



Taxation Determination

Income tax: consolidation: can the head company of a consolidated group claim a deduction under section 8-1 of the *Income Tax Assessment Act 1997* for interest paid on funds borrowed before consolidation and on-lent interest-free to a subsidiary member of the consolidated group?

Preamble

*The number, subject heading, date of effect and paragraphs 1 to paragraphs 7 of this document are a 'public ruling' for the purposes of Part IVAAA of the **Taxation Administration Act 1953** and are legally binding on the Commissioner.*

1. Yes, provided the interest expense satisfies the requirements of section 8-1 of the *Income Tax Assessment Act 1997* (ITAA 1997).
2. Outside consolidation, a parent company may be able to claim a deduction for interest on monies borrowed which are on-lent to a subsidiary interest-free. A basis for the deduction would be that the loan is to promote the profitability of the subsidiary in the expectation of a subsequent receipt of assessable income by a head company in the form of dividends. [Refer to Income Tax Ruling No. IT 2606 and *FC of T v. Total Holdings (Aust.) Pty Ltd* (1979) 79 ATC 4279, 9 ATR 885 (Total Holdings)].
3. During consolidation the single entity rule in section 701-1 of the ITAA 1997 treats subsidiary members of a consolidated group as parts of the head company rather than as separate entities for income tax purposes. Accordingly, arrangements such as an intra-group loan are taken to be arrangements between parts of the head company.
4. On the same basis, when a dividend is paid by one member of a consolidated group to another, the transaction is treated for income tax purposes as a movement of funds between two parts of the same entity (the head company) rather than the payment of a dividend.
5. Where an interest-free, intra-group loan exists between the head company and a subsidiary member of a consolidated group, the prospect of future dividends, which was a rationale for interest deductibility under section 8-1 of the ITAA 1997 accepted in *Total Holdings* and in IT 2606, cannot be the basis for a deduction for the head company's interest expense.

6. Accordingly, the deductibility of interest paid on the funds on-lent interest-free to the subsidiary member must be determined having regard to the purpose of the borrowing and the use to which the borrowed funds are put by the head company (as the relevant entity and on behalf of the consolidated group).

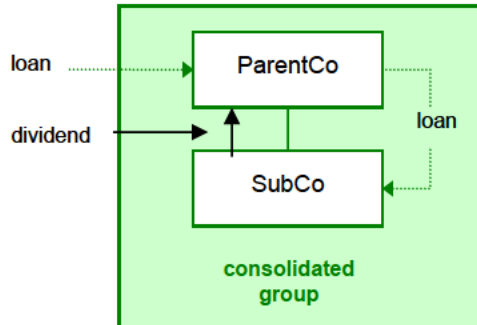
7. The general principles governing the deductibility of interest are applied to the head company as if it were a single entity. These principles are set out in Taxation Ruling TR 95/25 at paragraphs 2 and 3, with a further explanation for companies provided at paragraphs 12 to 17. Addendum 1 to TR 95/25 amends the Ruling in relation to the 1997-98 and later income years by inserting a reference to section 8-1 of the ITAA 1997. Taxation Ruling TR 2004/4 also discusses the deductibility of interest incurred prior to the commencement or after the cessation of the relevant income-producing activities.

Example 1

8. *ParentCo and its wholly-owned subsidiary, SubCo, are members of a group (figure 1). Before consolidation, ParentCo borrows money to make a loan to SubCo to finance SubCo's income-producing activities which returns income to ParentCo in the form of dividends.*

9. *The group subsequently consolidates. Before consolidation, the interest paid by ParentCo on the borrowed monies is deductible under section 8-1 of the ITAA 1997 as it is incurred in producing ParentCo's assessable income.*

Figure 1:



10. *During consolidation, the application of the single entity rule means that neither the intra-group loan nor any payment of dividends between ParentCo (as head company) and SubCo are recognised for the purposes of working out ParentCo's income tax position. This means that the previous rationale for allowing a deduction to ParentCo, that is, the monies are loaned to its subsidiary for the purposes of financing the subsidiary's income-producing activities and ultimately returning income to ParentCo, is no longer available.*

11. *ParentCo, as the head company of the consolidated group, must now apply the tests in section 8-1 of the ITAA 1997 on the single entity basis. The deductibility of interest paid on the borrowed funds must be determined by reference to the purpose of the borrowing and the use of the borrowed funds by the head company (as the relevant entity and on behalf of the consolidated group).*

Date of Effect

12. This Determination applies to years commencing both before and after its date of issue. However, it does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Commissioner of TaxationSeptember 2004

Previous draft:

TD 2004/D40

Related Rulings/Determinations:

IT 2606; TR 92/20; TR 95/25; TR 2004/4; TR 2004/11

Legislative references:

- TAA 1953 Pt IVA
- ITAA 1997 8-1
- ITAA 1997 701-1

Case references:

- FC of T v. Total Holdings (Aust.) Pty Ltd (1979) 79 ATC 4279, 9 ATR 885.

ATO references

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