


TD 2006/D16 - Income tax: can section 160ZZZJ of Part IIIB of the Income Tax Assessment Act 1936 apply to interest entered in the accounting records of an Australian branch of a foreign bank if the interest relates to a borrowing the branch has obtained from a third party?

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This document has been finalised by This Determination has been finalised by TD 2007/25.



Draft Taxation Determination

Income tax: can section 160ZZZJ of Part IIIB of the *Income Tax Assessment Act 1936* apply to interest entered in the accounting records of an Australian branch of a foreign bank if the interest relates to a borrowing the branch has obtained from a third party?

❗ This Ruling provides you with the following level of protection:

This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation provision applies, or would apply to entities generally or to a class of entities in relation to a particular scheme or a class of schemes. You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the way explained below. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don't have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

Ruling

1. No. Section 160ZZZJ of the *Income Tax Assessment Act 1936* (ITAA 1936) only applies to interest that is entered in the Australian branch's accounting records in respect of a 'notional borrowing' that is taken under Part IIIB of the ITAA 1936 to have been provided by the foreign bank to the Australian branch. A 'notional borrowing' will not be taken to have been provided to the Australian branch if an amount has not been 'made available' by the foreign bank for use by the Australian branch.

Example

2. A foreign bank carries on business through a permanent establishment in Sydney, Australia. That foreign bank has another branch operating from Hong Kong.
3. On 1 July 2003, the Australian branch arranged to borrow a sum of money from a third party lender located in Singapore for use in its banking business. However, this loan was booked through the branch operating from Hong Kong. The branch in Hong Kong played no role in raising the funds.

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4. *The sum borrowed by the bank is entered in the Australian branch's accounting records as having been provided to the branch by the Hong Kong branch. The amount of 'interest' payable by the Australian branch is entered in the branch's accounting records as interest that is payable to the Hong Kong branch in respect of each six month period.*

5. *As the Hong Kong branch played no role in obtaining the loan, the 'amount' recorded in the books will not constitute an amount that has been 'made available' by the Hong Kong branch for use by the Australian branch. In these circumstances Part IIIB of the ITAA 1936 will not deem the notional interest to be interest paid by the Australian branch to the Hong Kong branch and as a consequence there will be no amount to which section 160ZZZJ of the ITAA 1936 can apply. However, as the loan is traceable to the non-resident third party lender, the lender will be liable under section 128B of the ITAA 1936 to pay interest withholding tax on the full amount of any interest derived by it under the loan.*

Date of effect

6. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination.

Commissioner of Taxation

26 April 2006

Appendix 1 – Explanation

① *This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.*

Background

7. Part IIIB of the ITAA 1936 was introduced to recognise certain intra-bank transactions, including intra-bank loans, for the purpose of determining the taxable income of Australian branches of foreign banks. One of the reasons for introducing Part IIIB was the difficulty foreign banks have knowing the precise cost of funding used by their branches. The difficulty arises because intra-bank funding is generally provided from a pool of funds formed by a bank from an aggregation of deposits and other loans.¹

8. Under Part IIIB of the ITAA 1936 interest treated as being paid to a foreign bank by an Australian branch of the bank on an intra-bank loan is subject to non-resident interest withholding tax.² A foreign bank cannot elect out of the operation of Part IIIB in so far as it applies withholding tax to amounts that are taken to be interest under Part IIIB.³

9. The method for determining the amount of interest withholding tax payable by a foreign bank in respect of amounts that are deemed to be interest under Part IIIB of the ITAA 1936 is set out in section 160ZZZJ of the ITAA 1936. Where section 160ZZZJ applies, interest withholding tax is calculated on 50% of the interest amounts deemed by Part IIIB to be paid by the Australian branch to the foreign bank.

10. Part IIIB of the ITAA 1936 is not, however, an exclusive code in relation to withholding tax on interest paid by foreign banks. Section 128B of the ITAA 1936 may impose interest withholding tax on interest paid by a foreign bank and derived by a non-resident where the interest has been incurred by the bank in carrying on business through its Australian branch.⁴

Requirements of section 160ZZZJ

11. For section 160ZZZJ of the ITAA 1936 to apply, among other things, an amount must be taken by Part IIIB of the ITAA 1936 to be interest paid to, and derived by, a foreign bank by the Australian branch.⁵ An amount will be taken to have been paid to, and derived by, the foreign bank where an amount is taken to have been borrowed by the Australian branch from the foreign bank and, subject to a statutory ceiling,⁶ an amount is entered in the branch's accounting records as being interest in respect of that borrowing.

