Tax News & Insights

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Thin Capitalisation – Third Party Debt Test – Guidance

On 1 October 2025, the ATO issued its finalised guidance on the Third Party Debt Test ("TPDT") in Taxation Ruling TR 2025/2 and finalised Schedule 3 of Practice Compliance Guideline PCG 2025/2.

Our top ten takeaways* from the finalised guidance (applying ATO positions) are as follows:

1. The TPDT is designed to be **narrow** and is not intended to accommodate all third party debt financing arrangements. This statement has been made numerous times in the ATO guidance and the Explanatory Memorandum to the rules.

2. There is no **concession or grandfathering** of existing debt arrangements for the purposes of the TPDT. However, Schedule 3 of PCG 2025/2 provides specific restructures that, if undertaken in accordance with the outlined compliance approach, should mean that the taxpayer is taken to have met the requirements of the TPDT for the period prior to the restructure. Note, the restructures have to be undertaken by certain dates, which vary depending on the type of restructure and the fiscal year end of the taxpayer. For taxpayers with a March or June year end, certain restructures have to be undertaken by 31 March 2026 or 30 June 2026 respectively.

3. **Intra group swap payments** to an associate entity that are debt deductions (e.g., swap payments that hedge interest rate risk) are not included in the third party earnings limit and hence cannot be deducted under the TPDT. However, if a restructure is undertaken in accordance with the compliance approach to close out intra-group swaps and embed the swap cost as interest within the relevant intra-group debt agreement (including satisfying the further conditions within Example 37), then such swap payments should be deductible under the TPDT prior to the restructure.

4. To the extent that swap payments under a **Cross Currency Interest Rate Swap** ("CCIRS") are debt deductions, they appear to not be deductible under the TPDT, irrespective of them being paid to a third party financier.

5. To qualify for the TPDT, the relevant taxpayer must use all, or substantially all, of the of the borrowing proceeds under a debt interest for commercial activities in connection with Australia. For the purposes of this test, the use of the proceeds must be traced each period, and such use may change over time. This is similar to the **tracing requirements** of the Debt Deduction Creation Rules ("DDCR") though deductions are generally only denied under the DDCR for related party debt where assets are acquired from an associate or distributions are made to an associate.

6. **Commercial activities** do not include the making of income or capital distributions (e.g., dividends, trust income distributions, return of capital payments). Where debt has been used wholly or partially for such purposes (applying tracing principles), then the entire debt will not satisfy the third party debt conditions. It does not matter that interest on such debt is *prima facie* deductible outside of the thin capitalisation rules. If a restructure is undertaken under the ATO's compliance approach to use revenues to repay debt previously used to make equity distributions (including satisfying the additional conditions within Example 34), then the interest on such debt may be deductible under the TPDT for the period prior to the restructure. Note, commercial activities do include the refinancing of debt (but not equity) provided that the refinanced debt was previously used for commercial activities in connection with Australia.

7. If restructures are undertaken in accordance with the outlined compliance approach for on-lending arrangements between a **conduit financer** and the ultimate borrower to remove a margin or to ensure the back-to-back charging of costs, then the interest on on-lending arrangement should be deductible under the TPDT prior to the restructure.

8. Schedule 4 to PCG 2025/2 provides further two examples of low risk restructures and two examples of high risk restructures. For the purposes of restructures to comply with the TPDT, it is only the two low risk restructure examples that should be classified within the "green zone" of the risk assessment framework, and only the two high risk restructure examples that should be classified within the "red zone" of the **risk assessment framework**. All other restructures are likely to be within the "yellow zone" (unless the conditions for "white zone" are satisfied).

9. To qualify for the TPDT, the relevant financier must only have **recourse** to Australian assets, disregarding recourse to minor or insignificant assets. Importantly, a membership interest in an entity is not an Australian asset if that entity holds any foreign asset (irrespective of that foreign asset being minor or insignificant). Further, Australian assets do not include credit support rights from foreign associate entities (e.g., parental support rights or equity commitment deeds). Also, the concept of recourse is not the same as the concept of security – rather, recourse refers to all assets available in satisfaction or recovery of amounts owed to the financier, including an unsecured creditor.

10. Given the updated guidance from the ATO, taxpayers may need to consider applying to the Commissioner to **revoke** a thin capitalisation test choice for the 2024 and 2025 income years or to **seek an extension of time** for the making of a thin capitalisation test choice. The ATO has previously provided guidance on making such applications.

** The above list is not exhaustive and there are various other matters that may be relevant to different taxpayers.*

Better Targeted Superannuation Concessions changes

On 13 October 2025, the Federal Government announced significant changes to its superannuation tax policy, following substantial feedback on the proposed measures announced two years ago. The key announced changes are:

- Two-tiered approach with total concessional tax rates for large balance holders:
  - 30% tax rate on the proportion of earnings corresponding to superannuation balances between $3m and $10m; and
  - 40% tax rate on the proportion of earnings corresponding to superannuation balances above $10m.

- Both the $3m and $10m super balance thresholds will be indexed in $150,000 and $500,000 increments respectively, to maintain relativity with movements in the Transfer Balance Cap.

- The additional tax only applies to realised earnings (and not to unrealised gains), with calculation methodology proposed to be aligned to existing tax concepts. For capital gains, it is not yet clear if the additional tax will be applied to all historical gains (once realised) or prospective gains only. The removal of unrealised gains is especially welcome for those super funds with land holdings (including farms and commercial properties).

- From 1 July 2027, taxpayers earning between $28,000 and $45,000 will receive a $810 tax offset each financial year (up from $310).

The proposed start date of the measures has also been deferred to 1 July 2026 (focusing on Total Super Balances at 30 June 2027), with first notices of assessment expected to be issued in the 2027-28 financial year.

Consistent with previous announcements, individuals will be notified of their liability to pay additional tax by the ATO (based on lodged information by the super fund) and will have a choice to either pay the tax directly or from their superannuation fund balance.

No updated legislation was released with the announcement from the Federal Government. We expect there to be further consultation on various details relevant to the proposed new law before it is enacted.

Division 7A Loans and TD 2025/6

The ATO has released Taxation Determination TD 2025/6 which impacts on Division 7A loans, interposed entity arrangements and loan guarantees.

Pursuant to section 109U of the ITAA 1936, a private company is taken to make a payment to a shareholder or associate of a shareholder (target entity) if:

- The private company guarantees a loan made by another entity (first interposed entity)
- A reasonable person would conclude (having regard to all the circumstances) that the private company gave the guarantee solely or mainly as part of an arrangement involving a payment or loan to the target entity
- Another private company (which may be the first interposed entity or another interposed entity) makes a loan or payment to the target entity; and
- The amount paid or loaned by the other private company to the target entity exceeds that company's distributable surplus.

The TD confirms the Commissioner's view that the reference to "first interposed entity" in section 109U of the ITAA 1936 is not restricted to a type of entity. That is, section 109U is not limited to company to company guarantees and applies whenever an interposed entity is involved in a loan or guarantee arrangement, and a shareholder or associate ultimately receives a benefit.

Given the retrospective application of TD 2025/6 and the ATO's focus on high-risk Division 7A arrangements, taxpayers should review all interposed entity arrangements and guarantees and ensure that genuine commercial reasons and proper documentation exists for the same. We expect the Commissioner to seek a broad application of the principles outlined in TD 2025/6.

Contact

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