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Dear Paul,

Board of Taxation: Statutory review of Australia's thin capitalisation reforms

CPA Australia is Australia's leading professional accounting body and one of the largest in the world. We represent the diverse interests of more than 176,000 members in over 100 countries and regions. We make this submission in response to the inquiry into the Board of Taxation (BoT)'s targeted consultation **Statutory review of Australia's thin capitalisation reforms** on behalf of our members and in the broader public interest.

Our submission draws on direct member experience of the practical operation of the new regime since its commencement on 1 July 2023 (thin capitalisation) and 1 July 2024 (Debt Deduction Creation Rules).

Executive summary

CPA Australia supports the policy intent of the 2024 thin capitalisation reforms to align Australia's interest limitation rules with OECD best practice and curb excessive debt deductions by multinationals. The regime has succeeded in its principal objective: it has made it significantly harder to use asset inflation or manufactured related-party debt to shift profits out of Australia.

However, the practical operation of the new regime has proven materially more complex and disruptive than the policy intent required. Member feedback consistently identifies a fundamental tension: the "blunt" nature of an earnings-based cap, particularly the 30% Fixed Ratio Test (FRT), is catching genuine, commercially driven financing arrangements alongside the abusive structures it was designed to target. This is most acute in capital-intensive sectors (infrastructure, renewables, property) where EBITDA is structurally low or negative during development phases, and in common group treasury arrangements where the Third Party Debt Test (TPDT) conditions cannot be met due to standard commercial security and credit support practices.

The result is a regime that in its current form —adds a 'tax risk premium' to Australian investment decisions, deters inbound capital, and imposes compliance costs disproportionate to any additional integrity benefit. Without targeted refinement, these frictions risk becoming a permanent drag on Australia's productive investment and competitiveness.

We recommend targeted legislative and administrative refinements to better distinguish integrity risks from genuine commercial activity, such as clarifying core definitions and introducing workable de minimis/safe harbours, moving the $2 million threshold to a net concept, and narrowing Debt Deduction Creation Rules (DDCR) through purpose-based relief, while preserving the overall integrity objectives of the reforms.

Key issues at a glance

Third party debt test

Strict 'recourse' and credit support rules disqualify standard commercial financing — particularly parental guarantees, performance bonds and global security pools. Undefined terms ('minor or insignificant', 'Australian assets', 'commercial activities') create uncertainty risk and costly private rulings.

Debt Deduction Creation Rules

No purpose test means legitimate restructures and historical related-party debt are captured regardless of commercial motive. Forensic tracing obligations for legacy debt are onerous and, in many cases, practically impossible. All-or-nothing denial is disproportionate.

Tax EBITDA construction

NANE income (dividends, trust distributions) is excluded from the tax EBITDA base, creating a zero-EBITDA outcome for holding entities with genuine economic returns. Volatility in earnings-based tests creates year-by-year disallowances disconnected from commercial leverage norms.

$2m exemption threshold

The gross debt deduction threshold captures entities with offsetting interest income from on-lending arrangements, imposing full FRT compliance obligations where the net integrity risk is negligible.

Capital-intensive sectors

Construction-phase assets (infrastructure, renewables, build-to-rent) earn zero EBITDA during their highest debt exposure period. The regime as structured materially impairs the financial viability of nation-building investment.

Private and mid-market groups

Discretionary trust and individual-controlled structures cannot access excess tax EBITDA of lower-tier entities, creating inequitable outcomes relative to corporate groups. Cross-staple deeming rules capture private groups with no legal stapling.

Practical consequences at a glance

The practical consequences of the new regime are now clearly visible across Australia's business community. In responding to the reforms, taxpayers have been forced to amend financing facilities to satisfy limited-recourse rules, undertake forensic apportionment exercises to align with ATO PCG risk zones, refinance to third-party debt, and maintain detailed Continuity of Ownership Test documentation to preserve carryforwards.

At the group level, treasury functions have been fundamentally restructured: entities are centralising "clean" external borrowing vehicles, embedding purpose-tagging and tracing in treasury systems, formalising TPDT and obligor governance in legal agreements, and shifting to equity-first distributions to avoid DDCR taint. These are not the behaviours of entities engaged in profit-shifting — they are the compliance responses of legitimate businesses navigating an overly complex regime.

The burden falls across a wide stakeholder base, from large multinationals and foreign permanent establishments to mid-market groups and their advisers, with capital-intensive sectors — infrastructure, renewables, property and REITs, mining and agriculture — bearing a disproportionate share due to construction-phase EBITDA constraints, NANE and trust complexities, and TPDT credit support restrictions.

The economic consequences are tangible: members report deleveraging to stay under thresholds, equitisation of related-party debt, increased cost of capital, and delayed or foregone investment in large-scale projects.

Australia is losing ground to jurisdictions perceived as more commercially flexible.

Key recommendations

Addressing these outcomes requires a combination of targeted legislative reform — including TPDT credit support amendments, a DDCR purpose test, a net $2 million threshold, construction-phase relief, and NANE inclusion in tax EBITDA — alongside administrative measures such as expanded PCG safe harbours and extended transitional relief.

Please refer to the Appendix for our detailed discussions on the response to the consultation questions.

If you have any queries, please contact Jenny Wong, Tax Policy Lead on jenny.wong@cpaaustralia.com.au or Bill Leung on bill.leung@cpaaustralia.com.au

Yours sincerely,

Jenny Wong
Tax Policy Lead

Appendix

Consultation questions

1. Consistency with policy intent: addressing excessive debt deductions

In accordance with the Terms of Reference, the focus of this review is whether the Amendments are operating in a manner consistent with their policy intent which is stated to "strengthen Australia's thin capitalisation regime to address risks arising from the use of excessive debt deductions, informed by the OECD's best practice guidance"? The Board is not seeking submissions on the policy intent underlying these amendments.

At a macro level, the legislation aligns Australia with OECD BEPS Action 4 and has tightened key loopholes. At the operational level, however, the sheer complexity and breadth of the rules have created friction and unintended consequences for genuine commercial arrangements.

Where the amendments are achieving their policy intent

- Shift to earnings-based tests: replacing the asset-based safe harbour with the FRT links debt deductions to actual economic activity, preventing the revaluation of intangibles to inflate safe harbour capacity.
- Curbing artificial asset valuations: the OECD-aligned approach neutralises the prior strategy of using inflated intangible values to justify excessive related-party debt.
- Targeted integrity via DDCR: denying deductions for debt created through intra-group transactions to generate Australian deductions addresses a specific, well-documented profit-shifting mechanism.

