

Ruling Compendium – TD 2016/6

This is a compendium of responses to the issues raised by external parties to draft Taxation Determination TD 2015/D1 *Income tax: is an amount that is a cost in relation to a debt interest covered by paragraph 820-40(1)(a) of the Income Tax Assessment Act 1997 (ITAA 1997) deductible under section 25-90 of the ITAA 1997 (or, alternatively, under subsection 230-15(3) of the ITAA 1997) where that amount is incurred in earning income that meets the requirements of both section 23AH of the Income Tax Assessment Act 1936 and section 768-5 of the ITAA 1997?*

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	ATO Response/Action taken
1	It is inappropriate for the Commissioner to deal with a perceived policy concern by interpreting the statutory text in a manner inconsistent with its plain, unambiguous meaning. 'Under' in section 25-90 of the ITAA 1997 should not be limited to 'something akin to' 'by virtue of' or even 'only by virtue of'. If that had been the intention of parliament, specific words would have been inserted in section 25-90.	The interpretative approach taken is open on the words of the legislation and is supported by the clear policy intention of the provisions.
2	The approach in TD 2015/D1 seems inconsistent with the approach adopted in TD 2006/51, which dealt with the interaction of sections 23AI and 23AJ of the <i>Income Tax assessment Act 1936</i> (ITAA 1936) and concluded that they did not operate concurrently, because each provision has different consequences for the application of other provisions of the tax legislation. Any conflict between sections 23AH and 23AJ of the ITAA 1936 (now section 768-5 of the ITAA 1997) is similar to the interaction between sections 23AI and 23AJ.	The view set out in TD 2006/51 (regarding the interaction of sections 23AI and 23AJ of the ITAA 1936) and TD 2006/52 (regarding the interaction of sections 23AK and 23AJ of the ITAA 1936) can be distinguished from the interaction of sections 23AH and 23AJ of the ITAA 1936. It is clear from the statutory text of sections 23AI and 23AK of the ITAA 1936 that they cannot be interpreted to have their full effect unless they are given priority over section 23AJ of the ITAA 1936. The specific legislative treatment in subsections 23AI(2) and 23AK(10) to disregard any prohibition on deductions in relation to such income (such as, for example, in paragraph 8-1(2)(c) of the ITAA 1997) will be rendered ineffective if section 23AJ applies concurrently to that income. This has been the case since the provisions were enacted.

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		Conversely, sections 23AH and 23AJ will both continue to have their full effect if they are given concurrent operation. There is no indication that section 23AH and 23AJ were, at the time of their enactment, not intended to apply concurrently. The consequences that do arise from concurrent application stem from the application of section 25-90 of the ITAA 1997, a provision which was enacted subsequently and in circumstances where there was a clear policy intent to create different consequences for debt deductions incurred in deriving income at or through a foreign branch.
3	The proposed interpretation results in anomalous results that appear inconsistent with the intention of the legislature, such as a more beneficial outcome for a taxpayer where a permanent establishment is located in an unlisted country, or where a company fails the active income test. This is because these two outcomes result in dividends being considered non assessable non exempt (NANE) income under section 768-5 of the ITAA 1997 and not section 23AH of the ITAA 1936, such that amounts will be deductible under the Commissioner's approach to the interpretation of section 25-90. It is considered that, because the policy intent was to encourage the location of a permanent establishment in a listed country and to pass the active income test, it would be contrary to the intent of the legislature to interpret the legislation in a manner which gives a benefit where those conditions are not met.	Section 23AH of the ITAA 1936 and section 25-90 of the ITAA 1997 grant concessional treatment in respect of two different issues. Section 23AH of the ITAA 1936 is an exemption from Australian tax for foreign branch income, and the different tests imposed under that section for different classes of income reflect the tax treatment in the countries in which the income was derived. This was initially to ensure that the income had been subject to tax at a comparable rate to that of Australia, and now is intended to mirror what would be the treatment under the CFC regime. Section 25-90 of the ITAA 1997 is a removal of the restrictions on debt deductions in relation to certain NANE income, where those deductions will be subject to the caps imposed by the thin capitalisation provisions in Division 820 of the ITAA 1997. Restrictions on the application of one concession should not be relevant in the interpretation of another concession.

