IT 2332 - Income tax : interest withholding tax - publicly or otherwise widely distributed debentures issued overseas - interest paid in non-australian currency

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TAXATION RULING NO. IT 2332

INCOME TAX : INTEREST WITHHOLDING TAX - PUBLICLY OR OTHERWISE WIDELY DISTRIBUTED DEBENTURES ISSUED OVERSEAS - INTEREST PAID IN NON-AUSTRALIAN CURRENCY

F.O.I. EMBARGO: May be released

REF H.O. REF: 85/7753-6 DATE OF EFFECT: Immediate

B.O. REF: DATE ORIG. MEMO ISSUED:

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1209618	INTEREST WITHHOLDING - INTEREST PAYABLE IN NON-AUSTRALIAN CURRENCY	128F 128F(1)(d)

OTHER RULINGS ON TOPIC IT 2196; 2205

PREAMBLE Section 128F of the Income Tax Assessment Act exempts from withholding tax interest paid on certain publicly or otherwise widely distributed debentures issued overseas by Australian resident companies. The section specifies the conditions which are to be met before exemption operates. Paragraph (d) of sub-section 128F(1) specifically requires that the interest on the debentures must be paid outside Australia in a currency other than the currency of Australia. There is not any requirement that principal be repaid in a currency other than the currency of Australia.

FACTS 2. An opinion was recently sought from this office on the application of paragraph 128F(1)(d) in the following circumstances. A company proposed to issue fixed rate secured notes overseas. The notes were to be denominated in $A but subscribed for in $US. The notes were to provide for the payment of interest in $US. Conditions attaching to the notes provided, however, that noteholders could elect to receive interest payments either in $US or in $A.

3. The proposals contemplate the appointment of a principal paying agent to pay all amounts due under the notes. The Australian company would provide the principal paying agent with sufficient $US to pay interest as it became due. If a noteholder elects to receive payment in $A all payments made to the principal paying agent on behalf of the noteholder will be paid by the principal paying agent to a payment trustee. The payment trustee will have the responsibility of converting $US interest payments to $A.

4. It was claimed that the Australian company would fulfil its obligations in relation to the payment of interest once the appropriate amount of $US was paid by the principal paying agent

to the payment trustee. The subsequent conversion facility was a separate arrangement between the payment trustee and the noteholders and was not a matter relevant to the operation of paragraph 128F(1)(d).

RULING

5. Section 128F has to be read in conjunction with section 126. Section 126 was amended by Income Tax Assessment Act (No. 2) 1971. As a result of the amendment and of the enactment of the Income Tax (Bearer Debentures) Act 1971 interest paid by companies on bearer debentures issued in Australia where names and addresses of the holders were not supplied to the Commissioner was subject to tax at a special rate. The special rate was to discourage tax evasion by persons who do not disclose in their returns the interest received by them on bearer debentures (paragraph 3 of C.I.T.C.M. 867).

6. Where it was virtually certain that the interest would be paid to non-residents because the loan evidenced by the debentures complies with conditions (a) to (d) inclusive of sub-section 128F(1) the rate of tax was reduced to the normal interest withholding tax level, viz., 10% of the interest. The conditions were imposed to ensure that the interest, would be paid on overseas issued bearer debentures not likely to be acquired by Australian residents who, inferentially, could avoid the intent of section 126 (paragraph 212 of C.I.T.C.M. 867).

7. What is relevant to this ruling is the rationale behind paragraph 128F(1)(d) viz. that interest must be paid outside Australia in a currency other than the currency of Australia. It is indicated in paragraph 69 of C.I.T.C.M. 867 that this is another protection against the debentures (issued outside Australia) falling into the hands of Australian residents. If this condition is not met in relation to any interest payment, that interest would not be exempt (from withholding tax) under section 128F.

8. In the context of the present proposal advice was given that the proposal would not satisfy the condition for exemption from withholding tax in paragraph 128F(1)(d). The conversion option was an essential and integral part of the package for the issue of the notes. It could not be regarded as separate from the note issue.

9. As a result of announcements made by the Treasurer in Press Release No.65 of 1 July 1986 this ruling will have limited operation. The announcements included removal of section 128F exemption from withholding tax for interest on bearer debenture issues in respect of borrowings or loans contracted for after the date of the announcement. The ruling will apply, however, to borrowing arrangements entered into prior to 2 July 1986.

COMMISSIONER OF TAXATION
30 June 1986

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