Where operation diverges from intent

- **Disproportionate impact on capital-intensive sectors:** The FRT works well for mature, profitable businesses. For property, infrastructure and start-up sectors with years of high debt and zero EBITDA, it operates effectively as a ban on interest deductions during the most capital-intensive phase of the investment cycle. The TPDT was intended as a fallback for these sectors, but its restrictive recourse conditions have proven extremely difficult to satisfy.
- **The broad scope of DDCR:** Even after narrowing amendments, the rules capture ordinary commercial restructures and cash-pool arrangements with no tax-avoidance motive. The absence of a purpose test, combined with forensic tracing obligations on historical debt, creates a compliance burden that is disproportionate to the integrity risk.
- **High complexity and compliance costs:** The intricate definitions required to calculate tax EBITDA, combined with DDCR tracing requirements and TPDT conditions, have caused compliance costs to increase. This hinders foreign investment.

2. Consistency with policy intent: addressing excessive debt deductions

The overall performance of the amendments in strengthening Australia's thin capitalisation regime to address risks arising from the use of excessive debt deductions?

The 2024 amendments represent the most significant overhaul of Australia's thin capitalisation rules in over two decades. While the macro-level objective of preventing profit-stripping via debt is being met, the regime's performance is a work in progress. Key structural improvements include:

- Earnings-based test: the FRT prevents entities from using asset revaluations to justify excessive debt, capping deductions at 30% of tax EBITDA.

- Targeting debt creation: the DDCR addresses the long-standing risk of ‘manufactured’ internal debt created through intra-group transactions.
- Tightened TPDT: replaces the subjective arm’s length debt test with a more rigorous focus on genuine external borrowing.

Emerging performance gaps are significant:

- Complexity: The move from asset-based to tax-EBITDA calculations has dramatically increased the cost of compliance, particularly for "General Class Investors" in the property and infrastructure sectors.
- Volatility: unlike asset-based tests, the FRT is sensitive to profit fluctuations. A temporary earnings dip triggers large interest disallowances even if debt levels are unchanged and commercially appropriate.
- Trust and partnership uncertainty: significant uncertainty remains regarding how tax EBITDA and the TPDT apply to complex trust structures common in Australian property development.
- Elections: once a taxpayer elects the Group Ratio Test or TPDT, denied deductions under the FRT are forfeited — creating unnecessary commercial friction.
- Investment deterrence: a ‘tax risk premium’ is now factored into Australian project returns by foreign investors, with capital flowing to jurisdictions perceived as more commercially flexible.

Although the amendments have strengthened the thin capitalisation regime by making it harder to strip profits via debt, its "performance" is a work in progress. While the policy intent, that of limiting excessive debt deductions is being met, we submit the administrative burden and technical rigidities have prompted the need for "fine-tuning" to ensure Australia remains an attractive destination for foreign investment.

3. Minor and technical drafting changes – Third Party Debt Test focus

Any minor and technical drafting changes which are necessary for the practical administration of the laws, with a particular focus on the third-party debt test provisions and related undefined legislative terms?

Several critical drafting deficiencies in Subdivision 820-EAA are causing the TPDT to inadvertently disqualify commercially standard external borrowing. The following targeted fixes are urgently needed:

a. ‘Minor or insignificant assets’ (undefined)

The TPDT allows recourse to ‘minor or insignificant’ non-Australian assets without disqualification, but the term is undefined in the ITAA 1997. This creates cliff-edge risk where a minor offshore subsidiary or trademark in a security pool could invalidate a billion-dollar facility.

We recommend introducing a de minimis threshold (e.g. 5% of total security pool value) or a purpose test to ensure incidental recourse does not invalidate the debt instrument.

b. ‘Credit support rights’ (too broad)

The prohibition on credit support rights provided by non-residents is broad enough to capture performance bonds and bank guarantees that are standard in construction and property development. If a foreign parent provides a performance guarantee for a project, the ATO’s current interpretive stance suggests this could constitute ‘credit support’ for the underlying debt.

We recommend amending the definition to explicitly exclude non-financial performance guarantees and letters of comfort that do not create a legal obligation for the parent to repay principal or interest.

c. ‘Commercial activities’ — the distribution trap

The ATO controversially treats using debt to fund dividend payments or capital reductions as not constituting a ‘commercial activity’. This interpretation is logically inconsistent and contrary to normal corporate treasury practice. If $1 of a $100m facility funds a distribution, the entire facility fails the TPDT under strict reading.

We recommend ‘wholly used’ with ‘substantially used’ or provide a carve-out for distributions from earnings that are not part of a debt-creation scheme (cross-referencing the DDCR).

d. ‘Obligor group’ mechanics

The mechanics of how an entity joins or leaves the obligor group mid-year are poorly drafted and do not adequately account for M&A activity.

We recommend allowing pro-rata qualification of debt interests where the obligor group composition changes due to genuine commercial transactions. Clarify that passive holding companies can be obligor group members.

e. ‘Recourse’ — subrogation rights

Whether a lender’s right of subrogation against a third party constitutes ‘recourse’ to assets outside the Australian obligor group remains legally uncertain.

We recommend statutory clarification that rights of subrogation or indemnity arising by operation of law (rather than by contract) are not ‘recourse’ for TPDT purposes.

f. ‘Australian assets’ (undefined)

The ATO’s application of this term is logically inconsistent: shares in a foreign entity are automatically not Australian assets regardless of underlying asset location, while shares in an Australian entity may not qualify if some underlying assets are foreign. The term is undefined in the Bill and the Explanatory Memorandum provides limited guidance.

We recommend providing a legislative definition that focuses on assets substantially connected to Australian commercial operations, with clear bright-line rules for shares in Australian resident entities.

If the $2 million exemption threshold should operate as a net debt deduction concept?

We support a proposal to transition the $2 million de minimis threshold (s.820-35) from a gross to a net debt deduction basis.

The problem with the current gross basis

An entity with $2.5m in interest expense but $2.4m in interest income has a net economic exposure of only $100,000 to the revenue. Yet because the threshold is gross, this entity must perform the full FRT or elect the TPDT. This creates an outsized compliance burden on entities with back-to-back lending arrangements or high-volume, low-margin financing — precisely the types of entities that pose the least integrity risk.

