



New Business Tax System (Thin Capitalisation) Act 2001

No. 162, 2001



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**An Act to implement the New Business Tax System
in relation to thin capitalisation, and for related
purposes**

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New Business Tax System (Thin Capitalisation) Act 2001

No. 162, 2001

An Act to implement the New Business Tax System in relation to thin capitalisation, and for related purposes

[Assented to 1 October 2001]

The Parliament of Australia enacts:

1 Short title

This Act may be cited as the *New Business Tax System (Thin Capitalisation) Act 2001*.

2 Commencement

- (1) Subject to subsections (2) and (3), this Act is taken to have commenced on 1 July 2001, immediately after the commencement of the *New Business Tax System (Debt and Equity) Act 2001*.
- (2) Items 17 and 19 of Schedule 1 are taken to have commenced on the later of:
 - (a) 1 July 2001, immediately after the commencement of the *New Business Tax System (Debt and Equity) Act 2001*; or
 - (b) the time when the *Corporations Act 2001* commences.
- (3) Item 18 of Schedule 1 is taken to have commenced on the later of:
 - (a) 1 July 2001, immediately after the commencement of the *New Business Tax System (Debt and Equity) Act 2001*; or
 - (b) the time when Part 2 of the *Financial Sector (Collection of Data) Act 2001* commences.

3 Schedule(s)

Subject to section 2, each Act that is specified in a Schedule to this Act is amended or repealed as set out in the applicable items in the Schedule concerned, and any other item in a Schedule to this Act has effect according to its terms.

Schedule 1—Thin capitalisation rules

Part 1—New thin capitalisation rules

Income Tax Assessment Act 1997

1 Chapter 4

Repeal the Chapter, substitute:

Chapter 4—International aspects of income tax

Part 4-5—General

[The next Division is Division 820.]

Division 820—Thin capitalisation rules

Table of Subdivisions

	Guide to Division 820
820-A	Preliminary
820-B	Thin capitalisation rules for outward investing entities (non-ADI)
820-C	Thin capitalisation rules for inward investing entities (non-ADI)
820-D	Thin capitalisation rules for outward investing entities (ADI)
820-E	Thin capitalisation rules for inward investing entities (ADI)
820-F	How this Division applies to resident TC groups
820-G	Calculating the average values
820-H	Control of entities
820-I	Associate entities
820-J	Equity interests in trusts and partnerships
820-K	Zero-capital amounts

820-L Record keeping requirements

Guide to Division 820

820-1 What this Division is about

This Division applies to foreign controlled Australian entities, Australian entities that operate internationally and foreign entities that operate in Australia.

Financing expenses that an entity can otherwise deduct from its assessable income may be disallowed under this Division in the following circumstances:

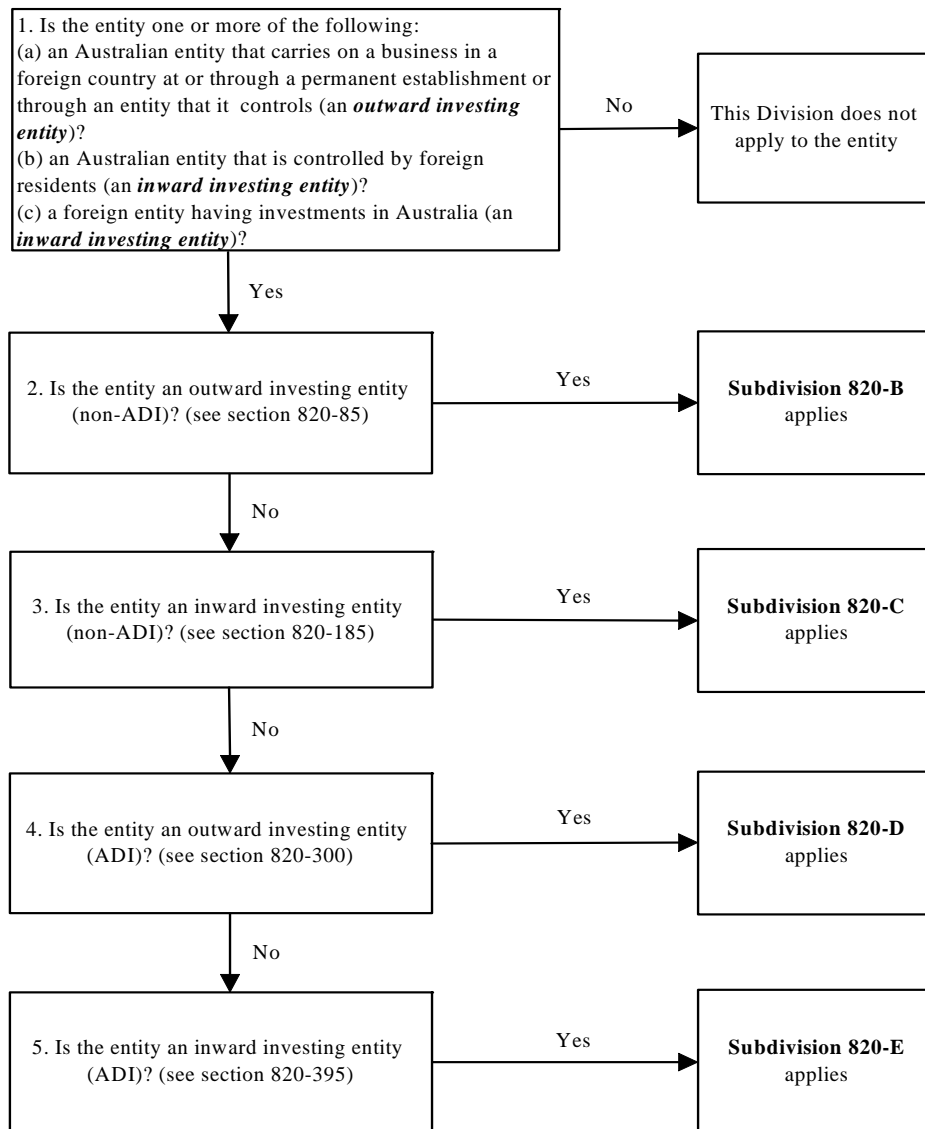
- for an entity that is not an authorised deposit-taking institution for the purposes of the *Banking Act 1959* (an **ADI**)—the entity’s debt exceeds the prescribed level (and the entity is therefore “thinly capitalised”);
- for an entity that is an ADI—the entity’s capital is less than the prescribed level (and the entity is therefore “thinly capitalised”).

Table of sections

820-5 Does this Division apply to an entity?
820-10 Map of Division

820-5 Does this Division apply to an entity?

The following diagram shows you how to work out whether this Division applies to an entity.



820-10 Map of Division

The following table sets out a map of this Division.

Schedule 1 Thin capitalisation rules
Part 1 New thin capitalisation rules

Map of Division

Item	This Subdivision:	sets out:
1	Subdivision 820-B or 820-C	(a) the meaning of maximum allowable debt for the Subdivision; and (b) how an entity covered by the Subdivision would have all or a part of its debt deductions disallowed if the maximum allowable debt is exceeded; and (c) the application of these rules in relation to a part of an income year.
2	Subdivision 820-D or 820-E	(a) the meaning of minimum capital amount for the Subdivision; and (b) how an entity covered by the Subdivision would have all or a part of its debt deductions disallowed if the minimum capital amount is not reached; and (c) the application of these rules in relation to a part of an income year.
3	Subdivision 820-F	special rules to apply this Division to resident TC groups.
4	Subdivision 820-G	the methods of calculating the average value of a matter for the purposes of this Division.
5	Subdivision 820-H	the rules for determining: (a) whether or not an Australian entity controls a foreign entity (for the purposes of determining whether or not Subdivision 820-B or 820-D applies to that Australian entity); and (b) whether or not an Australian entity is controlled by a foreign entity (for the purposes of determining whether or not Subdivision 820-C applies to that Australian entity).
6	Subdivision 820-I	the meaning of various concepts about associate entity for the purposes of this Division.
7	Subdivision 820-J	the meaning of equity interests in trusts and partnerships for the purposes of this Division.

Map of Division

Item	This Subdivision:	sets out:
8	Subdivision 820-K	the meaning of zero-capital amount for the purposes of this Division.
9	Subdivision 820-L	special record keeping requirements for the purposes of this Division.

[This is the end of the Guide.]

Subdivision 820-A—Preliminary

Table of sections

820-30	Object of Division
820-35	Application—\$250,000 threshold
820-37	Application—assets threshold
820-40	Meaning of <i>debt deduction</i>

820-30 Object of Division

The Object of this Division is to ensure that the following entities do not reduce their tax liabilities by using an excessive amount of *debt capital to finance their Australian operations:

- (a) *Australian entities that operate internationally;
- (b) Australian entities that are foreign controlled;
- (c) *foreign entities that operate in Australia.

820-35 Application—\$250,000 threshold

Subdivision 820-B, 820-C, 820-D or 820-E does not apply to disallow any *debt deduction of an entity for an income year if the total debt deductions of that entity and all its *associate entities for that year are \$250,000 or less.

820-37 Application—assets threshold

Subdivision 820-B, 820-C, 820-D or 820-E does not apply to disallow any *debt deduction of an entity for an income year if:

Schedule 1 Thin capitalisation rules

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- (a) the entity is an *outward investing entity (non-ADI) or an *outward investing entity (ADI) for a period that is all or any part of that year; and
- (b) the entity is not also an *inward investing entity (non-ADI) or an *inward investing entity (ADI) for all or any part of that period; and
- (c) the result of applying the following formula is equal to or greater than 0.9:

Sum of the average Australian assets of the entity and the average
Australian assets of each of the entity's *associates

Sum of the average total assets of the entity and the average total
assets of each of the entity's associates

where:

average Australian assets of an entity is the average value, for that year, of all the assets of the entity, other than:

- (a) assets attributable to the entity's *overseas permanent establishment; or
- (b) assets comprised by the entity's *controlled foreign entity equity; or
- (c) assets comprised by the entity's *controlled foreign entity debt.

average total assets of an entity means the average value, for that year, of all the assets of the entity.

820-40 Meaning of debt deduction

- (1) **Debt deduction**, of an entity and for an income year, is a cost incurred by the entity in relation to a *debt interest issued by the entity, to the extent to which:
 - (a) the cost is:
 - (i) interest, an amount in the nature of interest, or any other amount that is calculated by reference to the time value of money; or
 - (ii) the difference between the *financial benefits received, or to be received, by the entity under the *scheme giving rise to the debt interest and the financial benefits provided, or to be provided, under that scheme; or

- (iii) any amount directly incurred in obtaining or maintaining the financial benefits received, or to be received, by the entity under the scheme giving rise to the debt interest; or
 - (iv) any other expense incurred by the entity that is specified in the regulations made for the purposes of this subparagraph; and
 - (b) the entity can, apart from this Division, deduct the cost from its assessable income for that year; and
 - (c) the cost is not incurred before 1 July 2001 if the entity can deduct it under section 25-25.
- (2) A cost covered by paragraph (1)(a) includes, but is not limited to, any of the following:
- (a) an amount in substitution for interest;
 - (b) a discount in respect of a security;
 - (c) a fee or charge in respect of a debt, including application fees, line fees, service fees, brokerage and stamp duty in respect of document registration or security for the debt interest;
 - (d) an amount that is taken under an ^{*}income tax law to be an amount of interest in respect of a lease, a hire purchase arrangement or any other ^{*}arrangement specified in that law;
 - (e) any loss in respect of:
 - (i) a reciprocal purchase agreement (otherwise known as a repurchase agreement);
 - (ii) a sell-buyback arrangement;
 - (iii) a securities loan arrangement;
 - (f) any amount covered by paragraph (1)(a) that has been assigned or is dealt with in any way on behalf of the party who would otherwise be entitled to that amount.
- (3) To avoid doubt, the following amounts that are incurred by an entity in relation to a ^{*}debt interest issued by the entity are not covered by paragraph (1)(a):
- (a) losses and outgoings directly associated with hedging or managing the financial risk in respect of the debt interest;
 - (b) losses incurred by the entity in relation to which the following apply:

- (i) the losses would otherwise be a cost covered by subparagraph (1)(a)(ii); but
- (ii) the benefits mentioned in that subparagraph are measured in a foreign currency or a unit of account other than Australian currency (for example, ounces of gold) and the losses have arisen only because of changes in the rate of converting that foreign currency or that unit of account into Australian currency;
- (c) salary or wages;
- (d) rental expenses for a lease if the lease is not a debt interest;
- (e) an expense specified in the regulations made for the purposes of this paragraph.

Subdivision 820-B—Thin capitalisation rules for outward investing entities (non-ADI)

Guide to Subdivision 820-B

820-65 What this Subdivision is about

This Subdivision sets out the thin capitalisation rules that apply to an Australian entity that has certain types of overseas investments and is not an authorised deposit-taking institution (an **ADI**). These rules deal with the following matters:

- how to work out the entity's maximum allowable debt for an income year;
- how all or a part of the debt deductions claimed by the entity may be disallowed if the maximum allowable debt is exceeded;
- how to apply these rules to a period that is less than an income year.

Table of sections

Operative provisions

820-85 Thin capitalisation rule for outward investing entities (non-ADI)

820-90	Maximum allowable debt
820-95	Safe harbour debt amount—outward investor (general)
820-100	Safe harbour debt amount—outward investor (financial)
820-105	Arm’s length debt amount
820-110	Worldwide gearing debt amount
820-115	Amount of debt deduction disallowed
820-120	Application to part year periods

[This is the end of the Guide.]

Operative provisions

820-85 Thin capitalisation rule for outward investing entities (non-ADI)

Thin capitalisation rule

- (1) This subsection disallows all or a part of each *debt deduction of an entity for an income year (to the extent that it is not attributable to an *overseas permanent establishment of the entity) if, for that year:
 - (a) the entity is an *outward investing entity (non-ADI) (see subsection (2)); and
 - (b) the entity’s *adjusted average debt (see subsection (3)) exceeds its *maximum allowable debt (see section 820-90).

Note 1: This Subdivision does not apply if the total debt deductions of that entity and all its associate entities for that year are \$250,000 or less, see section 820-35.

Note 2: To work out the amount to be disallowed, see section 820-115.

Note 3: For the rules that apply to an entity that is an outward investing entity (non-ADI) for only a part of an income year, see section 820-120 in conjunction with subsection (2) of this section.

Note 4: A resident TC group may be an outward investing entity (non-ADI) to which this Subdivision applies, see Subdivision 820-F.

Outward investing entity (non-ADI)

- (2) The entity is an **outward investing entity (non-ADI)** for a period that is all or a part of an income year if, and only if, it is:
 - (a) an *outward investor (general) for that period (as set out in items 1 and 3 of the following table); or

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(b) an *outward investor (financial) for that period (as set out in items 2 and 4 of that table).

Outward investing entity (non-ADI)			
Item	If:	and:	then:
1	<p>the entity (the <i>relevant entity</i>) is one or both of the following throughout a period that is all or a part of an income year:</p> <p>(a) an *Australian controller of at least one *Australian controlled foreign entity (not necessarily the same Australian controlled foreign entity throughout that period);</p> <p>(b) an Australian entity that carries on a *business at or through at least one *overseas permanent establishment (not necessarily the same permanent establishment throughout that period)</p>	<p>the relevant entity is not a *financial entity, nor an *ADI, at any time during that period</p>	<p>the relevant entity is an <i>outward investor (general)</i> for that period</p>
2	<p>the entity (the <i>relevant entity</i>) satisfies this column in item 1</p>	<p>the relevant entity is a *financial entity throughout that period</p>	<p>the relevant entity is an <i>outward investor (financial)</i> for that period</p>
3	<p>(a) the entity (the <i>relevant entity</i>) is an *Australian entity throughout a period that is all or a part of an income year; and</p> <p>(b) throughout that period, the relevant entity is an *associate entity of another Australian entity; and</p> <p>(c) that other Australian entity is an *outward investing entity (non-ADI) or an *outward investing entity (ADI) for that period</p>	<p>the relevant entity is not a *financial entity, nor an *ADI, at any time during that period</p>	<p>the relevant entity is an <i>outward investor (general)</i> for that period</p>

Outward investing entity (non-ADI)

Item	If:	and:	then:
4	the entity (the <i>relevant entity</i>) and another Australian entity satisfy this column in item 3	the relevant entity is a *financial entity throughout that period	the relevant entity is an <i>outward investor (financial)</i> for that period

Note 1: To determine whether an entity is an Australian controller of an Australian controlled foreign entity, see Subdivision 820-H.

Note 2: The rules that apply to an outward investor (general) are different from those that apply to an outward investor (financial) in some instances. For example, see sections 820-95 and 820-100.

Adjusted average debt

- (3) The entity's *adjusted average debt* for an income year is the result of applying the method statement in this subsection. In applying the method statement, disregard any amount that is attributable to the entity's *overseas permanent establishments.

Method statement

- Step 1.* Work out the average value, for that year (the *relevant year*), of all the *debt capital of the entity that gives rise to *debt deductions of the entity for that or any other income year.
- Step 2.* Reduce the result of step 1 by the average value, for the relevant year, of all the *associate entity debt of the entity (other than any *controlled foreign entity debt of the entity).
- Step 3.* Reduce the result of step 2 by the average value, for the relevant year, of all the *controlled foreign entity debt of the entity.
- Step 4.* If the entity is a *financial entity throughout the relevant year, add to the result of step 3 the average value, for that year, of the entity's *zero-capital amount, to the extent that:

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- (a) the zero-capital amount is attributable to the securities loan arrangements mentioned in step 1 of the method statement in subsection 820-942(1); and
 - (b) the securities loan arrangements are not *debt interests.
- Step 5.* Add to the result of step 4 the average value, for the relevant year, of any *debt capital of the entity that does not give rise to any *debt deductions of the entity for that or any other income year, if:
- (a) the debt capital is comprised of *debt interests issued to another entity that remain *on issue; and
 - (b) that other entity is an *outward investing entity (non-ADI) or *inward investing entity (non-ADI) for a period that is, or includes, all or a part of the relevant year; and
 - (c) for the purposes of the application of this Division to the entities, and in relation to only that part of the period that falls within the relevant year, the entities do not use the same *valuation days and the same number of valuation days to calculate the average value of their respective debt capital.
- The result of this step is the *adjusted average debt*.

Note: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

- (4) The entity's *adjusted average debt does not exceed its *maximum allowable debt if the adjusted average debt is nil or a negative amount.

820-90 Maximum allowable debt

Entity is not also an inward investment vehicle (general) or inward investment vehicle (financial)

- (1) The entity's **maximum allowable debt** for an income year is the greatest of the following amounts if the entity is not also an *inward investment vehicle (general) or an *inward investment vehicle (financial) for all or any part of that year:
- (a) the *safe harbour debt amount;
 - (b) the *arm's length debt amount;
 - (c) the *worldwide gearing debt amount.

Note: The safe harbour debt amount and the worldwide gearing debt amount differ depending on whether the entity is an outward investor (general) or an outward investor (financial), see sections 820-95, 820-100 and 820-110.

Entity is also an inward investment vehicle (general) or inward investment vehicle (financial)

- (2) The entity's **maximum allowable debt** for an income year is the greater of the following amounts if the entity is also an *inward investment vehicle (general) or an *inward investment vehicle (financial) for all or any part of that year:
- (a) the *safe harbour debt amount;
 - (b) the *arm's length debt amount.

Note: The safe harbour debt amount differs depending on whether the entity is an outward investor (general) or an outward investor (financial), see sections 820-95 and 820-100.

820-95 Safe harbour debt amount—outward investor (general)

If the entity is an *outward investor (general) for the income year, the **safe harbour debt amount** is the result of applying the method statement in this section. In applying the method statement, disregard any amount that is attributable to the entity's *overseas permanent establishments.

Method statement

Step 1. Work out the average value, for the income year, of all the assets of the entity.

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<i>Step 2.</i>	Reduce the result of step 1 by the average value, for that year, of all the *associate entity debt of the entity, other than associate entity debt that is *controlled foreign entity debt of the entity.
<i>Step 3.</i>	Reduce the result of step 2 by the average value, for that year, of all the *associate entity equity of the entity, other than associate entity equity that is *controlled foreign entity equity of the entity.
<i>Step 4.</i>	Reduce the result of step 3 by the average value, for that year, of all the *controlled foreign entity debt of the entity.
<i>Step 5.</i>	Reduce the result of step 4 by the average value, for that year, of all the *controlled foreign entity equity of the entity.
<i>Step 6.</i>	Reduce the result of step 5 by the average value, for that year, of all the *non-debt liabilities of the entity. If the result of this step is a negative amount, it is taken to be nil.
<i>Step 7.</i>	Multiply the result of step 6 by $\frac{3}{4}$.
<i>Step 8.</i>	Add to the result of step 7 the average value, for that year, of the entity's *associate entity excess amount. The result of this step is the safe harbour debt amount .

Example: AK Pty Ltd, a company that is an Australian entity, has an average value of assets (other than assets attributable to its overseas permanent establishments) of \$100 million.

The average values of its relevant associate entity debt, associate entity equity, controlled foreign entity debt, controlled foreign entity equity and non-debt liabilities are \$10 million, \$8 million, \$5 million, \$2 million and \$5 million respectively. Deducting these amounts from the result of step 1 (through the application of steps 2 to 6) leaves \$70 million. Multiplying \$70 million by $\frac{3}{4}$ results in \$52.5 million. As the average value of the company's associate entity excess amount is \$4.5 million, the safe harbour debt amount is therefore \$57 million.

820-100 Safe harbour debt amount—outward investor (financial)

- (1) If the entity is an *outward investor (financial) for the income year, the *safe harbour debt amount* is the lesser of the following amounts:
- (a) the *total debt amount (worked out under subsection (2));
 - (b) the *adjusted on-lent amount (worked out under subsection (3)).

However, if the 2 amounts are equal, it is the total debt amount.

Total debt amount

- (2) The *total debt amount* is the result of applying the method statement in this subsection. In applying the method statement, disregard any amount that is attributable to the entity's *overseas permanent establishments.

Method statement

- Step 1.* Work out the average value, for the income year, of all the assets of the entity.
- Step 2.* Reduce the result of step 1 by the average value, for that year, of all the *associate entity debt of the entity, other than associate entity debt that is *controlled foreign entity debt of the entity.
- Step 3.* Reduce the result of step 2 by the average value, for that year, of all the *associate entity equity of the entity, other than associate entity equity that is *controlled foreign entity equity of the entity.
- Step 4.* Reduce the result of step 3 by the average value, for that year, of all the *controlled foreign entity debt of the entity.
- Step 5.* Reduce the result of step 4 by the average value, for that year, of all the *controlled foreign entity equity of the entity.
- Step 6.* Reduce the result of step 5 by the average value, for that year, of all the *non-debt liabilities of the entity.

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- Step 7.* Reduce the result of step 6 by the average value, for that year, of the entity's *zero-capital amount. If the result of this step is a negative amount, it is taken to be nil.
- Step 8.* Multiply the result of step 7 by ²⁰/₂₁.
- Step 9.* Add to the result of step 8 the average value, for that year, of the entity's *zero-capital amount.
- Step 10.* Add to the result of step 9 the average value, for that year, of the entity's *associate entity excess amount. The result of this step is the **total debt amount**.

Example: GLM Limited, a company that is an Australian entity, has an average value of assets (other than assets attributable to its overseas permanent establishments) of \$160 million.

The average values of its relevant associate entity debt, associate entity equity, controlled foreign entity debt, controlled foreign entity equity, non-debt liabilities and zero capital amount are \$5 million, \$5 million, \$9 million, \$6 million, \$5 million and \$4 million respectively. Deducting these amounts from the result of step 1 (through applying steps 2 to 7) leaves \$126 million. Multiplying \$126 million by ²⁰/₂₁ results in \$120 million. Adding the average zero capital amount of \$4 million results in \$124 million. As the company does not have any associate entity excess amount, the total debt amount is therefore \$124 million.

Adjusted on-lent amount

- (3) The **adjusted on-lent amount** is the result of applying the method statement in this subsection. In applying the method statement, disregard any amount that is attributable to the entity's *overseas permanent establishments.

Method statement

- Step 1.* Work out the average value, for the income year, of all the assets of the entity.
- Step 2.* Reduce the result of step 1 by the average value, for that year, of all the *associate entity equity of the entity, other than associate entity equity that is *controlled foreign entity equity of the entity.

