

TAXATION RULING NO. IT 2204 (as amended 20/11/86)

INCOME TAX : DEDUCTIBILITY OF INTEREST PAYABLE ON  
CONVERTIBLE NOTES

F.O.I. EMBARGO: May be released

REF H.O. REF: 84/300-8 DATE OF EFFECT:  
B.O. REF: DATE ORIG. MEMO ISSUED:

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1199628	CONVERTIBLE NOTE ISSUE INTEREST PAYABLE ON CONVERTIBLE NOTE	82SA 51(1)

PREAMBLE

Unless the requirements of section 82SA are fulfilled section 82R of the Income Tax Assessment Act prohibits an income tax deduction for interest payable on certain convertible notes where the loan represented by the convertible notes was made on or after 1 January 1976.

2. Section 82SA requires, amongst other things, that the rate of interest payable in respect of the loan is the same in respect of all periods occurring before the maturity date of the loan (sub-paragraph 82SA(1)(d)(vi)). This requirement is modified in respect of foreign loans where the rate of interest may be varied by reference to movements in a specified interest rate in a specified overseas market provided the variation does not have retrospective effect (sub-section 82SA(5)).

FACTS

3. A resident company proposed to raise a foreign loan by the issue of convertible bearer notes. The notes were to be offered publicly in two overseas financial centres and listed on their local stock exchanges. They were to carry a fixed interest rate for a 10 year term. In all respects, other than that which appears in the succeeding paragraph, the terms of the convertible note issue would have satisfied section 82SA.

4. To assist in marketing the notes, however, it was proposed that noteholders would have an optional right to redeem notes on the 5th anniversary of their issue at a premium of some 2% above the coupon rate. The redemption price would be set so as to give noteholders a return approximating the London five year bearer note interest rate.

RULING

5. The company was informed that if the proposal for redemption on the 5th anniversary of the notes was carried into effect it would not be accepted that the requirements of sub-paragraph 82SA(1)(d)(vi) were met, i.e. it would not be accepted that the rate of interest payable in respect of the loan was the same in respect of all periods occurring before maturity date.

6. The purpose of sub-paragraph 82SA(1)(d)(vi) is to ensure that the timing of the noteholder's exercise of his option to convert into share capital is not influenced by the company varying the interest rate payable on the notes. To vary the interest rate might conceivably cause noteholders to delay conversion with the consequence that the company would continue obtaining tax deduction for interest payments in lieu of paying dividends. In this case it was considered that the optional right to redemption on the 5th anniversary of their issue with its favourable conversion rate could conceivably cause a noteholder not to convert during the first five year period where he might otherwise have done so.

7. Sub-section 82SA(5) did not assist the company in this case. This sub-section modifies the test in sub-paragraph 82SA(1)(d)(vi) where the rate of interest is varied only by reference to movements in a specified interest rate in a specified overseas market and that a variation in the rate does not have retrospective effect.

COMMISSIONER OF TAXATION  
14 October 1985

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