The case for a net concept

- Alignment with FRT logic: the FRT limits deductions to 30% of tax EBITDA — a net earnings measure.
- OECD BEPS consistency: BEPS Action 4 recommends a de minimis threshold based on net interest expense. Moving to a net concept would bring Australia into closer alignment with international best practice.
- Reduced associate complexity: for groups with internal treasury functions where interest flows in both directions, a net concept simplifies the associate aggregation calculation.

Integrity safeguards required

A net concept must be accompanied by an integrity measure to prevent 'interest washing' — artificially inflating interest income from related-party transactions to stay below the $2m net cap.

Specific issues to resolve in drafting include:

- Defining 'interest income': restrict to assessable interest income subject to full Australian corporate tax.
- Associate aggregation: the net position should be calculated on an entity-by-entity basis, not a group net basis, to preserve integrity where one entity has high expense and another has high income.
- Symmetry with the FRT: if the threshold is net, consider whether the FRT should also be adjusted to a net disallowance mechanism to avoid a structural mismatch.

Whether the default Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA) calculation operates to appropriately reflect an entity's economic activity in the income year and across multiple income years, as intended?

The statutory tax EBITDA calculation (s.820-52) frequently acts as a distorted mirror of an entity's true economic activity. While it achieves the policy goal of creating a hard cap on interest deductions, its reliance on taxable income rather than accounting profit creates some friction.

Single-year distortions

- **NANE income exclusion:** dividends from foreign subsidiaries and distributions from certain trusts are excluded from the taxable income starting point. For holding companies that incur debt to acquire these assets, tax EBITDA can effectively be zero — even if the entity is economically highly profitable. This is the most significant design flaw in the current regime.
- **The 'floor' issue:** where a tax loss exceeds add-backs (depreciation plus interest), the entity has $0 tax EBITDA, meaning all interest deductions are disallowed for that year regardless of the economic position.
- **Prior year losses:** subsection 820-52(1A) assumes the entity deducts all prior year losses in working out tax EBITDA. At a minimum, losses incurred under the former asset-based regime (pre-July 2023) should be excluded from this assumption — they were calculated under fundamentally different rules and their inclusion is a transitional inequity.
- **Double counting in stapled structures:** the FRT assumption of maximum loss utilisation can create double counting where a company in a stapled structure chooses not to utilise losses in a given year.
- **10–50% investment holdings ('dead zone'):** investors with a TC control interest between 10% and 50% (e.g. joint ventures and consortiums) cannot access excess tax EBITDA of lower-tier entities and must disregard dividends received. This creates a dead zone with no clear policy rationale, rendering debt-funded investment in this range potentially unviable.

Multi-year distortions

- **15-year carry-forward:** the carry-forward period for denied deductions is helpful, but the 15-year cap may be insufficient for long-duration infrastructure and resources projects. Indefinite carry-forward (and carry-back to construction years) should be considered.
- **Volatility for cyclical industries:** earnings-based tests create year-by-year disallowances for industries with naturally cyclical earnings (mining, agriculture). A 3-year rolling average for tax EBITDA should be considered as a legislative option.
- **Ownership change:** the continuity of ownership test for carried-forward denied deductions should be relaxed for genuine corporate acquisitions to prevent permanent loss of tax assets.

The practical impact on the cost of complying with the debt deduction creation rules after restructures, including whether the rules have effectively discouraged debt creation schemes?

The DDCR have become one of the most controversial elements of the thin capitalisation reform package. The rules continue to generate compliance costs that are materially disproportionate to the integrity benefit.

Key compliance burdens

- **Retrospective tracing:** entities must review historical debt arrangements to determine whether initial funding was associated with a DDCR-relevant transaction. For debt that has been in place for years or decades, this forensic exercise is often practically impossible. This is effectively retrospective application of the law.
- **All-or-nothing denial:** the DDCR provides no graduated or apportioned outcome. If a tracing connection to a DDCR transaction is established, the entire related-party deduction is denied. The ATO may simply deny all related-party debt deductions and shift the onus to the taxpayer to disprove the connection.
- **Cash pool complexity:** in cash pool environments, it is frequently impossible to trace whether funds drawn were historically used to fund 'prohibited' transactions. The commercial reality of pooling is fundamentally incompatible with the tracing methodology assumed by the DDCR.
- **Legitimate restructure deterrence:** the absence of a purpose test means the DDCR deters genuine commercial restructures — for example, merging two Australian subsidiaries for operational efficiency — because the tax consequences cannot be managed with certainty.

There should be additional exclusions such as:

- Related party funding for the acquisition of trading stock from an associate pair — a common commercial transaction with no profit-shifting motive.
- Domestic debt between Australian resident associate pairs — the interest expense deducted is assessable income to the lender; there is no revenue risk.
- Entities satisfying the 90%+ Australian assets exclusion from thin capitalisation (s.820-37) — there is no clear policy rationale for excluding ss.820-35 and 820-39 but not s.820-37.
- Entities that have elected the TPDT — the current exclusions only reference s.820-46(4) choices (general class investors) and do not cover financial entities that elect under ss.820-85(2C) or 820-185(2C).

Practical examples of how entities have complied with the amended provisions?

The compliance landscape following the 2024 amendments has shifted fundamentally in character. Entities are no longer simply asking what the rules require — they are actively restructuring financing arrangements, renegotiating facility agreements, and investing in forensic analysis to position themselves within the ATO's PCG 2025/2 risk framework. The following examples drawn from member experience illustrate how this plays out in practice across different entity types and fact patterns. They also illustrate a broader point: in each case, the compliance burden falls on entities whose underlying financing arrangements are commercially legitimate, and the cost of achieving a satisfactory compliance position is substantial relative to any integrity benefit the rules generate in these contexts.

Infrastructure and property funds — restricting recourse to preserve TPDT eligibility

A property fund with significant third-party debt identified that its loan security pool included membership interests in an Australian holding company which, in turn, occasionally held minor non-Australian assets — a trademark registered in New Zealand and a small offshore bank account. On a strict reading of the TPDT recourse conditions, the lender's indirect access to these non-Australian assets through the security pool created a potential disqualifying recourse path.

