Department of the
Parliamentary Library

INFORMATION AND RESEARCH SERVICES

Bills Digest
No. 16 2001–02

New Business Tax System (Thin Capitalisation) Bill 2001

ISSN 1328-8091

Inquiries

Members, Senators and Parliamentary staff can obtain further information from the Information and Research Services on (02) 6277 2646.

Information and Research Services publications are available on the ParlInfo database.
On the Internet the Department of the Parliamentary Library can be found at:
http://www.aph.gov.au/library/

Published by the Department of the Parliamentary Library, 2001

INFORMATION AND RESEARCH SERVICES

Bills Digest
No. 16 2001–02

New Business Tax System (Thin Capitalisation) Bill 2001

Chris Field
Law and Bills Digest Group
7 August 2001

Contents

New Business Tax System (Thin Capitalisation) Bill 2001

Date Introduced: 28 July 2001

House: House of Representatives

Portfolio: Treasury

Commencement: 1 July 2001. Transitional provisions provide for the existing rules to remain in force for the remainder of a financial year for an entity where their year continues past 1 July 2001.

Purpose

To introduce new thin capitalisation rules which provide the circumstances under which a deduction for interest payments which would otherwise be allowable will be reduced as an entity does not have sufficient equity compared to its debt levels. The rules apply to entities which operate both in Australia and overseas and are designed to prevent excessive claims relating to the Australian business of a multi-national operator.

The new rules will be extended to Australian-controlled multi-national entities.

Background

Thin capitalisation currently refers to the rules which apply to limit the interest deductions available to an Australian entity which is foreign controlled and which has an overseas debt to equity ratio in excess of that allowed. A major function of the thin capitalisation rules is to prevent multi-national corporations from organising their debt to equity ratios for the purpose of claiming the maximum interest deduction in Australia, where interest on borrowings is generally fully deductible. The thin capitalisation rules are contained in Divisions 16 Fand 16G of the *Income Tax Assessment Act 1936* (ITAA).

The method for calculating whether a deduction will be allowed is complex. Additional details are contained in Appendix 1, however the following desciption provides a brief summary.

There are three concepts involved in the calculation: foreign control, foreign debt and foreign equity.

- foreign control - the principal test is where a non-resident is in a position to receive at least 15% of dividends, profits or capital of the entity

- level of foreign debt - this is based on whether interest is payable on any amounts borrowed from the foreign controller and their associates, so that if interest is not payable the amount is not included in the calculation of the amount of debt. There are some variations according to whether the entity is a financial institution.

- level of foreign equity - this is based on the amount of share capital the foreign controller and their associates are entitled to plus their entitlement to accumulated profits or asset revaluation, minus any amount owing to the foreign controller and their associates. Again, there are some variations for financial institutions.

Once the amount of relevant foreign debt and equity has been determined (the above is a simplification of the rules that may apply), the ITAA provides that a deduction for the resident entity will be disallowed where the interest paid to the foreign controller and associates exceed the allowable debt to equity ratio, which is 2:1 for general entities and 6:1 for financial institutions.

Whether the ratio has been exceeded and the extent of any excess is, prima facie, to be determined on the highest level of which debt exceeds equity during the year. However, the ITAA also allows entities the option of averaging the excess over the number of days during the year in which there was an excess which should result in a lower figure than the maximum excess during the year.

Ralph Report

The thin capitalisation rules were examined as part of the *Review of Business Taxation*, which reported in July 1999 (the Ralph Report). The Ralph Report noted that a major function of the thin capitalisation rules was to prevent multi-national corporations from organising their financial affairs to be able to claim the maximum interest deduction in Australia, where interest on borrowings is generally fully deductible, by distributing debt and equity within the organisation. It was also noted that a balance needed to made between the need to protect revenue and not to disadvantage genuine commercial arrangements and that:

> Australia's current thin capitalisation provisions are not fully effective at preventing an excessive allocation of debt to the Australian operations of multinationals because they refer only to foreign related party debt and foreign debt covered by a formal guarantee rather than total debt. Hence they do not restrict the proportion of third party debt that can be allocated to the Australian operations.[1]

To overcome this problem it was recommended that the rules be extended to deal with the total of an organisation, including where the entity is a branch or subsidiary of a foreign controller. It was also recommended that the rules be extended to Australian multi-national investors with non-portfolio investments on the basis that they were also in a position to maximise interest deductions. These recommendations were proposed to operate in conjunction with others relaxing the current rules, principally the debt: equity ratio.

