

EXPLANATORY STATEMENT

Issued by authority of the Assistant Treasurer and Minister for Financial Services

Income Tax Assessment Act 1997

Income Tax Assessment (1997 Act) Amendment (Term Subordinated Note) Regulations 2025

Section 909-1 of the *Income Tax Assessment Act 1997* (the Act) provides that the Governor-General may make regulations prescribing matters required or permitted by the Act to be prescribed, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

Section 974-135 of the Act defines what are ‘effectively non-contingent obligations’ and subsection 974-135(8) states that the regulations may make further provisions relating to what constitutes a non-contingent obligation.

The purpose of the *Income Tax Assessment (1997 Act) Amendment (Term Subordinated Note) Regulations 2025* (the Regulations) is to ensure consistent tax treatment for financial instruments issued by foreign regulated entities and Australian Prudential Regulation Authority (APRA) regulated entities that are subject to non-viability conditions.

In December 2010, the Basel Committee on Banking Supervision announced measures to strengthen global capital rules, referred to as the Basel III capital reforms. To implement these reforms, the capital adequacy prudential standards of the APRA were amended. These amendments were referred to as the capital adequacy reforms.

Among other things, the capital adequacy reforms require all regulatory capital to be capable of absorbing losses of the entity, or regulated group, if required to do so (known as the non-viability condition). Broadly, the non-viability condition requires that a regulatory capital instrument issued by an APRA regulated entity, or its subsidiary, be able to be written off or converted to common equity if APRA, or a comparable foreign regulator, considers that the issuer, or its parent, would be non-viable or require an injection of public sector funding without such a write off or conversion. Instruments subject to the non-viability condition are called bail-in bonds or contingent convertible bonds.

However, it was identified that the addition of the non-viability condition may have consequences for the tax treatment of instruments. This is because the condition would result in the payment obligations under the instrument being contingent, causing it to fail the debt instrument test in section 974-20 of the Act. In the 2012-13 Budget, the Government announced it would amend the income tax law to avoid any unintended tax outcome arising as a result of APRA’s adoption of the Basel III capital reforms.

To implement this decision, the *Income Tax Assessment Regulations 1997* (which were subsequently remade as the *Income Tax Assessment (1997 Act) Regulations 2021* (Principal Regulations)) were amended to provide that, from 12 December 2012, the non-viability condition would be disregarded when determining if certain financial instruments issued by entities regulated by APRA (including Australian owned and licensed authorised deposit-taking institutions) and their subsidiaries were non-contingent obligations.

The Regulations amend the Principal Regulations to extend this approach to equivalent instruments issued by entities regulated by comparable foreign regulators. As a result, all instruments subject to non-viability conditions imposed by regulators are eligible to be treated as debt, should the other requirements of the debt instrument test be satisfied.

An Exposure Draft of the Regulations was made publicly available on the Treasury's website for a consultation period from 10 July 2025 to 5 August 2025. A small number of submissions were received broadly agreeing with the proposal and urging that the approach be extended to other instruments. Such an extension would be beyond the intended policy scope of the Regulations and so the Regulations reflect the policy settings that were tested during the consultation period.

The Act does not specify any conditions that need to be satisfied before the power to make the Regulations may be exercised.

The Regulations are a legislative instrument for the purposes of the *Legislation Act 2003*. They are subject to disallowance and sunseting under that Act.

The Regulations commence on the day after the Regulations are registered on the Federal Register of Legislation. They apply from 12 December 2012.

The retrospective application of the measure is expected to be wholly beneficial to affected taxpayers and will not be affected by subsection 12(2) of the *Legislation Act 2003*. It ensures that affected financial instruments are eligible to be treated as debt as a result of the non-viability condition. It also makes the law consistent with the historical approach adopted by taxpayers.

Details of the Regulations are set out in Attachment A.

A statement of Compatibility with Human Rights is set out in Attachment B.

The amendments made by the Regulations are estimated to have no impact on receipts over five years from 2023-24.

Details of the *Income Tax Assessment (1997 Act) Amendment (Term Subordinated Note) Regulations 2025*

Section 1 – Name

This section provides that the name of the regulations is the *Income Tax Assessment (1997 Act) Amendment (Term Subordinated Note) Regulations 2025* (the Regulations).

Section 2 – Commencement

Schedule 1 to the Regulations commences on the day after the Regulations are registered on the Federal Register of Legislation.

Section 3 – Authority

The Regulations are made under the *Income Tax Assessment Act 1997* (the Act).

Section 4 – Schedule

The Principal Regulations are amended or repealed as set out in the applicable items in the Schedule.