To preserve TPDT eligibility, the fund was required to amend its facility agreement to add an explicit limitation of recourse clause, carving out the lender's right to enforce against any membership interests that provided indirect access to non-Australian assets. The amendment required negotiation with the lender, specialist legal drafting, and a detailed asset mapping exercise to identify every element of the security pool that could potentially carry non-Australian recourse. The outcome — maintaining eligibility for the TPDT and preserving the associated interest deductions — was achieved, but only through a process whose cost and complexity was entirely disproportionate to the underlying risk: the non-Australian assets in question were immaterial to the security package and of no practical value to the lender in any enforcement scenario.

This example illustrates a systemic problem with the TPDT's current drafting. The absence of a workable statutory de minimis for minor or insignificant non-Australian assets within a security pool means that entities must either undertake expensive facility amendments or accept the risk of full deduction disallowance. A legislated value-based safe harbour — for example, non-Australian assets comprising less than 5% of the total security pool — would resolve this class of issue without any meaningful integrity cost.

Multinational groups — forensic apportionment in cash pool environments

A multinational group operated a global cash pool used to fund both operational working capital and, in late 2023, a one-off intercompany dividend to an associate. Under the DDCR, debt used to fund distributions to associates is tainted, and the taint attaches to the interest on that portion of the debt regardless of subsequent use.

When the group refinanced its Australian facilities in 2025, it was unable to perfectly trace every dollar of the new debt to clean purposes — a practically unavoidable consequence of the commingled nature of cash pool balances. Rather than accept an all-or-nothing disallowance or leave the position undisclosed, the group undertook a detailed forensic cash flow analysis following the apportionment methodology in PCG 2025/2. By calculating the ratio of tainted usage — the dividend — to clean usage across the relevant cash pool balance over the relevant period, the group was able to identify and voluntarily disallow a proportionate share of its interest deductions. The proactive disclosure and transparent methodology moved the group from a high-risk to a low-risk classification in its 2026 ATO review.

This example is instructive in two respects. First, it demonstrates that compliant outcomes are achievable in cash pool environments — but only through forensic analysis that is time-consuming, methodologically uncertain, and dependent on the availability of historical transaction records that many groups do not retain in the form required. Second, and more fundamentally, it illustrates that the compliance solution available to this group required it to permanently forgo a portion of its interest deductions on debt that was predominantly used for entirely legitimate purposes. A purpose test within the DDCR — one that denied deductions only where the tainted use was the principal driver of the debt arrangement — would produce a more proportionate outcome without compromising the rules' integrity objectives.

High-growth entities — managing the zero tax EBITDA trap

A high-growth technology firm incurred significant debt to fund research and development activities, resulting in a tax loss for the 2025 income year. Because the tax EBITDA formula cannot produce a negative result, the firm's FRT limit was effectively zero — meaning 100% of its interest expense was potentially disallowable in that year despite the debt being applied to productive, commercially-driven investment.

The firm's compliance response involved two parallel workstreams. First, it assessed whether the TPDT was available — but was unable to satisfy the recourse conditions because its offshore parent had provided credit support for the facility. Remaining within the FRT, the firm instead focused its effort on meticulous documentation of its continuity of ownership and business continuity position, ensuring that the 2025 disallowed deductions could be carried forward and utilised when the business moved into taxable profit in 2026. When that occurred, the deferred deductions were applied against the 2026 tax liability, effectively smoothing the economic cost of the disallowance across years.

The outcome was satisfactory, but the path to it illustrates the disproportionate compliance burden imposed on entities engaged in exactly the kind of activity — domestic R&D investment — that Australia's tax system is designed to encourage. A construction-phase or pre-revenue safe harbour, or an amendment to include genuine reinvested earnings in the tax EBITDA base, would remove this class of case from the regime's reach without any integrity cost.

Private groups — replacing related-party debt to eliminate DDCR risk

A private group held a longstanding Division 7A loan from a family trust to its trading company. Under the 2024 amendments, this arrangement was identified as a potential Type 1 DDCR event — debt created in connection with an acquisition from an associate — carrying the risk of permanent interest disallowance going forward.

The group's response was to replace the related-party loan with a commercial bank facility, eliminating the DDCR exposure entirely. Because the group was able to demonstrate that the original related-party loan had been entered into for genuine commercial reasons — specifically, that the trading company had lacked the cash to fund the relevant transaction on other terms — and that the replacement with third-party debt was a genuine structural change rather than a technical manoeuvre, the ATO treated the refinancing as a low-risk restructure consistent with PCG 2025/2. The outcome preserved the group's interest deductions going forward and removed the latent disallowance risk.

This example highlights both what the compliance pathway looks like for private groups and the conditions under which it is accessible. The ability to characterise the original arrangement as commercially motivated, and to demonstrate that the refinancing was substantive, was critical to the outcome. Private groups that cannot satisfy those conditions — or that lack the documentation to establish them — face a materially less certain position, and the cost of obtaining the necessary advice and documentation is significant relative to the scale of many private group financing arrangements.

Across each of these examples, entities achieved compliant outcomes — but the path to compliance was expensive, uncertain, and in several cases required permanently foregoing deductions on debt applied to legitimate commercial purposes. The compliance burden in each case arose not from aggressive tax planning but from the interaction between standard commercial financing practices and rules drafted without adequate accommodation for those practices.

A more precisely targeted regime — with workable safe harbours, a DDCR purpose test, and defined thresholds for the TPDT's minor asset carve-out — would allow these entities to reach the same compliant outcome at a fraction of the current cost, without any reduction in the regime's effectiveness against the abusive structures it was designed to address.

Details of how Australian entities have integrated the amended provisions and interactions within their group financing arrangements?

Australian entities have moved through the initial implementation shock of the 2024 amendments and are now operating in what might be described as a structural redesign phase. Group financing arrangements that evolved over decades are being fundamentally reconfigured — not to reduce commercial risk or improve capital efficiency, but to manage the DDCR's reach into historical and ongoing related-party debt and to satisfy the TPDT's stringent recourse conditions. The integration has required sustained collaboration across treasury, legal, tax and corporate development functions in a way that has no precedent in the history of Australia's thin capitalisation rules.

Centralised clean funding vehicles

The most significant structural response has been the migration away from decentralised, entity-by-entity borrowing toward centralised external funding vehicles. Many multinational groups have established dedicated Australian SPVs that borrow exclusively from third-party lenders and on-lend to operational subsidiaries. The architecture is designed to satisfy the TPDT at the SPV level — with internal loans to subsidiaries treated as Australian assets within the obligor group — while insulating the external facility from any credit support or guarantee arrangements that would trigger prohibited credit support rules.

