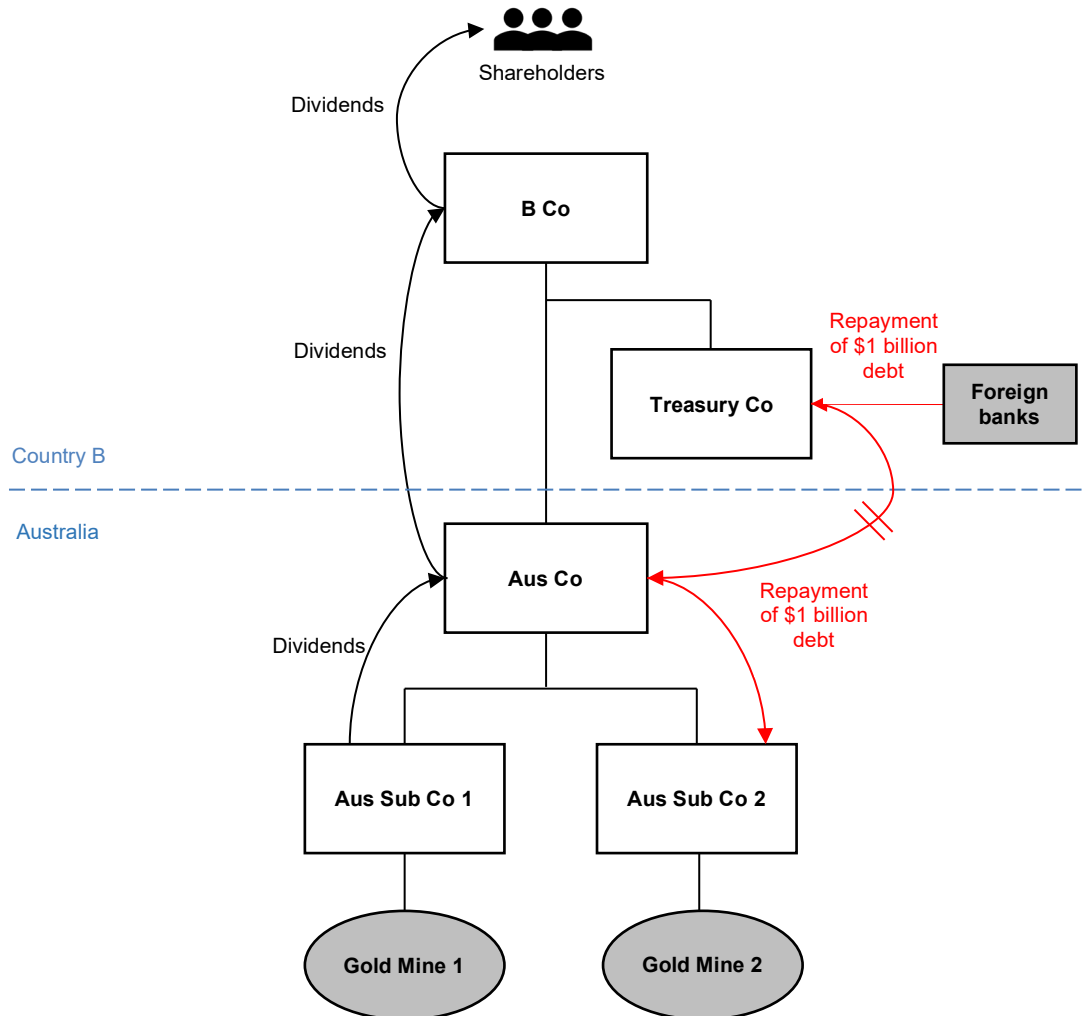
85. *While Gold Mine 2 is in development:*

- *Aus Sub Co 2 does not pay dividends to Aus Co.*
- *Aus Sub Co 1 continues to pay regular dividends to Aus Co from its retained earnings and in turn Aus Co continues to pay regular dividends of a similar amount to B Co.*

86. *Aus Co will not need to consider the application of the DDCR while Gold Mine 2 is in development, as Aus Co's borrowings are not used to fund or facilitate the funding of any dividends. We are unlikely to apply compliance resources while Gold Mine 2 is in development to determine the application of the DDCR.*

Example 3 – funding capital expenditure with related party debt

Diagram 3: Funding capital expenditure with related party debt



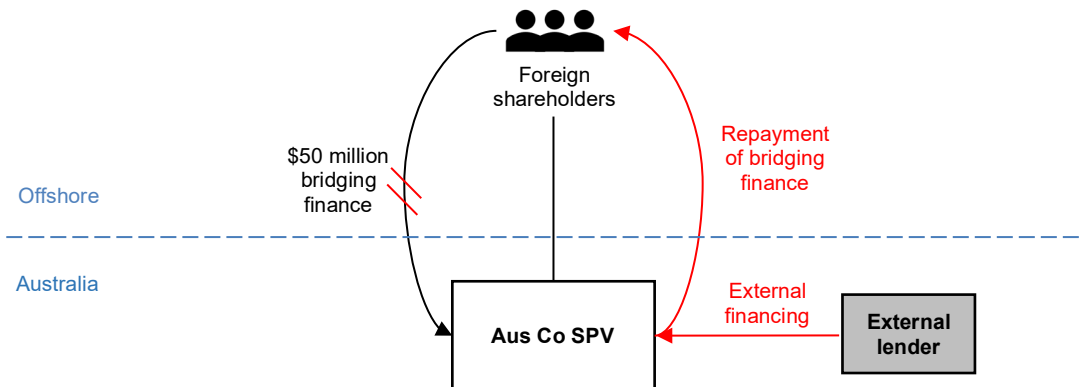
87. Assume the same facts as Example 2 of this Guideline.

88. Once Gold Mine 2 has completed development and begins to generate assessable income, Aus Sub Co 2 begins to pay down the \$1 billion debt using the proceeds of the operations in accordance with the principal and interest repayment conditions in the external borrowings (that is, on back-to-back terms).

89. We are unlikely to apply compliance resources to determine the application of the DDCR after Gold Mine 2 has completed development if the debt is being paid down using the cash generated by the operations.

Example 4 – bridging finance

Diagram 4: Bridging finance



90. Aus Co SPV is an Australian-incorporated entity and general class investor. It is commencing a new project in Australia for which capital expenditure is forecast to be approximately \$300 million.

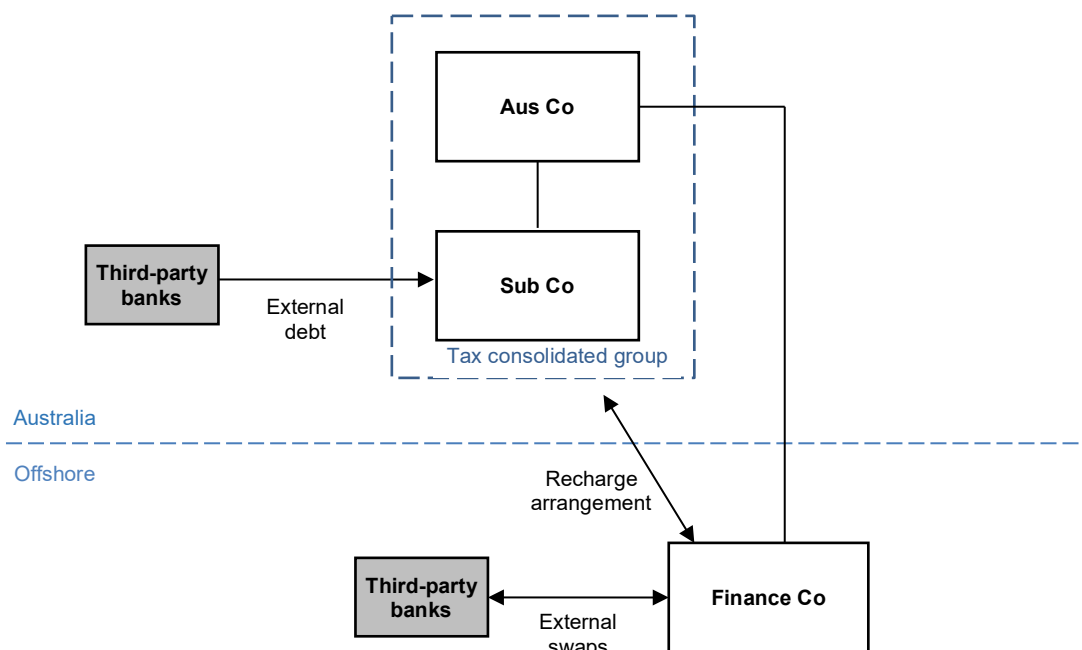
91. Due to commercial issues causing delays in external funding, \$50 million bridging finance is obtained from the SPV's shareholders to make initial capital acquisitions. None of the initial capital acquisitions are covered by subsection 820-423A(2).

92. Once external finance is obtained, Aus Co SPV repays the \$50 million shareholder bridging finance with the proceeds of the external financing.

93. Aus Co will not need to consider the DDCR as no related party debt deductions arise in relation to acquisitions from associate pairs. We are unlikely to apply compliance resources in this example to determine the application of the DDCR.

Example 5 – related party transactions to recharge outcomes arising from swaps

Diagram 5: Related party transactions to recharge outcomes arising from swaps



94. Aus Co is a general class investor and the head company of an Australian tax consolidated group. The group raises debt financing by issuing debt interests to third-party banks to fund its commercial activities (which does not include any acquisitions from associate pairs or payments to associate pairs).

95. The bank debt is denominated in various currencies at fixed rates. To manage the associated interest rate and exchange rate risks, the group enters into interest rate swaps (IRS) and cross currency interest rate swaps when it issues the debt interests to the third-party banks in order to convert the group's fixed interest rate exposure under the debt to floating United States dollar interest rate exposure.

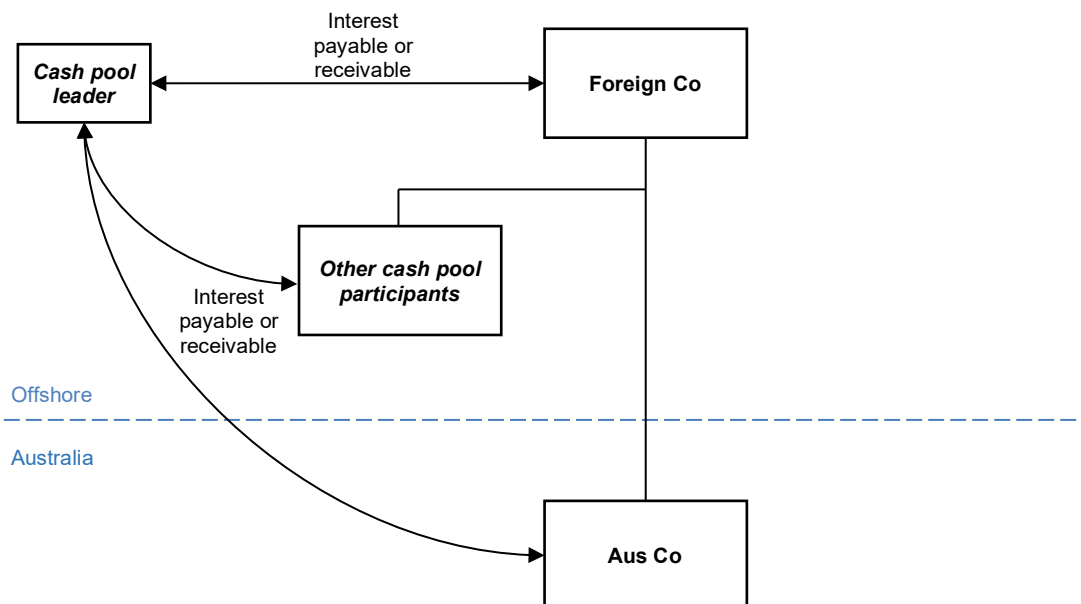
96. A related party (not within the tax consolidated group), Finance Co, undertakes all swap transactions for the group. It executes the swaps under International Swaps and Derivates Association agreements with third-party banks.