- Step 3.* Reduce the result of step 2 by the average value, for that year, of all the *controlled foreign entity debt of the entity.
- Step 4.* Reduce the result of step 3 by the average value, for that year, of all the *controlled foreign entity equity of the entity.
- Step 5.* Reduce the result of step 4 by the average value, for that year, of all the *non-debt liabilities of the entity.
- Step 6.* Reduce the result of step 5 by the amount (the **average on-lent amount**) which is the average value, for that year, of the entity's *on-lent amount (other than *controlled foreign entity debt of the entity). If the result of this step is a negative amount, it is taken to be nil.
- Step 7.* Multiply the result of step 6 by $\frac{3}{4}$.
- Step 8.* Add to the result of step 7 the average on-lent amount.
- Step 9.* Reduce the result of step 8 by the average value, for that year, of all the *associate entity debt of the entity, other than associate entity debt that is *controlled foreign entity debt of the entity.
- Step 10.* Add to the result of step 9 the average value, for that year, of the entity's *associate entity excess amount. The result of this step is the **adjusted on-lent amount**.

Example: GLM Limited, a company that is an Australian entity, has an average value of assets (other than assets attributable to its overseas permanent establishments) of \$160 million.

The average values of its relevant associate entity equity, controlled foreign entity debt, controlled foreign entity equity, non-debt liabilities and on-lent amount are \$5 million, \$9 million, \$6 million, \$5 million and \$35 million respectively. Deducting these amounts from the result of step 1 (through applying steps 2 to 6) leaves \$100 million. Multiplying \$100 million by $\frac{3}{4}$ results in \$75 million. Adding the average on-lent amount of \$35 million results in \$110 million. Reducing the result of step 8 by the associate entity debt amount of \$5 million equals \$105 million. As the company does not have any associate entity excess amount, the adjusted on-lent amount is therefore \$105 million.

820-105 Arm's length debt amount

- (1) The *arm's length debt amount* is a notional amount that, having regard to the factual assumptions set out in subsection (2) and the relevant factors mentioned in subsection (3), would satisfy both paragraphs (a) and (b):
- (a) the amount represents a notional amount of *debt capital that:
 - (i) the entity would reasonably be expected to have throughout the income year; and
 - (ii) would give rise to an amount of *debt deductions of the entity for that or any other income year; and
 - (iii) would be attributable to the entity's Australian business as mentioned in subsection (2);
 - (b) commercial lending institutions that were not *associates of the entity (the *notional lenders*) would reasonably be expected to have entered into *schemes that would:
 - (i) give rise to *debt interests that constituted that notional amount of debt capital of the entity; and
 - (ii) provide for terms and conditions for the debt interests that would reasonably be expected to have applied if the entity and the notional lenders had been dealing at arm's length with each other throughout the income year mentioned in subparagraph (1)(a)(i).

Note: The entity must keep records in accordance with section 820-980 if the entity works out an amount under this section.

Factual assumptions

- (2) Irrespective of what actually happened during that year, the following assumptions must be made in working out that amount:
- (a) the entity's commercial activities in connection with Australia (the *Australian business*) during that year do not include:
 - (i) any *business carried on by the entity at or through its *overseas permanent establishments; and
 - (ii) the holding of any *associate entity debt, *controlled foreign entity debt or *controlled foreign entity equity; and
 - (b) the entity had carried on the Australian business that it actually carried on during that year;

- (c) the nature of the entity's assets and liabilities (to the extent that they are attributable to the Australian business) had been as they were during that year;
- (d) except as stated in paragraph (1)(b) and paragraph (e) of this subsection, the entity had carried on the Australian business in the same circumstances as what actually existed during that year;
- (e) any guarantee, security or other form of credit support provided to the entity in relation to the Australian business during that year:
 - (i) by its *associates; or
 - (ii) by the use of assets of the entity that are attributable to the entity's overseas permanent establishments;is taken not to have been received by the entity.

Relevant factors

- (3) On the basis of the factual assumptions set out in subsection (2), the following factors must be taken into account in determining whether or not an amount satisfies paragraphs (1)(a) and (b):
 - (a) the functions performed, the assets used, and the risks assumed, by the entity in relation to the Australian business throughout that year;
 - (b) the terms and conditions of the *debt capital that the entity actually had in relation to the Australian business throughout that year;
 - (c) the nature of, and title to, any assets of the entity attributable to the Australian business that were available to the entity throughout that year as security for its debt capital for that business;
 - (d) the purposes for which *schemes for debt capital had been actually entered into by the entity in relation to the Australian business throughout that year;
 - (e) the entity's capacity to meet all its liabilities in relation to the Australian business (whether during that year or at any other time);
 - (f) the profit of the entity (within the meaning of the *accounting standards), and the return on its capital, in relation to the Australian business (whether during that year or at any other time);

- (g) the debt to equity ratios of the following throughout that year:
 - (i) the entity;
 - (ii) the entity in relation to the Australian business;
 - (iii) each of the entity's *associate entities that engage in commercial activities similar to the Australian business;
- (h) the commercial practices adopted by independent parties dealing with each other at arm's length in the industry in which the entity carries on the Australian business throughout that year (whether in Australia or in comparable markets elsewhere);
- (i) the way in which the entity financed its commercial activities (other than the Australian business) throughout that year;
- (j) the general state of the Australian economy throughout that year;
- (k) all of the above factors existing at the time when the entity last entered into a scheme that gave rise to an actual *debt interest attributable to the Australian business that remains *on issue throughout that year;
- (l) any other factors which are specified in the regulations made for the purposes of this section, including factors specific to an *outward investor (general) or an *outward investor (financial).

Commissioner's power

- (4) If the Commissioner considers an amount worked out by the entity under this section does not appropriately take into account the factual assumptions and the relevant factors, the Commissioner may substitute another amount that the Commissioner considers better reflects those assumptions and factors.

820-110 Worldwide gearing debt amount

Outward investor (general)

- (1) If the entity is an *outward investor (general) for the income year, the **worldwide gearing debt amount** is the result of applying the method statement in this subsection.

<i>Method statement</i>

- Step 1.* Divide the average value of all the entity's *worldwide debt for the income year by the average value of all the entity's *worldwide equity for that year.
- Step 2.* Multiply the result of step 1 by $^{12}/_{10}$.
- Step 3.* Add 1 to the result of step 2.
- Step 4.* Divide the result of step 2 by the result of step 3.
- Step 5.* Multiply the result of step 4 in this method statement by the result of step 6 in the method statement in section 820-95.
- Step 6.* Add to the result of step 5 the average value, for that year, of the entity's *associate entity excess amount. The result of this step is the **worldwide gearing debt amount**.

Example: AK Pty Ltd, a company that is an Australian entity, has an average value of worldwide debt of \$83.4 million and an average value of worldwide equity of \$27 million. The result of applying steps 1 and 2 is therefore 3.706. Dividing 3.706 by 4.706 (through applying steps 3 and 4) and multiplying the result by \$70 million (which is the result of step 6 in the method statement in section 820-95) equals \$55.13 million. As the average value of the company's associate entity excess amount is \$4.5 million, the worldwide gearing debt amount is therefore \$59.63 million.

Outward investor (financial)

- (2) If the entity is an *outward investor (financial) for that year, the **worldwide gearing debt amount** is the result of applying the method statement in this subsection.

Method statement

- Step 1.* Divide the average value of all the entity's *worldwide debt for the income year by the average value of all the entity's *worldwide equity for that year.
- Step 2.* Multiply the result of step 1 by $^{12}/_{10}$.
- Step 3.* Add 1 to the result of step 2.

- Step 4.* Divide the result of step 2 by the result of step 3.
- Step 5.* Multiply the result of step 4 in this method statement by the result of step 7 in the method statement in subsection 820-100(2).
- Step 6.* Add to the result of step 5 the average value, for that year, of the entity's *zero-capital amount (other than any zero-capital amount that is attributable to the entity's *overseas permanent establishments).
- Step 7.* Add to the result of step 6 the average value, for that year, of the entity's *associate entity excess amount. The result of this step is the **worldwide gearing debt amount**.

Example: GLM Limited, a company that is an Australian entity, has an average value of worldwide debt of \$120 million and an average value of worldwide equity of \$40 million. The result of applying steps 1 and 2 is therefore 3.6. Dividing 3.6 by 4.6 (through applying steps 3 and 4) and multiplying the result by \$126 million (which is the result of step 7 of the method statement in subsection 820-100(2)) equals \$98.61 million. The average value of zero-capital amount (see step 7 of the method statement in subsection 820-100(2)) is \$4 million. Adding that amount to \$98.61 million results in \$102.61 million. As the company does not have any associate entity excess amount, the worldwide gearing debt amount is therefore \$102.61 million.

820-115 Amount of debt deduction disallowed

The amount of *debt deduction disallowed under subsection 820-85(1) is worked out using the following formula:

$$\text{Debt deduction} \times \frac{\text{Excess debt}}{\text{Average debt}}$$

where:

average debt means the average value, for the income year, of all the *debt capital of the entity that gives rise to *debt deductions of the entity for that or any other income year (other than any debt capital attributable to any of the entity's *overseas permanent establishments).

debt deduction means each *debt deduction covered by subsection 820-85(1).

excess debt means the amount by which the entity's *adjusted average debt for that year (see subsection 820-85(3)) exceeds its *maximum allowable debt for that year.

820-120 Application to part year periods

- (1) This subsection disallows all or a part of each *debt deduction of an entity for an income year that is an amount incurred by the entity during a period that is a part of that year (to the extent that it is not attributable to an *overseas permanent establishment of the entity), if:
- (a) the entity is an *outward investing entity (non-ADI) for that period; and
 - (b) the entity's *adjusted average debt for that period exceeds the entity's *maximum allowable debt for that period.

Note: To determine whether an entity is an outward investing entity (non-ADI) for that period, see subsection 820-85(2).

- (2) The entity's **adjusted average debt** for that period is the result of applying the method statement in this subsection. In applying the method statement, disregard any amount that is attributable to the entity's *overseas permanent establishments.

Method statement

- Step 1.* Work out the average value, for that period, of all the *debt capital of the entity that gives rise to *debt deductions of the entity for that or any other income year.
- Step 2.* Reduce the result of step 1 by the average value, for that period, of all the *associate entity debt of the entity (other than any *controlled foreign entity debt of the entity).
- Step 3.* Reduce the result of step 2 by the average value, for that period, of all the *controlled foreign entity debt of the entity.
- Step 4.* If the entity is a *financial entity throughout that period, add to the result of step 3 the average value, for that period, of the entity's *zero-capital amount, to the extent that:

- (a) the zero-capital amount is attributable to the securities loan arrangements mentioned in step 1 of the method statement in subsection 820-942(1); and
- (b) the securities loan arrangements are not *debt interests.

Step 5. Add to the result of step 4 the average value, for that period (the *relevant period*), of any *debt capital of the entity that does not give rise to any *debt deductions of the entity for that or any other income year, if:

- (a) the debt capital is comprised of *debt interests issued to another entity that remain *on issue; and
- (b) that other entity is an *outward investing entity (non-ADI) or *inward investing entity (non-ADI) for a period that is, or includes, all or a part of the relevant period; and
- (c) for the purposes of the application of this Division to the entities, and in relation to only that part of the period that falls within the relevant period, the entities do not use the same *valuation days and the same number of valuation days to calculate the average value of their respective debt capital.

The result of this step is the *adjusted average debt*.

- (3) The entity's *adjusted average debt does not exceed its *maximum allowable debt if the adjusted average debt is nil or a negative amount.
- (4) For the purposes of determining:
 - (a) the *maximum allowable debt for the period mentioned in subsection (1); and
 - (b) the amount of each *debt deduction to be disallowed;sections 820-90 to 820-115 apply in relation to that entity and that period with the modifications set out in the following table:

Modifications of sections 820-90 to 820-115

Item	Provisions	Modifications
1	Sections 820-90 to 820-115	A reference to an income year is taken to be a reference to that period
3	Section 820-115	A reference to subsection 820-85(1) is taken to be a reference to subsection (1) of this section
4	Section 820-115	<i>adjusted average debt</i> is taken to have the meaning given by subsection (2) of this section <i>average debt</i> is taken to be the average value referred to in step 1 of the method statement in subsection (2) of this section

Subdivision 820-C—Thin capitalisation rules for inward investing entities (non-ADI)

Guide to Subdivision 820-C

820-180 What this Subdivision is about

This Subdivision sets out the thin capitalisation rules that apply to a foreign entity or a foreign controlled Australian entity that is not an authorised deposit-taking institution (an *ADI*). These rules deal with the following matters:

- how to work out the entity's maximum allowable debt for an income year;
- how all or a part of the debt deductions claimed by the entity may be disallowed if the maximum allowable debt is exceeded;
- how to apply these rules to a period that is less than an income year.

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[This is the end of the Guide.]

Operative provisions

820-185 Thin capitalisation rule for inward investing entities (non-ADI)

Thin capitalisation rule

- (1) This subsection disallows all or a part of each *debt deduction of an entity for an income year if:
- (a) the entity is an *inward investing entity (non-ADI) for that year (see subsection (2)), but is not also an *outward investing entity (non-ADI) (see section 820-85) for all or any part of that year; and
 - (b) for that year, the entity’s *adjusted average debt (see subsection (3)) exceeds its *maximum allowable debt (see section 820-190).

Note 1: This Subdivision does not apply if the total debt deductions of that entity and all its associate entities for that year are \$250,000 or less, see section 820-35.

Note 2: To work out the amount to be disallowed, see section 820-220.

Note 3: For the rules that apply to an entity that is an outward investing entity (non-ADI) as well as an inward investing entity (non-ADI), see Subdivision 820-B.

Note 4: For the rules that apply to an entity that is an inward investing entity (non-ADI) for only a part of an income year, see section 820-225 in conjunction with subsection (2) of this section.

Note 5: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

Note 6: A resident TC group may be an inward investing entity (non-ADI) to which this Subdivision applies, see Subdivision 820-F.

Inward investing entity (non-ADI)

- (2) The entity is an ***inward investing entity (non-ADI)*** for a period that is all or a part of an income year if, and only if, it is:
- (a) an *inward investment vehicle (general) for that period (as set out in item 1 of the following table); or
 - (b) an *inward investment vehicle (financial) for that period (as set out in item 2 of that table); or
 - (c) an *inward investor (general) for that period (as set out in item 3 of that table); or
 - (d) an *inward investor (financial) for that period (as set out in item 4 of that table).

Inward investing entity (non-ADI)			
Item	If the entity is a:	and the entity:	the entity is an:
1	*foreign controlled Australian entity throughout a period that is all or a part of an income year	is not a *financial entity, nor an *ADI, at any time during that period	<i>inward investment vehicle (general)</i> for that period
2	*foreign controlled Australian entity throughout a period that is all or a part of an income year	is a *financial entity throughout that period	<i>inward investment vehicle (financial)</i> for that period
3	*foreign entity throughout a period that is all or a part of an income year	is not a *financial entity, nor an *ADI, at any time during that period	<i>inward investor (general)</i> for that period
4	*foreign entity throughout a period that is all or a part of an income year	is a *financial entity throughout that period	<i>inward investor (financial)</i> for that period

Note 1: To determine whether an entity is a foreign controlled Australian entity, see Subdivision 820-H.

Note 2: The rules that apply to these 4 types of entities are different in some instances. For example, see sections 820-195 to 820-210.

Note 3: An entity covered by item 3 or 4 of the table may be required to keep certain records, see Subdivision 820-L.

Adjusted average debt

- (3) The entity's **adjusted average debt** for an income year is the result of applying the method statement in this subsection.

Method statement

- Step 1.* Work out the average value, for that year (the **relevant year**), of all the *debt capital of the entity that gives rise to *debt deductions of the entity for that or any other income year.
- Step 2.* Reduce the result of step 1 by the average value, for the relevant year, of:
- (a) if the entity is an *inward investment vehicle (general) or an *inward investment vehicle (financial) for that year—all the *associate entity debt of the entity; or
 - (b) if the entity is an *inward investor (general) or an *inward investor (financial) for that year—all the associate entity debt of the entity, to the extent that it is attributable to the entity's *Australian permanent establishments.
- Step 3.* If the entity is a *financial entity throughout the relevant year, add to the result of step 2 the average value, for that year, of the entity's *zero-capital amount, to the extent that:
- (a) the zero-capital amount is attributable to the securities loan arrangements mentioned in step 1 of the method statement in subsection 820-942(1); and
 - (b) the securities loan arrangements are not *debt interests.
- Step 4.* Add to the result of step 3 the average value, for the relevant year, of any *debt capital of the entity that does

not give rise to any *debt deductions of the entity for that or any other income year, if:

- (a) the debt capital is comprised of *debt interests issued to another entity that remain *on issue; and
- (b) that other entity is an *outward investing entity (non-ADI) or *inward investing entity (non-ADI) for a period that is, or includes, all or a part of the relevant year; and
- (c) for the purposes of the application of this Division to the entities, and in relation to only that part of the relevant year that falls within that period, the entities do not use the same *valuation days and the same number of valuation days to calculate the average value of their respective debt capital.

The result of this step is the *adjusted average debt*.

Note: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

- (4) The entity's *adjusted average debt does not exceed its *maximum allowable debt if the adjusted average debt is nil or a negative amount.

820-190 Maximum allowable debt

The entity's *maximum allowable debt* for an income year is the greater of the following amounts:

- (a) the *safe harbour debt amount;
- (b) the *arm's length debt amount.

Note: The safe harbour debt amount differs depending on whether the entity is an inward investment vehicle (general), inward investment vehicle (financial), inward investor (general) or inward investor (financial), see sections 820-195 to 820-215.

820-195 Safe harbour debt amount—inward investment vehicle (general)

If the entity is an *inward investment vehicle (general) for the income year, the *safe harbour debt amount* is the result of applying the method statement in this section.

Method statement

- Step 1.* Work out the average value, for the income year, of all the assets of the entity.
- Step 2.* Reduce the result of step 1 by the average value, for that year, of all the *associate entity debt of the entity.
- Step 3.* Reduce the result of step 2 by the average value, for that year, of all the *associate entity equity of the entity.
- Step 4.* Reduce the result of step 3 by the average value, for that year, of all the *non-debt liabilities of the entity. If the result of this step is a negative amount, it is taken to be nil.
- Step 5.* Multiply the result of step 4 by $\frac{3}{4}$.
- Step 6.* Add to the result of step 5 the average value, for that year, of the entity's *associate entity excess amount. The result of this step is the *safe harbour debt amount*.

Example: ALWZ Ltd, a company that is an Australian entity, has an average value of assets of \$100 million.

The average values of its associate entity debt, associate entity equity and non-debt liabilities are \$10 million, \$5 million and \$5 million respectively. Deducting these amounts from the result of step 1 (through applying steps 2 to 4) leaves \$80 million. Multiplying \$80 million by $\frac{3}{4}$ results in \$60 million. As the average value of the company's associate entity excess amount is \$2 million, the safe harbour debt amount is therefore \$62 million.

820-200 Safe harbour debt amount—inward investment vehicle (financial)

- (1) If the entity is an *inward investment vehicle (financial) for the income year, the *safe harbour debt amount* is the lesser of the following amounts:
- (a) the *total debt amount (worked out under subsection (2));
 - (b) the *adjusted on-lent amount (worked out under subsection (3)).

However, if the 2 amounts are equal, it is the total debt amount.

Total debt amount

- (2) The *total debt amount* is the result of the method statement in this subsection.

Method statement

- Step 1.* Work out the average value, for the income year, of all the assets of the entity.
- Step 2.* Reduce the result of step 1 by the average value, for that year, of all the *associate entity debt of the entity.
- Step 3.* Reduce the result of step 2 by the average value, for that year, of all the *associate entity equity of the entity.
- Step 4.* Reduce the result of step 3 by the average value, for that year, of all the *non-debt liabilities of the entity.
- Step 5.* Reduce the result of step 4 by the average value, for that year, of the entity's *zero-capital amount. If the result of this step is a negative amount, it is taken to be nil.
- Step 6.* Multiply the result of step 5 by ²⁰/₂₁.
- Step 7.* Add to the result of step 6 the average value, for that year, of the entity's *zero-capital amount.

Step 8. Add to the result of step 7 the average value, for that year, of the entity's *associate entity excess amount. The result of this step is the **total debt amount**.

Example: KJW Finance Pty Ltd, a company that is an Australian entity, has an average value of assets of \$120 million.

The average values of its associate entity debt, associate entity equity, its non-debt liabilities and its zero-capital amount are \$5 million, \$3 million, \$2 million and \$5 million respectively. Deducting these amounts from the result of step 1 (through applying steps 2 to 5) leaves \$105 million. Multiplying \$105 million by ²⁰/₂₁ results in \$100 million. Adding the zero-capital amount of \$5 million to \$100 million results in \$105 million. As the company does not have any associate entity excess amount, the total debt amount is therefore \$105 million.

Adjusted on-lent amount

- (3) The **adjusted on-lent amount** is the result of applying the method statement in this subsection.

Method statement

- Step 1.* Work out the average value, for the income year, of all the assets of the entity.
- Step 2.* Reduce the result of step 1 by the average value, for that year, of all the *associate entity equity of the entity.
- Step 3.* Reduce the result of step 2 by the average value, for that year, of all the *non-debt liabilities of the entity.
- Step 4.* Reduce the result of step 3 by the amount (the **average on-lent amount**) which is the average value, for that year, of the entity's *on-lent amount. If the result of this step is a negative amount, it is taken to be nil.
- Step 5.* Multiply the result of step 4 by ³/₄.
- Step 6.* Add to the result of step 5 the average on-lent amount.
- Step 7.* Reduce the result of step 6 by the average value, for that year, of all the *associate entity debt of the entity.

Step 8. Add to the result of step 7 the average value, for that year, of the entity's *associate entity excess amount. The result of this step is the **adjusted on-lent amount**.

Example: KJW Finance Pty Ltd, a company that is an Australian entity, has an average value of assets of \$120 million.

The average values of its associate entity equity, non-debt liabilities and on-lent amount are \$3 million, \$2 million and \$35 million respectively. Deducting these amounts from the result of step 1 (through applying steps 2 to 4) leaves \$80 million. Multiplying \$80 million by $\frac{3}{4}$ results in \$60 million. Adding the average on-lent amount of \$35 million results in \$95 million. Reducing \$95 million by the associate entity debt amount of \$5 million results in \$90 million. As the company does not have any associate entity excess amount, the adjusted on-lent amount is therefore \$90 million.

820-205 Safe harbour debt amount—inward investor (general)

If the entity is an *inward investor (general) for the income year, the **safe harbour debt amount** is the result of applying the method statement in this section.

Method statement

Step 1. Work out the average value, for the income year, of all of the following assets of the entity (the **Australian investments**):

- (a) assets that are attributable to the entity's *Australian permanent establishments;
- (b) other assets that are held for the purposes of producing the entity's assessable income.

Step 2. Reduce the result of step 1 by the average value, for that year, of all the *associate entity debt of the entity that has arisen because of the Australian investments.

Step 3. Reduce the result of step 2 by the average value, for that year, of all the *associate entity equity of the entity that has arisen because of the Australian investments.

Step 4. Reduce the result of step 3 by the average value, for that year, of all the *non-debt liabilities of the entity that have arisen because of the Australian investments. If the result of this step is a negative amount, it is taken to be nil.

Step 5. Multiply the result of step 4 by $\frac{3}{4}$.

Step 6. Add to the result of step 5 the average value, for that year, of the entity's *associate entity excess amount. The result of this step is the **safe harbour debt amount**.

Example: RJ Corporation is a company that is not an Australian entity. The average value of its Australian investments is \$100 million.

The average value of its relevant associate entity debt, associate entity equity and non-debt liabilities is \$10 million, \$5 million and \$5 million respectively. Deducting those amounts from the result of step 1 leaves \$80 million. Multiplying \$80 million by $\frac{3}{4}$ results in \$60 million. As the company does not have any associate entity excess amount, the safe harbour debt amount is therefore \$60 million.

820-210 Safe harbour debt amount—inward investor (financial)

- (1) If the entity is an *inward investor (financial) for that year, the **safe harbour debt amount** is the lesser of the following amounts:
- (a) the *total debt amount (worked out under subsection (2));
 - (b) the *adjusted on-lent amount (worked out under subsection (3)).

