

IT 2185 - Income tax: foreign debenture issue with premium payable upon redemption



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TAXATION RULING NO. IT 2185

INCOME TAX: FOREIGN DEBENTURE ISSUE WITH PREMIUM
PAYABLE UPON REDEMPTION

F.O.I. EMBARGO: May be released

REF

H.O. REF: 85/5370-0

DATE OF EFFECT: Immediate

B.O. REF:

DATE ORIG. MEMO ISSUED: 26 August 1985

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1124006	INTEREST WITHHOLDING TAX	128A(1)
	INCOME IN THE NATURE OF	128B
	INTEREST	51(1)
	DEDUCTIBILITY OF INTEREST & PREMIUM OUTGOINGS	

FACTS

This office was recently asked to examine the withholding tax implications of a borrowing by an industrial company in which debentures were to be issued overseas denominated in certain specified amounts of a foreign currency. The debentures were to bear interest on their face value at a rate per annum which was fully commercial for debentures of the particular type. The debentures were to be redeemable some years later in Australian currency for an amount which included a substantial premium calculated at current rates of exchange.

2. The premium payable on redemption in Australian currency was designed to avoid any loss on exchange which might arise on redemption of the debentures though there remained the risk of exchange loss on interests payments.

3. Notwithstanding any possible exemption from interest withholding tax which might be available for widely distributed debenture issues, confirmation was sought that:-

- (i) on the basis that the moneys were being borrowed for use in the company's business the company would be entitled to a deduction for outgoings of interest on the debentures at the specified annual rate in the year such amounts are paid;
- (ii) the company would be entitled to a deduction for the amount of the premium payable on redemption on an accrual basis over the life of the debentures or alternatively in the year in which the premium was paid;
- (iii) in the event exemption is not available the annual interest payment and the premium payable on redemption would be interest or amounts in the nature of interest and subject to interest withholding tax in the year of payment.

RULING

4. Confirmation was given concerning (i) and (iii) insofar as it related to interest payable at the specified annual rate on the face value of the debentures.

5. In relation to (ii) however, advice was given that no deduction would be allowable for the premium payable upon redemption to avoid currency exchange losses. The premium would be an outgoing of capital or of a capital nature, i.e. it would be part of the repayment of the principal amount. As a consequence there would be no liability for interest withholding tax in respect of the amount of the premium - it would not be an amount in the nature of interest.

6. The advice given in the preceding paragraph in relation to the deductibility of the premium would not apply in the case of a financial institution. Where a financial institution borrowed money overseas in the ordinary course of its business and not for some special purpose the payment of a premium to cover any loss on exchange on repayment of the borrowing would be an allowable income tax deduction, *Avco Financial Services Ltd v FC of T*, 82 ATC 4246 : 13 ATR63.

COMMISSIONER OF TAXATION

29 August 1985

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