97. When entering into these swaps, Finance Co and Aus Co also enter into internal arrangements which recharge or pass through the actual costs and payments of the external bank swaps to Aus Co which effectively hedge the bank debt. The recharge costs are debt deductions.

98. Aus Co will not need to consider the DDCR for this arrangement as the debt deductions in relation to the recharge arrangement are not in relation to a transaction with an associate pair. We are unlikely to apply compliance resources in this example to determine the application of the DDCR.

Example 6 – cash pooling

Diagram 6: Cash pooling



99. Aus Co is an Australian company with a foreign parent, Foreign Co.

100. Foreign Co operates a global cash pooling arrangement with numerous offshore cash pool participants and an offshore cash pool leader. The cash pool leader is an associate pair of Foreign Co and Aus Co. The arrangement requires all accounts to be nil, with positive balances transferred (or 'swept') to the cash pool leader and negative balances replenished by the cash pool leader daily.

101. *If a participant has its cash swept to the offshore cash pool leader, the leader pays interest on the balance owed to the participant at a rate determined under the arrangement.*

102. *If a participant is transferred an amount from the offshore cash pool leader in order to make its account balance nil, unless any amount is owed by the leader, the participant pays interest on the balance owed to the leader.*

103. *Aus Co has no other borrowings.*

104. *Aus Co uses its cash pool account to acquire CGT assets from associate pairs and to fund dividends, royalties and returns of capital to associate pairs.*

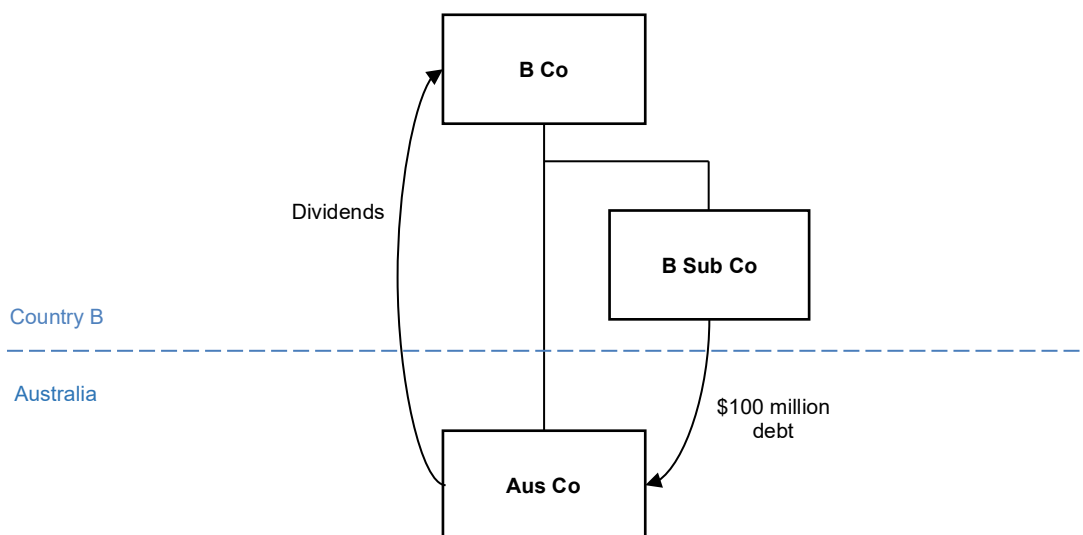
105. *Throughout the 2024–25 income year, Aus Co’s cash pool balance always remains positive. In the 2025–26 income year, Aus Co’s balance fluctuates between negative and positive.*

106. *Aus Co does not need to consider the application of the DDCR in relation to the 2024–25 income year as Aus Co’s cash pooling account did not give rise to debt deductions and we are unlikely to apply compliance resources in this example.*

107. *However, Aus Co does need to consider the application of the DDCR to the debt deductions arising in the 2025–26 income year and we are likely to consider applying compliance resources to verify the correct application of the DDCR for this year.*

Example 7 – funding working capital and dividends with related party debt

Diagram 7: Funding working capital and dividends with related party debt



108. *Aus Co is an Australian tax resident and a subsidiary of B Co, a multinational enterprise which is tax resident in Country B. B Co runs a global motor vehicle sales business.*

109. *Aus Co carries on the multinational enterprise’s business operations in Australia. It regularly pays dividends to B Co out of cash generated from the sales of motor vehicles to Australian customers.*

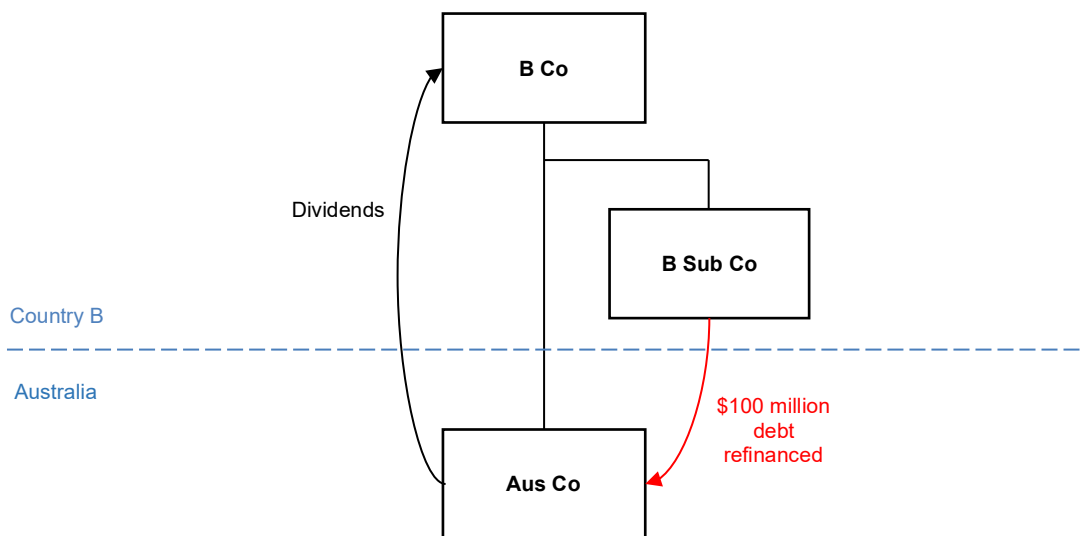
110. *In a particular year, Australian cash reserves are not sufficient for Aus Co to fund dividends and its continuing operations.*

111. *Aus Co issues a \$100 million debt interest to B Sub Co, a subsidiary of B Co which is tax resident in Country B. The funds raised under the debt interest are used by Aus Co to pay a dividend to B Co and to fund its commercial operations.*

112. *Aus Co will need to consider the application of the DDCR for the extent to which the financial arrangement funded or facilitated the funding of the dividends to B Co. We are likely to consider applying compliance resources to determine the correct application of the DDCR.*

Example 8 – funding working capital and dividends with related party debt

Diagram 8: Funding working capital and dividends with related party debt



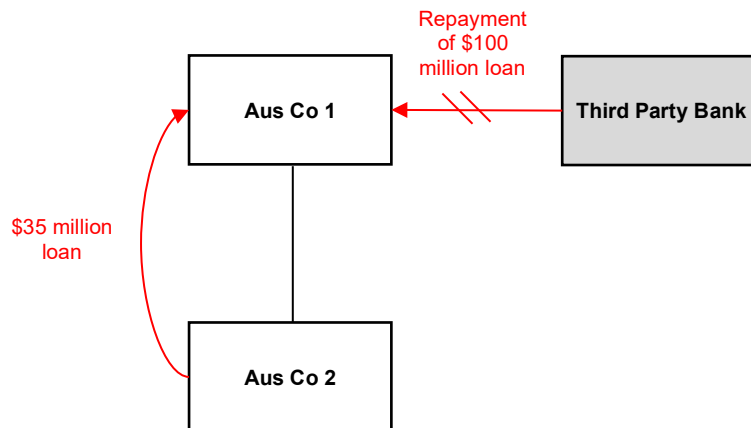
113. *Assume the same facts as Example 7 of this Guideline.*

114. *Once the \$100 million debt interest is due to expire, Aus Co and B Sub Co decide to refinance the debt interest for \$100 million for a further 9 years.*

115. *Aus Co will need to consider the application of the DDCR to the refinanced loan for the extent it refinanced a financial arrangement which funded or facilitated the funding of the dividend to B Co in Example 7 of this Guideline. We are likely to consider applying compliance resources to determine the correct application of the DDCR.*

Example 9 – refinancing third-party debt

Diagram 9: Refinancing third-party debt



116. *Aus Co 1 and Aus Co 2 are both Australian-incorporated entities and general class investors. They are also associate pairs.*

117. *In 2020, Aus Co 1 borrows \$100 million from Third Party bank. The loan is used for multiple purposes, including the acquisition of existing shares in an associate pair for \$40 million.*

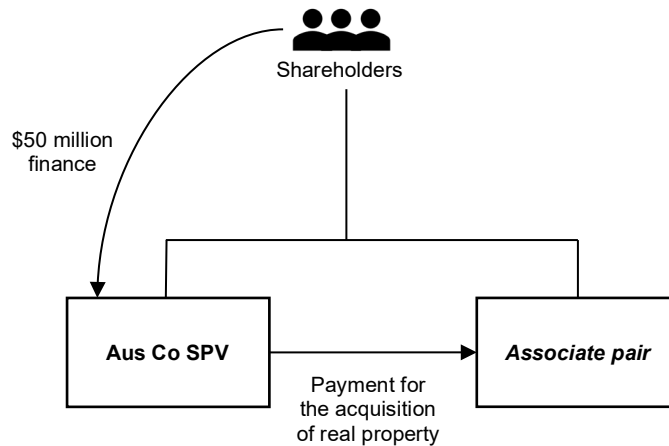
118. *In 2024, the loan is due to expire and has a remaining balance of \$35 million owing.*

119. *Aus Co 1 chooses to refinance the debt by borrowing from associate pair Aus Co 2 for \$35 million.*

120. *Aus Co 1 will need to consider the application of the DDCR to the related party loan. Aus Co 1's debt deductions will be disallowed to the extent they trace to the Type 1 acquisition, being the \$40 million acquisition of shares in Aus Co 2. We are likely to consider applying compliance resources to determine the correct application of the DDCR.*