However, if the 2 amounts are equal, it is the total debt amount.

Total debt amount

- (2) The **total debt amount** is the result of applying the method statement in this subsection.

Method statement

Step 1. Work out the average value, for the income year, of all of the following assets of the entity (the **Australian investments**):

- (a) assets that are attributable to the entity's *Australian permanent establishments;

(b) other assets that are held for the purposes of producing the entity's assessable income.

Step 2. Reduce the result of step 1 by the average value, for that year, of all the *associate entity debt of the entity that has arisen because of the Australian investments.

Step 3. Reduce the result of step 2 by the average value, for that year, of all the *associate entity equity of the entity that has arisen because of the Australian investments.

Step 4. Reduce the result of step 3 by the average value, for that year, of all the *non-debt liabilities of the entity that have arisen because of the Australian investments.

Step 5. Reduce the result of step 4 by the average value, for that year, of the entity's *zero-capital amount that has arisen because of the Australian investments. If the result of this step is a negative amount, it is taken to be nil.

Step 6. Multiply the result of step 5 by ²⁰/₂₁.

Step 7. Add to the result of step 6 the average value, for that year, of the entity's *zero-capital amount that has arisen because of the Australian investments.

Step 8. Add to the result of step 7 the average value, for that year, of the entity's *associate entity excess amount. The result of this step is the ***total debt amount***.

Example: FXS Financial SA is a company that is not an Australian entity. The average value of its Australian investments is \$120 million.

The average value of its relevant associate entity debt, associate entity equity, non-debt liabilities and zero-capital amount are \$5 million, \$2 million, \$3 million and \$5 million respectively. Deducting those amounts from the result of step 1 (through applying steps 2 to 5) leaves \$105 million. Multiplying \$105 million by ²⁰/₂₁ results in \$100 million. Adding the average zero-capital amount of \$5 million results in \$105 million. As the company does not have any associate entity excess amount, the total debt amount is therefore \$105 million.

Adjusted on-lent amount

- (3) The **adjusted on-lent amount** is the result of applying the method statement in this subsection.

Method statement

Step 1. Work out the average value, for the income year, of all of the following assets of the entity (the **Australian investments**):

- (a) assets that are attributable to the entity's *Australian permanent establishments;
- (b) other assets that are held for the purposes of producing the entity's assessable income.

Step 2. Reduce the result of step 1 by the average value, for that year, of all the *associate entity equity of the entity that has arisen because of the Australian investments.

Step 3. Reduce the result of step 2 by the average value, for that year, of all the *non-debt liabilities of the entity that has arisen because of the Australian investments.

Step 4. Reduce the result of step 3 by the amount (the **average on-lent amount**) which is the average value, for that year, of the *on-lent amount of the entity (to the extent that it is the value of all or a part of the Australian investments). If the result of this step is a negative amount, it is taken to be nil.

Step 5. Multiply the result of step 4 by $\frac{3}{4}$.

Step 6. Add to the result of step 5 the average on-lent amount.

Step 7. Reduce the result of step 6 by the average value, for that year, of all the *associate entity debt of the entity that has arisen because of the Australian investments. If the result of this step is a negative amount, it is taken to be nil.

Step 8. Add to the result of step 7 the average value, for that year, of the entity's *associate entity excess amount. The result of this step is the **adjusted on-lent amount**.

Example: FXS Financial SA is a company that is not an Australian entity. The average value of its Australian investments is \$120 million.

The average value of its relevant associate entity equity, non-debt liabilities and on-lent amount are \$2 million, \$3 million and \$35 million respectively. Deducting those amounts from the result of step 1 (through applying steps 2 to 4) leaves \$80 million. Multiplying \$80 million by $\frac{3}{4}$ results in \$60 million. Adding the average on-lent amount of \$35 million results in \$95 million. Reducing the result of step 6 by the associate entity debt amount of \$5 million results in \$90 million. As the company does not have any associate entity excess amount, the adjusted on-lent amount is therefore \$90 million.

820-215 Arm's length debt amount

- (1) The **arm's length debt amount** is a notional amount that, having regard to the factual assumptions set out in subsection (2) and the relevant factors mentioned in subsection (3), would satisfy both paragraphs (a) and (b):
- (a) the amount represents a notional amount of *debt capital that:
 - (i) the entity would reasonably be expected to have throughout the income year; and
 - (ii) would give rise to an amount of *debt deductions of the entity for that or any other income year; and
 - (iii) would be attributable to the entity's Australian business as mentioned in subsection (2);
 - (b) commercial lending institutions that were not *associates of the entity (the **notional lenders**) would reasonably be expected to have entered into *schemes that would:
 - (i) give rise to *debt interests that constituted that notional amount of debt capital of the entity; and
 - (ii) provide for terms and conditions for the debt interests that would reasonably be expected to have applied if the entity and the notional lenders had been dealing at arm's length with each other throughout the income year mentioned in subparagraph (1)(a)(i).

Note: The entity must keep records in accordance with section 820-980 if the entity works out an amount under this section.

Factual assumptions

- (2) Irrespective of what actually happened during that year, the following assumptions must be made in working out that amount:
- (a) the entity's commercial activities in connection with Australia (the ***Australian business***) during that year:
 - (i) if the entity is an *inward investment vehicle (general) or *inward investment vehicle (financial) for that year—do not include the holding of any *associate entity debt; and
 - (ii) if the entity is an *inward investor (general) or *inward investor (financial) for that year—consist only of its Australian investments (within the meaning of section 820-205 or 820-210, as appropriate), other than the holding of any associate entity debt that is attributable to its *Australian permanent establishments;
 - (b) the entity had carried on the Australian business that it actually carried on during that year;
 - (c) the nature of the entity's assets and liabilities (to the extent that they are attributable to the Australian business) had been as they were during that year;
 - (d) except as stated in paragraph (1)(b) and paragraph (e) of this subsection, the entity had carried on the Australian business in the same circumstances as what actually existed during that year;
 - (e) any guarantee, security or other form of credit support provided to the entity in relation to the Australian business during that year:
 - (i) by its *associates; or
 - (ii) by the use of assets of the entity that are attributable to the entity's overseas permanent establishments;is taken not to have been received by the entity.

Relevant factors

- (3) On the basis of the factual assumptions set out in subsection (2), the following factors must be taken into account in determining whether or not an amount satisfies paragraphs (1)(a) and (b):
- (a) the functions performed, the assets used, and the risks assumed, by the entity in relation to the Australian business throughout that year;

- (b) the terms and conditions of the *debt capital that the entity actually had in relation to the Australian business throughout that year;
- (c) the nature of, and title to, any assets of the entity attributable to the Australian business that were available to the entity throughout that year as security for its debt capital for that business;
- (d) the purposes for which *schemes for debt capital had been actually entered into by the entity in relation to the Australian business throughout that year;
- (e) the entity's capacity to meet all its liabilities in relation to the Australian business (whether during that year or at any other time);
- (f) the profit of the entity (within the meaning of the *accounting standards), and the return on its capital, in relation to the Australian business (whether during that year or at any other time);
- (g) the debt to equity ratios of the following throughout that year:
 - (i) the entity;
 - (ii) the entity in relation to the Australian business;
 - (iii) each of the entity's *associate entities that engage in commercial activities similar to the Australian business;
- (h) the commercial practices adopted by independent parties dealing with each other at arm's length in the industry in which the entity carries on the Australian business throughout that year (whether in Australia or in comparable markets elsewhere);
- (i) the general state of the Australian economy throughout that year;
- (j) all of the above factors existing at the time when the entity last entered into a *scheme that gave rise to an actual *debt interest attributable to the Australian business that remains *on issue throughout that year;
- (k) any other factors which are specified in the regulations made for the purposes of this section, including factors that are specific to an *inward investment vehicle (general), an *inward investment vehicle (financial), an *inward investor (general) or an *inward investor (financial).

Commissioner's power

- (4) If the Commissioner considers an amount worked out by the entity under this section does not appropriately take into account the factual assumptions and the relevant factors, the Commissioner may substitute another amount that the Commissioner considers better reflects those assumptions and factors.

820-220 Amount of debt deduction disallowed

The amount of *debt deduction disallowed under subsection 820-185(1) is worked out using the following formula:

$$\text{Debt deduction} \times \frac{\text{Excess debt}}{\text{Average debt}}$$

where:

average debt means the average value, for the income year, of all the *debt capital of the entity that gives rise to *debt deductions of the entity for that or any other income year.

debt deduction means each *debt deduction of the entity for that year.

excess debt means the amount by which the *adjusted average debt (see subsection 820-185(3)) exceeds the entity's *maximum allowable debt for that year.

820-225 Application to part year periods

- (1) This subsection disallows all or a part of each *debt deduction of an entity for an income year that is an amount incurred by the entity during a period that is a part of that year, if:
- (a) the entity is an *inward investing entity (non-ADI) for that period, but is not also an *outward investing entity (non-ADI) for all or any part of that period; and
 - (b) the entity's *adjusted average debt for that period exceeds the entity's *maximum allowable debt for that period.

Note: To determine whether an entity is an inward investing entity (non-ADI) for a period, see subsection 820-185(2).

- (2) The entity's **adjusted average debt** for that period is the result of applying the method statement in this subsection.

Method statement

- Step 1.* Work out the average value, for that period, of all the *debt capital of the entity that gives rise to *debt deductions of the entity for that or any other income year.
- Step 2.* Reduce the result of step 1 by the average value, for that period, of:
- (a) if the entity is an *inward investment vehicle (general) or an *inward investment vehicle (financial) for that period—all the *associate entity debt of the entity; or
 - (b) if the entity is an *inward investor (general) or an *inward investor (financial) for that period—all the associate entity debt of the entity, to the extent that it is attributable to the entity's *Australian permanent establishments.
- Step 3.* If the entity is a *financial entity throughout that period, add to the result of step 2 the average value, for that period, of the entity's *zero-capital amount, to the extent that:
- (a) the zero-capital amount is attributable to the securities loan arrangements mentioned in step 1 of the method statement in subsection 820-942(1); and
 - (b) the securities loan arrangements are not *debt interests.
- Step 4.* Add to the result of step 3 the average value, for that period (the **relevant period**), of any *debt capital of the entity that does not give rise to any *debt deductions of the entity for that or any other income year, if:
- (a) the debt capital is comprised of *debt interests issued to another entity that remain *on issue; and

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- (b) that other entity is an *outward investing entity (non-ADI) or *inward investing entity (non-ADI) for a period that is, or includes, all or a part of the relevant period; and
- (c) for the purposes of the application of this Division to the entities, and in relation to only that part of the period that falls within the relevant period, the entities do not use the same *valuation days and the same number of valuation days to calculate the average value of their respective debt capital.
- The result of this step is the *adjusted average debt*.

Note: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

- (2A) The entity's *adjusted average debt does not exceed its *maximum allowable debt if the adjusted average debt is nil or a negative amount.
- (3) For the purposes of determining:
- (a) the *maximum allowable debt for the period mentioned in subsection (1); and
 - (b) the amount of each *debt deduction to be disallowed;
- sections 820-190 to 820-220 apply in relation to that entity and that period with the modifications set out in the following table:

Modifications of sections 820-190 to 820-220		
Item	Provisions	Modifications
1	Sections 820-190 to 820-220	A reference to an income year is taken to be a reference to that period
3	Section 820-220	A reference to subsection 820-185(1) is taken to be a reference to subsection (1) of this section
4	Section 820-220	<i>adjusted average debt</i> is taken to have the meaning given by subsection (2) of this section <i>average debt</i> is taken to be the average value referred to in paragraph (2)(a) of this section

Subdivision 820-D—Thin capitalisation rules for outward investing entities (ADI)

Guide to Subdivision 820-D

820-295 What this Subdivision is about

This Subdivision sets out the thin capitalisation rules that apply to an entity that is both an authorised deposit-taking institution (an **ADI**) and an Australian entity that has certain types of overseas investments. These rules deal with the following matters:

- how to work out the entity's minimum capital amount for an income year;
- how all or a part of the debt deductions claimed by the entity may be disallowed if the minimum capital amount is not reached;
- how to apply these rules to a period that is less than an income year.

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820-320	Worldwide capital amount
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820-330	Application to part year periods

[This is the end of the Guide.]

Operative provisions

820-300 Thin capitalisation rule for outward investing entities (ADI)

Thin capitalisation rule

- (1) This subsection disallows all or a part of each *debt deduction of an entity for an income year (to the extent that it is not attributable to an *overseas permanent establishment of the entity) if, for that year:
- (a) the entity is an *outward investing entity (ADI) (see subsection (2)); and
 - (b) the entity's *adjusted average equity capital (see subsection (3)) is less than the entity's *minimum capital amount (see section 820-305).

Note 1: This Subdivision does not apply if the total debt deductions of that entity and all its associate entities for that year are \$250,000 or less, see section 820-35.

Note 2: To work out the amount to be disallowed, see section 820-325.

Note 3: For the rules that apply to an entity that is an outward investing entity (ADI) for only part of an income year, see section 820-330 in conjunction with subsection (2) of this section.

Note 4: A resident TC group may be an outward investing entity (ADI) to which this Subdivision applies, see Subdivision 820-F.

Outward investing entity (ADI)

- (2) The entity is an **outward investing entity (ADI)** for a period that is all or a part of an income year if, and only if, throughout that period, the entity is an *ADI to which at least one of the following paragraphs applies:
- (a) the entity is an *Australian controller of at least one *Australian controlled foreign entity (not necessarily the same Australian controlled foreign entity throughout that period);
 - (b) the entity is an *Australian entity that carries on a *business at or through at least one *overseas permanent establishment (not necessarily the same permanent establishment throughout that period);
 - (c) the entity is:
 - (i) an Australian entity; and

- (ii) an *associate entity of another entity that is an *outward investing entity (non-ADI) or an *outward investing entity (ADI) for that period.

Note: To determine whether an entity is an Australian controller of an Australian controlled foreign entity, see Subdivision 820-H.

Adjusted average equity capital

- (3) The entity's **adjusted average equity capital** for an income year is:
- (a) the average value, for that year, of all the *equity capital of the entity (other than equity capital attributable to its *overseas permanent establishments); minus
 - (b) the average value, for that year, of all the *controlled foreign entity equity of the entity (other than controlled foreign entity equity attributable to its overseas permanent establishments).

Note: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

820-305 Minimum capital amount

The entity's **minimum capital amount** for an income year is the least of the following amounts:

- (a) the *safe harbour capital amount;
- (b) the *arm's length capital amount;
- (c) the *worldwide capital amount.

Note: The entity cannot use the worldwide capital amount if the entity is also a foreign controlled Australian entity throughout that year, see section 820-320.

820-310 Safe harbour capital amount

The **safe harbour capital amount** is the result of applying the method statement in this section.

Method statement

Step 1. Work out the average value, for the income year, of all the *risk-weighted assets of the entity, other than risk-weighted assets attributable to any of the following:

- (a) the entity's *overseas permanent establishments;

- (b) assets comprised by the *controlled foreign entity equity of the entity (other than controlled foreign entity equity attributable to the entity's overseas permanent establishments);
- (c) assets for which *prudential capital deductions must be made by the entity (other than prudential capital deductions attributable to the entity's overseas permanent establishments).

Step 2. Multiply the result of step 1 by 4%.

Step 3. Add to the result of step 2 the average value, for that year, of all the *tier 1 prudential capital deductions for the entity (to the extent that they are not attributable to any of the entity's *overseas permanent establishments or any *Australian controlled foreign entities of which the entity is an *Australian controller). The result of this step is the ***safe harbour capital amount***.

Example: The Southern Cross Bank is an Australian bank that carries on its banking business through its overseas permanent establishments and through foreign entities that it controls. For the income year, its average value of risk-weighted assets is \$150 million (having discounted those risk-weighted assets that are excluded by step 1) and the average value of its relevant tier 1 prudential capital deductions is \$2 million. Multiplying \$150 million by 4% equals \$6 million, which is the result of step 2. Adding \$2 million to \$6 million equals \$8 million, which is the safe harbour capital amount.

820-315 Arm's length capital amount

- (1) The ***arm's length capital amount*** is a notional amount that, having regard to:
 - (a) the factual assumptions set out in subsection (2); and
 - (b) the relevant factors mentioned in subsection (3);would represent the minimum amount of *equity capital that the entity would reasonably be expected to have in carrying on the Australian business mentioned in subsection (2) throughout the income year if, throughout that year:
 - (c) the part of the entity carrying on that business had operated as if it were a separate entity; and
 - (d) that separate entity had been dealing at arm's length with:

- (i) the other part of the entity; and
- (ii) all the *Australian controlled foreign entities of which the entity is an *Australian controller.

Note: The entity must keep records in accordance with section 820-980 if the entity works out an amount under this section.

Factual assumptions

- (2) Irrespective of what actually happened during that year, the following assumptions must be made in working out that minimum amount:
 - (a) the entity's commercial activities in connection with Australia (the **Australian business**) during that year do not include:
 - (i) any *business carried on by the entity at or through its *overseas permanent establishments; or
 - (ii) the holding of any *controlled foreign entity equity;
 - (b) the entity had carried on the Australian business that it actually carried on during that year;
 - (c) the nature of the entity's assets and liabilities (to the extent that they are attributable to the Australian business) had been as they were during that year;
 - (d) except as mentioned in subsection (1), the entity had carried on the Australian business in the same circumstances as what actually existed during that year.

Relevant factors

- (3) On the basis of the factual assumptions set out in subsection (2), the following factors must be taken into account in determining that minimum amount:
 - (a) the functions performed, the assets used, and the risks assumed, throughout that year, by:
 - (i) the entity; and
 - (ii) the entity in relation to the Australian business;
 - (b) the credit rating of the entity throughout that year, including the effect of that credit rating on all of the following:
 - (i) the entity's ability to borrow in relation to the Australian business;

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- (ii) the interest rate at which the entity borrowed in relation to that business;
- (iii) the entity's gross profit margin in relation to that business;
- (c) the capital ratios of the following throughout that year:
 - (i) the entity;
 - (ii) the entity in relation to the Australian business;
 - (iii) each of the entity's *associate entities that engage in commercial activities similar to the Australian business;
- (d) the purposes for which *schemes for *debt capital and for *equity capital had been actually entered into, throughout that year, by:
 - (i) the entity; and
 - (ii) the entity in relation to the Australian business;
- (e) the profit (within the meaning of the *accounting standards), and the return on capital, whether during that year or at any other time, of:
 - (i) the entity; and
 - (ii) the entity in relation to the Australian business;
- (f) the commercial practices adopted by independent parties dealing with each other at arm's length in the industry in which the entity carries on the Australian business throughout that year (whether in Australia or in comparable markets elsewhere);
- (g) the way in which the entity financed its business (other than the Australian business) throughout that year;
- (h) the general state of the Australian economy throughout that year;
- (i) any other factors which are specified in the regulations made for the purposes of this section.

Commissioner's power

- (4) If the Commissioner considers an amount worked out by the entity under this section does not appropriately take into account the factual assumptions and the relevant factors, the Commissioner may substitute another amount that the Commissioner considers better reflects those assumptions and factors.

820-320 Worldwide capital amount

- (1) This section only applies if the entity is not also a *foreign controlled Australian entity throughout the income year.
- (2) The ***worldwide capital amount*** is the result of applying the method statement in this subsection.

Method statement

Step 1. Work out the average value, for the income year, of all the *risk-weighted assets of the entity, other than risk-weighted assets attributable to any of the following:

- (a) the entity's *overseas permanent establishments;
- (b) assets comprised by the *controlled foreign entity equity of the entity;
- (c) assets for which *prudential capital deductions must be made by the entity.

Step 2. Multiply the entity's worldwide group capital ratio for that year (see subsection (3)) by $\frac{8}{10}$.

Step 3. Multiply the result of step 1 by the result of step 2.

Step 4. Add to the result of step 3 the average value, for that year, of all the *tier 1 prudential capital deductions for the entity (to the extent that they are not attributable to any of the entity's *overseas permanent establishments or to any *Australian controlled foreign entities of which the entity is an *Australian controller). The result of this step is the ***worldwide capital amount***.

Example: Southern Cross Bank has an average value of risk-weighted assets of \$150 million (having discounted those risk-weighted assets that are excluded by step 1) and the average value of its relevant tier 1 prudential capital deductions is \$2 million. The entity's worldwide group capital ratio is 0.0875. Multiplying that ratio by $\frac{8}{10}$ equals 0.07, which is the result of step 2. Multiplying \$150 million by 0.07 equals \$10.5 million, which is the result of step 3. Adding that amount to the average value of the relevant tier 1 prudential capital deductions equals \$12.5 million, which is the worldwide capital amount.

Worldwide group capital ratio

- (3) The entity's *worldwide group capital ratio* for the income year is the result of applying the method statement in this subsection.

Method statement

- Step 1.* Work out the average value, for the income year, of the tier 1 capital (within the meaning of the *prudential standards) of the consolidated group of which the entity is a member (within the meaning of those standards) in accordance with those standards.
- Step 2.* Divide the result of step 1 by the average value, for that year, of the *risk-weighted assets of that group in accordance with the *prudential standards. The result is the *worldwide group capital ratio*.

Example: For the Southern Cross Bank, the average value of the tier 1 capital for the relevant consolidated group is \$14 million. Dividing \$14 million by the group's risk weighted assets of \$160 million equals 0.0875, which is the worldwide group capital ratio.

820-325 Amount of debt deduction disallowed

The amount of *debt deduction disallowed under subsection 820-300(1) is worked out using the following formula:

$$\text{Debt deduction} \times \frac{\text{Capital shortfall}}{\text{Average debt}}$$

where:

average debt means the average value, for the income year, of all the *debt capital of the entity that gives rise to *debt deductions of the entity for that or any other income year (other than any debt capital that is attributable to any of the entity's *overseas permanent establishments).

capital shortfall means the amount by which the *adjusted average equity capital of the entity for that year (see subsection 820-300(3)) is less than the entity's *minimum capital amount for that year.

debt deduction means each *debt deduction covered by subsection 820-300(1).

820-330 Application to part year periods

- (1) This subsection disallows all or a part of each *debt deduction of an entity for an income year that is an amount incurred by the entity during a period that is a part of that year (to the extent that it is not attributable to an *overseas permanent establishment of the entity) if, for that period:
- (a) the entity is an *outward investing entity (ADI); and
 - (b) the *adjusted average equity capital of the entity is less than the entity's *minimum capital amount.

Note: To determine whether an entity is an outward investing entity (non-ADI) for that period, see subsection 820-300(2).

- (2) The entity's **adjusted average equity capital** for that period is:
- (a) the average value, for that period, of all the *equity capital of the entity (other than equity capital attributable to any of its *overseas permanent establishments); minus
 - (b) the average value, for that period, of all the *controlled foreign entity equity of the entity (other than controlled foreign entity equity attributable to any of its overseas permanent establishments).
- (3) For the purposes of determining:
- (a) the entity's *minimum capital amount for that period; and
 - (b) the amount of each *debt deduction to be disallowed;
- sections 820-305 to 820-325 apply in relation to that entity and that period with the modifications set out in the following table:

Modifications of sections 820-305 to 820-325

Item	Provisions	Modifications
1	Sections 820-305 to 820-325	A reference to an income year is taken to be a reference to that period
2	Section 820-325	A reference to subsection 820-300(1) is taken to be a reference to subsection (1) of this section

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Modifications of sections 820-305 to 820-325

Item	Provisions	Modifications
3	Section 820-325	<i>adjusted average equity capital</i> has the meaning given by subsection (2) of this section <i>average debt</i> is taken to be the average value, for that period, of all the *debt capital of the entity that gives rise to *debt deductions of the entity for that or any other income year, to the extent that the debt capital is not attributable to any of the entity's *overseas permanent establishments

Subdivision 820-E—Thin capitalisation rules for inward investing entities (ADI)

Guide to Subdivision 820-E

820-390 What this Subdivision is about

This Subdivision applies to a foreign entity that is an authorised deposit-taking institution (an *ADI*). These rules deal with the following matters:

- how to work out the entity's minimum capital amount for an income year;
- how all or a part of the debt deductions claimed by the entity may be disallowed if the minimum capital amount is not reached;
- how to apply these rules to a period that is less than an income year.

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820-410	Arm's length capital amount
820-415	Amount of debt deduction disallowed
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[This is the end of the Guide.]

