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Ruling Compendium – TD 2008/27

This is a compendium of responses to the issues raised by external parties to draft TD 2008/D12 – Income tax: is the deductibility of compound interest determined according to the same principles as the deductibility of other interest?

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	Tax Office Response/Action taken
1	Suggests that the Determination should note that the purpose and use of a borrowing can change within a given income year, rather than suggesting that the issue needs to be considered from income year to income year only. Even within a given income year the purpose/use of a loan can change from non-income producing to income producing or vice versa.	Agreed; changes made to paragraph 13 of the Determination.
2	Suggests that it would be useful to have a discussion on the potential application of Part IVA of the <i>Income Tax Assessment Act 1936</i> (ITAA 1936) to compound interest.	Paragraph 15 of the Determination states that it does not deal with the application of Part IVA. This was not the focus of the Determination Guidance on the application of Part IVA can be found in Taxation Ruling TR 98/22.
3	The general principles as outlined in the Draft Determination are accepted as being relevant and applicable to the general situation regarding interest deductibility as well as the deductibility of compounded interest.	Acknowledged.
4	It would be useful to remind taxpayers of the limitations that apply to deductibility of interest where the arrangements are such that there is no reasonable likelihood that the relevant venture would ever become 'tax-positive'.	Agreed; changes made to the Determination at paragraph 6.

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Issue No.	Issue raised	Tax Office Response/Action taken
5	The Determination should remind taxpayers of the principle outlined in <i>Fletcher & Ors v. Federal Commissioner of Taxation</i> 91 ATC 4950 where the Court considered the situation where the relevant assessable income was less than the interest outgoing and the circumstances which must be considered in determining the deductibility of interest in this situation. They note that it can often be the case that the compounding of interest on a highly geared investment or venture could turn what may be deductible because of a marginal prospect of producing assessable income to produce a result where the disproportion between interest incurred and income expected to be derived would point to a conclusion of a purpose other than the derivation of assessable income. Taxation Ruling TR 95/33 should be referred to for further guidance as to the ATO's views on this issue.	It is agreed that the principle should be outlined. Changes made to the Determination at paragraph 6.

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6	Paragraph 8 of the draft Determination states that ‘the High Court did not have to deal with the question of the deductibility of the compound interest in that case because the Court found in favour of the Commissioner on the question of whether Part IVA applied to the arrangement in question.’ Ideally, this comment should be adjusted as it may suggest that the High Court essentially disregarded the Full Federal Court’s findings in respect of the deductibility of the compound interest, by substituting a more appropriate result through the use of Part IVA. The proper application of Part IVA is dependent on the existence of a tax benefit within the scope of section 177C of the ITAA 1936 (a deduction being available) arising under the ordinary application of the ITAA 1936. The High Court’s decision in Hart’s case does not (expressly or impliedly) derogate from the Full Federal Court’s decision on the question of the deductibility of the compound interest.	Agreed; changes made to the Determination at paragraph 9.
7	Paragraph 10 should clarify that the comments in the tax determination apply to both the original interest component and the compounding interest component (interest on interest) that arises under a compound interest arrangement. It is suggested that words should not have been quoted from paragraph 30 of Hill J’s decision in <i>Hart</i> and that the whole paragraph should rather have been included.	Agreed; changes made to the Determination at paragraph 10.

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Issue No.	Issue raised	Tax Office Response/Action taken
8	Suggest that the Determination does not add any value and that the issue was decided four years ago by the <i>Hart</i> litigation. It is suggested that the Determination should say interest on interest is tax deductible if the original interest was deductible and the underlying asset is still being used for an income producing purposes. The Determination is an attempt to override the exact words of three judges of the Full Federal Court with confusion and uncertainty.	The purpose of the Determination is two-fold: (1) to confirm that the Tax Office accepts the general proposition in <i>Hart v. Federal Commissioner of Taxation</i> [2002] FCAFC 222, 2002 ATC 4608, (2002) 50 ATR 369 (<i>Hart</i>) that compound interest is not different from ordinary interest so far as principles of its deductibility are concerned; and (2) to reject a view that compound interest is actually <i>more</i> deductible than ordinary interest because of certain wording of Hill J in <i>Hart</i>. The Determination specifically refutes the argument because it was causing some mischief. The Determination correctly applies the views of the Full Court of the Federal Court of Australia. The alternative of looking at phrases in isolation from their context and their express approval of more extensive statements on the deductibility of interest would be incorrect and misleading.