Example 10 – related party financing of related party acquisition

Diagram 10: Related party financing of related party acquisition



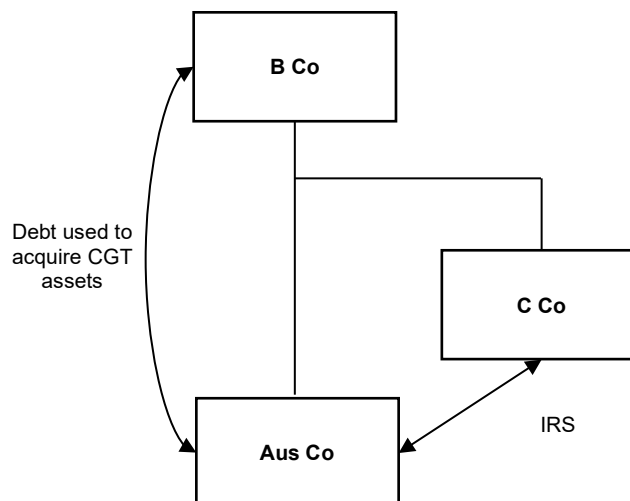
121. *Aus Co SPV is an Australian-incorporated entity and general class investor. It commences a new property project in Australia and acquires real property from an associate pair for approximately \$300 million.*

122. *Debt interests of \$50 million in total are issued by Aus Co SPV to SPV’s shareholders which are an associate pair in relation to Aus Co SPV.*

123. *Aus Co SPV will need to consider the application of the DDCR to debt deductions arising in relation to the \$50 million associate pair financing. We are likely to consider applying compliance resources to determine the correct application of the DDCR.*

Example 11 – debt deductions in relation to an acquisition from an associate pair

Diagram 11: Debt deductions in relation to an acquisition from an associate pair



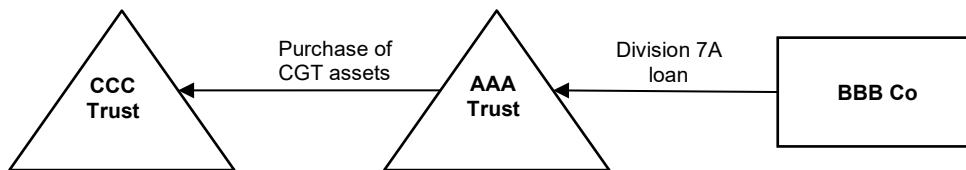
124. *Aus Co is an Australian tax resident and general class investor.*

125. *Aus Co acquires a CGT asset directly from B Co (an associate pair). The acquisition is not covered by section 820-423AA.*

126. *Aus Co finances the acquisition with an interest-bearing loan from B Co of \$100 million.*
127. *In order to swap its exposure to interest rate risk in relation to the loan, Aus Co enters into an IRS with another associate pair, C Co.*
128. *Aus Co would need to consider the application of the DDCR to the debt deductions in relation to the loan and the interest rate swap. We are likely to consider applying compliance resources to determine the correct application of the DDCR.*

Example 12 – acquisition from a related trust

Diagram 12: Acquisition from a related trust

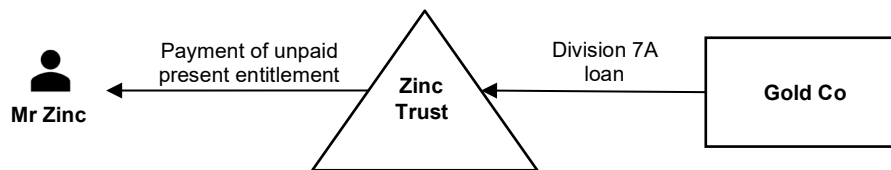


129. *AAA Trust is a general class investor and is part of a privately owned group which predominantly carries on business in Australia. AAA Trust, together with its associates, has more than \$2 million in debt deductions in a single income year.*
130. *BBB Co is a private company that holds a significant amount of funds in the group.*
131. *CCC Trust is a trust that holds a CGT asset.*
132. *AAA Trust, BBB Co and CCC Trust are part of a privately owned group and are associate pairs of each other.*
133. *In the 2024–25 income year, the trustee of the AAA Trust acquires the CGT asset held by CCC Trust to be used in its business.*
134. *AAA Trust does not have sufficient working capital to both acquire the CGT asset and fund its business operations.*
135. *The trustee of AAA Trust and BBB Co enters into a Division 7A (of the ITAA 1936) complying loan agreement²⁶ under which the trustee borrows an amount from BBB Co equal to the amount of the CGT asset's purchase price (Division 7A complying loan). The loan agreement stipulates that the trustee of AAA Trust must make minimum yearly repayments to BBB Co, and the rate of interest payable on the loan is equal to the benchmark interest rate for each year.*
136. *The trustee of AAA trust pays the CCC Trust the purchase price for the CGT asset using the funds provided under the Division 7A complying loan for the CGT asset acquired.*
137. *The trustee of AAA trust will need to consider the application of the DDCR to the debt deductions arising in relation to the acquisition from CCC Trust. We are likely to consider applying compliance resources to determine the correct application of the DDCR.*

²⁶ 'Complying loan agreement' refers to a written agreement which meets the minimum interest rate and maximum loan term. See section 109N of the ITAA 1936.

Example 13 – loan funding distribution by trustee

Diagram 13: Loan funding distribution by trustee



138. *Zinc Trust is a discretionary trust and a general class investor that, together with its associates, has more than \$2 million in debt deductions.*

139. *Mr Zinc is the appointor and primary beneficiary of Zinc Trust.*

140. *Gold Co is a private company of which Mr Zinc is the sole director and shareholder.*

141. *The 2 entities are part of a privately owned group and are associate pairs of each other.*

142. *In the 2021–22 income year, the trustee of Zinc Trust makes Mr Zinc presently entitled to 100% of the trust income. Mr Zinc agrees for the trustee to retain the amount to which his present entitlement relates in Zinc Trust as working capital.*

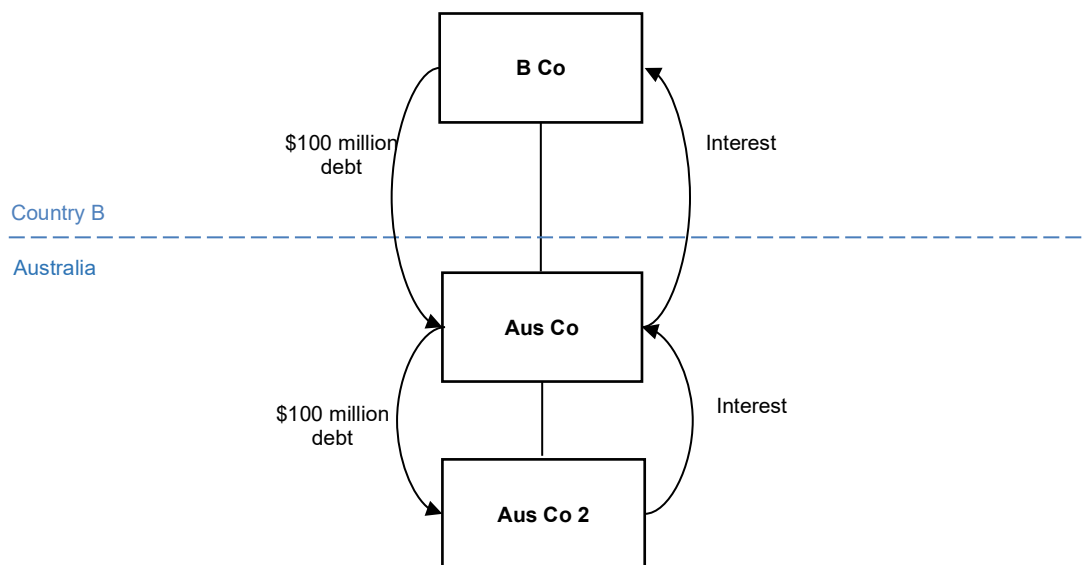
143. *On 30 June 2023, Mr Zinc calls for payment of his unpaid present entitlement (UPE). After reviewing the financial affairs of the Zinc Trust, the trustee decides to refinance the amount contributed by Mr Zinc by borrowing the same amount from Gold Co rather than reducing the working capital of the business. The loan is structured in accordance with Division 7A of the ITAA 1936 complying terms. The rate of interest payable on the loan from Gold Co is equal to the benchmark interest rate for each year.*

144. *The trustee uses the amount borrowed from Gold Co to pay off Mr Zinc's UPE.*

145. *The trustee will need to consider the application of the DDCR to Zinc Trust's debt deductions arising in relation to the borrowing from Gold Co used to fund or facilitate the funding of the payment of Mr Zinc's UPE. We are likely to consider applying compliance resources to determine the correct application of the DDCR.*

Example 14 – related party lending between multinational subsidiaries

Diagram 14: Related party lending between multinational subsidiaries



146. *Aus Co is an Australian tax resident and general class investor, wholly owned by B Co, a tax resident of Country B. Aus Co issued a \$100 million debt interest to B Co.*

147. *Using the proceeds of the debt interest, Aus Co acquires a \$100 million debt interest from Aus Co 2, another wholly owned subsidiary of B Co and Australian tax resident. No other entity has previously held the debt interest.*

148. *Aus Co 2 uses the proceeds to acquire CGT assets from unrelated entities in the ordinary course of its commercial operations.*

149. *Aus Co and Aus Co 2 will not need to consider the application of the DDCR for this arrangement as no related party debt deductions arise in relation to transactions with associate pairs other than the debt interests that are covered by the exception in subsection 820-423AA(3). We are unlikely to apply compliance resources in this example.*

150. *Aus Co and Aus Co 2 will need to consider the application of the DDCR to their respective debt deductions in relation to any other transactions Aus Co 2 enters with associate pairs, including whether those transactions were indirectly made by Aus Co. Where such transactions occur, we are likely to consider applying compliance resources to determine the correct application of the DDCR.*

Debt deduction creation rules records and evidence

151. The DDCR requires taxpayers to trace the use of debt funding transactions that are covered by subsections 820-423A(2) and (5), including both direct and indirect transactions.

152. In order to determine whether the DDCR has application to your arrangements, you and your associate pairs will need to obtain sufficient information to trace the use of related party debt and whether it funds transactions that are covered by subsections 820-423A(2) and (5), including both direct and indirect transactions. For example, the information should be sufficient to establish whether an arrangement has the characteristics of the examples in Schedules 1 and 2 to this Guideline.

Historical transactions

153. Stakeholders have raised practical concerns when seeking to comply with the DDCR where business records about historical transactions and related party debt may be limited.

154. We recognise that it can be challenging to obtain relevant documents and information to evidence or substantiate use of related party debt funding for historical transactions.

155. However, the onus is on the taxpayer to prove that the DDCR does not apply and you can prove this through the provision of information and documentation to us.

156. We anticipate that the following documents and information may assist taxpayers to demonstrate whether the DDCR applies to debt deductions in relation to your historical transactions:

- copies of loan documentation prepared when the related party debt was entered into or dealt with (for example, intercompany loan agreements or other documents setting out the purpose of the loan and key terms)
- copies of the taxpayer's and relevant associate pair's financial accounts for the relevant years, prepared in accordance with accounting principles, and any records or working papers prepared by the taxpayer or their professional advisers, for example, accounting or tax working papers
- copies of cash flow statements, general ledger, journals or other records or working papers with identifiable entries relating to historical transactions and related party debt
- copies of bank statements or payment records
- copies of board minutes, resolutions and papers, or any other contemporaneous documentation relating to the decisions to undertake historical transactions or enter into related party debt.

157. Stakeholders have requested that we do not allocate compliance resources to ongoing related party funding of historical transactions that occurred before a certain period (for example, more than 5 years before enactment). We do not consider such an approach is available and appropriate. We will assist taxpayers seeking to comply with the DDCR.

158. All information and documentation provided to us should be in English or be accompanied with an English translation.