The inclusion of total debt was seen as a means of addressing the situation described above where there is excess non-related foreign debt allocated to an Australian operation, while the extension of the thin capitalisation rules to branches as well as subsidiaries makes the treatment of these two methods of operating in Australia for a foreign entity more taxation neutral. (The rules currently apply only to Australian resident entities and branches of a foreign entity operating in Australia are not included in this category. The application of the rules to both subsidiaries and branches will make the choice of which vehicle to use less dependant on differing taxation treatment.)[2]

The extension of the rules to Australian multinationals was seen as a method of preventing 'excessive' debt being allocated to the Australian operations and so preventing 'unwarranted' interest deductions. The Ralph Report notes that this proposal faced broad opposition during consultations.[3]

In relation to the amount of debt on which interest deductions may be claimed, the Ralph Report recommended a two tier test.

First, deductions would be allowed where the debt: equity ratio did not exceed a 'safe harbour' limit, which was proposed to be 3:1. The increase from the current ratio of 2:1 was justified on the grounds that total debt would now be included. The amount of equity was proposed to be total shareholders funds, reflecting the use of total debt.

If the 3:1 ratio was exceeded, it was proposed that deductions be allowed if it could be shown that the gearing level could have been maintained by an independent party operating under the same terms and conditions having regard to a number of factors, including the world-wide gearing level of the group, the ability of the Australian operation to service the debt and global industry practices. This was termed the 'arm's length test'.[4] For financial institutions it was recommended that the ratio be the same as that imposed by the relevant regulatory body for capital reserves. If there was no relevant regulatory ratio, it was recommended that the general safe harbour ratio of 3:1 apply, with debt that has been 'on-lent' being excluded from the calculation, subject to a maximum ratio of 20:1.[5]

It was also recommended that the level of control to determine if there is a foreign controller be increased from the existing 15% to 50%. This was seen as consistent with the general rules applying to controlled foreign companies contained in Part X of the ITAA. It was considered that:

> Most foreign-owned investments are subject to 50 per cent or higher control, so moving to a 50 per cent control test will have minimal effect on the number of entities subject to thin capitalisation rules.[6]

The Ralph Report also examined new definitions for debt and equity designed to reflect the function of a contribution to an entity rather than its legal form. The new definitions are dealt with in the New Business Tax System (Debt and Equity) Bill 2001 and, while their impact on the proposed new thin capitalisation rules is relatively minor compared to the new rules contained in this Bill, their existence should be remembered when considering the impact of this Bill.

Government Response

The government's initial response to the Ralph report was to accept the recommendation regarding thin capitalisation, including its inclusion of total debt, application to Australian multinationals and the 'safe harbour' and 'arm's length' tests. It was proposed that the measures commence from 1 July 2001.[7] An Exposure Draft of the Bill was released on 21 February 2001 and following consultation and submissions on the Exposure Draft a number of further changes were announced on 22 May 2001. They included:

- The new rules will apply to an entity's financial year commencing after 30 June 2001, so that entities which do not have a financial year commencing on 1 July will not have to adopt the new rules during a financial year

- Where the proposed new debt and equity rules alter the status of an instrument entities will be able to elect that they retain their current status until 30 June 2004

- Taxpayers who claim interest deductions of less than $250 000 will be exempt from the thin capitalisation rules

- The safe harbour capital requirements for financial institutions will be reduced from 7% to 4%

- Certain large, low risk assets, such as leases, will be excluded from the definition of debt for financial institutions, and

- The definition of 'associates' for outward investors (ie Australian multinationals) will be altered to require that a family member by able to sufficiently influence the investor being included as an associate.

These and other changes are estimated to cost $70 million in 2001-2, $45 million in 2002-3, $60 million in 2003-4 and $70 million in 2004-5. The original revenue gains from the thin capitalisation changes were estimated by the Treasurer at $1340 million until the end of 2004-5 (Press Release No. 74 of 1999, Attachment O) and with these changes the new estimate is 'around $1.1 billion' (Budget Paper No. 2, 2001-2), reflecting the $245 million cost of the changes announced by the Treasurer.[8]

Main Provisions

Schedule 1 of the Bill will replace current Chapter 4 of the *Income Tax Assessment Act 1997* (ITAA97) by inserting a new Chapter 4 dealing with the new thin capitalisation rules. The current Chapter 4 has largely been repealed and dealt with the collection of various taxes which were deleted with the introduction of the Pay As You Go tax collection mechanism.