Maintaining the integrity of this structure requires ongoing governance that would have been unimaginable under the former regime. Treasury teams now maintain negative pledge registries to ensure that no foreign associate inadvertently provides a guarantee or comfort letter that could retrospectively invalidate the SPV's TPDT status. The margin for error is narrow: a single undocumented credit support arrangement, discovered in an ATO review, can disqualify the entire facility and convert years of claimed deductions into a permanent disallowance.

Purpose-tagging in cash pool and treasury management systems

Cash pooling — a staple of efficient multinational treasury management — has been fundamentally complicated by the DDCR. Because the rules can apply to any related-party debt used to fund a DDCR-relevant transaction, the commingled nature of cash pool balances creates an endemic tracing problem that cannot be resolved retrospectively with any confidence.

Groups have responded by integrating purpose-tagging directly into their treasury management systems. Every drawdown from a related-party cash pool is now classified at the point of drawdown — as capital expenditure, working capital, associate acquisition or distribution funding — with the classification feeding directly into tax provisioning software. Where a drawdown is tagged as a Type 1 or Type 2 DDCR event, the corresponding interest is automatically flagged as non-deductible in the current period tax provision. This real-time tagging is not merely a best-practice improvement — for many groups it is the only viable mechanism for managing DDCR exposure across high-volume treasury operations, and it requires significant investment in system configuration, staff training and ongoing monitoring to maintain.

The deeper problem is that this architecture only works prospectively. For historical cash pool balances drawn before the tagging systems were implemented, the tracing exercise remains manual, incomplete and in many cases irresolvable — leaving groups with a residual DDCR exposure that cannot be quantified with certainty regardless of the resources invested.

Obligor group governance in joint ventures and shareholders agreements

The TPDT's requirement that all associates within a borrower group make a consistent election has introduced a new dimension of legal complexity into joint venture and consortium structures. A minority partner's decision to apply the FRT for its own tax affairs can, in certain circumstances, compromise the TPDT status of the project's external debt — a consequence that goes directly to the commercial viability of the financing arrangement and that no individual partner can control unilaterally.

Groups have responded by embedding thin capitalisation election clauses into shareholders agreements and joint venture agreements at the outset of new transactions, requiring all partners to consent to a TPDT election where the project financing requires it. This represents a material expansion of the tax governance provisions in commercial agreements — introducing a layer of tax interdependency between joint venture partners that previously did not exist and that requires careful negotiation, particularly where partners have different tax profiles or where the optimal test election differs across the group.

For existing joint ventures, retrofitting these provisions into established agreements has in some cases required renegotiation of fundamental commercial terms, with attendant legal costs and relationship management considerations that fall entirely outside the compliance burden conventionally associated with a change in tax law.

Equity-first repatriation and dividend timing strategies

The DDCR's application to debt used to fund distributions to associates has driven a fundamental shift in how groups approach capital repatriation. The risk that a revolving credit facility drawn to fund a dividend — even one funded principally from operational cash flow — could be characterised as DDCR-tainted has led many groups to adopt equity-first repatriation strategies that eliminate the connection between debt and distributions entirely.

In practice this means two things. First, groups are systematically equitising historical related-party debt — converting interest-bearing intercompany loans into share capital to remove them from the DDCR's reach. The economic balance sheet is unchanged, but the tax risk profile is transformed. Second, dividend timing is now managed with reference to tax EBITDA forecasts: distributions are structured to coincide with periods of strong earnings, ensuring that residual debt remains within the FRT's 30% cap and that no distribution creates a DDCR nexus with outstanding related-party

borrowings. Treasury and tax functions that previously operated largely independently are now required to coordinate on distribution decisions in real time.

The M&A and due diligence dimension

The integration of the amended provisions has extended into the M&A process in ways that add both cost and complexity to transaction execution. Acquirers are now required to analyse the historical debt pedigree of target entities — tracing the original purpose of existing related-party debt to identify whether any portion is DDCR-tainted before acquisition. A target with a clean commercial history but poorly documented internal financing arrangements can represent a significant latent tax liability that does not appear on the face of the financial statements and may not be discoverable without extensive forensic work.

This analysis has become a standard component of tax due diligence for transactions involving Australian entities with related-party debt, adding cost and in some cases extending transaction timelines. Where DDCR-tainted debt is identified, the acquisition price or structure must be adjusted to reflect the lost deductions — a negotiation that requires both parties to form a view on quantum that may be genuinely uncertain.

The cumulative integration burden

Taken together, these integration responses represent a permanent expansion of the operational overhead required to manage group financing in Australia. The costs are not one-off: purpose-tagging systems require ongoing maintenance, obligor group governance requires ongoing monitoring, negative pledge registries require ongoing updating, and equity-first repatriation strategies require ongoing coordination between treasury and tax. These are structural costs embedded in the ongoing operation of Australian entities — costs that ultimately reduce the return on Australian investment and that fall on entities engaged in entirely legitimate commercial financing. CPA Australia submits that a regime whose integrity objectives could be achieved with more targeted rules should not impose this level of permanent operational burden on the broad population of affected entities.

Industry specific issues – are there features of your industry (for example, capital intensity, long asset lives, or reliance on particular financing structures) that have resulted in distinct impacts from the thin capitalisation amendments? Please explain and provide examples.

The 2024 thin capitalisation amendments were designed as a unified earnings-based framework applicable across all general class investors. In practice, the one-size-fits-all architecture of the regime has produced structural mismatches with the financing realities of several capital-intensive industries — not because those industries engage in aggressive tax planning, but because their legitimate commercial characteristics are fundamentally incompatible with a 30% tax EBITDA cap applied on an annual basis. The following sectors illustrate where the disconnect is most acute.

Infrastructure and renewable energy

Infrastructure and renewable energy projects are characterised by extreme capital intensity, multi-year construction phases with zero operating revenue, and financing structures built around special purpose vehicles. These features make the sector both the most reliant on debt financing and the least able to satisfy the regime's primary tests in its current form.

The core difficulty lies in the TPDT. The test was intended as the natural home for genuine third-party project finance — yet its requirement that lender recourse be strictly limited to Australian assets conflicts directly with how major infrastructure is actually financed. Global lenders routinely require parental guarantees or letters of credit from offshore sponsors as a condition of providing construction finance, particularly where the borrowing entity is an SPV with no operating history and no assets beyond the project under construction. Under the ATO's interpretation of the TPDT, these standard commercial arrangements constitute prohibited credit support, disqualifying the entire debt from the test.