Operative provisions

820-395 Thin capitalisation rule for inward investing entities (ADI)

Thin capitalisation rule

- (1) This subsection disallows all or a part of each *debt deduction of an entity for an income year if, for that year:
 - (a) the entity is an *inward investing entity (ADI) (see subsection (2)); and
 - (b) the entity's *average equity capital (see subsection (3)) is less than its *minimum capital amount (see section 820-400);to the extent that the debt deduction:
 - (c) is attributable to an *Australian permanent establishment of the entity at or through which it carries on its banking business; and
 - (d) is not an *allowable OB deduction.

Note 1: This Subdivision does not apply if the total debt deductions of that entity and all its associate entities for that year are \$250,000 or less, see section 820-35.

Note 2: To work out the amount to be disallowed, see section 820-415.

Note 3: For the rules that apply to an entity that is an inward investing entity (ADI) for part of an income year, see section 820-420 in conjunction with subsection (2) of this section.

Inward investing entity (ADI)

- (2) The entity is an ***inward investing entity (ADI)*** for a period that is all or a part of an income year if, and only if, throughout that period, the entity is a *foreign bank that carries on its banking business in Australia at or through one or more of its *Australian permanent establishments.

Note: The entity is required to keep certain records, see Subdivision 820-L.

Average equity capital

- (3) The entity's *average equity capital* for an income year is the sum of the following:
- (a) the average value, for that year, of the *equity capital of the entity that:
 - (i) is attributable to the *Australian permanent establishments at or through which it carries on its banking business in Australia; but
 - (ii) has not been allocated to the *OB activities of the Australian permanent establishments;
 - (b) the average value, for that year, of the total amounts that:
 - (i) are made available by the entity to the Australian permanent establishments of the entity as loans to the Australian permanent establishments; and
 - (ii) do not give rise to any *debt deductions of the entity for that or any other income year.

Note: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

820-400 Minimum capital amount

The entity's *minimum capital amount* for an income year is the lesser of the following amounts:

- (a) the *safe harbour capital amount;
- (b) the *arm's length capital amount.

820-405 Safe harbour capital amount

The entity's *safe harbour capital amount* for the income year is the result of applying the method statement in this section.

Method statement

Step 1. Work out the average value, for the income year, of that part of the *risk-weighted assets of the entity that:

- (a) is attributable to the *Australian permanent establishments at or through which it carries on its banking business in Australia; but

(b) is not attributable to the *OB activities of the Australian permanent establishments.

Step 2. Multiply the result of step 1 by 4%. The result of this step is the *safe harbour capital amount*.

Example: The Global Bank is a foreign bank that carries on its banking business in Australia through a permanent establishment. The average value of its relevant risk-weighted assets is \$140 million. Multiplying that amount by 4% results in \$5.6 million, which is the safe harbour capital amount.

820-410 Arm's length capital amount

- (1) The *arm's length capital amount* is a notional amount that, having regard to:
- (a) the factual assumptions set out in subsection (2); and
 - (b) the relevant factors mentioned in subsection (3);
- would represent the minimum amount of *equity capital that the entity would reasonably be expected to have in carrying on the Australian business mentioned in subsection (2) throughout the income year if, throughout that year:
- (c) the part of the entity carrying on that business had operated as if it were a separate entity; and
 - (d) that separate entity had been dealing at arm's length with the other part of the entity.

Note: The entity must keep records in accordance with section 820-980 if the entity works out an amount under this section.

Factual assumptions

- (2) Irrespective of what actually happened during that year, the following assumptions must be made in working out that minimum amount:
- (a) the entity's commercial activities in connection with Australia (the *Australian business*) during that year consist only of banking business attributable to its *Australian permanent establishments (other than its *OB activities);
 - (b) the entity had carried on the Australian business that it actually carried on during that year;

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- (c) the nature of the entity's assets and liabilities (to the extent that they are attributable to the Australian business) had been as they were during that year;
- (d) except as mentioned in subsection (1), the entity had carried on the Australian business in the same circumstances as what actually happened during that year.

Relevant factors

- (3) On the basis of the factual assumptions set out in subsection (2), the following factors must be taken into account in determining that minimum amount:
 - (a) the functions performed, the assets used, and the risks assumed, throughout that year, by:
 - (i) the entity; and
 - (ii) the entity in relation to the Australian business;
 - (b) the credit rating of the entity throughout that year, including the effect of that credit rating on all of the following:
 - (i) the entity's ability to borrow in relation to the Australian business;
 - (ii) the interest rate at which the entity borrowed in relation to that business;
 - (iii) the entity's gross profit margin in relation to that business;
 - (c) the capital ratios of the following throughout that year:
 - (i) the entity;
 - (ii) the entity in relation to the Australian business;
 - (iii) each of the entity's *associate entities that engage in commercial activities similar to the Australian business;
 - (d) the purposes for which *schemes for *debt capital and for *equity capital had been actually entered into, throughout that year, by:
 - (i) the entity; and
 - (ii) the entity in relation to the Australian business;
 - (e) the profit (within the meaning of the *accounting standards or any other accounting standards that would otherwise apply to the entity), and the return on capital, whether during that year or at any other time, of:
 - (i) the entity; and

- (ii) the entity in relation to the Australian business;
- (f) the commercial practices adopted by independent parties dealing with each other at arm's length in the industry in which the entity carries on the Australian business throughout that year (whether in Australia or in comparable markets elsewhere);
- (g) the general state of the Australian economy throughout that year;
- (h) any other factors which are specified in the regulations made for the purposes of this section.

Commissioner's power

- (4) If the Commissioner considers an amount worked out by the entity under this section does not appropriately take into account the factual assumptions and the relevant factors, the Commissioner may substitute another amount that the Commissioner considers better reflects those assumptions and factors.

820-415 Amount of debt deduction disallowed

The amount of *debt deduction disallowed under subsection 820-395(1) is worked out using the following formula:

$$\text{Debt deduction} \times \frac{\text{Capital shortfall}}{\text{Average debt}}$$

where:

average debt means the average value, for the income year, of all the *debt capital of the entity that gives rise to *debt deductions of the entity (other than *allowable OB deductions) for that or any other income year.

capital shortfall means the amount by which the entity's *average equity capital for that year (see subsection 820-395(3)) is less than the entity's *minimum capital amount for that year.

debt deduction means each *debt deduction of the entity (other than *allowable OB deduction) for the income year.

820-420 Application to part year periods

- (1) This subsection disallows all or a part of each *debt deduction of an entity for an income year that is an amount incurred by the entity during a period that is a part of that year if, for that period:
- (a) the entity is an *inward investing entity (ADI); and
 - (b) the entity's *average equity capital is less than its *minimum capital amount;
- to the extent that the debt deduction:
- (c) is attributable to an *Australian permanent establishment of the entity at or through which it carries on its banking business; and
 - (d) is not an *allowable OB deduction.

Note: To determine whether an entity is an inward investing entity (ADI) for that period, see subsection 820-395(2).

- (2) The entity's *average equity capital* for that period is the sum of the following:
- (a) the average value, for that period, of the *equity capital of the entity that:
 - (i) is attributable to its *Australian permanent establishments at or through which it carries on its banking business in Australia; but
 - (ii) has not been allocated to the *OB activities of the Australian permanent establishments;
 - (b) the average value, for that period, of the total amounts that:
 - (i) are made available by the entity to the Australian permanent establishments of the entity as loans to the Australian permanent establishments; and
 - (ii) do not give rise to any *debt deductions of the entity for that or any other income year.
- (3) For the purposes of determining:
- (a) the entity's *minimum capital amount for that period; and
 - (b) the amount of each *debt deduction to be disallowed;
- sections 820-400 to 820-415 apply in relation to that entity and that period with the modifications set out in the following table:

Modifications of sections 820-400 to 820-415

Item	Provisions	Modifications
1	Sections 820-400 to 820-415	A reference to an income year is taken to be a reference to that period
2	Section 820-415	The reference to subsection 820-395(1) is taken to be a reference to subsection (1) of this section
3	Section 820-415	<i>average debt</i> is taken to be the average value, for that period, of all the *debt capital of the entity that gives rise to its *debt deductions (other than *allowable OB deductions) for that year that are amounts incurred by the entity during that period <i>average equity capital</i> has the meaning given by subsection (2) of this section

Subdivision 820-F—Thin capitalisation rules for resident TC groups

Guide to Subdivision 820-F

820-450 What this Subdivision is about

This Subdivision sets out the thin capitalisation rules that apply to a group of entities (called a resident TC group). If those rules apply to the group, the rest of the Division does not apply separately to the entities in the group.

This Subdivision tells you:

- how to construct a resident TC group; and
- how to classify the group (in terms of which Subdivision of this Division to apply); and
- how to apply this Division to the group (including how the application is modified).

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[This is the end of the Guide.]

Operative provisions

820-460 Application

- (1) This Subdivision modifies how this Division applies to:
 - (a) each entity in a *resident TC group for an income year; and
 - (b) each *foreign bank of which an *Australian permanent establishment is in the group.
- (2) However, it does so only if:
 - (a) the group is one of these for the income year (because of section 820-550):

- (i) an *outward investor (general);
 - (ii) an *outward investor (financial);
 - (iii) an *inward investment vehicle (general);
 - (iv) an *inward investment vehicle (financial);
 - (v) an *outward investing entity (ADI); or
- (b) section 820-555 prevents this Division (except this Subdivision) from applying to any entity in the group for the income year (because the group is headed by a foreign-controlled Australian ADI); or
- (c) section 820-565 applies Subdivision 820-D to the group for the income year as if the group were an outward investing entity (ADI); or
- (d) section 820-575 applies Subdivision 820-E to the group for the income year as if the group were an inward investing entity (ADI).

Note: This Subdivision does *not* affect:

- how this Division applies to entities that are *not* in a resident TC group, even if they are members of the same wholly-owned group as an entity that is in a resident TC group; or
- how this Division applies to entities that are in a resident TC group that is not covered by any of paragraphs (2)(a) to (d).

(3) This Division (except this Subdivision) applies to each entity in the group as if:

- (a) the group had been a company throughout the income year; and
- (b) each entity in the group had been a division or part of that company, rather than a separate entity, at all times during the income year when the entity was in the group; and
- (c) without limiting paragraph (b), each *debt deduction, for the income year, of each entity in the group were a debt deduction of the group (even if it was incurred at a time when the entity was not in the group);

but with the modifications set out in sections 820-550 to 820-575.

Note: To work out the times during the income year when the entity was in the group, see section 820-530.

(3A) This Division (except this Subdivision) does not apply to an entity in the group except as mentioned in subsection (3).

Schedule 1 Thin capitalisation rules

Part 1 New thin capitalisation rules

- (4) If an ^{*}Australian permanent establishment of a ^{*}foreign bank is in the group, this Division (except this Subdivision) applies as if:
- (a) at all times when it was in the group during the income year, the Australian permanent establishment had been a division or part of the group; and
 - (b) the Australian permanent establishment had been a division or part of the foreign bank at no time during the income year; and
 - (c) without limiting paragraph (a) or (b), each deduction that:
 - (i) is a ^{*}debt deduction of the foreign bank for the income year; and
 - (ii) is attributable to the Australian permanent establishment;were a debt deduction of the group (even if it was incurred at a time when the Australian permanent establishment was not in the group);

but with the modifications set out in sections 820-550 to 820-575.

Note: To work out the times during the income year when the Australian permanent establishment was in the group, see section 820-530.

- (5) For the purposes of this Division (as applying because of this Subdivision), this Act (except this Division) applies as if the matters referred to in subsections (3) and (4) of this section were the case.

Note: This means that the group is treated for the purposes of this Division as if it had debt deductions for the income year, based on the actual costs incurred by the entities and Australian permanent establishments that are treated as divisions or parts under subsections (3) and (4).

820-465 Effect on entities in group if debt deduction disallowed

If:

- (a) this Division (as applying because of this Subdivision) disallows all or part of a ^{*}debt deduction of the group for an income year; and
- (b) apart from this Division, the deduction would be a deduction of an entity for that income year;

this subsection disallows the deduction of that entity to the same extent.

Note: This section does not disallow a debt deduction to the extent that, at the time when the entity incurred the cost, the amount of the cost was paid or owed to another entity that was in the group at that time.

This is because the cost would not be a deduction for the group, since both entities are treated as divisions or parts of the group (see subsection 820-460(3)).

820-470 Values to be based on what would be in consolidated accounts for group

- (1) For the purposes of this Division as applying because of this Subdivision to a *resident TC group for an income year, the value or amount of a particular matter as at a particular time is to be worked out, so far as practicable, on the basis of the information that would be contained in a set of consolidated accounts:
 - (a) prepared, in accordance with the *accounting standard on consolidated accounts, as at that time; and
 - (b) covering the entities of which the group consisted at that time.

Note: This subsection does not depend on whether such a set of consolidated accounts was prepared, or had to be prepared, for other purposes.

- (2) To avoid doubt, subsection (1) also applies to working out the value or amount, as at a particular time, of a matter mentioned in any of sections 820-550 to 820-575 (for example, an entity's tier 1 capital (within the meaning of the *prudential standards) or *paid-up share capital).

How to construct a resident TC group for an income year

820-500 Choice to be made by top entity of a maximum TC group

- (1) The *top entity of a *maximum TC group for an income year may make one only of the 3 choices set out in sections 820-505, 820-510 and 820-520.
- (2) If there are 2 or more *top entities of the maximum TC group, only one of them can make the choice.
- (3) A *maximum TC group* for an income year consists of:
 - (a) a company that, at the end of that income year, is a *100% subsidiary of no other company; and

- (b) each 100% subsidiary of that company at the end of that income year.
- (4) A **top entity** of a *maximum TC group for an income year is a company in the group of which each company in the group (other than that company) that, at the end of that income year:
 - (a) is an *Australian entity; and
 - (b) is *not* a *prescribed dual resident;is a *100% subsidiary.

820-505 Single group

- (1) The first choice can be made only if the income year ends on the same day for all companies (**eligible companies**) in the *maximum TC group that meet the conditions in subsection (3) at the end of the income year.

Note: If this condition is not met, those eligible companies for which the income year does end on the same day may be able to form one or more resident TC groups under section 820-510.

- (2) The choice is to treat as a single **resident TC group** for the income year:
 - (a) all the eligible companies; and
 - (b) each partnership and trust that section 820-515 includes in the resident TC group; and
 - (c) each *Australian permanent establishment of a *foreign bank that section 820-515 includes in the resident TC group.
- (3) The conditions for each company are that it:
 - (a) is an *Australian entity; and
 - (b) is *not* a *prescribed dual resident.

820-510 Multiple groups

- (1) The second choice is to treat the eligible companies referred to in section 820-505 as forming one or more resident TC groups for the income year, on the basis that each **resident TC group** consists of:
 - (a) one or more subgroups constructed under subsection (3) of this section; and
 - (b) each partnership and trust that section 820-515 includes in the resident TC group; and

- (c) each *Australian permanent establishment of a *foreign bank that section 820-515 includes in the resident TC group.
- (2) However, a resident TC group under subsection (1) can consist of or include 2 or more subgroups constructed under subsection (3) only if:
- (a) each company in the 2 or more subgroups is at the end of the income year a *100% subsidiary of the same company (the **link company**) in the *maximum TC group; and
 - (b) for each company in the 2 or more subgroups, the income year ends on the same day; and
 - (c) the resident TC group includes every company:
 - (i) that is a *100% subsidiary of the link company at the end of the income year; and
 - (ii) that meets the conditions in subsection 820-505(3) at the end of the income year; and
 - (iii) for which the income year ends on that same day.
- (3) A subgroup constructed under this subsection consists of:
- (a) an entity (the **node entity**) that:
 - (i) is in the *maximum TC group; and
 - (ii) meets the conditions in subsection 820-505(3) at the end of the income year; and
 - (iii) is a *100% subsidiary of no other entity in the maximum TC group that meets those conditions at the end of the income year; and
 - (b) each 100% subsidiary (if any) of the node entity:
 - (i) that meets those conditions at the end of the income year; and
 - (ii) for which the income year ends on the same day as for the node entity.

820-515 Partnerships, trusts, and Australian permanent establishments of foreign banks, included in a resident TC group

A *resident TC group for an income year also includes:

- (a) each partnership:

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- (i) all interests in whose income and capital are beneficially owned at the end of the income year by one or more companies in the group; and
 - (ii) for which the income year ends on the same day as for the companies in the group; and
- (b) each trust:
- (i) all interests in whose income and capital are beneficially owned at the end of the income year by one or more entities, each of which is a company in the group or is covered by paragraph (a); and
 - (ii) for which the income year ends on the same day as for the companies in the group; and
- (c) for each *foreign bank:
- (i) that is in the *maximum TC group and chooses to include its *Australian permanent establishments in the resident TC group; and
 - (ii) for which the income year ends on the same day as for the companies in the resident TC group;
- each Australian permanent establishment through which the foreign bank carries on its banking business in Australia.

820-520 No grouping

The third choice is to have this Division apply to each entity in the *maximum TC group without being affected by this Subdivision.

820-525 Effect of choice

A choice has effect accordingly, and cannot be revoked. It binds each entity in the *maximum TC group, and each entity in each *resident TC group (if any).

820-530 Entities making up group before end of income year

- (1) A *resident TC group for an income year is treated as consisting, at a particular time (the *test time*) before the end of that income year, only of:
 - (a) the companies in the group determined under subsection (2); and

- (b) each partnership in the group, all interests in whose income and capital are beneficially owned at the test time by one or more of those companies; and
- (c) each trust in the group, all interests in whose income and capital are beneficially owned at the test time by one or more entities, each of which is covered by paragraph (a) or (b) of this subsection; and
- (d) for each *foreign bank:
 - (i) that is in the *maximum TC group; and
 - (ii) that, at the test time, is a *100% subsidiary of the *top entity of the *maximum TC group or is that top entity;each *Australian permanent establishment that is in the resident TC group, and through which the foreign bank carries on its banking business in Australia at the test time.

Note: This section affects how Subdivision 820-G (about calculating average values) applies to the group when there are 2 or more measurement days to consider.

- (2) The companies in the group determined under this subsection are:
 - (a) in the case of a *resident TC group under section 820-505—each company in the group that, at the test time:
 - (i) is a *100% subsidiary of the *top entity of the *maximum TC group or is that top entity; and
 - (ii) meets the conditions in subsection 820-505(3); or
 - (b) in the case of a resident TC group under section 820-510 that consists of only one subgroup constructed under subsection 820-510(3)—each company in the group that, at the test time:
 - (i) is a 100% subsidiary of the node entity or is the node entity; and
 - (ii) is a 100% subsidiary of the top entity of the maximum TC group or is that top entity; and
 - (iii) meets the conditions in subsection 820-505(3); or
 - (c) in the case of a resident TC group under section 820-510 that consists of 2 or more subgroups constructed under subsection 820-510(3)—each company in the group that, at the test time:
 - (i) is a 100% subsidiary of the link company mentioned in paragraph 820-510(2)(a) or is that link company; and
 - (ii) is a 100% subsidiary of the top entity of the maximum TC group or is that top entity; and
 - (iii) meets the conditions in subsection 820-505(3).

How this Division applies to a resident TC group

820-550 Classification of the resident TC group

Outward investing entity (non-ADI)

- (1) A *resident TC group for an income year is an ***outward investing entity (non-ADI)*** for the income year if, and only if, it is:
- (a) an *outward investor (general) for the income year (because of subsection (2)); or
 - (b) an *outward investor (financial) for the income year (because of subsection (3) or (4)).

Outward investor (general)

- (2) A *resident TC group for an income year is an ***outward investor (general)*** for the income year if:
- (a) the group includes at least one entity that, apart from this Subdivision, would be an *outward investor (general) for a period ending at the end of the income year; and
 - (b) the group includes no entity that is a *financial entity or *ADI at the end of the income year.

Outward investor (financial)

- (3) A *resident TC group for an income year is an ***outward investor (financial)*** for the income year if:
- (a) the group includes at least one entity that, apart from this Subdivision, would be an *outward investor (financial) for a period ending at the end of the income year; and
 - (b) the group includes no entity that is an *ADI at the end of the income year.
- (4) A *resident TC group for an income year is also an ***outward investor (financial)*** for the income year if:
- (a) the group includes at least one entity that, apart from this Subdivision, would be an *outward investor (general) for a period ending at the end of the income year; and
 - (b) the group includes at least one entity that is a *financial entity at the end of the income year; and

- (c) the group includes no entity that is an *ADI at the end of the income year.

Inward investing entity (non-ADI)

- (5) A *resident TC group for an income year is an ***inward investing entity (non-ADI)*** for the income year if, and only if, it is:
- (a) an *inward investment vehicle (general) for the income year (because of subsection (6)); or
 - (b) an *inward investment vehicle (financial) for the income year (because of subsection (7)).

Inward investment vehicle (general)

- (6) A *resident TC group for an income year is an ***inward investment vehicle (general)*** for the income year if:
- (a) the group includes at least one entity that, apart from this Subdivision, would be an *inward investment vehicle (general) for a period ending at the end of the income year; and
 - (b) the group includes no entity that, apart from this Subdivision, would be an *outward investing entity (non-ADI) for a period ending at the end of the income year; and
 - (c) the group includes no entity that is a *financial entity or *ADI at the end of the income year.

Inward investment vehicle (financial)

- (7) A *resident TC group for an income year is an ***inward investment vehicle (financial)*** for the income year if:
- (a) the group includes at least one entity that, apart from this Subdivision, would be an *inward investment vehicle (financial) for a period ending at the end of the income year; and
 - (b) the group includes no entity that, apart from this Subdivision, would be an *outward investing entity (non-ADI) for a period ending at the end of the income year; and
 - (c) the group includes no entity that is an *ADI at the end of the income year.

Outward investing entity (ADI)

- (8) A *resident TC group for an income year is an ***outward investing entity (ADI)*** for the income year if, and only if:
- (a) the group includes at least one entity that, apart from this Subdivision, would be an *outward investing entity (ADI) for a period ending at the end of the income year; or
 - (b) the group includes:
 - (i) at least one entity that, apart from this Subdivision, would be an *outward investing entity (non-ADI) for a period ending at the end of the income year; and
 - (ii) at least one entity that is an *ADI at the end of the income year.

820-555 Rest of Division not to apply to group headed by foreign-controlled Australian ADI or its holding company

- (1) This Division (except this Subdivision) does not apply to any entity that is in a *resident TC group for an income year, if the group:
- (a) is *not* an *outward investing entity (ADI) for the income year; and
 - (b) consists solely of 2 or more entities, each of which is, at the end of the income year:
 - (i) an entity that is both a *foreign controlled Australian entity and an *ADI; or
 - (ii) a *100% subsidiary of an entity in the group that is covered by subparagraph (i); or
 - (iii) a partnership, all interests in whose income and capital are beneficially owned by one or more entities in the group, each of which is covered by subparagraph (i) or (ii); or
 - (iv) a trust, all interests in whose income and capital are beneficially owned at the end of the income year by one or more entities in the group, each of which is covered by subparagraph (i), (ii) or (iii); or
 - (v) a company that meets the condition in subsection (2).
- (2) To be covered by subparagraph (1)(b)(v), a company:
- (a) must be a *foreign controlled Australian company at the end of the income year; and

- (b) must beneficially own at the end of the income year all the *shares in an entity in the group that is covered by subparagraph (1)(b)(i); and
- (c) must have no other assets at the end of the income year; and
- (d) must have no *debt capital at any time during the income year.

820-560 Application of Subdivisions 820-B and 820-C to group

- (1) This section has effect for the purposes of:
 - (a) applying Subdivision 820-B to a *resident TC group that is an *outward investor (financial) for an income year; or
 - (b) applying Subdivision 820-C to a *resident TC group that is an *inward investment vehicle (financial) for an income year.
- (2) An *on-lent amount, or *zero-capital amount, of an entity in the group is to be taken into account only if the entity is a *financial entity throughout the income year.

820-562 Application of Subdivision 820-D to group

- (1) This section has effect for the purposes of applying Subdivision 820-D to a *resident TC group that is an *outward investing entity (ADI) for an income year.
- (2) The group's *adjusted average equity capital* for the income year is the average value, for that year, of the amount worked out under subsection (3).

Note: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

- (3) The amount worked out under this subsection as at a particular day is the total of the amounts worked out under the table below for each member of the group that is covered by an item in the table and is in the group on that day.