The threshold under which the proposed rules will not apply is contained in **proposed section 820-35**. It will apply where an entity and its associates have debt deductions of $250 000 or less. Debt deduction is given a wide meaning by **proposed section 820-40** and includes interest, the difference in value between a financial benefit received and provided, costs incurred in obtaining or maintaining a financial benefit and other expenses covered by the regulations. Specifically excluded items from the calculation of debt deduction include loses arising from hedging, salary and wages and rental expenses.

Outward Investors

The thin capitalisation rules for outward investors that are not authorised deposit-taking institutions (ADI) (An ADI is an entity which the Australian Prudential Regulation Authority has granted authorisation to conduct banking operations under the *Banking Act 1959,* eg banks are ADIs.) are contained in **proposed subdivision 820-B**.

An entity will be an outward investing entity (non-ADI) if it is an Australian controller of an Australian controlled foreign entity or has at least one overseas permanent establishment. The classification will also apply where an associate falls within this category and there will be two sub-categories, general and financial, with the latter applying where the entity is a financial entity, but not an ADI. If an entity is an outward investor, the next step is to determine if its adjusted average debt exceeds its maximum allowable debt.

- Adjusted average debt: In calculating this, any amount attributable to an overseas permanent establishment is to be disregarded (as these will be subject to tax in the country of the establishment).[9] The first step is to calculate the average value of the debt that gives rise to a debt deduction. From the average value of debt there is to be deducted relevant debt of associates and controlled foreign entities. It should be noted that this calculation deals with total debt and not just debt to a foreign controller therefore implementing the Ralph Report recommendations in this regard.

- Maximum allowable debt: This will be the greater of the safe harbour amount, arm's length amount or, if the outward investing entity is not also an inward investment entity, the worldwide gearing amount (Under the control rules it is possible for an entity to be classified as both an outward and inward investment entity. The recognition of the worldwide gearing amount for Australian entities allows them to gear Australian entities to the same extent as their overseas operations without interest deductions being disallowed.)

- Safe harbour amount: For a general outward investor this is determined according to **proposed section 820-95**, which provides for the value of the assets of the entity to be determined, and this amount to be reduced by associate entity debt and equity and controlled foreign entity debt and equity. This amount is further reduced by any non-debt liabilities of the entity and then multiplied by 0.75. Finally, any associate entity excess amount (calculated according to **proposed section 820-920**) is added. According to the Explanatory Memorandum this results in a debt: equity ratio of 3:1.[10]

  – For a financial outward investor, the safe harbour amount is the lesser of the total debt amount and the adjusted on-lent amount. The total debt amount is calculated on a similar basis to that for general outward investors, although the multiple used is 20/21 and, according to the Explanatory Memorandum, gives a debt: equity ratio of 20:1.[11] The adjusted on-lent amount allows a debt: equity ration of 3:1 after on-lent debt, certain leases and amounts agreed to be repurchased have been excluded.

- Arm's length amount: Basically this will be the amount of debt that the entity could reasonably be expected to have and which would have been provided by commercial lending institutions having regard to a number of factors, including the entity's commercial activities in Australia and the nature of the entity's assets and liabilities. This amount is a notional figure, does not depend on any actual offers of credit made and is to be estimated by the entity, although the Commissioner will have power to substitute a different amount (**proposed section 820-105**).

- Worldwide gearing debt amount: The formulas for calculating this amount for both general and financial outward investors are based on 120% of the average value of the worldwide debt of the entity divided by its average worldwide equity. This amount is subject to generally minor adjustments to reflect matters such as certain leasing and repurchasing arrangements (**proposed section 820-110**).

Where the entities adjusted average debt for the year exceeds their allowable debt for the year, the deduction for debt will be disallowed in accordance with the ratio by which the debt exceeds the allowable debt (**proposed section 820-115**). The same formulas will be used to determine if there is excess debt for a period of less than a year (**proposed section 820-120**).

Outward investing ADIs

The rules for these entities are contained in **proposed subdivision 820-D**. The thin capitalisation rules currently do not apply to an outward investing ADI unless it is foreign controlled. An entity will be an outward investing ADI if it is an ADI and:

- it controls one or more controlled foreign entities (whether an entity is controlled by a foreign interest is to be determined in accordance with the rules applying in relation to controlled foreign corporations – generally 50% control),
- it has a permanent establishment overseas, or
- it is an associate of an outward investing entity or an outward investing entity is an associate of it (it is possible for an entity to be an associate of another for tax purposes without the other entity being an associate of the first entity).