The consequence is that infrastructure projects are pushed into the FRT by default — and the FRT produces outcomes that are mathematically indefensible for construction-phase entities. A project with $200 million in debt, $15 million in annual interest, and zero tax EBITDA during the build phase faces

complete disallowance of its interest deductions in those years. While the 15-year carry-forward provides some theoretical relief, the time value of denied deductions during the highest-debt years of a project's life materially reduces after-tax returns and directly affects the feasibility assessments used by both domestic and foreign investors.

The practical result is visible in the market: financing costs for Australian renewable energy and infrastructure projects have increased, Power Purchase Agreement prices have risen to reflect the tax risk, and some major global funds have paused or rescaled their Australian pipelines. At a time when Australia's energy transition requires a sustained increase in private capital investment in large-scale renewable infrastructure, the thin capitalisation regime is operating as a structural impediment to that investment.

Real estate investment trusts and property development

The property sector faces a distinct but equally significant structural mismatch arising from the interaction between trust distribution mechanics and the tax EBITDA construct.

The tax EBITDA calculation begins with taxable income. For property trusts — particularly holding entities whose economic returns are generated through distributions classified as NANE income — this starting point dramatically understates commercial reality. A trust with a fully occupied, well-performing property portfolio may nonetheless report a suppressed or negligible tax EBITDA because the income flowing through its structure does not appear in the taxable income base on which the FRT operates. Interest deductions are then capped against this artificial floor, producing disallowances that bear no relationship to the entity's actual capacity to service its debt.

Property developers face a related but temporally distinct problem. Long construction cycles create a structural earnings lag: interest costs are highest during the development phase, while taxable income is not recognised until completion and sale. The FRT applies on an annual basis with no capacity to smooth this mismatch across the project lifecycle. The result is systematic interest disallowance during the years of maximum debt exposure, with carry-forward of denied deductions providing only partial relief given the time value implications and the risk of ownership changes during long development periods.

Mining and natural resources

The mining sector's primary exposure arises from the fundamental incompatibility between a cyclical earnings profile and an annual earnings-based cap.

Under the former safe harbour regime, a mine's debt capacity was anchored to the value of its assets — a metric that, while imperfect, was broadly stable across commodity price cycles. The FRT replaces this with a cap tied to annual tax EBITDA, which in the resources sector moves dramatically with commodity prices. When iron ore, lithium or coal prices fall, tax EBITDA contracts sharply while the debt used to construct the mine remains fixed. The result is large and sudden interest disallowances in price-trough years, precisely when mining entities are least able to absorb additional tax costs.

The carry-forward mechanism provides theoretical relief but introduces a compounding risk for long-life assets. Mining projects with asset lives of 20 to 50 years are frequently subject to ownership changes — through joint venture restructures, partial divestments, or market-driven acquisitions during downturns — that can trigger the modified continuity of ownership test and cause permanent loss of accumulated denied deductions. The prospect of this outcome creates a risk overhang that is factored into investment decisions, particularly for high-capex expansion projects where the financing decision is made years before the income is earned.

Agriculture and primary production

The agricultural sector presents a structural anomaly that illustrates the unintended consequences of applying a gross rather than net de minimis threshold.

Large-scale primary producers frequently carry high gross interest liabilities arising from seasonal crop financing, equipment loans and land acquisition debt — but simultaneously hold significant interest income through offset accounts, farm management deposits and on-lending within farming groups. Their net economic interest cost is often modest. Yet because the $2 million threshold operates on a gross basis, these entities are drawn into the full compliance burden of the thin capitalisation regime despite posing negligible net integrity risk.

The compliance obligations imposed on family-owned corporate farming groups — FRT calculations, tax EBITDA modelling, and potentially DDCR analysis — are disproportionate in scale to both the entities' sophistication and the revenue at stake. The straightforward fix — moving the threshold to a net debt deduction concept — would exempt the overwhelming majority of these entities while preserving the regime's reach over entities with genuine net interest exposure.

Across each of these sectors, the pattern is consistent: the structural characteristics that define legitimate commercial activity in that industry — SPV financing in infrastructure, trust distributions in property, earnings cyclicality in mining, seasonal gross interest in agriculture — are treated by the current regime not as features to be accommodated but as obstacles to compliance. The reforms would better achieve their stated policy intent if sector-specific safe harbours, construction-phase relief, and definitional clarity were introduced to distinguish these commercial realities from the profit-shifting arrangements the rules were designed to address.

The types and number of stakeholders affected

The thin capitalisation amendments were framed as a multinational tax integrity measure, but their practical reach extends well beyond the entities that were the primary legislative target. The breadth of impact reflects both the structural design of the new tests and the ATO's interpretation of key undefined terms — together producing a regime whose compliance burden falls across a far wider stakeholder population than the policy intent would suggest.

Primary corporate stakeholders

The replacement of the former inward and outward investor categories with the unified "General Class Investor" concept has brought a diverse range of entities under a single, undifferentiated earnings-based framework. The affected population includes foreign-controlled Australian subsidiaries that have historically relied on related-party debt from offshore parents; Australian multinational groups with foreign permanent establishments or controlled foreign entities; and foreign entities operating Australian branches, including foreign banks and professional services firms. Financial entities and authorised deposit-taking institutions, while largely excluded from the earnings-based tests, are nonetheless materially affected by the narrowed definition of "financial entity" and the operation of the third-party debt rules in the context of their lending and treasury activities.

What unites these otherwise diverse entities is that the new regime applies a single earnings-based metric — 30% of tax EBITDA — to capital structures that vary enormously in their commercial logic, funding lifecycle, and relationship to taxable earnings. The consequence is that entities whose financing arrangements are entirely legitimate but structurally incompatible with the FRT face the same compliance burden and deduction risk as the aggressive profit-shifting structures the rules were designed to target.

Industry-specific impacts

The disproportionate impact on certain sectors reflects the fundamental mismatch between an earnings-based test and capital structures that are asset-heavy, distribution-focused, or cyclically exposed.

Infrastructure and renewable energy groups face the most acute difficulties. Their reliance on special purpose vehicle financing and parental credit support means the TPDT — the test designed as a safe harbour for genuine third-party debt — is in practice inaccessible under standard commercial financing terms. The result is that the sector most critical to Australia's energy transition is among the most severely disadvantaged by the regime.