Note: To work out the times during the income year when an entity or Australian permanent establishment was in the group, see section 820-530.

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Resident TC group that is an outward investing entity (ADI)		
Item	For:	The amount is:
1	a company that, at the end of the income year: (a) is an *ADI; or (b) is a *100% subsidiary of an *ADI	the total value of all the company's tier 1 capital (within the meaning of the *prudential standards) as at the end of that day; minus the value of the company's *debt capital that is part of that tier 1 capital at the end of that day
2	a partnership or trust, all interests in whose income and capital are beneficially owned at the end of the income year by one or more entities in the group covered by item 1	the total value of all the tier 1 capital (within the meaning of the *prudential standards) of the partnership or trust as at the end of that day; minus the value of the *debt capital of the partnership or trust that is part of that tier 1 capital at the end of that day
3	a company that is not covered by item 1	the total value, as at the end of that day, of the company's *paid-up share capital, retained earnings, general reserves and asset revaluation reserves; minus the value of the company's *debt capital that is part of the company's paid-up share capital at the end of that day; plus the value of the company's debt capital at the end of that day that does not give rise to any *debt deductions of the company for the income year or any other income year
4	a partnership or trust that is not covered by item 2	the total value, as at the end of that day, of the capital and reserves of the partnership or trust; minus the value of the *debt capital of the partnership or trust that is part of the capital of the partnership or trust at the end of that day; plus the value of the debt capital of the partnership or trust at the end of that day that does not give rise to any *debt deductions of the partnership or trust for the income year or any other income year

Resident TC group that is an outward investing entity (ADI)

Item	For:	The amount is:
5	an *Australian permanent establishment through which a *foreign bank carries on its banking business in Australia	<p>the *equity capital of the foreign bank, as at the end of that day, that:</p> <p>(a) is attributable to that Australian permanent establishment; but</p> <p>(b) has not been allocated to the *OB activities of the foreign bank;</p> <p>plus the total of the amounts that, as at the end of that day:</p> <p>(c) are made available by the foreign bank to the Australian permanent establishment as loans to the Australian permanent establishment; and</p> <p>(d) do not give rise to any *debt deductions of the foreign bank for the income year or any other income year</p>

- (4) For each *Australian permanent establishment through which a *foreign bank carries on its banking business in Australia and that is in the group, the group's *risk-weighted assets include that part of the *risk-weighted assets of the foreign bank that:
- (a) is attributable to that Australian permanent establishment; but
 - (b) is not attributable to the *OB activities of the foreign bank.

820-565 Additional application of Subdivision 820-D to group that includes foreign-controlled Australian ADI

Subdivision 820-D applies to a *resident TC group for an income year, as if the group were an *outward investing entity (ADI), if:

- (a) the group is not an outward investing entity (ADI) for the income year; and
- (b) the group includes at least one entity that is at the end of the income year both a *foreign controlled Australian entity and an *ADI; and
- (c) the group includes at least one company that is at the end of the income year a *100% subsidiary of no entity covered by paragraph (b) of this section.

820-570 Effect on safe harbour capital amount if foreign-controlled Australian ADI in the group on-lends section 128F amounts

- (1) For the purposes of working out the *safe harbour capital amount of a *resident TC group for an income year, if:
 - (a) the group includes an entity (the *ADI subsidiary*) that is at the end of the income year both a *100% subsidiary of a *foreign bank and an *ADI; and
 - (b) the ADI subsidiary has:
 - (i) issued *debentures covered by section 128F (which exempts interest on the debentures from withholding tax) of the *Income Tax Assessment Act 1936*; and
 - (ii) made proceeds of the debentures available to an *Australian permanent establishment of the foreign bank, as loans to the Australian permanent establishment, for use in its Australian business; and
 - (c) the Australian permanent establishment is not in the resident TC group at the end of the income year;the group's *risk-weighted assets at a particular time are reduced by the total amounts of proceeds of the debentures that are at that time so made available by the ADI subsidiary.
- (2) This section applies only to the 2001-2002 income year and to each of the next 4 income years.

820-575 Additional application of Subdivision 820-E to group that includes Australian permanent establishment of foreign bank

- (1) Subdivision 820-E applies to a *resident TC group for an income year, as if the group were an *inward investing entity (ADI), if:
 - (a) the group includes at least one *Australian permanent establishment through which a *foreign bank carries on its banking business in Australia; and
 - (b) the group includes no entity that, apart from this Subdivision, would be an *outward investing entity (non-ADI), or an *outward investing entity (ADI), for a period ending at the end of the income year; and

(c) the group includes no entity that is at the end of the income year both a ^{*}foreign controlled Australian entity and an ^{*}ADI. However, it applies with the modifications in this section (in addition to the other modifications in this Subdivision).

(2) The group's *average equity capital* for the income year is the average value, for that year, of the amount worked out under subsection (2A).

Note: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

(2A) The amount worked out under this subsection as at a particular day is the total of the amounts worked out under the table below for each member of the group that is covered by an item in the table and is in the group on that day.

Note: To work out the times during the income year when an entity or Australian permanent establishment was in the group, see section 820-530.

Resident TC group treated as an inward investing entity (ADI)

Item	For:	The amount is:
1	a company	the total value, as at the end of that day, of the company's [*] paid-up share capital, retained earnings, general reserves and asset revaluation reserves; minus the value of the company's [*] debt capital that is part of the company's paid-up share capital at the end of that day; plus the value of the company's debt capital at the end of that day that does not give rise to any [*] debt deductions of the company for the income year or any other income year

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Part 1 New thin capitalisation rules

Resident TC group treated as an inward investing entity (ADI)

Item	For:	The amount is:
2	a partnership or trust	<p>the total value, as at the end of that day, of the capital and reserves of the partnership or trust; minus</p> <p>the value of the *debt capital of the partnership or trust that is part of the capital of the partnership or trust at the end of that day; plus</p> <p>the value of the debt capital of the partnership or trust at the end of that day that does not give rise to any *debt deductions of the partnership or trust for the income year or any other income year</p>
3	an *Australian permanent establishment through which a *foreign bank carries on its banking business in Australia	<p>the *equity capital of the foreign bank, as at the end of that day, that:</p> <p>(a) is attributable to that Australian permanent establishment; but</p> <p>(b) has not been allocated to the *OB activities of the foreign bank;</p> <p>plus the total of the amounts that, as at the end of that day:</p> <p>(c) are made available by the foreign bank to the Australian permanent establishment as loans to the Australian permanent establishment; and</p> <p>(d) do not give rise to any *debt deductions of the foreign bank for the income year or any other income year</p>

- (3) The group's *safe harbour capital amount* for the income year is worked out using the following method statement.

Method statement

Step 1. Work out the average value, for the income year, of the group's *risk-weighted assets.

Step 2. Multiply the result of step 1 by 4%. The result of this step is the safe harbour capital amount.

- (4) For each *Australian permanent establishment through which a *foreign bank carries on its banking business in Australia and that is in the group, the group's *risk-weighted assets include that part of the *risk-weighted assets of the foreign bank that:
- (a) is attributable to that Australian permanent establishment; but
 - (b) is not attributable to the *OB activities of the foreign bank.

Subdivision 820-G—Calculating the average values

Guide to Subdivision 820-G

820-625 What this Subdivision is about

This Subdivision sets out the methods of calculating the average values for the purposes of this Division. It also includes special rules about values and valuation that are relevant to that calculation.

Note: Section 820-25 of the *Income Tax (Transitional Provisions) Act 1997* provides for a transitional rule that affects the operation of this Subdivision in relation to an income year that begins before 1 July 2002 and ends before 30 June 2003.

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[This is the end of the Guide.]

How to calculate the average values

820-630 Methods of calculating average values

Methods of calculation for entities that are not ADIs

- (1) An entity to which Subdivision 820-B or 820-C applies for a period that is all or a part of an income year must use one of the following methods to calculate the average value of a matter mentioned in that Subdivision for the purposes of that application:
 - (a) the method set out in section 820-635 (the ***opening and closing balances method***);
 - (b) the method set out in section 820-640 (the ***3 measurement days method***);
 - (c) the method set out in section 820-645 (the ***frequent measurement method***).

Note 1: This subsection therefore applies only to an outward investing entity (non-ADI) or an inward investing entity (non-ADI).

Note 2: An entity cannot apply the 3 measurement days method if it is unable to meet the requirements in subsection 820-640(1). An entity's ability to apply that method may therefore be limited.

- (2) The entity must use the same method to calculate all such average values for that period for the purposes of that application.

Commissioner's power

- (3) If the entity fails to comply with subsection (2), the Commissioner may, irrespective of the methods used by the entity, recalculate all the average values for the entity and that period by using the opening and closing balances method.

Method of calculation for ADIs

- (4) An entity to which Subdivision 820-D or 820-E applies for a period that is all or a part of an income year must use the frequent measurement method to calculate the average value of a matter mentioned in that Subdivision for the purposes of that application.

Note: This subsection therefore applies only to an outward investing entity (ADI) or an inward investing entity (ADI).

820-635 The opening and closing balances method

An entity that uses the opening and closing balances method for a period must apply the following method statement to calculate the average value of a matter for that period.

Method statement

- Step 1.* Work out the value of the particular matter as at the first day of that period.
- Step 2.* Work out the value of the particular matter as at the last day of that period.
- Step 3.* Add the results of steps 1 and 2.
- Step 4.* Divide the result of step 3 by 2. The result of this step is the average value.

Example: ALWZ Corporation, a company that is an Australian entity, held assets valued at \$95 million on the first day of an income year. It held assets valued at \$105 million at the end of that year. Adding those amounts and dividing the result by 2 gives the average value of its assets for that year, which is \$100 million.

820-640 The 3 measurement days method

Application

- (1) An entity must not use the 3 measurement days method for a period that is a part of an income year unless the following days occur during that period:
- (a) the last day of the first half of the income year;
 - (b) one or both of the following days:
 - (i) the first day of that year;
 - (ii) the last day of that year.

Method statement

- (2) An entity that uses the 3 measurement days method for a period must apply the following method statement to calculate the average value of a matter for that period.

Method statement

- Step 1.* Work out the value of the particular matter as at the first measurement day (see subsection (3)).
- Step 2.* Work out the value of the particular matter as at the second measurement day (see subsection (3)).
- Step 3.* Work out the value of the particular matter as at the third measurement day (see subsection (3)).
- Step 4.* Add the results of steps 1, 2 and 3.
- Step 5.* Divide the result of step 4 by 3. The result of this step is the average value.

Example: RJ Corporation held assets valued at \$115 million on the first day of an income year. It held assets valued at \$105 million on the last day of the first half of that year, and \$80 million on the last day of that year. Adding these amounts and dividing the result by 3 gives the average value of its assets for that year, which is \$100 million.

Measurement days

- (3) The following are the **first**, **second** and **third measurement days**:
- (a) the **first measurement day** is the first day of the income year if it occurs during that period, otherwise it is the first day of that period;
 - (b) the **second measurement day** is the last day of the first half of that year;
 - (c) the **third measurement day** is the last day of that year if it occurs during that period, otherwise it is the last day of that period.

820-645 The frequent measurement method

- (1) An entity that uses the frequent measurement method for a period (the **measurement period**) must calculate the average value of a matter for that period by applying:
- (a) the method statement in subsection (2) (generally based on quarterly periods); or

- (b) the method statement in subsection (4) (generally based on regular intervals).

This section does not prevent the entity from applying the method statement in subsection (2) for one matter and the method statement in subsection (4) for another matter in relation to that period.

- (2) This is the method statement for the purposes of paragraph (1)(a).

Method statement

Step 1. Work out the value of the particular matter as at each of the following measurement days:

- (a) the first day of the measurement period;
- (b) the last day of each quarterly period of that income year (see subsection (3)) that occurs during the measurement period (if any);
- (c) the last day of the measurement period if it is not a day covered by paragraph (b).

Step 2. Add up those values.

Step 3. Divide the result of step 2 by the number of measurement days. The result of this step is the average value.

Example: KJW Finance Corporation, a company that is an Australian entity, held assets valued at \$130 million on the first day of an income year. On the last day of each quarterly period for that year it held assets valued at \$140 million, \$120 million, \$110 million and \$100 million respectively. Adding these amounts and dividing the result by 5 gives the average value of its assets for that year, which is \$120 million.

Quarterly period

- (3) The **quarterly periods of the income year** are:
- (a) the period consisting of the first, second and third months of that year; and
 - (b) each successive period of 3 months that occurs after that period during that year.

- (4) This is the method statement for the purposes of paragraph (1)(b):

Method statement

- Step 1.* Work out the value of the particular matter as at each of the following measurement days:
- (a) the first day of the measurement period;
 - (b) the last day of each regular interval for the measurement period (see subsection (5));
 - (c) the last day of the measurement period if it is not a day mentioned in paragraph (b).
- Step 2.* Add up those values.
- Step 3.* Divide the result of step 2 by the number of measurement days. The result of this step is the average value.

Example: TW Corporation, a company that is an Australian entity, adopts a weekly interval for the purposes of this subsection. The measurement period is a period of 12 weeks. On the first day of that period it had \$70 million of debt capital. Its debt capital was \$80 million on the last day of each of the first 7 weeks, and \$95 million on the last day of the remaining 5 weeks. Adding these amounts and dividing the result by 13 (the number of measurement days) gives the average value of its debt capital for that period, which is \$85 million.

Regular intervals

- (5) The **regular intervals** for the measurement period are:
- (a) a period which consists of a fixed number of days or months (not less than one day and not more than 3 months) adopted by the entity and begins at the start of the first day of the measurement period; and
 - (b) each successive period of the same duration that occurs during the measurement period.

Note: Examples of a regular interval therefore include a daily, weekly, fortnightly, monthly or quarterly interval.

- (6) The entity must use the same regular intervals when calculating the average values of different matters under subsection (4) for that period.

Special rules about values and valuation

820-675 Amount to be expressed in Australian currency

- (1) For the purposes of this Division, an amount (including a value used in a calculation under this Division) is to be expressed in Australian currency.
- (2) An entity must comply with the *accounting standards in converting an amount into Australian currency.
- (3) Subsection (2) has effect whether the *accounting standard would otherwise apply to the entity or not.

820-680 Valuation of assets, liabilities and equity capital

- (1) For the purposes of this Division, an entity must comply with the *accounting standards in calculating:
 - (a) the value of its assets (including revaluing its assets for the purposes of that calculation); and
 - (b) the value of its liabilities (including its *debt capital); and
 - (c) the value of its *equity capital.
- (2) A revaluation of assets mentioned in paragraph (1)(a) must be made by a person:
 - (a) who is an expert in valuing such assets; and
 - (b) whose pecuniary or other interests could not reasonably be regarded as being capable of affecting the person's ability to give an unbiased opinion in relation to that revaluation.
- (3) Subsection (1) has effect whether the *accounting standard would otherwise apply to the entity or not.

820-685 Valuation of debt capital

For the purposes of this Division, the regulations may make additional provisions for the valuation of the *debt capital of an entity.

820-690 Commissioner's power

If the Commissioner considers that, in relation to a calculation under this Division, an entity has:

- (a) overvalued its assets; or
 - (b) undervalued its liabilities (including its ^{*}debt capital);
- the Commissioner may, having regard to the ^{*}accounting standards, substitute a value that the Commissioner considers is appropriate.

Subdivision 820-H—Control of entities

Guide to Subdivision 820-H

820-740 What this Subdivision is about

This Subdivision sets out rules about the following:

- the meaning of an Australian controller of a foreign entity (for the purpose of determining whether or not an entity is an outward investing entity (non-ADI) or outward investing entity (ADI));
- the meaning of a foreign controlled Australian entity (for the purpose of determining whether or not an entity is an inward investing entity (non-ADI));
- the method of working out the extent to which one entity is controlled by another entity for those purposes.

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[This is the end of the Guide.]

Australian controller of a foreign entity

820-745 What is an Australian controlled foreign entity?

An *Australian controlled foreign entity*, in relation to a particular time, is an entity that is any of the following at that time:

- (a) a *controlled foreign company (except a *corporate limited partnership);
- (b) a *controlled foreign trust;
- (c) a *controlled foreign corporate limited partnership.

820-750 What is an Australian controller of a controlled foreign company?

An entity is an *Australian controller* of a *controlled foreign company mentioned in paragraph 820-745(a) at a particular time if, and only if, at that time:

- (a) that entity is an *Australian entity holding a *TC control interest in the controlled foreign company that is 10% or more; or
- (b) all of the following subparagraphs apply:
 - (i) the controlled foreign company is such a company because of paragraph 340(c) of the *Income Tax Assessment Act 1936*;
 - (ii) not more than 5 Australian entities, including that entity, control that controlled foreign company (either alone or together with *associate entities and whether or not any associate entity is also an Australian entity);
 - (iii) that entity holds a *TC control interest in the controlled foreign company that is at least 1%.

Note: A corporate limited partnership that is a foreign entity may be a controlled foreign corporate limited partnership, see section 820-760.

820-755 What is an Australian controller of a controlled foreign trust?

An entity is an *Australian controller* of a *controlled foreign trust at a particular time if, and only if, at that time, the entity is an *Australian entity holding a *TC control interest in the trust that is 10% or more.

820-760 What is an Australian controller of a controlled foreign corporate limited partnership?

Australian controller of a controlled foreign corporate limited partnership

- (1) An entity is an *Australian controller* of a *controlled foreign corporate limited partnership at a particular time if, and only if, at least one of the following paragraphs applies to the entity at that time:
 - (a) the entity is an *Australian entity that is a *general partner of the partnership;
 - (b) the entity is an Australian entity holding a *TC control interest in the partnership that is 10% or more.

Controlled foreign corporate limited partnership

- (2) A *corporate limited partnership is a ***controlled foreign corporate limited partnership*** at a particular time if, and only if, at that time:
- (a) it is not an *Australian entity; and
 - (b) at least one of the following subparagraphs applies to it:
 - (i) at least one *general partner of the partnership is an *Australian entity or an *Australian controlled foreign entity;
 - (ii) not more than 5 Australian entities (each of which holds a *TC control interest in the partnership that is at least 1%) hold a total of TC control interests in the partnership that is 50% or more.

Foreign controlled Australian entity

820-780 What is a foreign controlled Australian entity?

A ***foreign controlled Australian entity***, in relation to a particular time, is an entity that is any of the following at that time:

- (a) a *foreign controlled Australian company;
- (b) a *foreign controlled Australian trust;
- (c) a *foreign controlled Australian partnership.

820-785 What is a foreign controlled Australian company?

- (1) A company (except a *corporate limited partnership) is a ***foreign controlled Australian company*** (or an ***FCAC***) at a particular time if, and only if, at that time, it is an *Australian entity to which at least one of the following paragraphs applies:
- (a) not more than 5 *foreign entities (each of which holds a *TC control interest in the company that is at least 1%) hold a total of TC control interests in the company that is 50% or more;
 - (b) a foreign entity holds a TC control interest in the company that is 40% or more, and no other entity or entities (except an *associate entity of the foreign entity or entities including the foreign entity or its associate entities) control the company;
 - (c) not more than 5 foreign entities control the company (whether or not with associate entities and whether or not any associate entity is a foreign entity).

Schedule 1 Thin capitalisation rules
Part 1 New thin capitalisation rules

Note: A corporate limited partnership that is an Australian entity may be a foreign controlled Australian partnership, see section 820-795.

Exception

- (2) Despite subsection (1), a company is not an FCAC at a particular time if, at that time:
- (a) the company would, apart from this subsection, be an FCAC only because of paragraph (1)(a) or (b); but
 - (b) the total of the following interests would be less than 20% if paragraphs 820-875(2)(a) and (b) were disregarded:
 - (i) the *TC direct control interest in the company held by the *foreign entity or entities mentioned in paragraph (1)(a) or (b);
 - (ii) the *TC indirect control interest in the company held by the foreign entity or entities;
 - (iii) the TC direct control interests in the company held by any *associate entities of the foreign entity or entities (other than any TC direct control interests that have been taken into account in calculating the interest mentioned in subparagraph (ii));
 - (iv) the TC indirect control interests in the company held by the entity's associate entities (other than any TC indirect control interests that have been taken into account in calculating the interest mentioned in subparagraph (ii)).

Note: Paragraphs 820-875(2)(a) and (b) set out special rules under which an entity is taken to hold a TC control tracing interest in another entity that is equal to 100%, which could then be taken into account in calculating a TC indirect control interest.

820-790 What is a foreign controlled Australian trust?

- (1) A trust is a *foreign controlled Australian trust* (or an *FCAT*) at a particular time if, and only if, at that time, it is an *Australian trust to which at least one of the following paragraphs applies:
- (a) not more than 5 *foreign entities (each of which holds a *TC control interest in the trust that is at least 1%) hold a total of TC control interests in the trust that is 50% or more;
 - (b) a foreign entity holds a TC control interest in the trust that is 40% or more, and no other entity or entities (except an *associate entity of the foreign entity or entities including the foreign entity or its associate entities) control the trust;

- (c) all of the following subparagraphs apply to the trust:
 - (i) at least one of the objects or beneficiaries of the trust is a foreign entity;
 - (ii) there has been at least one distribution of income or capital of the trust made to such an object or beneficiary (whether directly or indirectly) during the income year in which that particular time occurs, or during the preceding 2 income years;
 - (iii) the total TC control interests in the trust that are held by all its beneficiaries that are *Australian entities do not exceed 50%;
 - (d) a foreign entity is in a position to control the trust (see subsection (2)).
- (2) A *foreign entity is in a position to control a trust if, and only if:
- (a) the entity, or an *associate entity of the entity, whether alone or with other associate entities (the *relevant entity*), has the power to obtain the beneficial enjoyment of the trust's capital or income (whether or not by exercising its power of appointment or revocation, and whether with or without another entity's consent); or
 - (b) the relevant entity is able to control the application of the trust's capital or income in any manner (whether directly or indirectly); or
 - (c) the relevant entity is able to do a thing mentioned in paragraph (a) or (b) under a *scheme; or
 - (d) a trustee of the trust is accustomed or is under an obligation (whether formally or informally), or might reasonably be expected, to act in accordance with the relevant entity's directions, instructions or wishes; or
 - (e) the relevant entity is able to remove or appoint a trustee of the trust.

Exception

- (3) Despite subsection (1), a trust is not an FCAT at a particular time if, at that time:
- (a) the trust would, apart from this subsection, be an FCAT only because of paragraph (1)(a) or (b); but
 - (b) the total of the following interests would be less than 20% if paragraphs 820-875(2)(a) and (b) were disregarded:

- (i) the *TC direct control interest in the trust held by the *foreign entity or entities mentioned in paragraph (1)(a), (b) or (c);
- (ii) the *TC indirect control interest in the trust held by the foreign entity or entities;
- (iii) the TC direct control interests in the trust held by any *associate entities of the foreign entity or entities (other than any TC direct control interests that have been taken into account in calculating the interest mentioned in subparagraph (ii));
- (iv) the TC indirect control interests in the trust held by the entity's associate entities (other than any TC indirect control interests that have been taken into account in calculating the interest mentioned in subparagraph (ii)).

Note: Paragraphs 820-875(2)(a) and (b) set out special rules under which an entity is taken to hold a TC control tracing interest in another entity that is equal to 100%, which could then be taken into account in calculating a TC indirect control interest.

820-795 What is a foreign controlled Australian partnership?

Corporate limited partnership

- (1) A *corporate limited partnership is a **foreign controlled Australian partnership** (or an **FCAP**) at a particular time if, and only if, at that time:
 - (a) it is an *Australian entity; and
 - (b) at least one of the following subparagraphs applies to it:
 - (i) not more than 5 *foreign entities (each of which holds a *TC control interest in the partnership that is at least 1%) hold a total of TC control interests in the partnership that are 50% or more;
 - (ii) at least one *general partner of the partnership is a foreign entity or a *foreign controlled Australian entity.

Partnership that is not a corporate limited partnership

- (2) A partnership other than a *corporate limited partnership is a **foreign controlled Australian partnership** (or an **FCAP**) at a particular time if, and only if, at that time:
 - (a) it is an *Australian partnership; and

- (b) at least one of the following subparagraphs applies to it:
 - (i) not more than 5 *foreign entities (each of which holds a *TC control interest in the partnership that is at least 1%) hold a total of TC control interests in the partnership that is 50% or more;
 - (ii) a foreign entity holds a TC control interest in the partnership that is 40% or more, and no other entity or entities (except an *associate entity of the foreign entity or entities including the foreign entity or its associate entities) control the partnership.