159. In the course of our compliance activities, we may request the documents mentioned in paragraph 156 of this Guideline or similar information from you as evidence of relevant tracing.

160. Where the onus to prove that the DDCR does not apply to you is not discharged, we may have cause to apply compliance resources to determine whether the correct amount of debt deductions have been disallowed under subsection 820-423A(1).

Transactions since enactment

161. Since the enactment of the DDCR, best practice record-keeping practices have changed. We would expect taxpayers to keep contemporaneous documentation and associated analysis on the operation of the DDCR (including evidentiary support for tracing the use of funds).

162. We also expect associate pairs to provide taxpayers with full disclosure of all relevant information to work out whether the DDCR applies to debt deductions in relation to transactions covered by subsections 820-423A(2) and (5), including for indirect arrangements.

163. A deduction should not be claimed unless sufficient information is available to support a conclusion that the DDCR does not apply.

Tracing of funds and apportionment

164. Stakeholders have requested guidance on methodologies to trace and apportion the disallowance of debt deductions under subsection 820-423A(1).

Tracing of funds

165. We consider that tracing is a factual exercise and should be the method used to determine the disallowed debt deduction under subsection 820-423A(1) wherever possible.

Apportionment

166. Apportionment does not replace tracing. However, apportionment may be appropriate where it is not possible to trace, such as where funds from various sources that were used for different purposes were combined into a single debt interest.

167. Whether an apportionment methodology is appropriate will depend on whether it is fair and reasonable in the relevant facts and circumstances.

168. An example of fair and reasonable apportionment is where the debt deductions under a facility are disallowed in the same proportion of the 'DDCR debt' to total debt in circumstances where related party debt that funded transactions covered by subsections 820-423A(2) or (5) is refinanced into a single related party debt facility that also includes debt in relation to other purposes. This includes any repayments of principal and capitalisation of interest.

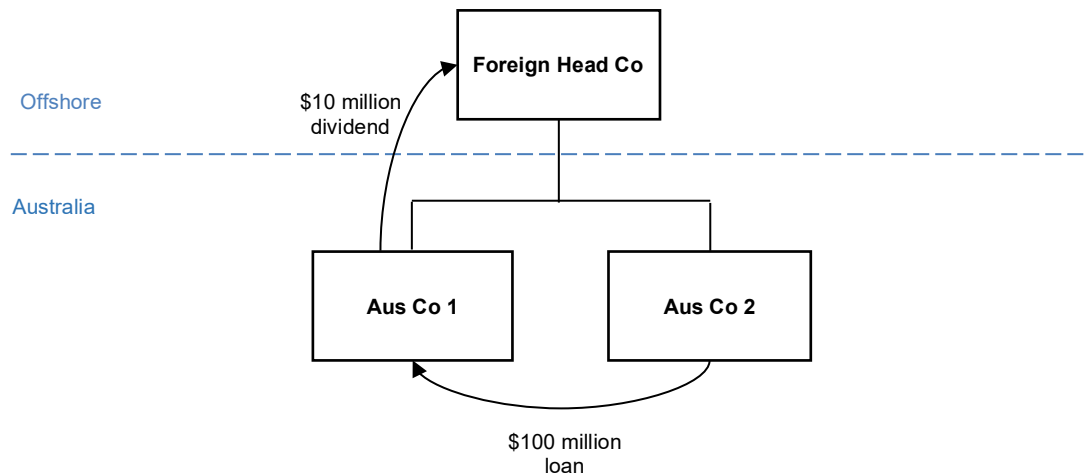
169. We are aware of potential methodologies, including:

- methodologies that rely on a hypothesis of what may instead have occurred had the DDCR been in operation at the time
- methodologies that allocate historical principal repayments (including those made prior to the enactment of the DDCR) to any debt or part of a debt that may give rise to disallowance under the DDCR, and allocating principal repayments to other debt after the DDCR debt portion has first been treated as repaid without contemporaneous documentation to support that allocation.

170. We do not consider such approaches are designed to provide a fair and reasonable apportionment as they do not reflect the facts and circumstances of taxpayers' affairs. We would apply compliance resources to investigate any such apportionment approach.

Example 15 – fair and reasonable identification of disallowed debt deductions

Diagram 15: Fair and reasonable identification of disallowed debt deductions



171. *Aus Co 1 is an Australian tax resident and general class investor. It is wholly owned by Foreign Head Co.*

172. *Aus Co 1 has a \$100 million historical loan from a related party, Aus Co 2. Aus Co 1's information and documents indicate the loan refinanced 2 prior loans from associate pairs, a \$90 million borrowing used to acquire real property from a third party and a \$10 million borrowing used to fund a dividend to Foreign Head Co.*

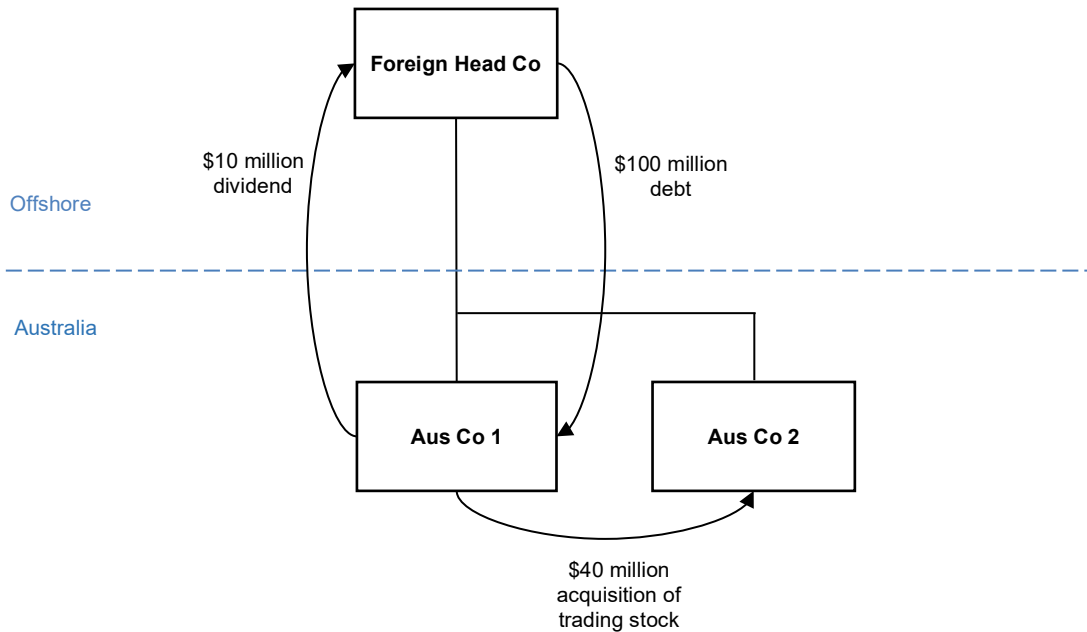
173. *Aus Co 1 is able to identify, using contemporaneous loan and dividend documentation from the time that the dividend was paid, that 10% of the \$100 million loan proceeds were used to refinance a borrowing originally used to fund a Type 2 payment (that is, the dividend to Foreign Head Co). It is appropriate to conclude that 10% of the debt deductions in relation to the refinanced loan are disallowed under the DDCR based on the historical use of the original \$10 million borrowing.*

174. *The remaining \$90 million of the \$100 million loan proceeds did not fund or arise in relation to a Type 1 or Type 2 transaction.*

175. *Aus Co 1 has disallowed debt deductions on a fair and reasonable basis for the purpose of applying the DDCR having regard to their circumstances.*

Example 16 – fair and reasonable apportionment of debt used for multiple purposes

Diagram 16: Fair and reasonable apportionment of debt used for multiple purposes



176. *Aus Co 1 and Aus Co 2 are Australian tax residents and general class investors. They are both wholly owned by Foreign Head Co, a foreign tax resident.*

177. *In the 2024–25 income year, Aus Co 1 issues a debt interest to Foreign Head Co permitting a maximum drawdown of \$100 million. Interest is payable on any drawdowns at a 10% annual interest rate.²⁷*

178. *In the same income year, Aus Co 1 draws down and uses \$40 million of the debt interest to acquire trading stock from Aus Co 2. Aus Co 1 incurs \$4 million of debt deductions in relation to the debt interest, which were all incurred in relation to the trading stock acquisition.*

179. *Aus Co 1 identifies that the debt deductions relating to the acquisition of trading stock from Aus Co 2 is a Type 1 transaction and will be denied under the DDCR, thereby resulting in a \$4 million denial.*

180. *In the 2025–26 income year, Aus Co 1 draws down and uses \$10 million of the debt proceeds to effectively pay a dividend to Foreign Head Co.*

181. *In the 2025–26 income year, Aus Co 1 incurs \$10 million of debt deductions. \$4 million of those debt deductions relate to the trading stock acquisition, thereby resulting in a \$4 million denial. In the 2025–26 income year, Aus Co also uses 10% of the debt interest to fund the dividend to Foreign Head Co. Aus Co identifies that this is a Type 2 transaction, thereby resulting in an additional \$1 million of the debt deductions being denied.*

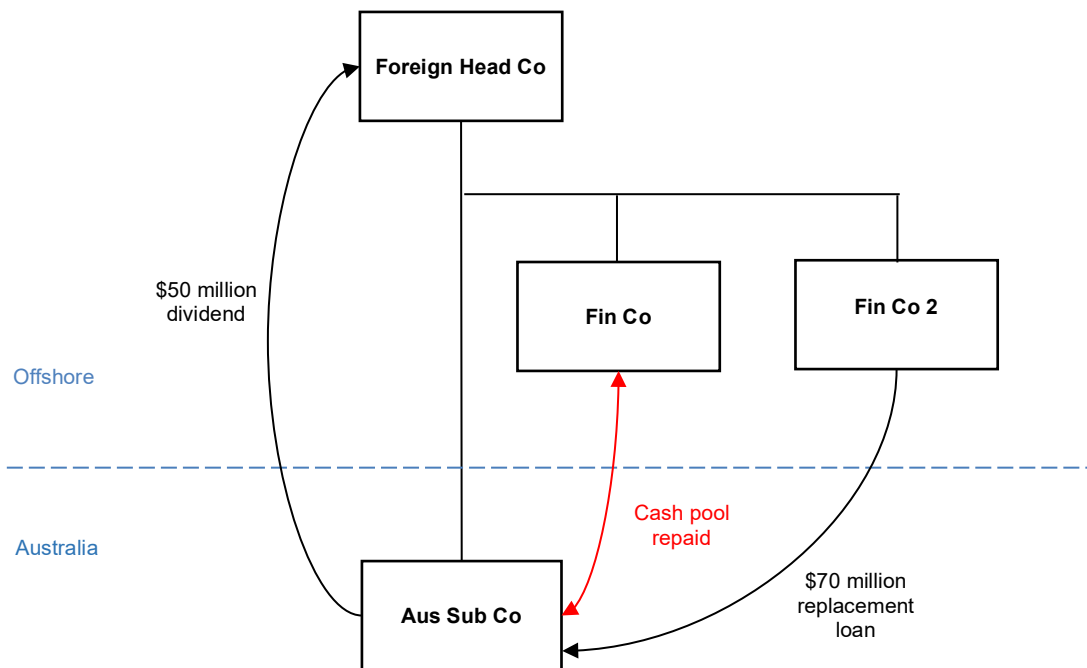
182. *Aus Co 1 maintains documentation to evidence the use of the remaining funds for other purposes that are not Type 1 or Type 2 transactions in future years and continues to consider the portion of debt deductions to be disallowed each year.*

²⁷ A 10% interest rate has been used for illustrative purposes only.