Real estate investment trusts and property funds are structurally exposed to the tax EBITDA construct, which excludes NANE income and trust distributions from the earnings base. For holding entities whose economic returns are generated through distributions rather than taxable income, this

produces a tax EBITDA that dramatically understates commercial reality, with debt deductions denied on the basis of a metric that bears little relationship to the entity's actual capacity to service its debt.

Mining and resources groups are affected by the volatility inherent in an earnings-based cap. A commodity price downturn that reduces EBITDA in a given year can produce a large and sudden interest disallowance even where debt levels and commercial leverage are unchanged. The strict continuity of ownership requirements for carrying forward denied deductions create an additional risk for groups that undergo ownership changes through genuine commercial transactions.

Agricultural enterprises present a particular anomaly. Large-scale primary producers frequently exceed the $2 million gross threshold despite carrying minimal net debt, because the gross nature of the threshold captures both sides of on-lending arrangements that cancel out economically. These entities are drawn into full FRT compliance obligations for what amounts to negligible net integrity risk.

The advisory and professional services community

The compliance burden does not fall on corporate taxpayers alone. The undefined terms, interpretive uncertainty, and forensic complexity of the new regime have created a sustained and significant demand for specialist tax and legal advice that represents a deadweight cost on the Australian economy. Law firms, accounting practices and tax advisers are devoting substantial resources to issues — including the meaning of "minor or insignificant assets," the boundaries of "commercial activities," the mechanics of DDCR tracing in cash pool environments — that should have been resolved in the legislation or explanatory memorandum and were not.

The compliance pyramid

Taken together, the affected population forms what might be described as a compliance pyramid. At the apex, large multinationals are managing complex DDCR tracing exercises across historical debt portfolios, often at costs running into millions of dollars with no certainty of outcome. In the middle tier, infrastructure, property and trust-based structures are spending heavily to navigate TPDT recourse restrictions and tax EBITDA mismatches that make their standard financing arrangements non-compliant on technical grounds unrelated to any profit-shifting motive. At the base, mid-market and privately-owned groups — including agricultural enterprises and domestically-focused businesses inadvertently captured by the gross threshold — are incurring compliance costs that are disproportionate to both their scale and the integrity risk they represent.

The width and depth of this stakeholder impact is not a feature of a well-targeted integrity measure. It is the consequence of rules drafted broadly and interpreted restrictively, without adequate definitional clarity or proportionate safe harbours. CPA Australia submits that the Board's review provides the appropriate forum to assess whether the compliance burden currently falling across this stakeholder population is justified by a corresponding reduction in base erosion risk — and, where it is not, to recommend the targeted reforms necessary to restore proportionality.

Compliance time and costs in restructuring existing, or accessing new, financing facilities?

Member feedback consistently identifies compliance costs as one of the most significant practical consequences of the thin capitalisation reforms — and one that has not diminished over time. What was initially characterised as a one-off implementation burden has become a structural, ongoing administrative cost embedded in how Australian entities manage their financing arrangements. The impacts fall across three distinct phases of the financing lifecycle.

Existing facilities — the forensic look-back burden

The most significant and least anticipated compliance cost arises from the DDCR's application to historical debt. Because the rules contain no grandfathering provision, entities are required to trace the original purpose of related-party debt that may have been in place for years or decades. A loan

that funded an internal asset transfer in 2005 potentially generates non-deductible interest today, regardless of whether the original transaction had any tax-avoidance purpose or whether the relevant entities or records still exist in their original form.

The practical consequences are severe. Many groups are incurring substantial costs to retrieve records from decommissioned accounting systems, reconstruct transaction histories from long-closed subsidiaries, and obtain defensive tax opinions on debt positions whose original commercial rationale can no longer be clearly established. This is compounded by the nature of the disallowance: unlike FRT denials, DDCR disallowances are permanent — there is no 15-year carry-forward. The cost of getting the position wrong is therefore significantly higher than under the former safe harbour regime, which drives a level of defensive spend that is disproportionate to any integrity benefit where the underlying arrangements were commercially genuine.

For entities operating cash pools or centralised treasury functions, the tracing exercise is in many cases practically impossible. The fundamental architecture of cash pooling — where funds are commingled and deployed dynamically — is incompatible with the granular purpose-tracing the DDCR assumes. Members report that this uncertainty is itself a significant cost driver, as groups cannot form a confident view of their exposure without extensive and expensive analysis, and in some cases cannot form a confident view at all.

New facilities — the tax-first financing environment

Accessing new financing in the current environment requires a tax-first approach to structuring and documentation that has materially inflated legal and advisory costs across the transaction lifecycle.

New debt facilities must now be meticulously drafted to satisfy TPDT conditions. This includes limited recourse clauses that explicitly carve out non-Australian assets, careful delineation of the obligor group, and facility terms that avoid triggering the prohibited credit support rules — all of which require specialist tax input at the term sheet and documentation stages rather than as a post-execution review. Standard commercial features that were previously unremarkable, most significantly parental guarantees and cross-collateralisation arrangements, now create a compliance wall that requires negotiation of alternative security structures acceptable to both the lender and the TPDT conditions. In practice, lenders are not always willing or able to restructure their standard security requirements to accommodate Australian tax constraints, which in some cases results in the project being unable to access the facility at all.

The FRT has also introduced a new layer of modelling into the financing process. Borrowers must now produce tax EBITDA forecasts — not merely accounting EBITDA — as part of the loan application and covenant compliance process. For sectors with volatile or construction-phase earnings, this modelling is inherently uncertain and requires ongoing tax specialist involvement throughout the life of the facility, not just at origination.

Restructuring for compliance — the PCG 2025/2 burden

To avoid high-risk classification under PCG 2025/2, many entities are undertaking proactive restructures whose upfront costs are substantial even where the long-term risk reduction justifies them.

Groups converting related-party debt to equity to eliminate thin capitalisation exposure entirely face transaction costs — stamp duty advice, corporate secretarial work, intercompany agreement amendments, and foreign law considerations for cross-border structures — that can reach into the hundreds of thousands of dollars for complex groups, with no corresponding economic benefit beyond the removal of compliance risk. The ATO's justified trust framework adds a further layer, requiring entities to document that any restructure was not primarily motivated by tax benefit. Assembling that evidence base — commercial board papers, financing history, group-level decision records — often requires months of internal effort and external legal review.