Item 1 – section 974-135.05

Item 1 amends paragraph 974-135.05(3)(a) of the *Income Tax Assessment (1997 Act) Regulations 2021* (the Principal Regulations) to provide that a term subordinated note is **relevant** if the note is issued by an entity, or a subsidiary of an entity, that is regulated for prudential purposes by APRA or a comparable foreign regulator.

Section 974-135.05 of the Principal Regulations applies to relevant term subordinated notes, providing that such instruments are not prevented from being non-contingent obligations by the inclusion of a non-viability condition.

The effect of the amendment is that effectively non-contingent obligations issued by any entity or the subsidiary of such an entity, are eligible to be treated as debt even if they contain a non-viability condition to comply with the requirements of a regulator irrespective of whether that regulator is APRA or a comparable foreign regulator. Among other things, being treated as debt means that the interest and other costs associated with the instrument may be tax-deductible.

Consistent with the amendments made in 2012 in relation to instruments issued by entities regulated by APRA (and their subsidiaries), the amendments made by the Regulations do not deem any instrument to be a debt instrument. If an instrument fails to satisfy the debt instrument test in subsection 974-20(1) of the Act even when the non-viability condition is disregarded, it will be a debt instrument.

In the context of this regulation, a comparable foreign regulator is a foreign regulator that issues and administers prudential standards that, in material respects, are substantially similar to those made and administered by APRA. In effect, a comparable regulator is one with similar regulatory powers and responsibilities relating to capital adequacy. For this

purpose, whether the entity has other powers and functions is of limited relevance – for example, some comparable foreign regulators also have central bank functions.

Similarly, in this context the term ‘subordinated note’ is used in a wide sense to refer to unsecured debt instruments that are ranked below other unsecured securities in the event of insolvency. It includes instruments with these characteristics even if they are issued under a different name.

Item 2 – transitional matters

Item 2 inserts a new Part 1000-9 into the Principal Regulations dealing with transitional matters relating to the Regulations.

Section 1000-9.01 provides that the amendments made by the Regulations apply to obligations to pay principal or interest under a relevant term subordinated note arising on or after 12 December 2012.

This aligns the application of the amendments made by the Regulations with the application of the amendments made in 2012 in relation to instruments issued by an entity, or the subsidiary of an entity, regulated by APRA. This retrospective application provides for consistent treatment of instruments containing non-viability conditions since their introduction.

The retrospective application of the amendments reflects the historical practice of taxpayers and avoids any disruption to settled tax affairs in past periods. It is expected to be wholly beneficial to the taxpayers that are affected.

Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Income Tax Assessment (1997 Act) Amendment (Term Subordinated Note) Regulations 2025

This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview of the Legislative Instrument

The purpose of the *Income Tax Assessment (1997 Act) Amendment (Term Subordinated Note) Regulations 2025* (the Regulations) is to ensure consistent tax treatment for financial instruments issued by foreign regulated entities and Australian Prudential Regulation Authority (APRA) regulated entities that are subject to non-viability conditions.

In December 2010, the Basel Committee on Banking Supervision announced measures to strengthen global capital rules, referred to as the Basel III capital reforms. To implement these reforms, the capital adequacy prudential standards of the APRA were amended.

Among other things, the amendments made at that time, referred to as the capital adequacy reforms, require all regulatory capital to be capable of absorbing losses of the entity, or regulated group, if required to do so (known as the non-viability condition). Broadly, the non-viability condition requires that a regulatory capital instrument issued by an APRA regulated entity, or its subsidiary, be able to be written off or converted to common equity if APRA, or a comparable foreign regulator, considers that the issuer, or its parent, would be non-viable or require an injection of public sector funding without such a write off or conversion. Instruments subject to the non-viability condition are called bail in bonds or contingent convertible bonds.

However, it was identified that the addition of the non-viability condition may have consequences for the tax treatment of instruments, as the condition would result in the payment obligations under the instrument being contingent, causing it to fail the debt instrument test in section 974-20 of the *Income Tax Assessment Act 1997*. In the 2012-13 Budget, the Government announced it would amend the income tax law to avoid any unintended tax outcome arising as a result of APRA's adoption of the Basel III capital reforms.

To implement this decision, the *Income Tax Assessment Regulations 1997* (which were subsequently remade as the *Income Tax Assessment (1997 Act) Regulations 2021*) were amended to provide that, from 12 December 2012, the non-viability condition would be disregarded when determining if certain financial instruments issued by entities regulated by APRA (including Australian owned and licensed authorised deposit-taking institutions) and their subsidiaries were non-contingent obligations.

Human rights implications

This Legislative Instrument does not engage any of the applicable rights or freedoms.

Conclusion

This Legislative Instrument is compatible with human rights as it does not raise any human rights issues as it impacts only foreign entities and they are not natural persons.