183. *Aus Co 1 has apportioned the debt deductions between debt deductions disallowed under the DDCR and debt deductions not disallowed under the DDCR on a fair and reasonable basis having regard to their circumstances.*

Example 17 – borrowing under a cash pool for dividend and refinancing

Diagram 17: Borrowing under a cash pool for dividend and refinancing



184. *Aus Sub Co is an Australian tax resident subsidiary of Foreign Head Co. Foreign Head Co is a foreign tax resident company and an associate pair of Aus Sub Co.*

185. *Aus Sub Co has a cash pool with Fin Co (a foreign-resident subsidiary of Foreign Head Co and associate pair) that includes ‘cash sweeping’ (swept on a daily basis). Generally, cash inflows comprise receipts from sales to customers, and cash outflows comprise operating and capital expenditures.*

186. *Interest accrues on a daily basis and is calculated by reference to the daily balance of the facility.*

187. *On 27 June 2024, Aus Sub Co pays a dividend of \$50 million to Foreign Head Co which was funded with a borrowing from Fin Co for the same amount through the cash pool facility. No other transactions occurred in the cash pool on that day and, as a result, the cash sweeping gives rise to a \$50 million debt interest issued by Aus Sub Co to Fin Co under the cash pooling arrangement.*

188. *On 30 June 2024, the balance of the cash pool is net payable, with Aus Sub Co owing \$70 million to Fin Co (including the \$50 million debt interest issued to Fin Co). Aus Sub Co refinances its cash pool borrowings to a new debt interest issued to Fin Co 2 (also a foreign-resident subsidiary of Foreign Head Co and associate pair), borrowing \$70 million (‘replacement loan’).*

189. *Aus Sub Co uses the proceeds of the replacement loan to repay the cash pool facility.*

190. *Aus Sub Co enters into a new cash pooling arrangement with Fin Co.*

191. *As at 1 July 2024 (the start date for the DDCR), the replacement loan remains owing by Aus Sub Co to Fin Co 2.*

192. *Aus Sub Co identifies that debt deductions in relation to \$50 million of the \$70 million owing under the cash pool facility would have been denied under the DDCR. Aus Sub Co further identifies that the same proportion of debt deductions in relation to the refinancing will be denied under the DDCR and denies the apportioned 71%²⁸ (\$50 million out of the \$70 million) of debt deductions accordingly.*

193. *Aus Sub Co has apportioned the debt deductions between debt deductions disallowed under the DDCR and debt deductions not disallowed under the DDCR on a fair and reasonable basis having regard to their circumstances.*

²⁸ We have rounded this figure up to the nearest whole number for illustrative purposes only.

SCHEDULE 2 – Restructures in response to the debt deduction creation rules

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Scope of this Schedule

194. The Schedule provides our view on the compliance risks associated with restructures in response to the DDCR.

195. The risk assessment framework in this Guideline applies to the restructuring examples in this Schedule.

196. Concerns have been raised about the potential for us to apply the DDCR or Part IVA of the ITAA 1936 to cancel all or part of a tax benefit where a taxpayer restructures to avoid the application of the DDCR but preserves tax benefits going forward, such as debt deductions arising in relation to transactions covered by subsections 820-423A(2) or (5).

197. For example, replacing a debt interest to an associate pair with a debt interest to an unrelated entity to eliminate related party debt deductions with other debt deductions.

198. This Schedule provides examples of restructures that we consider to be low-risk restructures and high-risk restructures. Many of these examples build on examples in Schedule 1 to this Guideline and the 2 schedules should be read as complementary.

Low-risk restructures

199. We expect the lowest-risk restructures to involve the repayment of all related party debt in relation to transactions covered by subsections 820-423A(2) or (5) without any additional debt being issued or acquired. That is, by eliminating all debt deductions that would otherwise be disallowed under subsection 820-423A(1).

200. Some of the following examples involve the repayment of related party debt without additional debt being introduced. Others involve the introduction of new debt.

201. Where a restructure is low risk, we will generally have cause to allocate compliance resources only to obtain comfort and verify your self-assessment.

202. Restructures are only low risk where the arrangements are otherwise commercial. The following features must be present for a restructure to be low risk:

- Debt deductions disallowed by the DDCR prior to the restructure have been accurately calculated.
- Prior to the restructure, the arrangements would not have attracted the application of Part IVA of the ITAA 1936.
- The restructure occurs in a straightforward manner having regard to the circumstances, without any associated contrivance or artificiality and is on arm's length terms.
- The arrangement following the restructure will not otherwise attract the application of Part IVA of the ITAA 1936.

203. If all of these features are present, the restructure will be regarded as a low-risk restructure. If any of these features are not present, the restructure will not be regarded as a low-risk restructure.

Example 18 – low risk: repaying debt interest

204. *Aus Co is an Australian tax resident and general class investor, with a wholly owned subsidiary B Co which is a tax resident of Country B.*

205. *Aus Co identifies debt deductions which are expected to be incurred in the 2024–25 income year that are in relation to acquisitions of CGT assets from an associate pair and financial arrangements used to fund dividends paid to associate pairs that occurred in prior income years.*

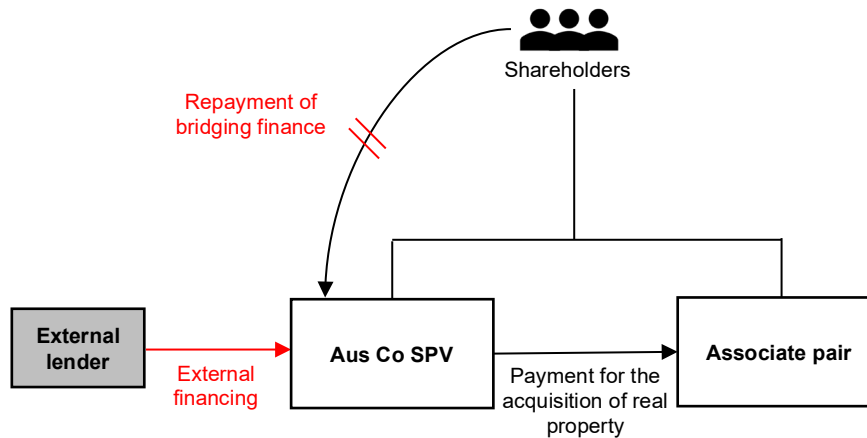
206. *Aus Co repays all of the debt interests under which the debt deductions arise from retained earnings and dividends received from B Co.*

207. *There are no debt deductions arising from its restructured arrangements.*

208. *This is a low-risk restructure.*

Example 19 – low risk: repaying bridging finance

Diagram 18: Low risk: repaying bridging finance



209. Assume the facts in Example 10 of this Guideline.

210. Aus Co SPV determines that the DDCR will apply to debt deductions in relation to the acquisition of real property from an associate pair arising from the \$50 million debt interests that Aus Co SPV issues to its shareholders (shareholder debt).

211. Based on contemporaneous documentation and correspondence with financial institutions and intermediaries, the shareholder debt is issued in anticipation of additional external financing being secured by Aus Co SPV to fund the acquisition of the real property. Upon the provision of external financing in October 2024, the \$50 million 'bridging' shareholder debt is repaid by Aus Co SPV.

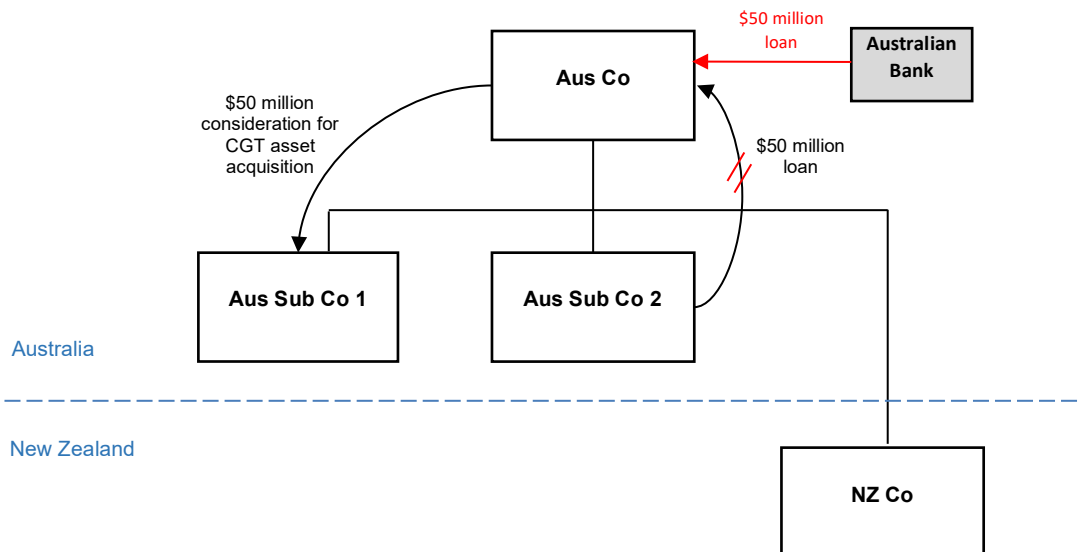
212. This is a low-risk restructure.

213. The use of the shareholder debt as related party bridging finance was commercially necessary and its replacement with external financing always intended and documented.

214. Aus Co SPV will need to consider the correct amount of debt deductions disallowed under the bridging finance due to the operation of the DDCR until it is repaid.

Example 20 – low risk: replacing related party debt with third-party debt

Diagram 19: Low risk: replacing related party debt with third-party debt



215. Aus Co is an Australian tax resident and a general class investor. It is the head of an Australian economic group of entities with operations in New Zealand operating through a foreign-resident subsidiary (NZ Co).

216. Aus Co acquires a CGT asset directly from Aus Sub Co 1 (an associate pair). The acquisition is covered by section 820-423A and is not included in an exemption in section 820-423AA.

217. Aus Co finances the acquisition with an interest-bearing loan from Aus Sub Co 2 of \$50 million.

218. Aus Co considers the application of the DDCR and determines that it will apply to deny deductions on the related party loan from Aus Co 2. Aus Co's broader economic group does not have the financial capacity to repay the loan due to loss making operations and disposals of Aus Co. Aus Co's economic group therefore needs to obtain a third party loan from Australian Bank of \$50 million to repay the loan. Aus Co uses the newly borrowed funds to repay that related party loan, including any unpaid accrued interest.

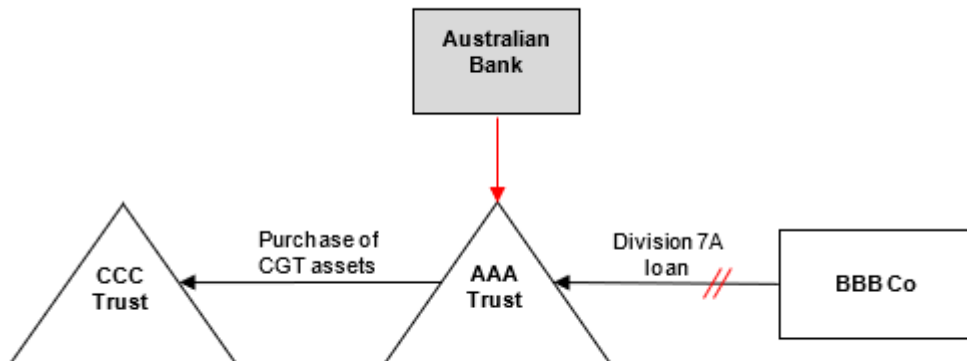
219. Aus Co's broader economic group will now incur interest expenditure due to the third-party borrowings from the Australian bank and the restructure is not associated with:

- any broader group reorganisation or refinancing
- any back-to-back or connected arrangements in connection with the loan from the Australian bank
- any associated reduction in any third-party debt owing by an associate of Aus Co.