The minimum capital amount for outward investing ADIs will be the lesser of their safe harbour capital amount, arm's length capital amount and their worldwide capital amount. These are defined as:

- Safe harbour amount: This is to be determined according to the formula contained in **proposed section 820-310** and is the value of the risk weighted assets of the entity (basically the prudential regulator's determination of these assets less such assets attributable to overseas permanent establishments, certain controlled foreign equity assets and assets disregarded by the prudential regulator), multiplied by 4% plus the average of tier 1 prudential capital deductions of the entity, which is to be determined according to the prudential standards applicable to the entity.
- Arm's length capital amount: The minimum capital amount that the entity could be expected to have in carrying out its Australian business if the entity was a separate business acting at arm's length from other parts of the entity. As with the other classes of outwards investors this amount is a notional sum based on a number of assumptions, including that the Australian business did not carry on business through its overseas permanent establishments and had no controlled foreign entity equity and its assets and liabilities are as they were during the year (simply, this will be the amount of capital needed to support its Australian operations) (**proposed section 820-315**).
- Worldwide capital amount: This will be calculated by determining the relevant risk weighted assets of the entity, excluding those relating to overseas permanent establishments and controlled foreign entity equity, multiplied by 8/10ths of the group's worldwide capital ratio. To this is added the average of the relevant tier 1 prudential capital deductions of the entity (**proposed section 820-320**).

Where the average equity capital of the entity is less than its minimum requirement, a proportion of its debt deductions will be disallowed. The proportion will be determined by dividing the capital shortfall by the average debt for the year (**proposed section 820-325**).

Inward investing entities (non-ADI)

Proposed section 820-185 provides that part of a debt deduction will be disallowed where the inward investing entity is not also an outward investing entity (if it is proposed section 820-85 will apply) and its adjusted average debt exceeds its maximum allowable debt.

The rules will apply to foreign controlled Australian entities (investment vehicles) and foreign entities and, as with outward investment entities, there will be general and financial categories (the rules to determine if an Australian entity is foreign controlled will be discussed below).

- Adjusted average debt: The average value of the debt capital that gives rise to a deduction less, if the entity is a foreign controlled Australian entity, the value of associated entity debt or, if the entity is a foreign entity, associated entity debt attributable to the Australian operations.

- The maximum allowable debt will be the greater of the safe harbour debt amount and the arm's length debt amount.

  – Safe harbour debt amount: There are four categories of safe harbour debt amount depending on whether the entity is a foreign controlled Australian entity (inward investment vehicle) or a foreign entity and then whether they are a general or financial entity.

  – For a general inward investment vehicle, the safe harbour amount is to be determined according to **proposed section 820-195**, which provides that the amount is to be determined according to the average value of the assets of the entity, reduced by the debts of associated entities and equity and non-debt equity. This amount is to be multiplied by ¾. This is a similar formula as used for outward general investors and should result in the same 3:1 debt: equity ratio (ie deductions will not be reduced if an entity's debt to equity ratio does not exceed the same ratio allowed for outward investment entities).

  – Inward investment vehicle (financial): As with outward investors (financial) their safe harbour investment amount will be the lesser of their 'total debt amount' or their adjusted 'on-lent amount'. Similarly, the formula used to calculate the amount of debt relates to that used for the general vehicles, but the allowable ratio is 20:1 rather than 3:1. The similarities continue in the calculation of the on-lent amount where amounts borrowed and subsequently on-lent are excluded and a 3: debt equity ratio applies. Again this places the outward and inward investors in a similar position (**proposed section 820-200**).

  – Inward investor (general): This will be determined in a similar manner for outward investors but with only assets attributable to the Australian branch to be taken into consideration. Again the debt to equity ratio will be ¾ of these assets, resulting in a 3:1 debt: equity ratio (**proposed section 820-205**).

- Inward investor (financial): A repeat of the situation for general inward investors but with the multiple being 20/21 resulting in a 20:1 allowable debt: equity ratio and only Australian assets being considered. Such entities will also have the option of choosing the on-lent version of the test where only Australian assets are considered, on-lent amounts are disregarded and the debt: equity ratio is 3:1 (**proposed section 820-210**).