Exception

- (3) Despite subsections (1) and (2), a partnership is not an FCAP at a particular time if, at that time:
 - (a) the partnership would, apart from this subsection, be an FCAP only because of subparagraph (1)(b)(i), (2)(b)(i) or (ii); but
 - (b) the total of the following interests would be less than 20% if paragraphs 820-875(2)(a) and (b) were disregarded:
 - (i) the *TC direct control interest in the partnership held by the *foreign entity or entities mentioned in subparagraph (1)(b)(i), (2)(b)(i) or (ii);
 - (ii) the *TC indirect control interest in the partnership held by the foreign entity or entities;
 - (iii) the TC direct control interests in the partnership held by any *associate entities of the foreign entity or entities (other than any TC direct control interests that have been taken into account in calculating the interest mentioned in subparagraph (ii));
 - (iv) the TC indirect control interests in the partnership held by the entity's associate entities (other than any TC indirect control interests that have been taken into account in calculating the interest mentioned in subparagraph (ii)).

Note: Paragraphs 820-875(2)(a) and (b) set out special rules under which an entity is taken to hold a TC control tracing interest in another entity that is equal to 100%, which could then be taken into account in calculating a TC indirect control interest.

Thin capitalisation control interest

820-815 General rule about thin capitalisation control interest in a company, trust or partnership

Meaning of TC control interest

- (1) The *thin capitalisation control interest* (or *TC control interest*) that an entity holds in a company, trust or partnership at a particular time is the total of the following interests:
 - (a) the *TC direct control interest (if any) held by the entity in the company, trust or partnership at that time;
 - (b) the *TC indirect control interest (if any) held by the entity in the company, trust or partnership at that time;
 - (c) the TC direct control interests (if any) held by the entity's *associate entities in the company, trust or partnership at that time;
 - (d) the TC indirect control interests (if any) held by the entity's associate entities in the company, trust or partnership at that time.

This section has effect subject to sections 820-820 to 820-835 (which set out special rules to avoid double counting).

Note: For the rules about a TC direct control interest, see sections 820-855 to 820-865. For the rules about a TC indirect control interest, see sections 820-870 to 820-875.

- (2) This section does not apply to an *associate entity of the entity if it is such an associate entity only because of subsection 820-905(3B).

820-820 Special rules about calculating TC control interest held by an entity

- (1) This section applies for the purposes of calculating the *TC control interest that an entity holds in a company, trust or partnership.
- (2) Disregard a *TC indirect control interest held by the entity to the extent to which it is calculated by reference to:
 - (a) a *TC direct control interest taken into account under paragraph 820-815(c); or
 - (b) a TC indirect control interest taken into account under paragraph 820-815(d).

(3) Disregard a *TC indirect control interest held by an *associate entity of the entity to the extent to which it is calculated by reference to:

- (a) a *TC direct control interest taken into account under paragraph 820-815(a) or (c); or
- (b) a TC indirect control interest taken into account under paragraph 820-815(b) or (d).

This subsection does not apply to an associate entity of the entity if it is such an associate entity only because of subsection 820-905(3B).

(4) Take into account only one of the following things if both would otherwise be counted in calculating the *TC control interest:

- (a) the holding of a *TC direct control interest by the entity or any other entity;
- (b) an entitlement to acquire that TC direct control interest.

(5) The operation of this section in relation to an entity does not prevent the operation of section 820-825 in relation to a group of entities that includes that entity.

820-825 Special rules about calculating TC control interests held by a group of entities

(1) This section applies for the purposes of calculating the total *TC control interests that a group of entities holds in a company, trust or partnership.

(2) Take into account a particular *TC direct control interest or *TC indirect control interest only once if it would otherwise be counted more than once because the entity holding it is an *associate entity of one or more entities in the group. This subsection does not apply to an associate entity of one or more entities in the group if it is such an associate entity only because of subsection 820-905(3B).

(3) Take into account only one of the following things if both of them would otherwise be counted in calculating the total *TC control interests:

- (a) the holding of a *TC direct control interest by an entity;
- (b) an entitlement to acquire that TC direct control interest.

- (4) The operation of this section in relation to a group of entities does not prevent the operation of section 820-820 in relation to an entity that is a member of that group.

820-830 Special rules about determining percentage of TC control interest

- (1) This section applies for the purposes of determining whether an entity, or a group of entities, holds at least a particular percentage of *TC control interests for the purposes of a provision in this Subdivision.
- (2) If, apart from this subsection, an entity, or each of 2 or more entities, would hold a *TC direct control interest equal to 100%, or a *TC control tracing interest equal to 100%, in another entity (the *controlled entity*):
- (a) only the entity, or one of the 2 or more entities, is to be taken to hold that particular interest in the controlled entity equal to 100%; and
 - (b) another entity is not to be taken to hold that particular interest in the controlled entity (whether or not it would, apart from this subsection, hold that interest in the controlled entity equal to 100%).

820-835 Commissioner's power

For the purposes of this Subdivision, the Commissioner may decide:

- (a) which one of 2 things is to be taken into account for the purposes of subsection 820-820(4) or subsection 820-825(3); or
- (b) which one of 2 or more entities is to be chosen for the purposes of paragraph 820-830(2)(a).

TC direct control interest, TC indirect control interest and TC control tracing interest

820-855 TC direct control interest in a company

- (1) A *thin capitalisation direct control interest* (or a *TC direct control interest*) that an entity holds in a company (except a *corporate

limited partnership) at a particular time is the percentage of the direct control interest (if any) that the entity holds in the company at that time under the provisions applied by subsection (2).

Note: For the TC direct control interest that an entity holds in a corporate limited partnership, see section 820-865.

- (2) For the purposes of subsection (1), provisions of Part X of the *Income Tax Assessment Act 1936* are applied with the modifications set out in the following table.

Modifications of provisions in Part X of the <i>Income Tax Assessment Act 1936</i>		
Item	Provisions	Modifications
1	Section 350 (including any other provision in Part X of the <i>Income Tax Assessment Act 1936</i> that defines a term used in the section)	The section applies for the purposes of this Subdivision rather than only for the purposes of Part X of the <i>Income Tax Assessment Act 1936</i>
2	Subsections 350(6) and (7)	If section 350 is used for the purposes of determining whether or not a company is a *foreign controlled Australian company, the subsections apply as if subsection (6) referred to *foreign entities and foreign entity rather than *Australian entities and Australian entity If section 350 is used for the purposes of determining whether or not an entity is an *Australian controller of a *controlled foreign company, the subsections do not apply
3	Section 350	A reference to an *associate is taken to be a reference to an *associate entity

820-860 TC direct control interest in a trust

- (1) A *thin capitalisation direct control interest* (or a *TC direct control interest*) that an entity holds in a trust at a particular time is the percentage of the direct control interest (if any) that the entity holds in the trust at that time under the provisions applied by subsection (2).

Schedule 1 Thin capitalisation rules
Part 1 New thin capitalisation rules

- (2) For the purposes of subsection (1), provisions of Part X of the *Income Tax Assessment Act 1936* are applied with the modifications set out in the following table.

Modifications of provisions in Part X of the <i>Income Tax Assessment Act 1936</i>		
Item	Provisions	Modifications
1	Section 351 (including any other provision in Part X of the <i>Income Tax Assessment Act 1936</i> that defines a term used in the section)	The section applies for the purposes of this Subdivision rather than only for the purposes of Part X of the <i>Income Tax Assessment Act 1936</i>
2	Subsections 351(3) and (4)	The subsections do not apply

- (3) In addition, for the purposes of determining whether or not an entity (other than a trust mentioned in paragraph (a) or (b)) is a *foreign controlled Australian entity:
- (a) if a trust is covered by paragraph 820-790(1)(c)—a foreign entity that is an object of the trust at a particular time is taken to hold, at that time, a TC direct control interest in the trust that is equal to 100%; and
 - (b) if a trust is covered by paragraph 820-790(1)(d)—a foreign entity that is in a position to control the trust at a particular time is taken to hold, at that time, a *TC direct control interest in the trust that is equal to 100%.

Note: The foreign entity therefore holds a TC control tracing interest in the trust (see section 820-875). That interest may then be taken into account in calculating any TC indirect control interest that the foreign entity holds in another entity in relation to which the trust is an interposed entity (see section 820-870). As a result, that other entity may become a foreign controlled Australian entity.

820-865 TC direct control interest in a partnership

A *thin capitalisation direct control interest* (or a *TC direct control interest*) that an entity holds in a partnership at a particular time is whichever of the following percentages is applicable, and if there are 2 or more such percentages, the greatest of them:

- (a) in the case of a *corporate limited partnership—100% if the entity is a *general partner of the partnership;

- (b) in the case of a partnership that is not a corporate limited partnership—the percentage of the control of voting power in the partnership that the entity has at that time;
- (c) in any case—the percentage that the entity holds, or is entitled to acquire, at that time, of any of the following:
 - (i) the total amount of assets or capital contributed to the partnership;
 - (ii) the total rights of partners to distributions of capital, assets or profits on the dissolution of the partnership;
 - (iii) the total rights of partners to distributions of capital, assets or profits otherwise than on the dissolution of the partnership.

820-870 TC indirect control interest in a company, trust or partnership

What is a TC indirect control interest?

- (1) An entity holds a ***thin capitalisation indirect control interest*** (or a ***TC indirect control interest***) in a company, trust or partnership at a particular time if, and only if:
 - (a) there is an interposed entity, or a continuous series of at least 2 interposed entities, between that entity and the company, trust or partnership; and
 - (b) the interposed entity, or each of the interposed entities, is:
 - (i) a *foreign controlled Australian entity if this section is used for the purposes of determining whether or not an entity is a foreign controlled Australian entity; or
 - (ii) an *Australian controlled foreign entity if this section is used for the purposes of determining whether or not an entity is an Australian controlled foreign entity or an *Australian controller of such an entity.

Note: In the case of a continuous series of interposed entities between an entity and a company, trust or partnership, the entity must hold a TC control tracing interest in the first interposed entity (see subsection (2)). In addition, under subsection (2), each interposed entity in the series must hold a TC control tracing interest in the next interposed entity (except in the case of the last one, which holds a TC control tracing interest in the company, trust or partnership).

What is an interposed entity?

- (2) For the purposes of this section, an entity (the *middle entity*) is interposed between 2 other entities at a particular time if, and only if, at that time:
- (a) the first of those 2 entities holds a *TC control tracing interest in the middle entity; and
 - (b) the middle entity holds a TC control tracing interest in the second of those 2 entities.

Note: For the rules about a TC control tracing interest, see section 820-875.

How to calculate a TC indirect control interest

- (3) The *TC indirect control interest that an entity (the *top entity*) holds in a company, trust or partnership at a particular time is calculated in accordance with subsection (4), (5) or (6) (as appropriate).

One interposed entity only

- (4) The *TC indirect control interest is the result of applying the following method statement if there is only one interposed entity between the top entity and the company, trust or partnership at that time.

Method statement

- Step 1.* Calculate the *TC control tracing interest that the top entity holds in the interposed entity at that time.
- Step 2.* Multiply the result of step 1 by the *TC control tracing interest that the interposed entity holds in the company, trust or partnership at that time.

2 interposed entities

- (5) The *TC indirect control interest is the result of applying the following method statement if there are 2 interposed entities between the top entity and the company, trust or partnership at that time.

Method statement

- Step 1.* Calculate the *TC control tracing interest that the top entity holds in the first of those interposed entities at that time.
- Step 2.* Multiply the result of step 1 by the *TC control tracing interest that the first interposed entity holds in the next interposed entity (the *second interposed entity*) at that time.
- Step 3.* Multiply the result of step 2 by the *TC control tracing interest that the second interposed entity holds in the company, trust or partnership at that time.

More than 2 interposed entities

- (6) The *TC indirect control interest is the result of applying the following method statement if there are more than 2 interposed entities between the top entity and the company, trust or partnership at that time.

Method statement

- Step 1.* Calculate the *TC control tracing interest that the top entity holds in the first of those interposed entities at that time.
- Step 2.* Multiply the result of step 1 by the *TC control tracing interest that the first interposed entity holds in the next interposed entity (the *second interposed entity*) at that time.
- Step 3.* Multiply the result of step 2 by the *TC control tracing interest that the second interposed entity holds in the next interposed entity at that time.
- Step 4.* Continue this pattern of multiplying the result of the last multiplication by the *TC control tracing interest in the next interposed entity held by the preceding entity, ending with a multiplication by the TC control tracing

interest held by the last interposed entity in the company, trust or partnership.

820-875 TC control tracing interest in a company, trust or partnership

- (1) A *thin capitalisation control tracing interest* (or a *TC control tracing interest*) that an entity holds in a company, trust or a partnership at a particular time is equal to the *TC direct control interest in the company, trust or partnership that the entity holds at that time.
- (2) Despite subsection (1), an entity is taken to hold a *TC control tracing interest in a company, trust or partnership that is equal to 100% at a particular time if, at that time:
 - (a) the entity and its *associate entities hold a total of *TC direct control interests in the company, trust or partnership that is 50% or more; or
 - (b) the following subparagraphs apply:
 - (i) the entity (the *controlling entity*) and its associate entities hold a total of TC direct control interests that is 40% or more in the company, trust or partnership;
 - (ii) no other entity or entities (except the controlling entity, its associate entities or entities including the controlling entity or its associate entities) control the company, trust or partnership; or
 - (c) the entity (whether or not together with associate entities) controls the company, trust or partnership.
- (3) Paragraph (2)(b) does not apply if the *TC direct control interests mentioned in subparagraph (2)(b)(i) are held in a *corporate limited partnership.

Subdivision 820-I—Associate entities

Guide to Subdivision 820-I

820-900 What this Subdivision is about

This Subdivision sets out the meaning of various concepts about associate entities for the purposes of this Division.

Table of sections

820-905	Associate entity
820-910	Associate entity debt
820-915	Associate entity equity
820-920	Associate entity excess amount

[This is the end of the Guide.]

820-905 Associate entity

Meaning of associate entity

- (1) An entity (the **first entity**) that is not an individual is an **associate entity** of another entity at a particular time if, at that time, the first entity is an *associate of that other entity and at least one of the following paragraphs applies:
- (a) that other entity holds an *associate interest of 50% or more in the first entity (see subsections (4) to (8));
 - (b) the first entity is accustomed or under an obligation (whether formal or informal), or might reasonably be expected, to act in accordance with the directions, instructions or wishes of that other entity in relation to:
 - (i) the distribution or retention of the first entity's profits;
or
 - (ii) the financial policies relating to the first entity's assets, *debt capital or *equity capital;whether those directions, instructions or wishes are, or might reasonably be expected to be, communicated directly or through interposed entities.

However, this subsection does not apply to the first entity in its capacity as the *responsible entity of a *registered scheme (see subsection (2A)).

- (2) An entity (the **first entity**) that is an individual is an **associate entity** of another entity at a particular time if, at that time:
- (a) the first entity is an *associate of that other entity; and
 - (b) the first entity:
 - (i) is accustomed or under an obligation (whether formal or informal); or
 - (ii) might reasonably be expected; to act in accordance with the directions, instructions or wishes of that other entity in relation to the first entity's financial affairs, whether those directions, instructions or wishes are, or might reasonably be expected to be, communicated directly or through interposed entities.
- (2A) An entity (the **first entity**), in its capacity as the *responsible entity of a *registered scheme at a particular time, is an **associate entity** of another entity at that time if the first entity, in that capacity, is an *associate of that other entity at that time and at least one of the following paragraphs applies at that time:
- (a) that other entity holds an *associate interest of 50% or more in the registered scheme (see subsections (4) to (8));
 - (b) that other entity holds an associate interest of 20% or more in the registered scheme and the first entity, in that capacity, is accustomed or under an obligation (whether formal or informal), or might reasonably be expected, to act in accordance with the directions, instructions or wishes of that other entity in relation to:
 - (i) the distribution or retention of the profits of the registered scheme; or
 - (ii) the financial policies relating to the assets, *debt capital or *equity capital of the registered scheme;whether those directions, instructions or wishes are, or might reasonably be expected to be, communicated directly or through interposed entities.

Note: The first entity, in another capacity, may also be an associate entity of an entity under another provision of this section (see also section 960-100).

- (3) Subsection (1) or (2A) also has effect as if the first entity satisfies paragraph (b) of that subsection at a particular time if any of the following is expected to act in the manner mentioned in that paragraph at that time:
- (a) a director of the first entity if it is a company;
 - (b) a partner of the first entity if it is a partnership;
 - (c) the *general partner of the first entity if it is a *corporate limited partnership;
 - (d) the trustee of the first entity if it is a trust;
 - (e) a member of the first entity's committee of management if it is an unincorporated association or body.
- (3A) If:
- (a) an entity (the **first entity**) is an *associate entity of another entity (the **head entity**) under subsection (1), (2), (2A) or (3) at a particular time; and
 - (b) a third entity is also an associate entity of the head entity under subsection (1), (2), (2A) or (3) at that time;
- the first entity is an **associate entity** of the third entity at that time.
- (3B) If an entity (the **first entity**) is an *associate entity of another entity under subsection (1), (2), (2A), (3) or (3A) at a particular time, that other entity is also an **associate entity** of the first entity at that time.
- (3C) However, an entity in its capacity as the *responsible entity of a *registered scheme (the **responsible entity**) is not an *associate entity of another entity under subsection (3B) at a particular time if, at that time, the responsible entity:
- (a) would be an associate entity of that other entity under subsection (3B) (apart from the effect of this subsection); but
 - (b) is not an associate entity of that other entity under subsection (2A).

Associate interest in a company (except a corporate limited partnership)

- (4) An **associate interest** that an entity holds in a company (except a *corporate limited partnership) at a particular time is the percentage of the direct control interest (if any) that the entity holds in the company at that time under the provisions applied by subsection (5).

Schedule 1 Thin capitalisation rules

Part 1 New thin capitalisation rules

- (5) For the purposes of subsection (4), provisions of Part X of the *Income Tax Assessment Act 1936* are applied with the modifications set out in the following table:

Modifications of provisions in Part X of the <i>Income Tax Assessment Act 1936</i>		
Item	Provisions	Modifications
1	Section 350 (including any other provision in Part X of the <i>Income Tax Assessment Act 1936</i> that defines a term used in the section)	The section applies for the purposes of this subsection rather than only for the purposes of Part X of the <i>Income Tax Assessment Act 1936</i>
2	Subsections 350(6) and (7)	The subsections do not apply

Associate interest in a trust

- (6) An ***associate interest*** that an entity holds in a trust at a particular time is the percentage of the direct control interest (if any) that the entity holds in the trust at that time under the provisions applied by subsection (7).
- (7) For the purposes of subsection (6), provisions of Part X of the *Income Tax Assessment Act 1936* are applied with the modifications set out in the following table:

Modifications of provisions in Part X of the <i>Income Tax Assessment Act 1936</i>		
Item	Provisions	Modifications
1	Section 351 (including any other provision in Part X of the <i>Income Tax Assessment Act 1936</i> that defines a term used in the section)	The section applies for the purposes of this subsection rather than only for the purposes of Part X of the <i>Income Tax Assessment Act 1936</i>
2	Subsections 351(3) and (4)	The subsections do not apply

Associate interest in a partnership

- (8) An ***associate interest*** that an entity holds in a partnership at a particular time is whichever of the following percentages is applicable, and if there are 2 or more such percentages, the greatest of them:

- (a) in the case of a *corporate limited partnership—100% if the entity is a *general partner of the partnership;
- (b) in the case of a partnership that is not a corporate limited partnership—the percentage of the control of voting power in the partnership that the entity has at that time;
- (c) in any other case—the percentage that the entity holds, or is entitled to acquire, at that time, of any of the following:
 - (i) the total amount of assets or capital contributed to the partnership;
 - (ii) the total rights of partners to distributions of capital, assets or profits on the dissolution of the partnership;
 - (iii) the total rights of partners to distributions of capital, assets or profits otherwise than on the dissolution of the partnership.

820-910 Associate entity debt

- (1) This section applies to an entity (the *relevant entity*) that is an *outward investing entity (non-ADI) or an *inward investing entity (non-ADI) for a period that is all or a part of an income year, and each *associate entity of the relevant entity that is:
 - (a) an *outward investing entity (non-ADI), an *inward investment vehicle (general), or an *inward investment vehicle (financial), for that period; or
 - (b) an *inward investor (general) or an *inward investor (financial) for that period if it carries on its *business in Australia at or through one or more of its *Australian permanent establishments throughout that period.
- (2) The entity's *associate entity debt* at a particular time during that period is the result of applying the method statement in this subsection.

Method statement

Step 1. Apply step 2 to each *associate entity of the relevant entity that is the kind of entity mentioned in paragraph (1)(a) at that particular time. The result of that step is the *associate entity debt amount* for that associate entity.

- Step 2.* Work out the value, as at that time, of all the *debt interests that have been issued to the relevant entity by the *associate entity, if:
- (a) the debt interests remain *on issue at that time; and
 - (b) the costs in relation to the debt interest (to the extent that they are not amounts mentioned in paragraph (2)(c) of the definition of **debt deduction** that are ordinarily payable to an entity other than the relevant entity) are assessable income of the relevant entity for an income year; and
 - (c) the terms and conditions for the debt interests are those that would apply if the relevant entity and the associate entity were dealing at arm's length with each other.
- Step 3.* Apply steps 2 and 4 to each *associate entity of the relevant entity that is the kind of entity mentioned in paragraph (1)(b) at that time. The lesser of the results of those steps is the **associate entity debt amount** for that associate entity.
- Step 4.* Work out the value, as at that time, of the *debt capital of the *associate entity, to the extent that it is attributable to the *Australian permanent establishments of that associate entity.
- Step 5.* Add the associate entity debt amounts for all the *associate entities. The result of this step is the **associate entity debt**.

820-915 Associate entity equity

- (1) This section applies to an entity that is an *outward investing entity (non-ADI) or an *inward investing entity (non-ADI) for a period that is all or a part of an income year.
- (2) The entity's **associate entity equity** at a particular time during that period is the sum of:

- (a) the total value of *equity interests that the entity holds in all of its *associate entities at that time; and
- (b) the total value of *debt interests issued to the entity by its associate entities that:
 - (i) do not give rise to any *debt deductions for that or any other income year; and
 - (ii) remain *on issue at that time.

820-920 Associate entity excess amount

- (1) This section applies to an entity that is an *outward investing entity (non-ADI) or an *inward investing entity (non-ADI) for a period that is all or a part of an income year.
- (2) The entity's *associate entity excess amount* at a particular time during that period is the result of applying the method statement in this subsection.

Method statement

- Step 1.* Work out the premium excess amount (see subsection (3)), as at that particular time, for an *associate entity of the entity (the *relevant entity*) that is an *outward investing entity (non-ADI) or an *inward investing entity (non-ADI) at that time.
- Step 2.* Add to the result of step 1 the attributable safe harbour excess amount (see subsection (4)) for that *associate entity as at that time.
- Step 3.* Apply steps 1 and 2 to all such *associate entities of the relevant entity and add all the results that are positive amounts. The result of this step is the *associate entity excess amount*.

- (3) An *associate entity's *premium excess amount* at a particular time during that period is the result of applying the method statement in this subsection. In applying the method statement, disregard any amount that is attributable to an entity's *overseas permanent establishments if it is an *outward investing entity (non-ADI) at that time.

Method statement

- Step 1.* Work out the value, as at that particular time, of all the *associate entity equity of the relevant entity that is attributable to the *associate entity (other than the relevant entity's *controlled foreign entity equity if the relevant entity is an outward investing entity (non-ADI) at that time).
- Step 2.* Reduce the result of step 1 by the value, as at that time, of the *equity capital of the *associate entity that is attributable to the relevant entity.
- Step 3.* Multiply the result of step 2 by:
- (a) $\frac{20}{21}$ if the *associate entity excess amount is applied for the purpose of working out the *total debt amount of the relevant entity for that period under subsection 820-100(2), 820-200(2) or 820-210(2); or
 - (b) $\frac{3}{4}$ if the associate entity excess amount is applied for the purpose of working out the *adjusted on-lent amount of the relevant entity for that period under subsection 820-100(3), 820-200(3) or 820-210(3); or
 - (c) $\frac{3}{4}$ if the associate entity excess amount is applied for the purpose of working out the *safe harbour debt amount of the relevant entity for that period under section 820-95, 820-195 or 820-205; or
 - (d) the result of step 4 of the method statement in subsection (1) or (2) of section 820-110 (as appropriate) if the associate entity excess amount is applied for the purpose of working out the *worldwide gearing debt amount of the relevant entity for that period.