220. This is a low-risk restructure.

Example 21 – low risk: replacing Division 7A loan with third-party debt

Diagram 20: Low risk: replacing Division 7A with third-party debt



221. Assume the same facts as Example 12 of this Guideline. Assume that AAA Trust is not otherwise indebted.

222. AAA Trust is not controlled by another entity and is not part of a broader economic group.

223. AAA Trust repays BBB Co the outstanding amount owing on the Division 7A complying loan. AAA Trust does not have the financial capacity to repay the loan itself due to its loss-making operations and obtains a third-party loan from Australian Bank in order to fund the repayment of the Division 7A loan. Australian Bank does not have any arrangements with any of AAA Trust's associates impacted by these arrangements.

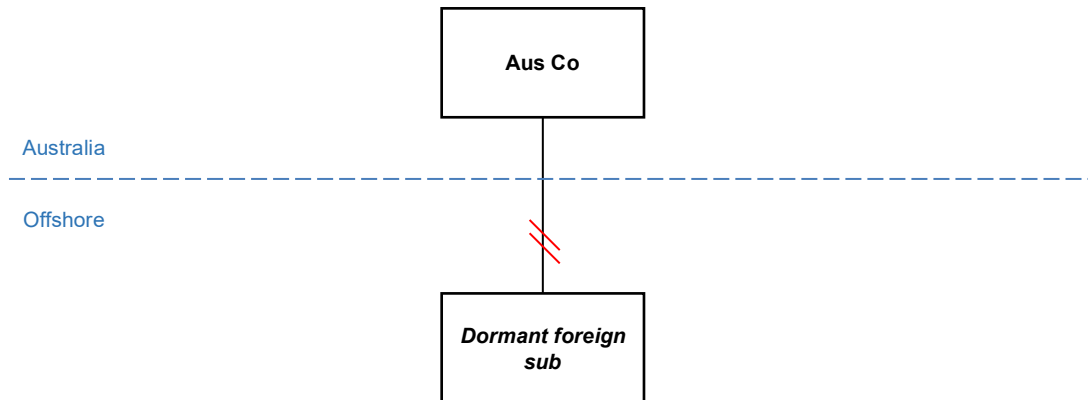
224. AAA Trust will now incur interest expenditure due to the introduction in third-party borrowings and the restructure is not associated with:

- any broader group reorganisation or refinancing
- any back to back connected arrangements in connection with the loan from the Australian bank
- any associated reduction in any third-party debt owing by an associate of AAA Trust.

225. This is a low-risk restructure.

Example 22 – low risk: disposing of foreign assets

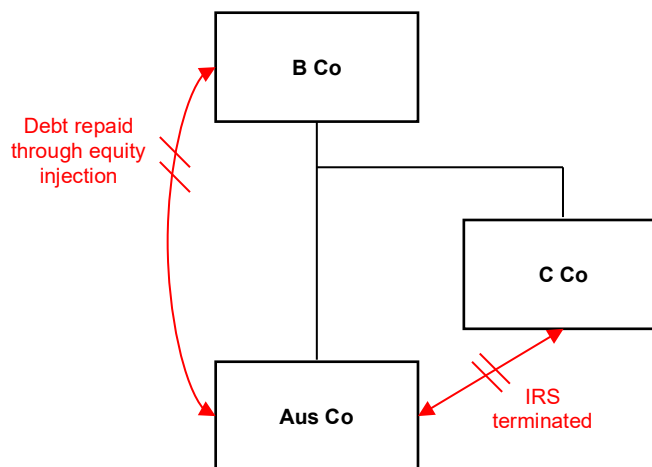
Diagram 21: Low risk: disposing of foreign assets



- 226. *Aus Co is a general class investor that satisfies section 820-37 (known as the 90% Australian assets threshold).*
- 227. *Aus Co has a single foreign subsidiary.*
- 228. *In anticipation of the DDCR applying, Aus Co liquidates the foreign subsidiary. There is no capital gain or capital loss on the liquidation.*
- 229. *In the following income year, Aus Co will no longer be a general class investor.*
- 230. *This is a low-risk restructure.*
- 231. *Aus Co has disposed of a dormant entity and its business operations are not otherwise impacted as a result of the restructure.*

Example 23 – low risk: repaying debt interest, terminating swaps, recapitalising subsidiary

Diagram 22: Low risk: repaying debt interest, terminating swaps, recapitalising subsidiary



- 232. *Assume the facts in Example 11 of this Guideline.*

233. Aus Co determines that the DDCR will apply to its debt deductions in relation to its purchase of tangible assets from B Co (that is, Aus Co’s debt deductions relating to its \$100 million debt issued to B Co and its swap with C Co).

234. Aus Co repays its \$100 million debt, funded by an injection of equity by B Co and terminates the IRS.

235. Subsequently, Aus Co and B Co reconsiders their approach to funding the acquisition of tangible assets and Aus Co is sufficiently capitalised to pay B Co in accordance with its payment terms, preventing potential further related party debt arising through the transfer of assets between the entities.

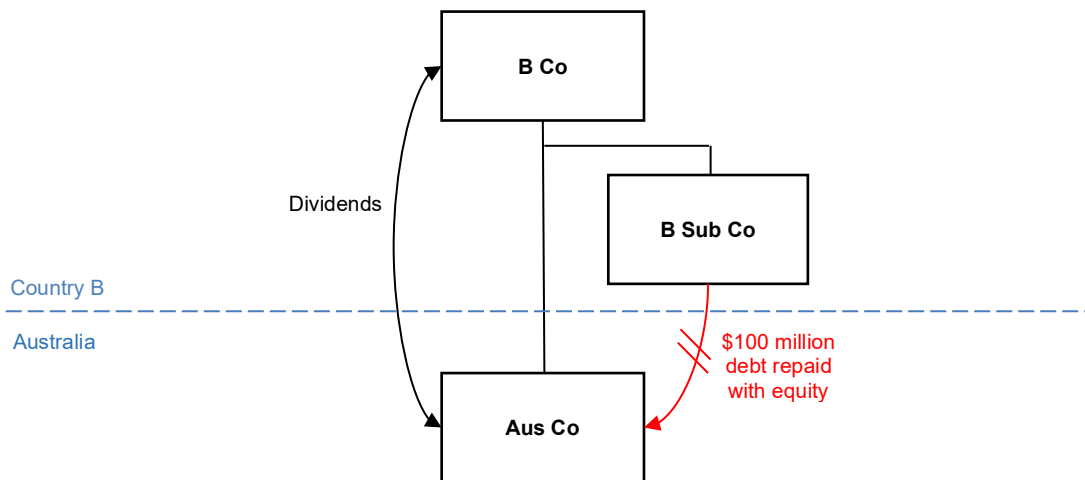
236. This is a low-risk restructure.

237. Debt deductions are no longer incurred in relation to the acquisition from an associate pair.

238. Aus Co will need to consider the correct amount of debt deductions disallowed under the arrangement due to the operation of the DDCR until the debt to B Co is repaid and the swap terminated (including any deductible costs arising on termination of the swap).

Example 24 – low risk: repaying debt interest

Diagram 23: Low risk: repaying debt interest



239. Assume the facts in Example 7 of this Guideline.

240. Aus Co determines that the DDCR will apply to disallow debt deductions in relation to the \$100 million debt interest used to fund the dividends paid to an associate pair.

241. Aus Co repays its \$100 million debt interest held by B Sub Co by issuing additional equity interests to B Co.

242. This is a low-risk restructure.

243. Aus Co will need to consider the correct amount of debt deductions disallowed under the \$100 million debt interest due to the operation of the DDCR until it is repaid.

Example 25 – low risk: cash pooling

244. Assume the facts in Example 6 of this Guideline.

245. *Aus Co determines that the DDCR will apply in the 2024–25 income year to disallow debt deductions for the cash pooling arrangement in relation to acquiring CGT assets from associate pairs or funding dividends, royalties and returns of capital to associate pairs.*

246. *During the 2024–25 income year, Aus Co repays its cash pool to a nil balance.*

247. *Subsequently, Aus Co and B Co reconsider funding of Aus Co's transactions with associate pairs and:*

- *B Co increases its capitalisation of Aus Co (through issuing additional equity interests) and annually reviews this arrangement to ensure that Aus Co is sufficiently capitalised to fund Aus Co's relevant transactions and payments with associate pairs.*
- *Aus Co enters into relevant transactions and payments with associate pairs from a separate account or borrowing that is not interest bearing (or used to offset other accounts).*

248. *This is a low-risk restructure.*

249. *Aus Co will need to consider the correct amount of debt deductions disallowed for Foreign Co's global cash pooling arrangement due to the operation of the DDCR until Aus Co repays its negative cash pool balance.*

High-risk restructures

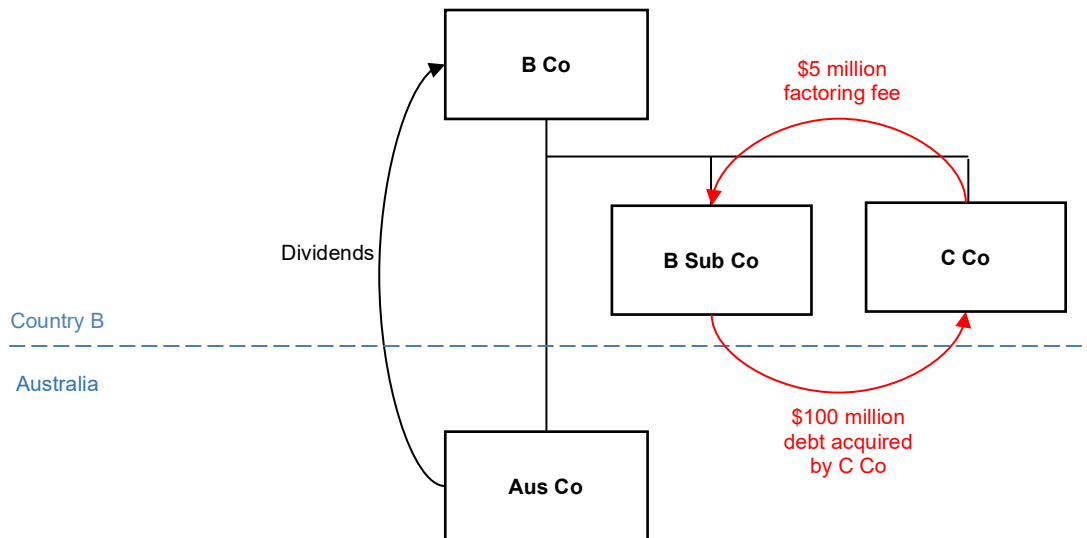
250. We expect the highest-risk restructures would involve arrangements where debt deductions are expected to be disallowed under subsection 820-423A(1) and a similar level of debt deductions are contended to be available under restructured or recharacterised arrangements.