- Arm's length debt amount: This is a combination of the amount of debt that an entity could reasonably be expected to have (and is attributed to its Australian operations) and the amount that non-associated commercial financial institutions could be expected to have lent the entity. As with other calculations of arm's length amounts, this is a notional amount to be determined according to a number of assumptions, including that the entity vehicle did not have associated entity debt or, if it is a foreign entity, the debt only relates to the Australian operations and that any guarantee or security given by associates or overseas permanent establishments is disregarded. Account is also to be had of the nature of the assets of the Australian entity, the entity's capacity to meet its liabilities and any profits of the entity (**proposed section 820-215**).

If the adjusted average debt exceeds the maximum allowable debt, a proportion of debt deductions will be disallowed. The proportion will be the same as that calculated by dividing the excess debt by the average debt (**proposed section 820-220**).

Inward investors (ADI)

An ADI inward investor will be a foreign bank that carries out its operations in Australia through one or more permanent establishments and will have its debt deductions reduced where its average equity capital is less than a minimum capital amount.

- Average equity capital: This will be the average value during the year of equity capital attributable to the Australian permanent establishments that are not related to 'OB activities' (this term is defined in section 121D of the ITAA and generally relates to activities involving an overseas person) and loans to the Australian permanent establishments which do not give rise to a deduction (**proposed section 820-395**).

- Minimum capital amount: This will be the lesser of the safe harbour capital amount and the arm's length capital amount. The safe harbour amount will be 4% of the risk-weighted assets of the entity that relate to the Australian permanent establishment, excluding those relating to OB activities. The arm's length capital amount will be the minimum amount of equity capital that the entity could reasonably be expected to have to carry on its Australian operations if it was a separate entity and dealt with other parts of the group on an arm's length basis. As with other arm's length amounts, this is a notional sum determined having regard to a number of assumptions and factors, including that the entity only conducted banking activity in Australia and that the entity's assets and liabilities were the same as they actually were during the year (**proposed section 820-410**).

The proportion of the debt to be disallowed will be determined according to the capital shortfall divided by the average debt for the year (**proposed section 820-415**).

Groups

The Bill allows members of a group to choose to be treated as a group for the calculation of whether part of the debt deductions should be denied, and, the proportional reduction in the deduction will apply to all members of the group.

Proposed subdivision 820-F deals with the rules for resident groups. In applying the rules, the various amounts are to be calculated as if the group prepared consolidated accounts (whether such accounts are prepared or not) (**proposed section 820-470**). For a 'maximum TC group' (ie one where one company which is not a 100% subsidiary of another company and its 100% owned subsidiaries), one of the companies is an Australian entity, not a dual national and is a 100% subsidiary may choose:

- that all companies which are Australian entities and not dual residents which end their financial year on the same day, together with all partnerships and trusts in which the group holds all interests and permanent establishments of foreign banks which choose to be in the group, be treated as one group (**proposed section 820-505**).
- that the entities be treated as more than one group with the members of the subgroups being subsidiaries of the same company in the maximum TC group (**proposed section 820-510**), or
- that there be no groups (**proposed section 820-520**).

As with individual entities, groups will be classified as outward investors (non-ADI), general or financial, outward investors (ADI), inward investors (non-ADI), general or financial or inward investors (ADI). The classification will be made under the following rules:

- Outward investor (general): At least one entity in the group is an outward investor (general) and none is a financial entity or an ADI.
- Outward investor (financial): At least one member is an outward investor (financial) and no entity is an ADI, or the group has at least one outward investor (general) and a financial entity, that is not an ADI, at the end of the year (this reflects the similar rules particularly the 3:1 safe harbour ratio once on-lent amounts are excluded that apply to these two classes).

- Inward investment vehicle (general): At least one entity in the group is an inward investment vehicle (general) and the group has no outward investment vehicle (non-ADI), financial entity or ADI at the end of the year.
- Inward investment vehicle (financial): At least one member of the group falls within this category and, at the end of the year, no group member is an outward investment vehicle, general or financial, or an ADI.
- Outward investment entity (ADI): The group has at least one of these entities at the end of the year, or at the end of the year, at least one of the members of the group is an outward investing entity (non-ADI) and one member is an ADI (**proposed section 820-550**).
- Inward investing entities (ADI) will generally not be able to use the grouping rules unless they are also an outward investing entity (ADI) (**proposed section 820-555**).
- The general rule is that once a group has been classified the previously described rules for that classification will apply to the group, although there will be modifications to some components in the various formulas that apply (eg in determining adjusted average equity capital) (**proposed sections 820-560-575**).

