


TD 93/D8 - Income tax: should a resident deduct withholding tax from interest incurred under a loan from a non-resident if there is no actual payment of the interest?

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This document has been finalised by TD 93/146.

Draft Taxation Determinations (TDs) represent the preliminary, though considered, views of the ATO. Draft TDs may not be relied on; only final TDs are authoritative statements of the ATO.

Draft Taxation Determination

Income tax: should a resident deduct withholding tax from interest incurred under a loan from a non-resident if there is no actual payment of the interest?

1. Yes, provided the interest is not incurred in carrying on a business at or through a permanent establishment outside Australia. The requirement to withhold the tax arises at the time the interest is 'paid' according to Division 4 of Part VI of the *Income Tax Assessment Act 1936*.
2. Subsections 221YL(2A) and 221YL(2B) require a person to deduct withholding tax from interest 'paid' or 'payable' to a non-resident. Subsection 221YK(3) deems interest to have been paid or payable when it is 'reinvested, accumulated, capitalised, carried to any reserve, sinking fund or insurance fund however designated, or otherwise dealt with on behalf of the other person or as the other person directs'. Therefore, the requirement to withhold the tax from the interest does not require an actual payment of the interest. It is enough if the interest liability arises and any of the actions outlined in subsection 221YK(3) occurs.
3. Conversely, the non-resident is liable, under subsection 128B(5), to withholding tax on interest 'paid' to him/her. Subsection 128A(2) deems the interest to have been paid to a non-resident when it is dealt with in the same manner as described in subsection 221YK(3). The non-resident's liability to withholding tax in these circumstances is therefore unaffected by the absence of an actual payment of the interest.

Example:

A is an Australian resident who borrows \$250 000 on 1 July 1992 from non-resident, NR, at 10% simple interest calculated and payable annually over 5 years. By agreement between them, the annual interest is capitalised each year until the 5th year when the total amount standing to the credit of the loan account is payable.

A has an annual interest liability of \$25 000 payable on 30 June. Even though the interest is not actually paid over to NR each year the interest debt is satisfied each year by crediting it to NR's loan account. This arrangement is enough to invoke the requirements of the withholding tax provisions to deduct withholding tax from the interest credited each year. Therefore, A is required to deduct \$2 500 at the time interest is credited to the loan account and remit it to the Australian Taxation Office.

Commissioner of Taxation

21/01/93

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