¹ See paragraphs 11.9 to 11.11 of the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 3) 1994.

² Subsection 160ZZVA(2) and section 160ZZW of the ITAA 1936.

³ Paragraph 160ZZVB(3)(b) of the ITAA 1936.

⁴ Subparagraph 128B(2)(b)(ii) of the ITAA 1936.

⁵ Subsection 160ZZZJ(1) of the ITAA 1936.

⁶ The notional amount of interest is limited to the London Inter Bank Offer Rate (LIBOR) ceiling and any amounts in excess of LIBOR will not be recognised under Part IIIB – see paragraph 160ZZZA(1)(c) of the ITAA 1936.

Requirements for a notional borrowing

12. An amount will be treated as having been borrowed by the Australian branch from the foreign bank where an 'amount' has been 'made available' by the foreign bank for use by the Australian branch and the amount is recorded in the branch's accounting records as having been provided by the bank to the branch.⁷

13. The use of the expression 'made available' in section 160ZZZ of the ITAA 1936 means that the real effect of what has taken place must be that another part of the bank has itself placed an amount at the disposal of the Australian branch.⁸ Therefore, for example, an Australian branch will not be taken to have borrowed an amount from the foreign bank where it is evident that the Australian branch has itself arranged a borrowing directly from a third party and has simply booked the borrowing through another branch's accounts. Nor will the Australian branch be taken to have borrowed an amount from the foreign bank where another branch has acted at the direction of and on behalf of the Australian branch in arranging a borrowing for the Australian branch from a third party (as distinct from the other branch simply accessing the foreign bank's pool of funds).⁹ In such cases any interest paid by the foreign bank and derived by a non-resident in respect of such a borrowing will be liable to withholding tax in accordance with subparagraph 128B(2)(b)(ii) of the ITAA 1936 (subject to the possible operation of subsection 128B(3) of the ITAA 1936).¹⁰

⁷ Section 160ZZZ of the ITAA 1936.

⁸ *Gosling v. McCombie* (1972) 126 CLR 487, *Thompson v. Smith* (1976) 135 CLR 102.

⁹ Note also that Part IVA of the ITAA 1936 may apply in circumstances where an arrangement has been entered into or carried out with the dominant purpose of avoiding withholding tax (see section 177CA of the ITAA 1936). This includes circumstances where an arrangement has been entered into or carried out with the dominant purpose of enabling a non-resident to avoid liability for withholding tax on the full amount of interest paid to the non-resident.

¹⁰ See, by way of illustration only, Draft Taxation Ruling TR 2005/D18.

Appendix 2 – Your comments

14. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date. (Note: The Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel. The Tax Office may use a sanitised version (names and identifying information removed) of the compendium in providing its responses to persons providing comments. Please advise if you do not want your comments included in a sanitised compendium.)

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2005/D18

Subject references:

- Australian branches of foreign banks
- notional borrowing
- withholding tax

Legislative references:

- ITAA 1936 128B
- ITAA 1936 128B(2)(b)(ii)
- ITAA 1936 128B(3)
- ITAA 1936 Pt IIIB
- ITAA 1936 160ZZVA(2)

- ITAA 1936 160ZZVB(3)(b)
- ITAA 1936 160ZZW
- ITAA 1936 160ZZZ
- ITAA 1936 160ZZZA(1)(c)
- ITAA 1936 160ZZZJ
- ITAA 1936 160ZZZJ(1)
- ITAA 1936 177CA
- ITAA 1936 Pt IVA

Case references:

- Gosling v. McCombie (1972) 126 CLR 487
- Thompson v. Smith (1976) 135 CLR 102

Other references:

- Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 3) 1994

ATO references

NO: 2005/17082

ISSN: 1038-8982

ATOlaw topic: Income Tax ~~ Withholding Tax ~~ dividends, interest and royalties