



20 December 2023

Amendments to the Thin Capitalisation rules – ATO's Public Advice and Guidance (PAG) consultation

1. Purpose

- Members of the National Tax Liaison Group (**NTLG**), Large Business Stewardship Group (**LBSG**) and Private Groups Stewardship Group (**PGSG**) are invited to provide feedback on the contents of this document on behalf of the representative organisations. In particular, the ATO requests stakeholders to consider:
 - potential PAG topics
 - prioritisation of potential PAG topics
 - the form of any potential PAG (e.g. practical compliance guideline, ruling, determination, web guidance etc).

2. Background

- On 22 June 2023, *Treasury Laws Amendment (Making Multinationals Pay Their Fair Share—Integrity And Transparency) Bill 2023* (the [Bill](#)) was introduced into the House of Representatives, and referred to the Senate Economics Legislation Committee (the **Committee**) for inquiry.
- On 22 September 2023, the Committee provided its Report (the [Report](#)). The Committee recommended that Schedule 1 (Multinational tax transparency) of the Bill be passed unamended and Schedule 2 (Thin capitalisation rules) of the Bill be passed subject to technical amendments foreshadowed by Treasury.
- On 18 October 2023, public consultation opened on exposure draft parliamentary amendments to Schedule 2 of the Bill, reflecting the technical amendments foreshadowed by Treasury. The public consultation process concluded on 30 October 2023.
- On 5 December 2023, the Senate referred the updated [parliamentary amendments to Schedule 2 of the Bill](#) back to the Committee for inquiry and report by 5 February 2024 with further consideration of the Bill to be an order of the day for the first sitting day after the Committee has reported (e.g. 6 February 2024).
- As currently drafted, the new thin capitalisation rules will generally apply to income years beginning on or after 1 July 2023. The debt deduction creation rules apply to income years beginning on or after 1 July 2024.

3. Stakeholder engagement with PAG

- On 16 March 2023, the Government released an exposure draft (**ED**) of its proposed thin capitalisation rules for stakeholder consultation.
- As part of this consultation, stakeholders' views were requested on "*priority issues that would inform the ATO's administrative approach and public advice and guidance on this measure*". A similar request was included in the public consultation on the exposure draft parliamentary amendments released on 18 October 2023.
- To date, stakeholders' engagement with these requests has been limited.

4. The ATO's consultation principles

Purposeful	We are clear about the purpose and objectives of the consultation and have a plan.
Targeted	We explain who will be consulted and ensure consultation captures the diversity of stakeholders
Timely	We outline a timeline for efficient and meaningful consultation.
Accessible	We ensure stakeholders can readily contribute to consultation matters.
Transparent	We promote transparent and comprehensive consultation, engaging stakeholders from the earliest possible stage to participate in the process and make outcomes visible.
Evaluate and review	We evaluate our consultation to identify ways of making them more effective.

5. ATO Thin Capitalisation amendments PAG contacts

[REDACTED]	[REDACTED]	[REDACTED]

6. Consultation strategy

- While stakeholders' focus has largely been with respect to policy issues to date, we now invite stakeholders to consider providing their feedback on potential PAG topics, prioritisation and form.
- The ATO is inviting broader stakeholder engagement through the Advice Under Guidance Page on PAG topics, prioritisation and form of any PAG.
- The consultation will also be promoted through a variety of channels:
 - Direct email - e.g. ATO's Business Bulletin
 - Social media – e.g. LinkedIn posts by several ATO senior leaders
 - Messaging for ATO senior leaders to communicate during online and face-to-face public and private engagements with relevant stakeholders
- The ATO is seeking stakeholder's views prior to enactment to ensure that the ATO is able to prepare timely, effective PAG and be able to prioritise PAG topics based on stakeholder feedback.
- Priorities of PAG are determined having regard to stakeholder feedback and ATO resourcing considerations. It is anticipated that the ATO will not be able to resource all requested PAG and will need to prioritise to ensure our advice (via PAG) to stakeholders and the community is timely and effective. This means that PAG may not be commenced on all potential PAG topics suggested by the ATO or consultation stakeholders.

7. Milestones and expected timeframes

- The ATO encourages stakeholder engagement to generate and prioritise PAG in relation to the new thin capitalisation measures.
- The following milestones and indicative timeframes are based upon the information presently on hand and is subject to change. Further, the indicative timeframes contained below will be directly influenced by the timeframes for the passage of the Bill.