Control

Proposed subdivision 820-H, which deals with the definition of control of entities for both Australian and foreign controllers, and **proposed subdivision 820-I**, which deals with who is an associate of an entity, are substantially similar to the rules contained in Part X of the ITAA for controlled foreign corporations (as was recommended in the Ralph Report – see above). As the provisions do not implement new policy they will not be examined in this Digest, except to note that the control test will increase from the current 15% rate to 50% or 40% in certain circumstances. Control is determined according to the interest of the relevant entity and its associates.

Record Keeping

Proposed subdivision 820-L will insert special record keeping rules in respect of:

- inward investors which operate through a permanent establishment in Australia. The requirements are that the entity maintain sufficient records to establish the position of the Australian permanent establishment, which is necessary for the operation of the new rules,
- the arm's length values calculated by an entity. The records are to relate to the various assumptions and factors to be considered when determining the notional value allocated to an arm's length transaction.

Application: To the income year commencing on or after 1 July 2001. However, the record keeping requirements are to apply from the year commencing on or after 1 July 2002. There are also transitional provisions which allow the current rules contained in the ITAA to continue to apply for the remainder of a financial year for an entity which had a financial year commencing before 1 July 2001 (this will prevent the entity from being required to apply different rules for parts of a financial year). These transition provisions are contained in **proposed Division 820** which will be inserted into the *Income Tax (Transitional Provisions) Act 1997* by **item 22** of **Schedule 1** of the Bill. As a consequential amendment, **item 4** of **Schedule 1** will repeal the current rules contained in Divisions 16F and 16G of the ITAA

Endnotes

1 Review of Business Taxation, Report, July 1999, p.659.

2 ibid.

3 ibid., p. 665.

4 ibid., pp. 660–1.

5 ibid., p. 663.

6 ibid., p. 666.

7 Treasurer, *Press Release* No. 74 of 1999, 11 November 1999, Attachment G.

8 Budget Measures 2001-02, Budget Paper No. 2, p. 34.

9 There are three methods for calculating average amounts of the value of the amount, in this case debt, at the first and last days of the financial year added together and divided by 2; the three day method where the first, last and middle days of the year are added and divided by 3; and the frequent measurement method where quarterly or more frequent measurements are taken, added together and divided by the number of periods used – **proposed subdivision 820-G**).

10 *Explanatory Memorandum*, p. 33.

11 ibid.

Appendix 1

Control, Debt and Equity Current Rules

A non-resident, or a prescribed dual resident, will be taken to be in control of a resident entity where that person, either alone or with their associates, satisfies one a number of requirements. The principal test is whether the non-resident is in a position of receive 15% of the dividends or capital of a company, 15% of the capital or profits of a partnership or 15% of the income or corpus of a trust estate, or is capable under a scheme of gaining such an entitlement. The 15% threshold is relatively common in other areas of the law, such as determining the controlling interests for corporations, although in other areas of taxation law, such as determining if a corporation is a controlled foreign corporation, a higher level test is used.

Where there is a foreign controller, the next step is to determine the level of foreign debt and equity. The level of foreign debt is based on whether interest is payable on any amounts borrowed from the foreign controller and their associates, so that if interest is not payable the amount is not included in the calculation of the amount of debt. Where the resident company is not a financial institution, amounts borrowed from a non-resident who is not the foreign controller or their associate may be included if it is borrowed subject to a guarantee by the foreign controller or their associate. However, this amount will not be included if the Commissioner is satisfied that the amount could have been borrowed without the guarantee. Amounts raised by the issue of debentures through a public offer are excluded from the calculation of debt to the foreign controller. For financial institutions, amounts held by a foreign bank in accounts maintained solely for the short term settlement of international transactions are also to be excluded in calculating the amount of debt.

The calculation of foreign equity for a resident company is based on the amount of share capital the foreign controller and their associates are entitled to plus any amount from accumulated profits or asset revaluation which the foreign controller and their associates would be entitled to. This amount is then reduced by amounts owed to the resident company by the foreign controller or their associates, although public issue debentures and short term trade credits are excluded from calculating the amounts owed. For financial institutions, amounts held for the short term settlement of international transactions are also excluded. For partnerships and trusts, the value of the foreign controller's equity is determined according to their interest in the partnership (where the interest is determined according to the end of year balance sheet of the partnership) or trust (where the interest is based on their fixed interest in the trust). In both cases the interest is reduced by any amount owed to the partnership or trust. There are also specific anti-avoidance provisions contained in the ITAA to reduce the chances of foreign controlled entities reducing debt or increasing equity through various schemes.