251. For example, higher-risk arrangements may include round robin financing, contended change in 'use' of debt under other related party arrangements or a contrived arrangement to choose and use the TPDT under subsection 820-46(4) with the purported effect of preventing the DDCR from applying.

252. The following examples are restructures that are high risk and should be expected to attract intensive compliance action.

Example 26 – high risk: contending to change the character of costs incurred

Diagram 24: High risk: contending to change the character of costs incurred



253. Assume the facts in Example 7 of this Guideline.

254. Aus Co determines that the DDCR would apply to disallow debt deductions in relation to the \$100 million debt interest issued by Aus Co to B Sub Co used to fund dividends paid to B Co (an associate pair).

255. B Sub Co enters into a factoring arrangement with C Co, another subsidiary of B Co, which is also a tax resident of Country B. C Co acquires the \$100 million debt interest from B Sub Co at its face value less an agreed factoring fee of 5% of face value.

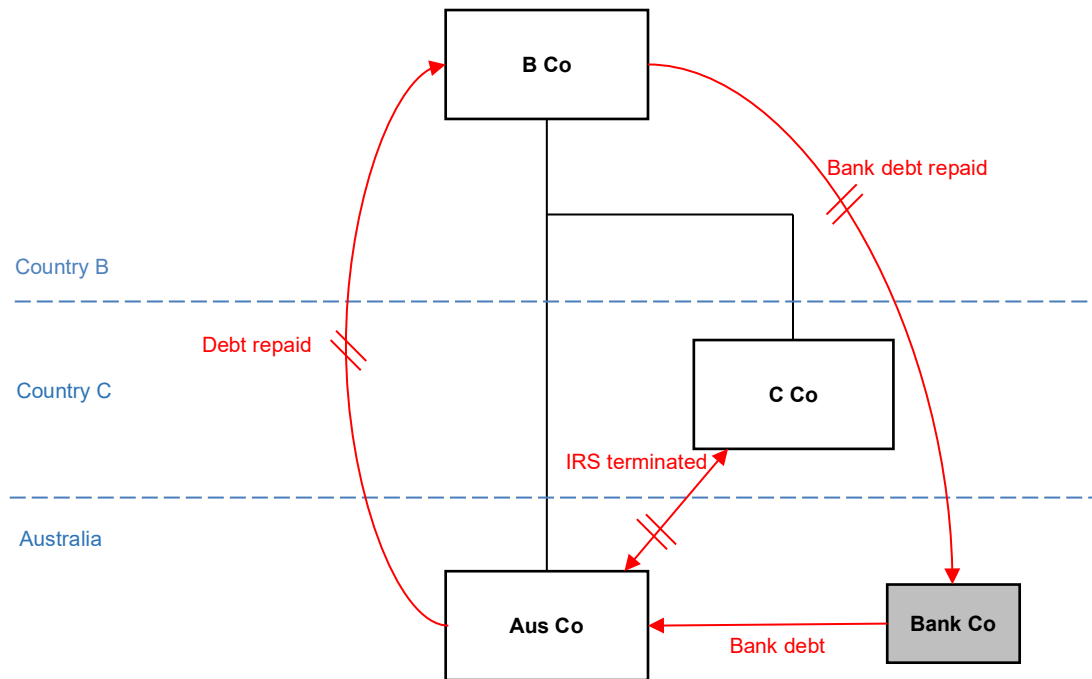
256. Aus Co contends that the debt deductions for the debt factored by B Sub Co to C Co does not relate to the underlying funding of the dividends paid by A Co to B Co.

257. This restructure presents risks that the contended change in use does not reflect the underlying arrangement.

258. This is a high-risk restructure.

Example 27 – high risk: replacing related party debt with third-party debt

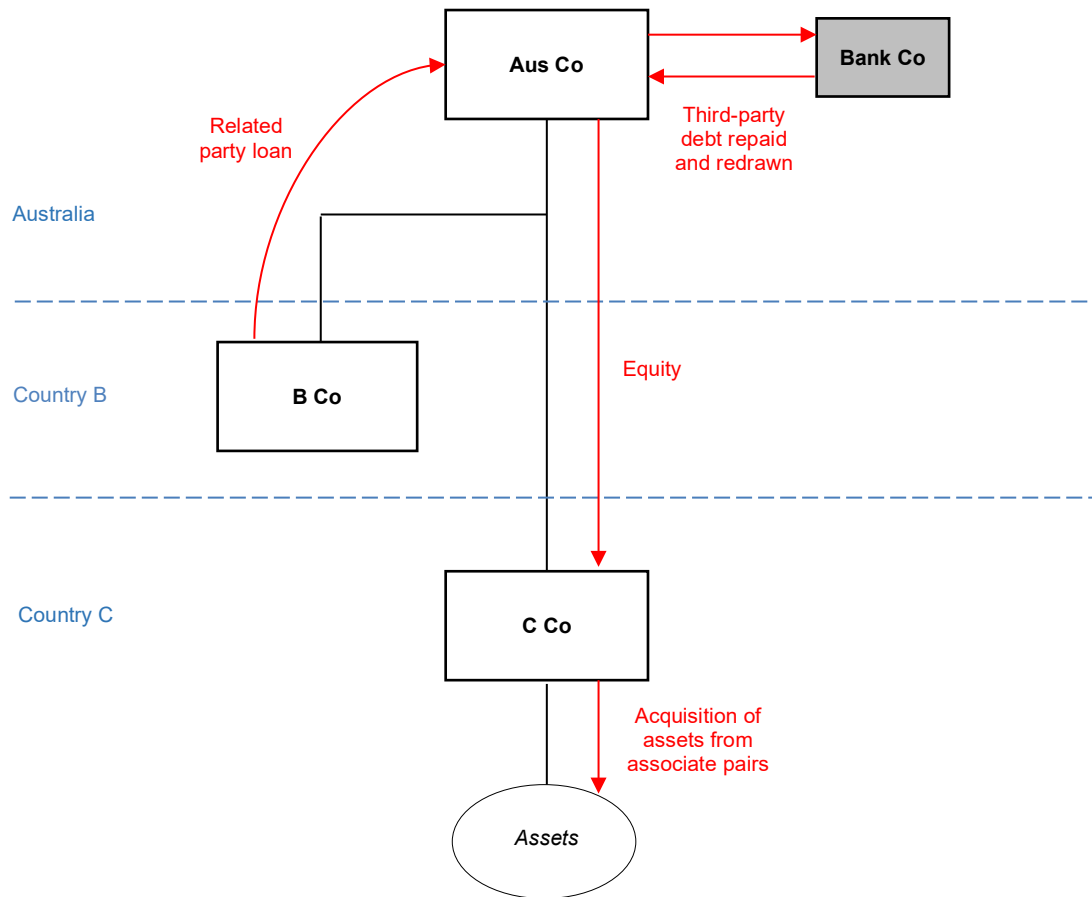
Diagram 25: High risk: replacing related party debt with third-party debt



259. Assume the facts in Example 11 of this Guideline.
260. Aus Co determines that the DDCR will apply to its debt deductions in relation to its purchase of tangible assets from B Co (that is, Aus Co’s debt deductions relating to its \$100 million debt issued to B Co and its swap with C Co).
261. Aus Co repays its \$100 million debt, funded by the proceeds of issuing a \$100 million debt interest to Bank Co.
262. Around the same time, B Co repays \$100 million worth of debt owed to Bank Co.
263. This restructure presents risks associated with the effective reallocation of group third-party debt to Australia, in response to the operation of the DDCR in relation to Aus Co’s debt interest issued to its associate B Co. The refinancing of related party debt with third-party debt has the effect of ‘dumping’ debt into Australia going forward, with an associated reduction in the third-party debt issued by B Co’s offshore group.
264. This is a high-risk restructure. This restructure would also be high risk if the IRS arrangement was not present.

Example 28 – high risk: using related party debt to fund offshore operations

Diagram 26: High risk: using related party debt to fund offshore operations



265. Aus Co is an Australian tax resident and general class investor. Aus Co has significant offshore operations in Country B, through its subsidiary, B Co. B Co is very profitable.

266. Aus Co also operates in Country C, through its subsidiary, C Co. C Co is a loss-making company. C Co has funded the acquisition of trading stock and intellectual property (IP) from associate pairs by issuing equity interests to Aus Co. Aus Co borrows from B Co to acquire those equity interests.

267. Subsequent to the enactment of the DDCR, Aus Co issues additional debt interests to B Co to fund the acquisition of further equity interests in C Co.

268. Aus Co contends that, rather than acquiring C Co equity interests, it uses the proceeds of issuing debt interests to B Co to pay down an existing third-party debt facility from Bank Co. Aus Co immediately redraws an identical amount from the debt facility to acquire equity interests in C Co and C Co's subsequent acquisition of assets from associate pairs.

269. Aus Co will need to consider the application of the DDCR to the related party loan from B Co because it has funded the equity contribution into C Co and C Co's subsequent acquisition of related party assets.

270. *This is a high-risk restructure. This restructure presents risks that the contended use of funds does not reflect the underlying arrangement.*

SCHEDULE 3 – Third party debt test compliance approach (pending)

271. Schedule 3 of this Guideline remains in draft form while we finalise TR 2024/D3. When finalised, this Schedule will provide targeted compliance approaches in respect to certain requirements of the TPDT.

272. We plan to finalise Schedule 3 and TR 2024/D3 shortly.

SCHEDULE 4 – Restructures in response to the thin capitalisation changes

Table of Contents	Paragraph
Thin capitalisation (non-debt deduction creation rules) restructuring	332
<u>Example 37 – low risk: restructuring to account for differing individual tax EBITDA of entities within a group</u>	336
<u>Example 38 – low risk: amending conduit financing interest rates</u>	342
<u>Example 39 – high risk: introducing debt to maximise debt deductions under the fixed ratio test</u>	348
<u>Example 40 – high risk: amending conduit financing interest rates</u>	358

Thin capitalisation (non-debt deduction creation rules) restructuring

332. This Schedule provides our view on compliance risks associated with certain restructures in response to the thin capitalisation rules.

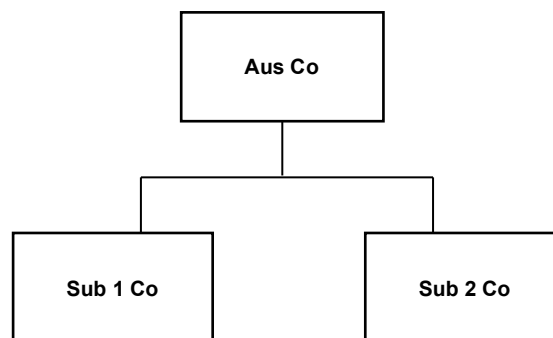
333. The risk assessment framework in this Guideline applies to the restructuring examples in this Schedule.

334. Concerns have been raised about the potential for us to apply Part IVA of the ITAA 1936 to cancel all or part of a tax benefit where a taxpayer restructures in response to the thin capitalisation changes but preserves tax benefits going forward.

335. This Schedule provides examples of restructures that we consider to be low-risk restructures and high-risk restructures.