No.	Milestone	Status	Indicative timeframe for engagement	Stakeholders	Expected consultation process
Existing PAG					
1.	Upon introducing the Bill into Parliament, update existing impacted formal and informal PAG with an annotation.	Completed	-	-	-
See Appendix A and Appendix B for details.					
2.	Identify all existing formal PAG relating to current Thin Capitalisation rules requiring potential amendment.	Underway	Pre and post enactment	Public	Comments welcomed on PAG identified at Appendix A .
See Appendix A for details.					
3.	Consult, amend and/or withdraw existing PAG.	Underway	Pre and post enactment	Public	Following identification of all existing PAG requiring potential amendment, ATO to prioritise resources including considering what new PAG may be required (see Appendix C).
Web guidance					

No.	Milestone	Status	Indicative timeframe for engagement	Stakeholders	Expected consultation process
4.	<p>The ATO has extensive website guidance on the existing thin capitalisation rules. Review existing guidance and consider updates where relevant.</p> <p>Internal review has been completed. Drafting of priority pages underway.</p> <p>See Appendix B for details.</p>	Underway	Pre and post enactment	ATO	Updates likely to be non-interpretive as per previous website guidance material. Unlikely to benefit from public consultation prior to publication.
Potential new PAG					
5.	<p>Publish new website guidance (non-interpretive).</p>	Underway	Post enactment	Public	Content not proposed to be interpretative, so unlikely to benefit from public consultation at the expense of timeliness and clear messaging.
6.	<p>The ATO is committed to ensuring that there is stakeholder input into the needs and priorities of new law guidance.</p> <p>We will seek stakeholder feedback on:</p> <ul style="list-style-type: none"> priority issues that would inform the ATO's administrative approach and public advice and guidance on this measure, and the preferred form of any public advice and guidance necessary to support understanding of the measure. <p>See Appendix C for details</p>	Underway	Pre and post enactment	Public	<p>ATO has commenced seeking input through Treasury's consultation on the 16 March 2023 exposure draft and 18 October 2023 exposure draft parliamentary amendments.</p> <p>Stakeholder input is sought on potential PAG topics, prioritisation of potential PAG and form of potential PAG.</p> <p>ATO is seeking stakeholder views pre-enactment to assist the ATO's preparation for public consultation on the right issues post-enactment.</p>
7.	<p>Prepare and publish PAG on priority issues.</p>	Underway	Pre and post enactment	Public	ATO to prioritise resources including considering what new PAG may be required. Priority PAG to consider those items that are likely to have the most material impact on first applicable income year.

Appendix A – Existing formal PAG

- The below table outlines existing formal PAG that may require revision. It is not an exhaustive list and additional affected PAG may be identified.
- Potential changes may include revisiting rulings to ensure consistency with new rules and withdrawing rulings no longer applicable.
- All PAG listed below has been updated with an annotation on the amendments to the Thin Capitalisation rules (see **Appendix B** for details).

No.	Type	Document Title/Number
1.	Taxation Ruling	TR 2020/4 Income tax: thin capitalisation – the arm's length debt test (Published on 12 August 2020)
2.	Taxation Ruling	TR 2014/6 Income tax: transfer pricing – the application of section 815-130 of the Income Tax Assessment Act 1997 (Published on 12 Nov 2014)
3.	Taxation Ruling	TR 2010/7 Income tax: the interaction of Division 820 of the Income Tax Assessment Act 1997 and the transfer pricing provisions (Published on 27 October 2010)
4.	Taxation Ruling	TR 2002/20 Income tax: Thin Capitalisation – Definition of assets and liabilities for the purposes of Division 820. (Published on 30 October 2002)
5.	Taxation Determination	TD 2020/2 Income tax: thin capitalisation – valuation of debt capital for the purposes of Division 820 (Published on 25 March 2020)
6.	Taxation Determination	TD 2019/12 Income tax: what type of costs are debt deductions within scope of subparagraph 820-40(1)(a)(iii) of the Income Tax Assessment Act 1997? (Published on 17 July 2019)
7.	Practical Compliance Guideline	PCG 2020/7 Arm's length debt test – ATO compliance
8.	Practical Compliance Guideline	PCG 2017/4 ATO compliance approach to taxation issues associated with cross-border related party financing arrangements and related transactions
9.	ATO Interpretative Decision	ATO ID 2003/973 Are periodic payments made by the company on convertible notes a debt deduction within the meaning of subsection 820-40(1) of the Income Tax Assessment Act 1997 (ITAA 1997)?
10.	ATO Interpretative Decision	ATO ID 2002/942 For the purpose of calculating the attributable safe harbour excess amount in section 820-920(4) of the Income Tax Assessment Act 1997 ('ITAA 1997'), can a Step 1 amount, which is zero, when reduced by a negative adjusted average debt amount give rise to a positive Step 2 amount?