The result of this step is the *premium excess amount*.

- (4) The *associate entity's *attributable safe harbour excess amount* at a particular time during that period is the result of applying the method statement in this subsection. In applying the method statement, disregard any amount that is attributable to an entity's *overseas permanent establishments if it is an *outward investing entity (non-ADI) at that time.

Method statement

Step 1. Work out the *safe harbour debt amount of the *associate entity for the day during which that particular time occurs, as if:

- (a) the associate entity were an *outward investing entity (non-ADI) or *inward investing entity (non-ADI), as appropriate, for the period consisting only of that day; and
- (b) if the associate entity would otherwise be treated as an *outward investor (financial) for that day and the relevant entity is not a *financial entity throughout that day—the associate entity were an *outward investor (general) for that day; and
- (c) if the associate entity would otherwise be treated as an *inward investment vehicle (financial) for that day and the relevant entity is not a financial entity throughout that day—the associate entity were an *inward investment vehicle (general) for that day.

Step 2. Reduce the result of step 1 by the value of the *adjusted average debt of the *associate entity for that day as if it had been the kind of entity that it is taken to be under step 1 for that day. If the result of this step is a negative amount, it is taken to be nil.

Step 3. Multiply the result of step 2 by the sum of:

- (a) the value, as at that time, of all the *equity capital of the *associate entity that is attributable to the relevant entity at that time; and

- (b) the value, as at that time, of all the *debt interests issued to the relevant entity by the associate entity that do not give rise to *debt deductions of the associate entity for that or any other income year and remain *on issue at that time.

Step 4. Divide the result of step 3 by the sum of:

- (a) the value, as at that time, of all the *equity capital of the *associate entity; and
- (b) the value, as at that time, of all the *debt interests issued by the associate entity that do not give rise to *debt deductions of the associate entity for that or any other income year and remain *on issue at that time.

The result of this step is the *attributable safe harbour excess amount*.

Subdivision 820-J—Equity interest in a trust or partnership

Guide to Subdivision 820-J

820-925 What this Subdivision is about

This Subdivision provides for the meanings of an equity interest in a trust or partnership for the purposes of this Division.

Table of sections

920-930 *Equity interest* in a trust or partnership

[This is the end of the Guide.]

820-930 *Equity interest in a trust or partnership*

Application of provisions

- (1) For the purposes of this Division, an *equity interest* in an entity that is a trust or partnership has the meaning given by the provisions in Division 974 that are applied with the following modifications:

Modifications of Division 974		
Item	Provisions	Modifications
1	Subdivisions 974-C and 974-D	A reference in those provisions to a company is taken to be a reference to an entity that is a trust or a partnership
2	Subdivisions 974-C and 974-D	A reference in those provisions to the equity test in subsection 974-75(1) is taken to be a reference to the equity test in subsection (2) of this section
3	Section 974-75	The section does not apply and subsections (2) to (4) of this section apply instead
4	Section 974-80	The example does not apply
5	Section 974-95	A reference in those provisions to the table in subsection 974-75(1) is taken to be a reference to the table in subsection (2) of this section
6	Subsection 974-95(4)	The subsection does not apply
7	Subdivision 974-F	The Subdivision applies for the purposes of this section
8	Subdivisions 974-C, 974-D and 974-F	A reference in those provisions to the regulations is taken to be a reference to the regulations made under the provisions applied by this subsection

Note: An interest that satisfies both the equity test and the debt test set out in Subdivision 974-B is treated as a debt interest and not an equity interest (see that Subdivision in conjunction with the provisions applied by subsection (1)).

Equity tests

- (2) A *scheme satisfies the equity test in this subsection in relation to an entity that is a trust or partnership if the scheme gives rise to an interest set out in the following table:

Schedule 1 Thin capitalisation rules
Part 1 New thin capitalisation rules

Equity interests	
Item	Interest
1	In the case of a trust, an interest as a beneficiary of the trust In the case of a partnership, an interest as a partner in the partnership
2	An interest that carries a right to a variable or fixed return from the entity if either the right itself, or the amount of the return, is in substance or effect *contingent on the economic performance (whether past, current or future) of: (a) the entity; or (b) a part of the entity's activities; or (c) an *associate of the entity or a part of the activities of an associate of the entity The return may be a return of an amount invested in the interest
3	An interest that carries a right to a variable or fixed return from the entity if either the right itself, or the amount of the return, is at the discretion of: (a) the entity; or (b) an *associate of the entity The return may be a return of an amount invested in the interest
4	An *interest issued by the entity that: (a) gives its holder (or an *associate of the holder) a right to be issued with an *equity interest in the entity or an associate of the entity; or (b) is an interest that will, or may, convert into an equity interest in the entity or an associate of the entity

This subsection has effect subject to subsection (3) (requirement for financing arrangement).

Note: Section 974-90 as applied by subsection (1) allows regulations to be made clarifying when a right or return is taken to be at the discretion of an entity or an associate.

Financing arrangement

- (3) A *scheme that would otherwise give rise to an *equity interest in an entity that is a trust or partnership because of an item in the table in subsection (2) (other than item 1) does not give rise to an equity interest in the entity unless the scheme is a *financing arrangement (see section 974-130 as applied by this section) for the trust or partnership.

Form interest may take

- (4) The interest referred to in item 2, 3 or 4 in the table in subsection (2) may take the form of a proprietary right, a chose in action or any other form.

Regulations

- (5) Subject to regulations made under subsection (6), the regulations made under Subdivisions 974-C, 974-D and 974-F are applied for the purposes of this section as if they were regulations made under the provisions applied by subsection (1).
- (6) Regulations may be made under the provisions applied by subsection (1) specifically in relation to:
- (a) an *equity interest in a trust; or
 - (b) an equity interest in a partnership.

Subdivision 820-K—Zero-capital amount

Guide to Subdivision 820-K

820-940 What this Subdivision is about

The zero-capital amount represents the value of certain assets that receive special treatment in working out the maximum allowable debt of a financial entity. This Subdivision sets out the rules about the calculation of this amount.

Table of sections

820-942 How to work out the zero-capital amount

[This is the end of the Guide.]

820-942 How to work out the zero-capital amount

- (1) An entity's **zero-capital amount** at a particular time is the result of the method statement in this subsection.

Method statement

- Step 1.* Work out the total amounts, as at that particular time, that have been received by the entity for the sale of securities (other than any fees associated with the sale) under the following *arrangements if the entity has not repurchased the securities under the arrangements at that time:
- (a) reciprocal purchase agreements (otherwise known as repurchase agreements);
 - (b) sell-buyback arrangements;
 - (c) securities loan arrangements.
- Step 2.* Add to the result of step 1 the total value, as at that time, of all the *debt interests issued to the entity to which the following paragraphs apply at that time:
- (a) the debt interests remain *on issue;
 - (b) each of the debt interests is a loan of money for which no fees, charges or other consideration for the purpose of enhancing the credit rating of the issuer of the interest has been paid or is payable to the entity, any of the entity's *associates or another entity that is a *foreign entity;
 - (c) each of the entities issuing the interests has the required credit rating for the interests concerned in accordance with subsections (4) and (5).
- Step 3.* Add to the result of step 2 the total value, as at that time, of all the *debt interests that are assets of the entity (whether they are debt interests issued to the entity or

not) and to which the following paragraphs apply at that time:

- (a) the risk weight of each of the debt interests is either 0% or 20% under the *prudential standards;
- (b) the debt interests do not satisfy all of the paragraphs in step 2.

Step 4. Add to the result of step 3 the total value, as at that time, of all the *securitised assets that the entity has at that time if the entity is a *securitisation vehicle at that time (see subsections (2) and (3)). The result is the ***zero-capital amount***.

Securitisation vehicle

- (2) An entity is a ***securitisation vehicle*** if:
- (a) it is an entity established for the purposes of acquiring, funding and holding *securitised assets (see subsection (3)); and
 - (b) it has acquired the securitised assets from another entity (the ***originator***); and
 - (c) the acquisition of the securitised assets is wholly funded by the issuing of *debt interests by the entity; and
 - (d) in issuing the debt interests, the entity does not receive any guarantee, security or other form of credit support from any of its *associate entities, the originator or any associate entity of the originator; and
 - (e) the entity has not issued debt interests for any purpose other than for the purpose of funding the acquisition of the securitised assets; and
 - (f) there are no debt interests issued to the entity by any of the entity's associate entities, the originator or any associate entity of the originator; and
 - (g) any *arrangements the entity has with any of its associate entities, the originator or any associate entity of the originator are those that would reasonably be expected to have been entered into by parties dealing at arm's length with each other.

Securitised assets

- (3) An asset of an entity is a *securitised asset* if:
- (a) the entity is a *securitisation vehicle; and
 - (b) the asset consists of:
 - (i) *debt interests issued by an entity other than the originator in relation to the securitisation vehicle that is mentioned in paragraph (2)(b); or
 - (ii) a lease for the hire of goods that would be a lease covered by paragraph (b) of the definition of *on-lent amount* if a reference to an entity in that definition were a reference to that originator; or
 - (iii) a *scheme that, apart from the operation of paragraph 974-25(1)(b), would have given rise to a debt interest covered by subparagraph (i); and
 - (c) the asset provides security for the issuing of debt interests that funded the acquisition of the asset by the securitisation vehicle (see paragraph (2)(c)).

What is the required credit rating?

- (4) For the purposes of step 2 of the method statement in subsection (1), the required credit rating for an entity issuing a *debt interest is:
- (a) if the interest is a *subordinated debt interest—a long-term foreign currency corporate credit rating of at least A (or equivalent) given to the entity by an internationally recognised rating agency; or
 - (b) if the interest is a not a subordinated debt interest—a long-term foreign currency corporate credit rating of at least BBB (or equivalent) given to the entity by an internationally recognised rating agency.

When must an entity have the required credit rating

- (5) The entity must have the required credit rating as specified in any of the following paragraphs:
- (a) the entity had the required credit rating for the *debt interest when the interest was issued;
 - (b) the following subparagraphs apply:

- (i) the entity did not have any long-term foreign currency corporate credit rating given to it by an internationally recognised rating agency when the debt interest was issued; but
- (ii) the entity had the required credit rating for that interest at any time during the period of 6 months immediately before the interest was issued;
- (c) the following subparagraphs apply:
 - (i) when the debt interest was issued, and throughout the period of 6 months immediately before the interest was issued, the entity did not have any long-term foreign currency corporate credit rating given to it by an internationally recognised rating agency; but
 - (ii) the entity has the required credit rating for that interest at any time during the period of 6 months immediately after the interest was issued.

Subdivision 820-L—Record keeping requirements

Guide to Subdivision 820-L

820-950 What this Subdivision is about

This Subdivision sets out special record keeping requirements and related provisions about the following:

- (a) an entity that carries on its business at or through its Australian permanent establishments;
- (b) an arm's length debt amount or arm's length capital amount worked out under this Division.

Table of sections

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820-960 Records about Australian permanent establishments

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Offences committed by certain entities

820-990 Offences—treatment of partnerships

820-995 Offences—treatment of unincorporated companies

[This is the end of the Guide.]

Records about Australian permanent establishments

820-960 Records about Australian permanent establishments

- (1) If an entity:
- (a) is an *inward investor (general), *inward investor (financial) or *inward investing entity (ADI), for all or a part of an income year; and
 - (b) carries on its *business at or through one or more of its *Australian permanent establishments throughout that year; the entity must keep the following records for that year:
 - (c) a statement of financial position for the *Australian permanent establishments;
 - (d) a statement of financial performance for the Australian permanent establishments.

Note: A person must comply with the requirements in section 262A of the *Income Tax Assessment Act 1936* about the keeping of these records (see subsections (2AA) and (3) of that section).

- (2) The entity must prepare these records:
- (a) before the time by which the entity must lodge its tax return for the income year; and
 - (b) in accordance with the *accounting standards (in particular, but not limited to, accounting standards AASB 1001, AASB 1018 and AASB 1040) as if:
 - (i) the *Australian permanent establishments were an entity (the *notional entity*) for which these records would be required to be prepared under the accounting standards; and
 - (ii) for the purposes of the statement of financial position—the assets, liabilities (including *debt capital) and *equity capital that are attributable to the Australian

- permanent establishments for that income year were assets, liabilities and equity of the notional entity for that year; and
- (iii) for the purposes of the statement of financial performance—the revenues and expenses that are attributable to the Australian permanent establishments for that year were the revenues and expenses of the notional entity for that year; and
 - (iv) a reference to a financial year in the accounting standards were a reference to an income year.
- (3) In this section, *statement of financial position* and *statement of financial performance* have the same respective meanings as in the *accounting standards and include all the notes required to accompany them under the standards.
- (4) Despite subsections (2) and (3), the Commissioner may decide that an entity is not required to comply with all or any part of the *accounting standards for one or more income years for the purposes of this section if the Commissioner is satisfied that it would be unreasonable that the entity be required to do so.
- (5) The Commissioner:
- (a) may make a decision under subsection (4) in such cases and to such extent as the Commissioner thinks fit; and
 - (b) must make the decision in writing.

820-965 Review of Commissioner's decision

A person who is dissatisfied with a decision of the Commissioner under subsection 820-960(4) may object against the decision in the manner set out in Part IVC of the *Taxation Administration Act 1953*.

Records about arm's length amounts

820-980 Records about arm's length debt amount and arm's length capital amount

- (1) An entity must keep records under this section for an *arm's length debt amount or *arm's length capital amount that the entity worked out for the purposes of this Division.

Schedule 1 Thin capitalisation rules

Part 1 New thin capitalisation rules

- (2) The records must contain particulars about the factual assumptions and relevant factors mentioned in section 820-105, 820-215, 820-315 or 820-410 (as appropriate) that have been taken into account in working out that amount.

Note: A person must comply with the requirements in section 262A of the *Income Tax Assessment Act 1936* about the keeping of these records (see subsections (2AA) and (3) of that section).

Offences committed by certain entities

820-990 Offences—treatment of partnerships

- (1) The provisions set out in the following paragraphs (the *relevant provisions*) apply, in relation to records required to be kept under this Subdivision, to a partnership as if it were a person, but with the modifications set out in this section:
- (a) sections 820-960 and 820-980;
 - (b) section 262A of the *Income Tax Assessment Act 1936*;
 - (c) Part III of the *Taxation Administration Act 1953*.
- (2) If the relevant provisions would otherwise require or permit something to be done by the partnership, the thing may be done by one or more of the partners on behalf of the partnership.
- (3) An obligation that would otherwise be imposed on the partnership by the relevant provisions:
- (a) is imposed on each partner instead; but
 - (b) may be discharged by any of the partners.
- (4) The partners are jointly and severally liable to pay an amount that would otherwise be payable by the partnership under the relevant provisions.
- (5) An offence against any of the relevant provisions that would otherwise be committed by the partnership is taken to have been committed by each partner who:
- (a) did the relevant act or made the relevant omission; or
 - (b) aided, abetted, counselled or procured the relevant act or omission; or
 - (c) was in any way knowingly concerned in, or party to, the relevant act or omission (whether directly or indirectly or whether by any act or omission of the partner).

- (6) For the purposes of subsection (5):
- (a) to establish that a partnership engaged in a particular conduct, it is sufficient to show that the conduct was engaged in by a partner:
 - (i) in the ordinary course of the business of the partnership;
or
 - (ii) within the scope of the actual or apparent authority of the partner; and
 - (b) to establish that a partnership had a particular state of mind when it engaged in that conduct, it is sufficient to show that the partner had the relevant state of mind.
- (7) For the purposes of the relevant provisions, a change in the composition of a partnership does not affect the continuity of the partnership.

820-995 Offences—treatment of unincorporated companies

- (1) The provisions set out in the following paragraphs (the *relevant provisions*) apply, in relation to records required to be kept under this Subdivision, to an unincorporated company as if it were a person, but with the modifications set out in this section:
- (a) sections 820-960 and 820-980;
 - (b) section 262A of the *Income Tax Assessment Act 1936*;
 - (c) Part III of the *Taxation Administration Act 1953*.
- (2) If the relevant provisions would otherwise require or permit something to be done by the company, the thing may be done by one or more members of the company's committee of management (the *members*) on behalf of the company.
- (3) An obligation that would otherwise be imposed on the company by the relevant provisions:
- (a) is imposed on each member instead; but
 - (b) may be discharged by any of the members.
- (4) The members are jointly and severally liable to pay an amount that would otherwise be payable by the company under the relevant provisions.

Schedule 1 Thin capitalisation rules

Part 1 New thin capitalisation rules

- (5) An offence against any of the relevant provisions that would otherwise be committed by the company is taken to have been committed by each member who:
- (a) did the relevant act or made the relevant omission; or
 - (b) aided, abetted, counselled or procured the relevant act or omission; or
 - (c) was in any way knowingly concerned in, or party to, the relevant act or omission (whether directly or indirectly or whether by any act or omission of the member).
- (6) For the purposes of subsection (5), to establish that the company had a particular state of mind when it engaged in a particular conduct, it is sufficient to show that a member had the relevant state of mind.

[The next Chapter is Chapter 5.]

Part 2—Consequential and other amendments

Income Tax Assessment Act 1936

2 After subsection 128F(1)

Insert:

- (1A) This section also applies to interest paid by a company in respect of a debenture if:
- (a) the company was a non-resident when it issued the debenture; and
 - (b) the company is a non-resident when the interest is paid; and
 - (c) the debenture was issued, and the interest is paid, by the company in carrying on business at or through a permanent establishment in Australia; and
 - (d) the issue of the debenture satisfies the public offer test set out in subsection (3) or (4).

3 Subsection 128F(9) (definition of *associate*)

Repeal the definition, substitute;

associate has the meaning given by section 318, except that paragraphs (1)(b), (2)(a) and (4)(a) of that section must be disregarded.

4 Divisions 16F and 16G of Part III

Repeal the Divisions.

4A Subsection 160AE(1)

Insert:

debt deduction has the same meaning as in the *Income Tax Assessment Act 1997*.

4B Subsection 160AE(1)

Insert:

overseas permanent establishment has the same meaning as in the *Income Tax Assessment Act 1997*.

4C Subsection 160AF(8) (paragraph (a) of the definition of *net foreign income*)

After “assessable income”, insert “(other than any relevant debt deductions)”.

4D Subsection 160AF(8) (paragraph (c) of the definition of *net foreign income*)

After “apportionable deductions”, insert “that are not relevant debt deductions”.

4E Subsection 160AF(8)

Insert:

relevant debt deduction, for a taxpayer, means a debt deduction of the taxpayer for an income year, to the extent that it is not attributable to any of the taxpayer’s overseas permanent establishments.

5 Subsection 160AFD(9) (definition of *foreign income deduction*)

Omit all the words after “any deduction”, substitute:

other than:

- (a) a deduction under section 532 or 533; or
- (b) a debt deduction (to the extent that it is not attributable to the taxpayer’s overseas permanent establishment);

that, disregarding section 79D, is allowed or allowable from the assessable income of the taxpayer of that year of income, to the extent that the deduction relates to assessable foreign income of that class of any year of income.

6 Paragraph 160ZZW(1)(a)

Omit “160ZZZB,”.

7 Section 160ZZZB

Repeal the section.

8 Section 160ZZZD

Repeal the section.

9 Subsection 160ZZZJ(2)

Repeal the formula and all the words after the formula, substitute:

$$\frac{\text{Taxable amount}}{2}$$

10 After subsection 262A(2)

Insert:

(2AA) The records to be kept under subsection (1) include records required to be kept for the purposes of section 820-960 or 820-980 of the *Income Tax Assessment Act 1997*.

11 At the end of subsection 262A(3)

Add:

- ; and (c) for records required to be kept under section 820-960 of the *Income Tax Assessment Act 1997*—comply with subsections (2) to (4) of that section; and
- (d) for records required to be kept under section 820-980 of that Act—comply with subsection (2) of that section.

12 Paragraph 389(a)

Omit “Divisions 15, 16F and 16G”, substitute “Division 15”.

13 At the end of section 389

Add:

- ; (c) Division 820 of the *Income Tax Assessment Act 1997*.

Income Tax Assessment Act 1997

14 Section 12-5 (table item headed “interest”)

Omit:

thin capitalisation by non-residents, generally **159GZA to 159GZX**

15 Section 12-5 (after table item headed “theft”)

Insert:

thin capitalisation

disallowing of deductions..... Division 820

16 After section 25-85

Insert:

25-90 Deduction relating to foreign exempt income

An *Australian entity can deduct an amount of loss or outgoing from its assessable income for an income year if:

- (a) the amount is incurred by the entity in deriving income from a foreign source; and
- (b) the income is exempt income under section 23AI, 23AJ or 23AK of the *Income Tax Assessment Act 1936*; and
- (c) the amount is a cost in relation to a *debt interest issued by the entity that is covered by paragraph (1)(a) of the definition of *debt deduction*.

17 Subsection 995-1(1) (definition of *accounting standards*)

Omit “Corporations Law”, substitute “*Corporations Act 2001*”.

18 Subsection 995-1(1) (paragraph (a) of the definition of *financial entity*)

Omit “*Financial Corporations Act 1974*”, substitute “*Financial Sector (Collection of Data) Act 2001*”.

19 Subsection 995-1(1) (paragraph (c) of the definition of *financial entity*)

Repeal the paragraph, substitute:

- (c) an entity that:
 - (i) is a financial services licensee within the meaning of the *Corporations Act 2001* whose licence covers dealings in financial products mentioned in paragraphs 764A(1)(a), (b) and (j) of that Act; and
 - (ii) carries on a *business of dealing in securities; and
 - (iii) does not carry on that business predominantly for the purposes of dealing in securities with, or on behalf of, the entity’s *associates.

Income Tax (Transitional Provisions) Act 1997

20 At the end of Division 25

Add:

25-50 Application of section 25-90 of the *Income Tax Assessment Act 1997*

Section 25-90 (which is about deductions relating to foreign exempt income) of the *Income Tax Assessment Act 1997* applies to an amount incurred in an income year that begins on or after 1 July 2001.

21 Section 405-1 (link note)

Omit “*Chapter 6*”, substitute “*Chapter 5*”.

22 After Division 405

Insert:

Chapter 4—International aspects of income tax

Part 4-5—General

[The next Division is Division 820.]

Division 820—Application of the thin capitalisation rules

Table of sections

820-10	Application of Division 820 of the <i>Income Tax Assessment Act 1997</i>
820-12	Application of Division 974 of the <i>Income Tax Assessment Act 1997</i> for the purposes of Division 820 of that Act
820-15	Transitional provision—application of Divisions 16F and 16G of Part III of the <i>Income Tax Assessment Act 1936</i>
820-20	Transitional provision—application of section 389 of the <i>Income Tax Assessment Act 1936</i>
820-25	Transitional provision—average value of a matter for the first income year
820-30	Transitional provision—average value of a matter for resident TC group that includes an ADI or an Australian permanent establishment of a foreign bank
820-35	Transitional provision—transitional debt interests
820-40	Transitional provision—transitional equity interests

820-10 Application of Division 820 of the *Income Tax Assessment Act 1997*

- (1) Subject to subsection (2), Division 820 of the *Income Tax Assessment Act 1997* applies in relation to an income year that begins on or after 1 July 2001.
- (2) Subdivision 820-L of that Act, to the extent that it relates to the requirements under section 820-960 of that Act, applies only in relation to an income year that begins on or after 1 July 2002.

820-12 Application of Division 974 of the *Income Tax Assessment Act 1997* for the purposes of Division 820 of that Act

- (1) Division 974 of the *Income Tax Assessment Act 1997* applies for the purposes of determining whether, for the purposes of Division 820 of that Act, an interest is a debt interest or an equity interest at any time on or after 1 July 2001 (whether or not the debt and equity test amendments apply to transactions in relation to that interest at that time).
- (2) In this section, *debt and equity test amendments* has the same meaning as in Part 4 of Schedule 1 to the *New Business Tax System (Debt and Equity) Act 2001*.

