TD 2019/12EC - Compendium

This cover sheet is provided for information only. It does not form part of *TD 2019/12EC - Compendium*

On 8 April 2024, the *Treasury Law Amendment (Making Multinationals Pay Their Fair Share - Integrity and Transparency) Act 2024* was enacted. The amendments apply to assessments for income years commencing on or after 1 July 2023, with the exception of new integrity rules (debt deduction creation rules) which apply in relation to assessments for income years starting on or after 1 July 2024.

Under the new thin capitalisation rules:

- the newly classified 'general class investors' will be subject to one of 3 new tests
    - fixed ratio test
    - group ratio test
    - third party debt test
- financial entities will continue to be subject to the existing safe harbour test and worldwide gearing test or may choose the new third party debt test
- ADIs will continue to be subject to the previous thin capitalisation rules
- the arm's length debt test has been removed for all taxpayers.

ADIs, securitisation vehicles and certain special purpose entities are excluded from the debt deduction creation rules.

Entities that are Australian plantation forestry entities are excluded from the new rules. For these entities, the previous rules will continue to apply.

Public advice and guidance compendium – TD 2019/12

On 8 April 2024, the Treasury Law Amendment (Making Multinationals Pay Their Fair Share - Integrity and Transparency) Act 2024 was enacted. The amendments apply to assessments for income years commencing on or after 1 July 2023, with the exception of new integrity rules (debt deduction creation rules) which apply in relation to assessments for income years starting on or after 1 July 2024.

Under the new thin capitalisation rules:

- *the newly classified 'general class investors' will be subject to one of 3 new tests*
  - *fixed ratio test*
  - *group ratio test*
  - *third party debt test*
- *financial entities will continue to be subject to the existing safe harbour test and worldwide gearing test or may choose the new third party debt test*
- *ADIs will continue to be subject to the previous thin capitalisation rules*
- *the arm's length debt test has been removed for all taxpayers.*

ADIs, securitisation vehicles and certain special purpose entities are excluded from the debt deduction creation rules.

Entities that are Australian plantation forestry entities are excluded from the new rules. For these entities, the previous rules will continue to apply.

This is a compendium of responses to the issues raised by external parties to draft Taxation Determination TD 2018/D5 *Income tax: what type of costs are debt deductions within the scope of subparagraph 820-40(1)(a)(iii) of the Income Tax Assessment Act 1997?*

This compendium of comments has been edited to maintain the anonymity of entities that have commented.

Summary of issues raised and responses

Issue No.	Issue raised	ATO response / action taken
1	Including amounts indirectly incurred, such as tax advisory fees, is not correct.	The ATO considers that certain tax advisory costs can be directly incurred. Appendix 1 of the final Determination explains this further.

Issue No.	Issue raised	ATO response / action taken
2	Explain why tax advisory costs are directly incurred and how they are distinguished from foreign currency /hedging losses in relation to a debt interest.	Foreign currency/hedging losses are indirect costs as the losses related to commercial risk mitigation strategies and are not directly related to the obtaining or maintaining of the financial benefits under the debt capital – the direct relationship is with the hedging instrument.
3	If the ATO expansive view of subparagraph 820-40(1)(a)(iii) were correct, it could render provisions such as subsection 820-946(2) redundant.	The ATO disagrees that the view in the Determination will render provisions such as subsection 820-946(2) redundant, because cost-free debt capital is debt capital that does not give rise to any debt deductions at any time.
4	Clarification is needed that normal interest-free financing (quasi-equity) arrangements, which do not raise integrity concerns, will continue to be excluded from the calculation of adjusted average debt.	For the purposes of Division 820, any debt capital that give rise to any debt deductions (including debt deductions that meet the requirements of subparagraph 820-40(1)(a)(iii)) at any time are not considered to be quasi-equity, and are included in the calculation of an entity's adjusted average debt.
5	The ATO should provide more detailed explanation on why costs incurred for pre- and post-loan tax advice position are or are not debt deductions.	Appendix 1 of the final Determination explains this further.
6	There is concern about the retrospective application of TD 2018/D5.	The final Determination does not change the ATO's application of subparagraph 820-40(1)(a)(iii).
7	The better view is that unless tax advice was directly linked to the loan (a requirement to obtain tax advice is embedded in the loan documentation) they should not be treated as debt deductions for thin capitalisation.	The ATO does not agree. Our view is consistent with paragraph 1.58 of the Explanatory Memorandum to the New Business Tax System (Thin Capitalisation) Bill 2001, which highlights that a 'cost of debt capital may not be explicit in an arrangement'.