



Tax Insights

Interest-free loans – ATO finalises long-awaited guidance

Snapshot

On 10 December 2020, the ATO issued in final its long-awaited transfer pricing guidance on interest-free loans between related parties, in “*Schedule 3 – Interest-free loans*” (Schedule) to the ATO’s financing Practical Compliance Guideline (PCG 2017/4). The Schedule has effect from 1 January 2020 and applies to existing and newly created **related party interest free loans**.

The Schedule covers only outbound interest-free loans between related parties for transfer pricing purposes and focuses on two areas:

1. Factors under which the PCG risk score for outbound interest-free loans with related parties, based on Schedule 1 of the PCG, might be modified; and
2. Practical guidance as to when the ATO will dedicate resources to review arrangements involving interest-free loans.

The Schedule also includes a number of examples showing how the framework is intended to operate.

The Schedule is very similar to the Draft Schedule that the ATO released on 12 August 2020 (details of which and an overview of how the Schedule works can be found [here](#)). However, the following notable changes have been made to the final version:

1. Removal of the ‘Sovereign risk of borrower’ indicator when determining the risk rating of outbound interest-free loans under this Schedule.

2. The ATO stated that the characterisation of an arrangement would not be expected to change over the life of the transaction unless there are material amendments to the arrangement. In this final version, the ATO has now stated that the characterisation could also be changed if it can be demonstrated that there are material changes to the borrower's circumstances. This therefore means that taxpayers should regularly review arrangements not only to see if those arrangements have changed, but to see whether the Borrower's circumstances have changed.
3. Having indirect ownership appears to be sufficient to enable a positive response to the question of whether the lender has "rights and obligations of a shareholder". This is evidenced based on the changes the ATO has made to the ownership of relevant entities in Example 3.

This is a welcome addition to the ATO's suite of guidance as it is the first time the ATO has formally provided guidance for interest-free loans since the new transfer pricing rules in Subdivision 815-B came into force.

Observations

The Schedule provides long-awaited guidance on the ATO's position on interest-free loans. The considerations outlined by the ATO are broadly consistent with commentary previously made by the ATO in TR 92/11, which is positive as it provides on-going consistency for taxpayers.

In addition, the ATO has provided a useful framework, with some worked through examples, for when the PCG risk rating of interest-free loans can be reduced to the blue zone (low to moderate risk) or green zone (low risk).

We recommend that taxpayers with outbound interest-free loans consider their positions in light of this new guidance. Moreover, given the highly subjective nature of the relevant considerations vis-à-vis interest-free loans, a careful analysis of a taxpayer's specific facts should be undertaken, while contemporaneous documentation and supporting evidence should be maintained as to why the loan is classified as interest-free at the time of entering into the loan agreement. All of this will be critical in supporting positions of lower risk, if adopted.

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