820-15 Transitional provision—application of Divisions 16F and 16G of Part III of the *Income Tax Assessment Act 1936*

If Division 16F or 16G of Part III of the *Income Tax Assessment Act 1936* would have applied to an entity for a period that is all or a part of an income year that begins before 1 July 2001, then, despite the repeal of that Division, it continues to apply to that entity for that period.

820-20 Transitional provision—application of section 389 of the *Income Tax Assessment Act 1936*

If Division 16F or 16G of Part III of the *Income Tax Assessment Act 1936* continues to apply to an entity for a period under section 820-15, section 389 of that Act applies to that entity for that period as if that section has not been amended by the *New Business Tax System (Thin Capitalisation) Act 2001*.

820-25 Transitional provision—average value of a matter for the first income year

- (1) If:
- (a) Division 820 of the *Income Tax Assessment Act 1997* applies to an entity for a period that is all or a part of an income year; and
 - (b) that income year begins before 1 July 2002 and ends before 30 June 2003;

the entity may, for the purposes of that application, choose to use the value of a particular matter as at the end of that period as if it were the average value of that matter for that period.

Note: This means that the entity may, for that period, apply subsection (1) instead of calculating an average value in accordance with Subdivision 820-G of the *Income Tax Assessment Act 1997*.

- (2) However, an entity making that choice must apply subsection (1) throughout that period for every matter for which an average value is required to be calculated for the purposes of that Division's application to that entity.
- (3) This section alters the effect of that Division accordingly.

820-30 Transitional provision: average value of a matter for a resident TC group that includes an ADI or an Australian permanent establishment of a foreign bank

- (1) This section affects how the average value of a matter is determined for the purposes of Division 820 of the *Income Tax Assessment Act 1997*, as it applies to a resident TC group for an income year beginning before 1 July 2002 and ending before 30 June 2003.
- (2) If:
- (a) the group is an outward investing entity (ADI) for that income year, or section 820-565 of that Act applies Subdivision 820-D of that Act to the group for that income year as if it were an outward investing entity (ADI); and
 - (b) apart from this section, a day on which the group did not include at least one entity that is an ADI would be a measurement day for the group under section 820-645 of that Act;

that day is treated as not being such a measurement day.

(3) If:

- (a) section 820-575 of that Act applies Subdivision 820-E of that Act to the group for that income year as if it were an inward investing entity (ADI); and
- (b) apart from this section, a day on which the group did not include at least one Australian permanent establishment through which a foreign bank carries on its banking business in Australia would be a measurement day for the group under section 820-645 of that Act;

that day is treated as not being such a measurement day.

820-35 Transitional provision—transitional debt interests

(1) This section applies to an interest for the period starting from 1 July 2001 and ending immediately before 1 July 2004 (the *transitional period*) if:

- (a) the interest was issued before 1 July 2001; and
- (b) disregarding the debt and equity test amendments (within the meaning of Part 4 of Schedule 1 to the *New Business Tax System (Debt and Equity) Act 2001*), the interest would be:
 - (i) an asset of an entity comprised by equity issued by another entity; or
 - (ii) equity issued by an entity to another entity; and
- (c) the interest is a debt interest that remains on issue.

What happens if there is no election

(2) If:

- (a) the issuer of the interest does not elect under paragraph 118(6)(b) of Schedule 1 to the *New Business Tax System (Debt and Equity) Act 2001* to have that paragraph apply to the interest; and
- (b) at any time during the transitional period, Division 820 of the *Income Tax Assessment Act 1997* applies to an entity that is the issuer or the holder of the interest;

the interest must be treated as an equity interest for the purposes of applying that Division to that entity at that time.

What happens if there is an election

- (3) Subsections (4) to (6) apply if the issuer of the interest elects under paragraph 118(6)(b) of Schedule 1 to the *New Business Tax System (Debt and Equity) Act 2001* to have that paragraph apply to the interest.
- (4) For the purposes of applying Division 820 of the *Income Tax Assessment Act 1997* at any time during the transitional period to an entity that is the issuer of the interest at that time, the interest must be treated as a debt interest at that time.
- (5) Except as provided by subsection (6), for the purposes of applying that Division at any time during the transitional period to an entity that is the holder of the interest at that time, the interest must be treated as an equity interest at that time.
- (6) Despite subsection (5), the interest must be treated as a debt interest at that time for the purposes of applying that Division to that holder at that time if:
 - (a) apart from this section, the interest would be included in the associate entity debt of that holder at that time for those purposes; and
 - (b) at that time, the issuer of the interest is not an Australian controlled foreign entity for which that holder is an Australian controller.

820-40 Transitional provision—transitional equity interests

- (1) This section applies to an interest for the period starting from 1 July 2001 and ending immediately before 1 July 2004 (the *transitional period*) if:
 - (a) the interest was issued before 1 July 2001; and
 - (b) disregarding the debt and equity test amendments (within the meaning of Part 4 of Schedule 1 to the *New Business Tax System (Debt and Equity) Act 2001*), the interest would be:
 - (i) an asset of an entity comprised by a debt owed to the entity by the issuer of the interest; or
 - (ii) a debt owed by the issuer of the interest to another entity; and
 - (c) the interest is an equity interest.

For the issuer

- (2) The interest must be treated as an equity interest at any time during the transitional period for the purposes of applying Division 820 of the *Income Tax Assessment Act 1997* to an entity that is the issuer of that interest at that time.

For the holder

- (3) Except as provided by subsection (4), the interest must be treated as a debt interest at any time during the transitional period for the purposes of applying that Division to an entity that is the holder of the interest at that time.
- (4) Despite subsection (3), that interest must be treated as an equity interest at that time for the purposes of applying that Division to that holder at that time if:
- (a) apart from this section, the interest would be included in the associate entity equity of that holder at that time for those purposes; and
 - (b) at that time, the issuer of the interest is not an Australian controlled foreign entity for which that holder is an Australian controller.

Part 3—Application provisions

23 Application—section 128F of the *Income Tax Assessment Act 1936*

The amendment of section 128F of the *Income Tax Assessment Act 1936* made by this Schedule applies only in relation to a debenture that is issued on or after 1 July 2001.

23A Application—section 160AF of the *Income Tax Assessment Act 1936*

The amendments of section 160AF of the *Income Tax Assessment Act 1936* made by this Schedule apply in relation to assessable income of a year of income that begins on or after 1 July 2001.

24 Application—section 160AFD of the *Income Tax Assessment Act 1936*

The amendment of section 160AFD of the *Income Tax Assessment Act 1936* made by this Schedule applies to a class of assessable foreign income of a year of income that begins on or after 1 July 2001.

25 Application—section 160ZZZJ and related provisions of the *Income Tax Assessment Act 1936*

- (1) The amendments of sections 160ZZW and 160ZZZJ of the *Income Tax Assessment Act 1936* made by this Schedule applies only to an amount of interest taken under section 160ZZZA of that Act to be paid to, and derived by, a foreign bank during an income year that begins on or after 1 July 2001.
- (2) Despite the repeals of sections 160ZZZB and 160ZZZD of the *Income Tax Assessment Act 1936* by this Schedule, those sections continue to apply in relation to an amount of interest taken under section 160ZZZA of that Act to be paid to, and derived by, a foreign bank during an income year that began before 1 July 2001.

26 Application—section 262A of the *Income Tax Assessment Act 1936*

The amendment of section 262A of the *Income Tax Assessment Act 1936* made by this Schedule applies:

Schedule 1 Thin capitalisation rules

Part 3 Application provisions

- (a) for records required to be kept under section 820-960—in relation to an income year that begins on or after 1 July 2002; and
- (b) for records required to be kept under section 820-980—in relation to an income year that begins on or after 1 July 2001.

Schedule 2—Dictionary amendments

Income Tax Assessment Act 1997

1 Section 960-100

Repeal the link note, substitute:

Subdivision 960-F—Distribution by corporate tax entities

Table of sections

960-115	Meaning of <i>corporate tax entity</i>
960-120	Meaning of <i>distribution</i>

960-115 Meaning of *corporate tax entity*

An entity is a *corporate tax entity* at a particular time if:

- (a) the entity is a company at that time; or
- (b) the entity is a *corporate limited partnership in relation to the income year in which that time occurs; or
- (c) the entity is a *corporate unit trust in relation to the income year in which that time occurs; or
- (d) the entity is a *public trading trust in relation to the income year in which that time occurs.

960-120 Meaning of *distribution*

- (1) What constitutes a *distribution* by various *corporate tax entities is set out in the following table:

Distribution		
Item	Corporate tax entity	Distribution
1	company	a dividend, or something that is taken to be a dividend, under this Act

Distribution		
Item	Corporate tax entity	Distribution
2	*corporate limited partnership	(a) a distribution made by the partnership, whether in money or in other property, to a partner in the partnership, other than a distribution, or so much of a distribution, as is attributable to profits or gains arising during a year of income in relation to which the partnership was not a corporate limited partnership (b) something that is taken to be a dividend by the partnership under this Act
3	*corporate unit trust	a unit trust dividend, as defined in subsection 102D(1) of the <i>Income Tax Assessment Act 1936</i>
4	*public trading trust	a unit trust dividend, as defined in section 102M of the <i>Income Tax Assessment Act 1936</i>

(2) A *corporate tax entity *makes a distribution* in the form of a dividend on the day on which the dividend is paid, or taken to have been paid.

2 Subsection 995-1(1)

Insert:

accounting standards has the same meaning as in the Corporations Law.

3 Subsection 995-1(1)

Insert:

adjusted average debt has the meaning given by sections 820-85, 820-120, 820-185 and 820-225.

4 Subsection 995-1(1)

Insert:

adjusted average equity capital has the meaning given by sections 820-300, 820-330 and 820-562.

5 Subsection 995-1(1)

Insert:

adjusted on-lent amount has the meaning given by sections 820-100, 820-200 and 820-210.

6 Subsection 995-1(1)

Insert:

allowable OB deduction has the meaning given by subsection 121EF(2) of the *Income Tax Assessment Act 1936*.

7 Subsection 995-1(1)

Insert:

arm's length capital amount:

- (a) for an *outward investing entity (ADI)—has the meaning given by section 820-315; and
- (b) for an *inward investing entity (ADI)—has the meaning given by section 820-410.

8 Subsection 995-1(1)

Insert:

arm's length debt amount:

- (a) for an *outward investing entity (non-ADI)—has the meaning given by section 820-105; and
- (b) for an *inward investing entity (non-ADI)—has the meaning given by section 820-215.

9 Subsection 995-1(1)

Insert:

associate entity has the meaning given by section 820-905.

10 Subsection 995-1(1)

Insert:

associate entity debt has the meaning given by section 820-910.

11 Subsection 995-1(1)

Insert:

associate entity equity has the meaning given by section 820-915.

12 Subsection 995-1(1)

Insert:

associate entity excess amount has the meaning given by section 820-920.

13 Subsection 995-1(1)

Insert:

associate interest has the meaning given by section 820-905.

14 Subsection 995-1(1)

Insert:

Australian controlled foreign entity has the meaning given by section 820-745.

15 Subsection 995-1(1)

Insert:

Australian controller:

- (a) of a *controlled foreign company mentioned in paragraph 820-745(a)—has the meaning given by section 820-750; and
- (b) of a *controlled foreign trust—has the meaning given by section 820-755; and
- (c) of a *controlled foreign corporate limited partnership—has the meaning given by section 820-760.

16 Subsection 995-1(1)

Insert:

Australian entity has the same meaning as in Part X of the *Income Tax Assessment Act 1936*.

17 Subsection 995-1(1)

Insert:

Australian permanent establishment, of an entity, means a
*permanent establishment of the entity that is in Australia.

18 Subsection 995-1(1)

Insert:

Australian trust has the same meaning as in Part X of the *Income Tax Assessment Act 1936*.

19 Subsection 995-1(1)

Insert:

average equity capital has the meaning given by sections 820-395, 820-420 and 820-575.

20 Subsection 995-1(1)

Insert:

controlled foreign company has the same meaning as in Part X of the *Income Tax Assessment Act 1936*.

21 Subsection 995-1(1)

Insert:

controlled foreign corporate limited partnership has the meaning given by section 820-760.

22 Subsection 995-1(1)

Insert:

controlled foreign entity debt, of an entity and at a particular time, means the total amount of *debt interests *on issue at that time that have been issued to the entity by any *Australian controlled foreign entities of which it is an *Australian controller at that time.

23 Subsection 995-1(1)

Insert:

controlled foreign entity equity, of an entity and at a particular time, means the total value of *equity interests that the entity holds, at that time, in any *Australian controlled foreign entities of which it is an *Australian controller at that time.

24 Subsection 995-1(1)

Insert:

controlled foreign trust has the same meaning as in Part X of the *Income Tax Assessment Act 1936*.

25 Subsection 995-1(1)

Insert:

corporate tax entity has the meaning given by section 960-115.

26 Subsection 995-1(1)

Insert:

debt capital, of an entity and at a particular time, means any *debt interests issued by the entity that are still *on issue at that time.

27 Subsection 995-1(1)

Insert:

debt deduction has the meaning given by section 820-40.

28 Subsection 995-1(1)

Insert:

distribution, by a *corporate tax entity, has the meaning given by section 960-120.

29 Subsection 995-1(1)

Insert:

equity capital, of an entity and at a particular time, means:

- (a) if the entity is a company that is not an *outward investing entity (ADI) at that time:

- (i) the total value of the entity's *paid-up share capital, retained earnings, general reserves and asset revaluation reserves as at that time; minus
- (ii) the value of the entity's *debt capital that is part of the entity's paid-up share capital at that time; or
- (b) if the entity is a company that is an outward investing entity (ADI) at that time:
 - (i) the total value of all the entity's tier 1 capital (within the meaning of the *prudential standards) as at that time; minus
 - (ii) the value of the entity's debt capital that is part of the entity's tier 1 capital at that time; or
- (c) if the entity is a trust or partnership at that time:
 - (i) the total value of the entity's capital and reserves as at that time; minus
 - (ii) the value of the entity's debt capital that is part of the entity's capital at that time.

30 Subsection 995-1(1)

Insert:

equity interest in an entity that is a trust or partnership has the meaning given by section 820-930.

31 Subsection 995-1(1)

Insert:

financial entity, at a particular time, means an entity other than an *ADI that is any of the following at that time:

- (a) a registered corporation under the *Financial Corporations Act 1974*;
- (b) a *securitisation vehicle;
- (c) an entity that:
 - (i) holds a dealer's licence granted under Part 7.3 of the Corporations Law; and
 - (ii) carries on a *business of dealing in securities; and
 - (iii) does not carry on that business predominantly for the purposes of dealing in securities with, or on behalf of, the entity's *associates.

32 Subsection 995-1(1)

Insert:

foreign bank means an *ADI that is a *foreign entity.

33 Subsection 995-1(1)

Insert:

foreign controlled Australian company has the meaning given by section 820-785.

34 Subsection 995-1(1)

Insert:

foreign controlled Australian entity has the meaning given by section 820-780.

35 Subsection 995-1(1)

Insert:

foreign controlled Australian partnership has the meaning given by section 820-795.

36 Subsection 995-1(1)

Insert:

foreign controlled Australian trust has the meaning given by section 820-790.

37 Subsection 995-1(1)

Insert:

foreign entity means an entity that is not an *Australian entity.

38 Subsection 995-1(1)

Insert:

general partner means a partner of a *corporate limited partnership whose liability in relation to the partnership is not limited.

39 Subsection 995-1(1)

Insert:

inward investing entity (ADI) has the meaning given by section 820-395.

40 Subsection 995-1(1)

Insert:

inward investing entity (non-ADI) has the meaning given by sections 820-185 and 820-550.

41 Subsection 995-1(1)

Insert:

inward investment vehicle (financial) has the meaning given by sections 820-185 and 820-550.

42 Subsection 995-1(1)

Insert:

inward investment vehicle (general) has the meaning given by sections 820-185 and 820-550.

43 Subsection 995-1(1)

Insert:

inward investor (financial) has the meaning given by section 820-185.

44 Subsection 995-1(1)

Insert:

inward investor (general) has the meaning given by section 820-185.

45 Subsection 995-1(1)

Insert:

maximum allowable debt:

- (a) for an *outward investing entity (non-ADI)—has the meaning given by section 820-90 (or that section as applied by section 820-120); and

- (b) for an *inward investing entity (non-ADI) covered by paragraph 820-185(1)(a) (or 820-225(1)(a))—has the meaning given by section 820-190 (or that section as applied by section 820-225).

46 Subsection 995-1(1)

Insert:

maximum TC group has the meaning given by section 820-500.

47 Subsection 995-1(1)

Insert:

minimum capital amount:

- (a) for an *outward investing entity (ADI)—has the meaning given by section 820-305 (or that section as applied by section 820-330); and
- (b) for an *inward investing entity (ADI)—has the meaning given by section 820-400 (or that section as applied by section 820-420).

48 Subsection 995-1(1)

Insert:

non-debt liabilities, of an entity and at a particular time, means liabilities that the entity has at that time, other than:

- (a) any *debt capital of the entity; or
- (b) any *equity interest in the entity; or
- (c) a provision for a *distribution of profit if the entity is a *corporate tax entity; or
- (d) any liability of the entity under a securities loan arrangement if, as at that time, the entity:
 - (i) has received amounts for the sale of securities (other than any fees associated with the sale) under the arrangement; and
 - (ii) has not repurchased the securities under the arrangement.

49 Subsection 995-1(1)

Insert:

OB activity has the meaning given by section 121D of the *Income Tax Assessment Act 1936*.

50 Subsection 995-1(1)

Insert:

on-lent amount, of an entity and at a particular time, means the value, as at that time, of:

- (a) all the assets of the entity that are comprised by *debt interests issued by other entities; and
- (b) all the assets of the entity that are comprised by leases for the hire of goods that are not covered by paragraph (a) and in relation to which the following subparagraphs are satisfied:
 - (i) each of the leases is for a term of 6 months or more;
 - (ii) the leases are part of the *business of hiring goods that the entity carries on;
 - (iii) the entity's business of hiring goods is not carried on predominantly for the purposes of hiring goods to the entity's *associates; and
- (c) all the securities that were held by the entity that:
 - (i) have been sold by the entity under a reciprocal purchase agreement (otherwise known as a repurchase agreement), sell-buyback arrangement or securities loan arrangement; but
 - (ii) have not yet been repurchased by the entity under the agreement or arrangement.

51 Subsection 995-1(1)

Insert:

outward investing entity (ADI) has the meaning given by sections 820-300 and 820-550.

52 Subsection 995-1(1)

Insert:

outward investing entity (non-ADI) has the meaning given by sections 820-85 and 820-550.

53 Subsection 995-1(1)

Insert:

outward investor (financial) has the meaning given by sections 820-85 and 820-550.

54 Subsection 995-1(1)

Insert:

outward investor (general) has the meaning given by sections 820-85 and 820-550.

55 Subsection 995-1(1)

Insert:

overseas permanent establishment, of an entity, means a *permanent establishment of the entity that is in a country other than Australia.

56 Subsection 995-1(1)

Insert:

prudential capital deduction, for an entity and at a particular time, means the total amounts that must be deducted in calculating the following in accordance with the *prudential standards as in force at that time:

- (a) the eligible tier 1 capital of the entity at that time (within the meaning of those standards);
- (b) the sum of the eligible tier 1 and tier 2 capital of the entity at that time (within the meaning of those standards).

56A Subsection 995-1(1)

Insert:

registered scheme has the same meaning as in the *Corporations Act 2001*.

56B Subsection 995-1(1)

Insert:

responsible entity, of a *registered scheme, has the same meaning as in the *Corporations Act 2001*.

57 Subsection 995-1(1)

Insert:

risk-weighted assets, of an entity and at a particular time, means the sum of the entity's risk exposures that the entity has at that time, as is determined in accordance with:

- (a) if the entity is an *Australian entity that is not a *foreign controlled Australian entity—the *prudential standards; or
- (b) in any other case—either of the following:
 - (i) the prudential standards;
 - (ii) the prudential standards determined by the prudential regulator in the country of which the entity, or the *foreign bank that has *TC control interests of at least 40% in the entity, is a resident.

58 Subsection 995-1(1)

Insert:

resident TC group for an income year means 2 or more entities that, because of a choice under section 820-500, are to be treated as a resident TC group for that income year.

59 Subsection 995-1(1)

Insert:

safe harbour capital amount:

- (a) for an *outward investing entity (ADI)—has the meaning given by section 820-310; and
- (b) for an *inward investing entity (ADI)—has the meaning given by section 820-405; and
- (c) for a *resident TC group to which section 820-575 applies—has the meaning given by that section.

60 Subsection 995-1(1)

Insert:

safe harbour debt amount:

- (a) for an *outward investor (general)—has the meaning given by section 820-95; and

- (b) for an *outward investor (financial)—has the meaning given by section 820-100; and
- (c) for an *inward investment vehicle (general)—has the meaning given by section 820-195; and
- (d) for an *inward investment vehicle (financial)—has the meaning given by section 820-200; and
- (e) for an *inward investor (general)—has the meaning given by section 820-205; and
- (f) for an *inward investor (financial)—has the meaning given by section 820-210.

61 Subsection 995-1(1)

Insert:

securitised asset has the meaning given by section 820-942.

62 Subsection 995-1(1)

Insert:

securitisation vehicle has the meaning given by section 820-942.

62A Subsection 995-1(1)

Insert:

subordinated debt interest means a *debt interest issued to:

- (a) an unsecured creditor; or
- (b) a secured creditor who, in the event of the liquidation of the entity issuing the interest, can only make a claim regarding that interest after the claims of other secured creditors regarding other debt interests issued by that entity have been met.

63 Subsection 995-1(1)

Insert:

TC control interest has the meaning given by section 820-815 (which is affected by sections 820-820 to 820-835).

64 Subsection 995-1(1)

Insert:

TC control tracing interest has the meaning given by section 820-875.

65 Subsection 995-1(1)

Insert:

TC direct control interest:

- (a) for a company—has the meaning given by section 820-855; and
- (b) for a trust—has the meaning given by section 820-860; and
- (c) for a partnership—has the meaning given by section 820-865.

66 Subsection 995-1(1)

Insert:

TC indirect control interest has the meaning given by section 820-870.

67 Subsection 995-1(1)

Insert:

tier 1 prudential capital deduction, for an entity and at a particular time, means the amounts that must be deducted in the calculation of the eligible tier 1 capital (within the meaning of the *prudential standards) of the entity at that time in accordance with the prudential standards as in force at that time.

68 Subsection 995-1(1)

Insert:

top entity of a *maximum TC group has the meaning given by section 820-500.

69 Subsection 995-1(1)

Insert:

total debt amount has the meaning given by sections 820-100, 820-200 and 820-210.

69A Subsection 995-1(1)

Insert:

valuation days, in relation to the calculation of the average value of a matter for an entity under Division 820, means the particular days at which the value of that matter is measured under Subdivision 820-G for the purposes of that calculation.

70 Subsection 995-1(1)

Insert:

worldwide capital amount, for an *outward investing entity (ADI), has the meaning given by section 820-320.

71 Subsection 995-1(1)

Insert:

worldwide debt, of an entity and at a particular time, means the total of the following amounts:

- (a) all the *debt interests issued by the entity:
 - (i) to entities other than any *Australian controlled foreign entities (the *controlled entities*) of which the entity is an *Australian controller at that time; and
 - (ii) that are still *on issue at that time;
- (b) all the debt interests issued by the controlled entities:
 - (i) to entities other than the entity or other controlled entities; and
 - (ii) that are still *on issue at that time.

72 Subsection 995-1(1)

Insert:

worldwide equity, of an entity and at a particular time, means the total of the following amounts:

- (a) all the *equity capital of the entity as at that time, other than *paid-up share capital of the entity held by *Australian controlled foreign entities (the *controlled entities*) of which the entity is an *Australian controller at that time;
- (b) all the equity capital of the controlled entities as at that time, other than paid-up share capital of the controlled entities held by:
 - (i) the entity; or

(ii) other controlled entities.

73 Subsection 995-1(1)

Insert:

worldwide gearing debt amount, for an *outward investing entity (non-ADI), has the meaning given by section 820-110.

74 Subsection 995-1(1)

Insert:

zero-capital amount has the meaning given by section 820-942.

[*Minister's second reading speech made in—
House of Representatives on 28 June 2001
Senate on 8 August 2001*]

(131/01)