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4	ATO ID 2007/184 took the view that sections 23AH and the former 23AJ of the ITAA 1936 are mutually exclusive, as section 23AH cannot apply to an amount that is NANE income under the former section 23AJ. This is because section 23AH applies to 'foreign income' within the meaning of subsection 23AH(15), which only includes an amount that, but for section 23AH, would be included in assessable income under another provision of the ITAA 1936 or ITAA 1997. This will not include amounts that fall within former section 23AJ of the ITAA 1936 as they are made NANE under a provision of the Act. Therefore, the application of section 768-5 of the ITAA 1997 should take priority over the application of section 23AH of the ITAA 1936.	ATO ID 2007/184 was withdrawn in 2009 because the Commissioner was reconsidering his view as to the operation of sections 23AH and 23AJ. Having reconsidered, the Commissioner considers that the better view is that sections 23AH of the ITAA 1936 and section 768-5 of the ITAA 1997 (or, formerly, section 23AJ of the ITAA 1936) can apply concurrently to the same income. It is not the case that foreign income 'only includes an amount that, but for section 23AH, would be included in assessable income under another provision of the ITAA 1936 or ITAA 1997.' Rather, foreign income in 23AH also includes amounts which are intrinsically foreign income, without the intended expansion of the subsection 23AH(15) definition. Subsection 23AH(15) says <i>foreign income</i> includes an amount that (a) apart from this section would be included in assessable income under a provision of this Act ... The term foreign income as defined in Subsection 23AH(15) is an inclusive definition.
5	The issue of priority between sections 23AH of the ITAA 1936 and 768-5 of the ITAA 1997 is a fundamental threshold issue that needs to be addressed.	The Commissioner considers that none of the arguments raised in respect of section 768-5 of the ITAA 1997 having priority over section 23AH of the ITAA 1936 are persuasive. There is nothing in the text of the legislation nor the extrinsic material related to the enactment of section 23AH of the ITAA 1936, the former 23AJ of the ITAA 1936 or section 768-5 of the ITAA 1997 which would indicate Parliament's intention that section 768-5 should have priority over section 23AH, or vice versa. The better view is that there is concurrent operation of sections 23AH of the ITAA 1936 and 768-5 of the ITAA 1997.

This edited version of the Compendium of Comments is not intended to be relied upon. It provides no protection from primary tax, penalties, interest or sanctions for non-compliance with the law.

Page status: **not legally binding**

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6	The approach in TD 2015/D1 is a reversal of the current understanding and practice, such that it would be appropriate to apply the views in the Determination only to new arrangements entered into after the finalisation date of the Determination.	ATO ID 2007/184 indicated that section 23AJ of the ITAA 1936 would have priority over section 23AH of the ITAA 1936, such that the interpretative issue regarding section 25-90 of the ITAA 1997 did not arise. However, ATO ID 2007/184 was withdrawn in 2009, and the Commissioner advised in the notice of withdrawal that he was reconsidering his position. The Commissioner considers that any uncertainty that may have arisen from these circumstances is mitigated sufficiently by the application of a prospective application date for the Determination in respect of losses and outgoings incurred after 30 June 2015.
7	Clarification was sought as to the compliance approach that will be taken by the ATO. Will a taxpayer be able to lodge a return for a year ending prior to 30 June 2015 on the basis that section 25-90 of the ITAA 1997 allows a deduction for income that is NANE under both section 23AH of the ITAA 1936 and section 768-5 of the ITAA 1997? Further, will penalties and interest be applied to a taxpayer who lodges on this basis and the deduction is subsequently disallowed by the ATO?	Subject to the terms of any settlement or any express written communication with a taxpayer, the Commissioner does not intend to apply compliance resources to deductions for income years commencing prior to 1 July 2015. However, if the Commissioner is asked or required to state a view (for example in a private ruling or in submissions in a litigation matter) in respect of deductions for income years commencing prior to 1 July 2015, the Commissioner will do so consistently with the views set out in this Determination.