The cumulative effect

The combined weight of these costs is producing a structural change in financing behaviour that goes beyond the integrity objectives of the reforms. Mid-market entities in particular are reducing debt levels to stay below the $2 million gross threshold rather than incurring the cost of full FRT compliance — even where that deleveraging constrains growth or acquisition capacity. Larger groups are directing management time and capital toward compliance infrastructure that generates no productive return. And at the transaction level, the tax complexity of Australian financing arrangements is increasingly factored into deal economics as a cost and risk premium that makes Australian projects less competitive relative to international alternatives.

CPA Australia submits that compliance costs of this magnitude — falling on entities engaged in legitimate commercial financing — are not an acceptable feature of a well-designed integrity regime. The reforms should be recalibrated so that their burden falls on abusive structures, not on the cost of doing business in Australia.

Whether entities have reduced their level of debt financing in response to the amendments?

Member feedback confirms that many Australian entities have reduced their levels of debt financing or significantly restructured their financing arrangements in response to the amendments. Critically, this shift is not primarily driven by a reduction in commercial risk appetite — it is a rational response to compliance costs, the all-or-nothing risk of deduction denial, and the structural impossibility of satisfying the TPDT under standard commercial financing terms.

The deleveraging is occurring across four distinct patterns.

The first is direct debt reduction. Because the $2 million exemption operates on a gross rather than net basis, many mid-sized entities are paying down debt or converting to equity funding simply to avoid being drawn into the full compliance burden of the earnings-based regime. For a significant number of these entities, the professional fees required to perform the FRT or undertake DDCR forensic tracing exceed the tax benefit of maintaining the debt — making deleveraging a cost-minimisation strategy rather than a commercial one.

The second is the equitisation of related-party debt. Multinational groups have increasingly converted interest-bearing loans from offshore parents into share capital. Since the DDCR specifically targets related-party debt used for internal asset transfers or distributions, converting these arrangements to equity eliminates the risk of permanent disallowance. While this reduces interest deductions — an outcome the policy intended — it also constrains the flexibility of global treasury operations to deploy capital efficiently within the group, with no corresponding integrity benefit where the arrangements were commercially genuine.

The third is the shift from related party to third-party debt. Where overall debt levels have remained constant, there is a clear trend toward refinancing internal borrowing with external bank facilities. Entities that elect the TPDT are generally exempt from the DDCR, providing a strong incentive to restructure. Following PCG 2025/2, groups are also restructuring to ensure their related-party gearing does not exceed the global group's leverage, in order to sit within the ATO's low-risk zone.

The fourth is the adoption of precautionary buffer gearing. Particularly in the mining sector, the volatility of an earnings-based cap has led entities to maintain debt levels purposefully below what commercial considerations would otherwise support. A sudden commodity price fall — and the corresponding EBITDA decline — can produce a disproportionate and sudden tax disallowance. Holding a debt buffer against that risk is a rational response, but it represents a permanent suppression of commercially appropriate leverage.

In capital-intensive sectors the impact is more acute. Infrastructure and renewables projects have reported difficulty securing TPDT-compliant debt given the strict rules against parental credit support, leading to project delays and increased reliance on more expensive domestic equity. In build-to-rent and large-scale residential development, the mismatch between construction-phase debt and the FRT has caused major global funds to pause or rescale their Australian pipelines.

CPA Australia's assessment is that this deleveraging is a double-edged outcome. To the extent it reflects the unwinding of genuinely artificial, base-eroding debt structures — particularly in large multinationals that previously used asset revaluations to expand their safe harbour capacity — the reforms have achieved their integrity objective. However, a material and growing portion of the deleveraging reflects not the shedding of abusive structures but the retreat of legitimate commercial capital from an environment that has become too complex and too uncertain to navigate cost-effectively. The distinction matters: the former represents a healthier tax base; the latter represents a permanent drag on Australia's productive investment capacity and competitiveness as a destination for foreign capital.

Suggested solutions (both administrative and legislative, if possible)?

CPA Australia proposes a two-pronged approach: legislative relief for structural deficiencies, supplemented by administrative flexibility during the transitional period.

Legislative solutions

- **TPDT reform:** amend the TPDT to explicitly allow standard commercial credit support (parental guarantees, performance bonds) where debt is sourced from a genuine third-party lender. Provide legislative definitions for all undefined key terms. Replace 'wholly used' with 'substantially used' or equivalent. Allow proportional TPDT qualification (rather than all-or-nothing).
- **DDCR purpose test:** add a principal purpose test so the DDCR does not apply where a transaction or restructure is driven by genuine commercial objectives. Introduce explicit carve-outs for trading stock, domestic debt, 90%+ Australian asset groups and TPDT electors.
- **Tax EBITDA:** include certain NANE income in the tax EBITDA base. Provide a 3-year rolling average option for cyclical industries. Exclude pre-commencement losses from the s.820-52(1A) assumption. Address the 10–50% investment holding dead zone.
- **$2m threshold:** change s.820-35 from gross to net debt deductions, with appropriate integrity rules for associate aggregation.
- **Construction-phase relief:** introduce an asset-based safe harbour for greenfield infrastructure and renewables projects until the asset becomes operational.
- **Carry-forward:** consider indefinite carry-forward of denied deductions, with carry-back capacity for construction years.
- **Private groups:** enable discretionary trusts to access excess tax EBITDA of lower-tier entities as controlling entities under s.820-60. Clarify s.820-48(3) to exclude private groups without legal stapling.

Administrative solutions

- **PCG 2025/2 expansion:** broaden the 'green zone' to include genuine commercial consolidations. Extend the transitional compliance window by 12–24 months beyond 1 January 2027.
- **TPDT guidance:** ATO to clarify that subrogation rights arising by operation of law are not 'recourse'; publish a value-based safe harbour for minor or insignificant assets (5% of security pool); revise inconsistent positions on Australian assets and commercial activities.
- **DDCR guidance:** publish an administrative position on historic tracing for pre-July 2024 debt, acknowledging the practical impossibility of tracing in cash pool environments.
- **Greenfield safe harbour:** ATO to issue a PCG providing a 'low risk' rating for renewable energy and infrastructure projects during their construction phase.

- **Trust guidance:** ATO to issue specific guidance on tax EBITDA calculations for trust structures and the double-counting concern for stapled structures.