Example 37 – low risk: restructuring to account for differing individual tax EBITDA of entities within a group

Diagram 35: Low risk: restructuring to account for differing individual tax EBITDA



336. *Aus Co, an Australian tax resident company, has 2 wholly owned subsidiaries, Sub 1 Co and Sub 2 Co, who are also Australian tax resident companies. The company has not entered into new debt financing in the current income year.*

337. *Under the thin capitalisation rules, Sub 2 Co’s net debt deductions exceed its fixed ratio earnings limit.*

338. *Aus Co makes a choice to become the head company of an Australian tax consolidated group, the Aus Co Consolidated Group, with Sub 1 Co and Sub 2 Co identified as 2 subsidiary members of the consolidated group.*

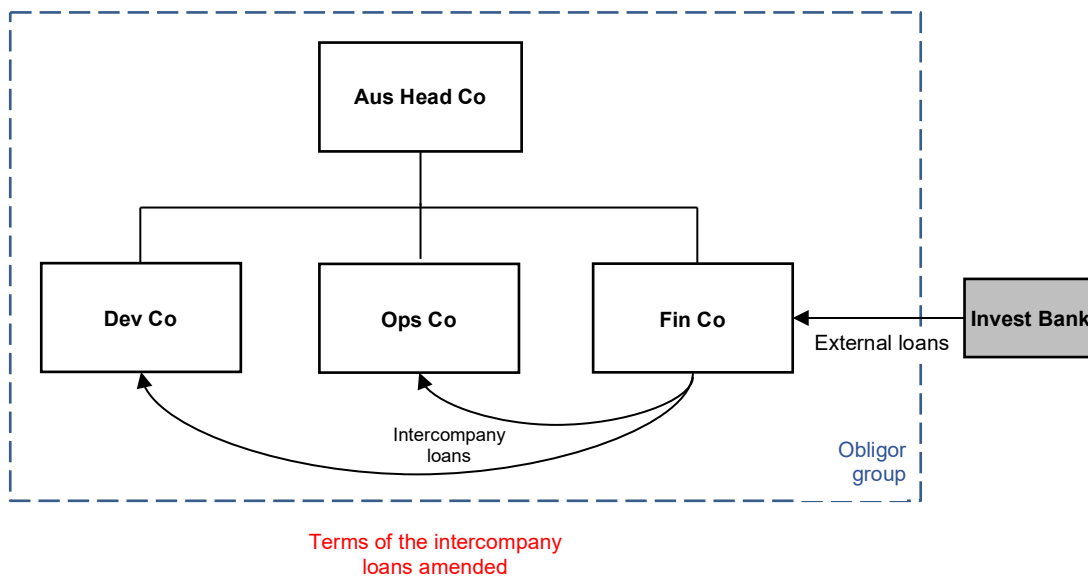
339. *Due to the single entity rule, the Aus Co Consolidated Group’s net debt deductions are below its fixed ratio earnings limit, and no debt deductions incurred with respect to any of the entities are disallowed.*

340. *This scenario is a low-risk restructure.*

341. *While consolidating has reduced the group’s disallowed debt deductions, the group availed itself of a choice open to it and did not otherwise restructure its affairs to produce this result.*

Example 38 – low risk: amending conduit financing interest rates

Diagram 36: Low risk: amending conduit financing interest rates



342. *Aus Head Co, and Australian tax resident company, has 3 Australian subsidiaries, Dev Co, Ops Co and Fin Co.*

343. *Dev Co and Ops Co each have separate long-term development projects under way that are financed through intercompany loans with the Group’s treasury entity, Fin Co.*

344. *These intercompany loans are funded via external loans between Fin Co and third-party lenders. There are multiple external loans, and they comprise of a variety of interest rates and maturity dates.*

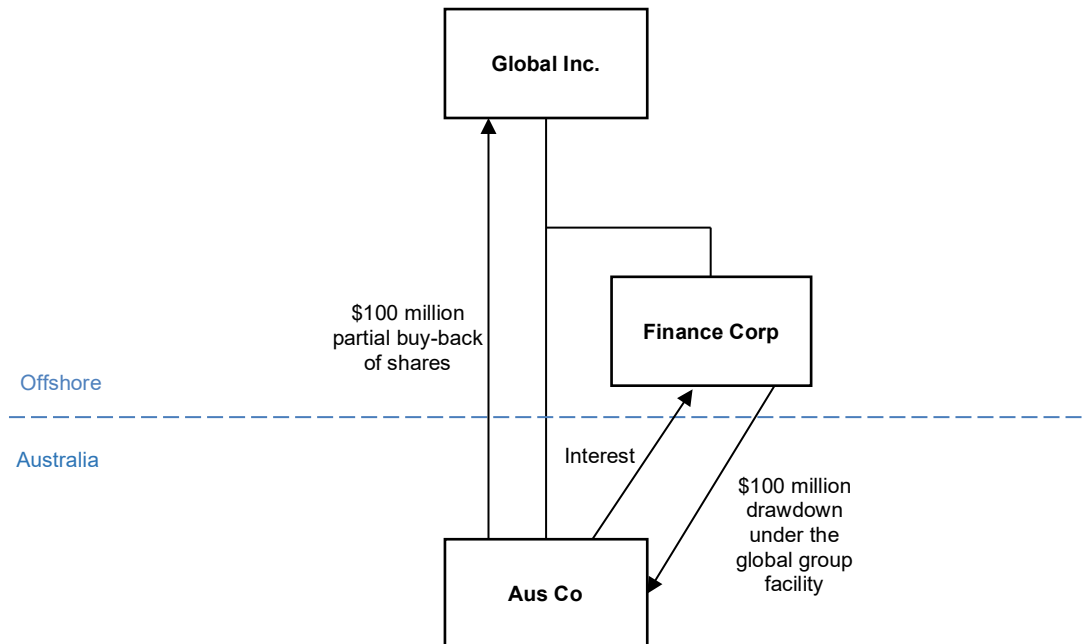
345. *While the entire quantum of the external loans is on-lent through the intercompany loans to Dev Co and Ops Co, none of the intercompany loans are entered into on the same terms as any of the external loan agreements. For example, none of the loans match in terms of tenor or interest rate.*

346. *Fin Co, Dev Co and Ops Co agree to formally amend the intercompany loan agreements so that the terms of the tenor and interest rate match that of each of the relevant external loan agreements.*

347. *This is a low-risk restructure.*

Example 39 – high risk: introducing debt to maximise debt deductions under the fixed ratio test

Diagram 37: High risk: introducing debt to maximise debt deductions under the fixed ratio test



348. *Global Inc. is a foreign tax resident entity, and the ultimate parent entity of the International Group.*

349. *Aus Co, a wholly owned subsidiary company of Global Inc., is the only Australian tax resident entity of the International Group. Aus Co was an inward investment vehicle (general) for the purposes of the former thin capitalisation rules, and is a general class investor for the purposes of the current thin capitalisation rules.*

350. *Finance Corp, a wholly owned foreign incorporated subsidiary entity of Global Inc., performs all treasury functions for the International Group.*

351. *Finance Corp provides Aus Co access to its common global group facility. Access is subject to the facility's terms of agreement, which state that interest accrues daily and is payable to Finance Corp for any outstanding drawdown of facility funds by an International Group entity, until repayment of such funds.*

352. *Since accessing the facility, Aus Co, on average, incurs \$3 million annually in net debt deductions. Under the former thin capitalisation rules, these amounts did not result in Aus Co having an excess debt amount.*

353. *Under the current thin capitalisation rules, Aus Co has a tax EBITDA of \$30 million and annual net debt deductions of \$3 million. No debt deductions are denied under the fixed ratio test as Aus Co's fixed ratio earnings limit is \$9 million (30% × \$30 million).*

354. *Aus Co restructures its capital in response to the current thin capitalisation rules. It undertakes a round robin financing with the result that Aus Co draws down a further \$100 million from Finance Corp through the common global group facility.*

355. *The restructure does not result in any change to Aus Co's business operations, nor does it result in a material change in the International Group's global leverage. Aus Co's*

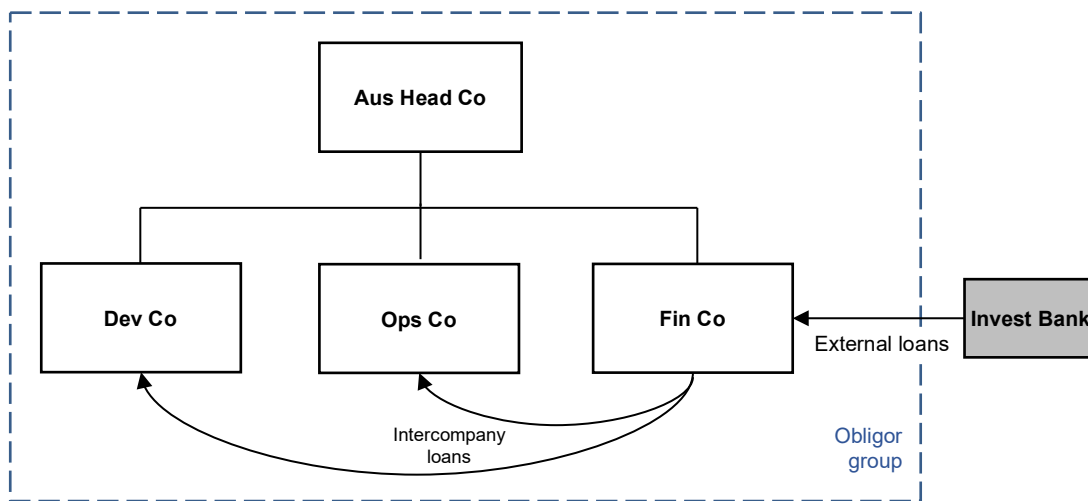
net debt deductions are still less than its fixed ratio earnings limit despite the additional interest expense incurred with respect to the further drawdowns.

356. This is a high-risk restructure.

357. The additional debt appears to have been introduced for the purpose of maximising debt deduction ‘capacity’ under the FRT and has no apparent commercial purpose. Aus Co may also need to consider the DDCR.

Example 40 – high risk: amending conduit financing interest rates

Diagram 38: High risk: amending conduit financing interest rates



Terms of the intercompany loans are amended to that of the highest interest rate of all external loans

358. Assume the same facts as Example 38 of this Guideline.

359. Fin Co, Dev Co and Ops Co agree to formally amend the intercompany loan agreements. However, their terms are all changed to that of the highest interest rate of all the external loans.

360. This is a high-risk restructure.

361. The decision to adopt the highest interest rate indicates it was done to maximise debt deductions.

References*Previous draft:*

PCG 2024/D3

Related rulings and determination:

TR 2024/D3

Legislative references:

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- ITAA 1936 109N
- ITAA 1936 Pt IVA
- ITAA 1997 Div 820
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- ITAA 1997 820-37
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- ITAA 1997 820-56
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- ITAA 1997 Subdiv 820-C
- ITAA 1997 Subdiv 820-EAA
- ITAA 1997 Subdiv 820-EAB
- ITAA 1997 820-423A(1)
- ITAA 1997 820-423A(2)
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- ITAA 1997 820-423A(2)(e)
- ITAA 1997 820-423A(2)(g)
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- ITAA 1997 820-423A(3A)(a)
- ITAA 1997 820-423A(5)
- ITAA 1997 820-423A(5)(a)
- ITAA 1997 820-423A(5)(b)
- ITAA 1997 820-423A(5)(b)(iii)

- ITAA 1997 820-423A(5)(b)(iv)
- ITAA 1997 820-423A(5)(c)
- ITAA 1997 820-423A(5)(f)
- ITAA 1997 820-423A(5A)
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- Banking Act 1959

Other references:

Supplementary Explanatory Memorandum Treasury Laws Amendment (Making Multinationals Pay Their Fair Share - Integrity and Transparency) Bill 2023

ATO references

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