The following products have been identified for no revision other than inclusion of an annotation (see **Appendix B** for details):

No.	Type	Document Title/Number
11.	Taxpayer Alert	TA 2016/3 Arrangements involving related party foreign currency denominated finance with related party cross currency interest rate swaps
12.	Taxpayer Alert	TA 2016/10 Cross-border round robin financing arrangements
13.	Taxation Ruling Compendium	TR 2010/7EC Compendium (Published on 27 October 2010)
14.	Taxation Determination Compendium	TD 2020/2EC Compendium (Published on 25 March 2020)

Appendix B – Web guidance

- The below table lists existing ATO website materials that will need to be updated.
- The ATO has commenced drafting of priority pages. Thin capitalisation website guidance is generally more procedural and non-interpretive. We expect it to remain non-interpretive for any required updates.

No.	Website guidance
1.	<p>Upon introducing the Bill into Parliament, all products listed at Appendix A have been updated with the below annotation. This annotation may need to be removed/updated. Currently reads as follows:</p> <p>! <i>On 25 October 2022, the Government announced amendments to strengthen Australia's thin capitalisation rules. The amendments will apply for income years commencing on or after 1 July 2023.</i></p> <p><i>Under the new measures, general class entities will be subject to one of three new tests - fixed ratio test, group ratio test and third-party debt test. Financial entities and ADIs will continue to be subject to the existing thin capitalisation rules, with the exception of the existing arm's length debt test which will be repealed.</i></p>
2.	<p>New legislation landing page: Multinational Tax Integrity Package - Thin capitalisation rules.</p>
3.	<p>Existing Thin Cap Guide will require updating including the detailed worked examples. A new supplement to the Thin Cap guide on the 3 new tests for General Class Investors is being prepared for publication following passage of the Bill.</p>

Appendix C – Potential PAG topics

- The below table lists potential PAG topics as identified by the ATO based on the current status of the Bill. These are listed in no particular order and do not represent the ATO's view on the priority of the relevant PAG.
- The below table is not intended to be an exhaustive list and the ATO will seek broad stakeholder input into the needs and priorities of new PAG.

No.	Potential PAG topic
1	Thin capitalisation rules for general class investors (Subdivision 820-AA) The proposed Fixed Ratio Test and Group Ratio Test apply to general class investors and require mechanical calculations including an entity's 'tax EBITDA' and 'net debt deductions'. We expect that guidance on new concepts and exceptions may assist certain affected stakeholders and will engage with stakeholders to understand their priorities.
2	Third Party Debt Test (Subdivision 820-EAB) The proposed Third Party Debt Test includes new concepts in working out whether debt deductions may count towards the proposed Third Party Earnings Limit. We expect that guidance on the operation of some or all of the concepts in this test would assist stakeholders responding to the proposed changes and will engage with stakeholders to understand their priorities.
3	Debt deduction limitation rule for debt deduction creation (DDCR) (Subdivision 820-EAA) The proposed DDCR includes new concepts and exceptions in working out whether debt deductions that are directly or indirectly referable to amounts paid to associates are disallowed. The proposed DDCR also includes a specific anti-avoidance provision. We expect that guidance on the operation of these new concepts, exceptions and anti-avoidance rules would assist stakeholders responding to the proposed changes and will engage with stakeholders to understand their priorities.

No.	Potential PAG topic
4	Other changes

The Bill and exposure draft parliamentary amendments also update or modify definitions and interactions with other parts of the tax law. These include:

- a. An updated definition of 'debt deduction'
- b. An updated definition of 'financial entity'
- c. A modified definition of 'associate entity' used in proposed Subdivisions 820-AA and 820-EAB
- d. Changes to section 815-140 where proposed Subdivisions 820-AA and 820-EAB apply
- e. Changes to the interaction between the consolidation and thin capitalisation regime in response to the proposed carry forward of 'FRT disallowed amounts'.

We expect that guidance on these proposed changes would assist stakeholders to respond to the new thin capitalisation regime and broader consequential issues. We will engage with stakeholders to understand their priorities.
