Tax News & Insights

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OmniTax Professionals

Arm's length amount of inbound cross-border related party financing – draft PCG

On 29 May 2025, the ATO released Draft Practical Compliance Guideline PCG 2025/D2 to assist taxpayers to determine if the amount of their inbound, cross-border related party financing arrangements are consistent with arm's length conditions.

By way of background, when taxpayers are considering the extent to which their debt costs are deductible, they need to consider both the application of the transfer pricing rules in Subdivision 815-B (if the debt is from a related party) and the thin capitalisation provisions in Division 820 if applicable. As part of the enactment of recent changes to the thin capitalisation rules, the transfer pricing rules were amended such that affected entities will need to work out both the **amount** and **rate** of their cross-border financing arrangements as if arm's length conditions operated.

PCG 2017/4 continues to outline the ATO's compliance approach in relation to the rate (or pricing) of cross-border related party financing arrangements and this recently released PCG 2025/D2 outlines the ATO's compliance approach in relation to the amount of inbound cross-border related party financing arrangements.

The draft PCG notes that when independent entities raise debt capital, the amount (or quantum) of a financing arrangement is affected by factors which include funding requirements, group policies and practices, returns to shareholders, costs of funds, covenants, explicit guarantees, security, serviceability and leverage levels.

Per the draft PCG, the ATO considers the amount of inbound cross-border related party financing to be **low risk** where:

- for an entity choosing to use the third party debt test – its related party debt deductions are not included in its third party earnings limit, or
- for any other entity – the leverage and interest cover ratios are equal to or better than its global group and comparable entities.

In contrast, the ATO considers the amount of inbound cross-border related party financing to be **high risk** where:

- an entity may not have had regard to options realistically available in view of its significant cash reserves; or
- an entity relies on an explicit guarantee to obtain an amount of debt greater than it could have borrowed without the guarantee; or
- the inbound, cross-border related party financing arrangements absorb available capacity under the entity's 'fixed ratio earnings limit' to generate a return below that of the expected return.

This draft guidance will be particularly relevant for entities with inbound related party debt that rely on the fixed ratio test for thin capitalisation purposes. It can also apply for entities using the third party debt test where the conduit financing conditions have been satisfied.

When applicable, it is evident the ATO not only requires that the amount of borrowing does not exceed amounts which could be borrowed from arm's length lenders, but it also requires taxpayers to maintain documentation and evidence to support and justify the transfer pricing position for each income year that the financing arrangement remains on issue.

Year end planning – depreciating assets – composite items

As part of year end planning and in particular, tax fixed asset register reviews, it is timely to consider the ATO's Taxation Ruling TR 2024/1 *Income Tax: composite items – identifying the relevant depreciating asset for capital allowances*.

This is relevant to taxpayers because it impacts on:
- the relevant asset's effective life and therefore the rate at which depreciation deductions can be claimed,
- whether certain costs may be able to be claimed as an immediate deduction, and
- testing an asset's eligibility for certain immediate tax write-offs and concessions.

The ruling provides guidance on:

- Whether a composite item is treated as a single depreciating asset or as multiple depreciating assets. For this purpose, it is necessary to evaluate whether the composite item functions independently or if it depends on other components.

- Whether an “interest in an underlying asset” requires an entity to have an interest in all parts of a composite item that is itself a depreciating asset, or whether an interest in any part of the asset is enough.

The ruling also covers the following principles:

- Modifications or alterations to existing depreciating assets can be separate depreciating assets, and this is more likely where the addition or attachment substantially alters the original depreciating asset, the original depreciating asset continues to perform its function, and the addition or attachments serves its own function.

- Restorations / repairs and minor alterations that do not change the overall function of the existing depreciating asset will generally not be considered separate depreciating assets.

In light of the ruling, taxpayers are encouraged to review their tax fixed asset registers and capital expenditure policies.

Year end planning – MIT eligibility

Confirmation of Managed Investment Trust (MIT) eligibility is important prior to the year-end distribution review because it has implications for the fund and its investors, and moreover is reviewed by the ATO in justified trust reviews.

MIT eligibility is an annual test and must involve consideration of all requirements and in particular:
- Widely held test,
- Closely held restrictions,
- Alternative test for special investors (in section 275-20(4)), and
- Safe harbour options – for entities in start-up or wind down phases or subject to temporary factors.

Supplementary Annual GST Return

Public and multinational businesses that have received a GST assurance rating through a Top 100 or Top 1,000 assurance review on or before 30 June 2024 are required to lodge an additional *Supplementary Annual GST return* with the ATO in respect of the 2024-25 financial year. Other public and multinational businesses will need to complete a supplementary return starting from the financial year following the financial year a GST assurance report is received. For example, if you received your first GST assurance rating in a Top 1,000 combined assurance review report issued after 30 June 2024, but before 30 June 2025, you will need to complete a *Supplementary annual GST return* for the 2025-26 financial year onwards.

The due date for the return will be at least 7 months after the end of the taxpayer’s financial year. The ATO will issue a notice to relevant taxpayers to lodge the return by a specified due date.

The supplementary return covers:

- How you’ve actioned recommendations, areas of low assurance or red flags outlined by the ATO in your most recent GST assurance review (including subsequent interactions with us)
- Whether you’ve maintained or increased your level of GST governance and if you’ve had any material business or system changes that impact your GST control framework since your last GST assurance review
- The reconciliation between your audited financial statements and your annualised business activity statements
- Whether you’ve taken any material uncertain GST positions in the period
- Whether you’ve identified any material GST errors in the period and how these have been rectified, and whether you claimed any material amounts of credits in the period that were referable to earlier periods.

Contact

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