IT 2679 - Income tax: global notes - section 128F exemption from interest withholding tax

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Australian Taxation Office

Taxation Ruling
Income tax: global notes - section 128F exemption from interest withholding tax

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other Rulings on this topic

IT 2196 IT 2238 IT 2288 IT 2647 CITCM 867

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What this Ruling is about

1. Section 128F of the *Income Tax Assessment Act 1936* exempts from withholding tax interest paid overseas by an Australian company in respect of debentures issued outside Australia to raise a loan overseas if the Commissioner of Taxation has issued an exemption certificate under subsection 128F(4) for the loan. Before issuing the certificate, the Commissioner is required by subsection 128F(4) to be satisfied that:

(a) it is reasonable to regard the debentures as having been issued with a view to public subscription or purchase or other wide distribution among investors; and

(b) the borrowed money is to be used ultimately in, or in connection with, an Australian business.

2. This Ruling explains that:

- the interests of investors in a single or 'global' note or global certificate (including a global certificate of deposit) constitute debentures for the purposes of section 128F;
- a debenture issue that is evidenced by a global note or certificate is capable of wide distribution among investors in terms of paragraph 128F(4)(a);
- a distinction needs to be drawn, in considering applications for exemption certificates under subsection 128F(4), between a global note or global certificate (which generally involves a single issue of debentures) and a global note facility (which usually involves a series of debenture issues).

3. This Ruling is not directed to the 'use of funds in an Australian business' criterion in paragraph 128F(4)(b) on which the Commissioner must also be satisfied. Taxation Ruling IT 2647 considers aspects of that requirement.

Ruling

Global notes and global certificates

4. The individual shares or interests of investors in a global note or global certificate are debentures for the purposes of section 128F.

5. If a loan is evidenced by a single global note or certificate, that fact will not, of itself, preclude a finding that debentures have been issued with a view to a wide distribution among investors.

6. An exemption certificate will be issued under subsection 128F(4) for a loan evidenced by a global note or certificate if the 'wide distribution' criterion in paragraph 128F(4)(a) and the other requirements of section 128F are satisfied.

7. For the wide distribution criterion to be satisfied it is sufficient if it can reasonably be expected at the time of issue that the various interests in the global note or certificate will be held by a sufficient number of investors in the same way that has traditionally been required when a loan is raised by issuing conventional debentures, such as definitive notes. It is relevant to consider the number of investors who actually hold interests in the global note or certificate at the time an application for an exemption certificate is lodged.

8. The distribution of those interests among the initial subscribers to the loan will therefore be taken into account in considering whether the wide distribution criterion is satisfied in relation to that loan. The expression 'initial subscribers' is used here to refer to:

(a) managers and dealers who acquire the debentures in their own right or who hold debentures for a period after which any on-selling would properly be characterised as secondary trading; and

(b) clients of managers and dealers if the clients subscribe before secondary trading commences.

9. In satisfying himself whether it is reasonable to regard interests in a global note as having been issued by a company with a view to wide distribution among investors four factors must be taken into account by the Commissioner:

(i) The arrangements under which the interests in the note were offered for subscription, and any arrangements that were made, or action taken, for the offering of all or any of the interests for sale by subscribers.

(ii) The ordinary business practices of agents or other persons who took part in the arrangements for the raising of the loan.

(iii) The arrangements that were made for dealing with offers to subscribe for interests in the note.

(iv) Any circumstances indicating the existence, at the time of the raising of the loan, of any arrangements for any interests in the note to be offered for subscription, or purchased after subscription, by persons connected with-

- each other, or
- the company raising the loan, or
- a person by whom the loan moneys, or moneys derived directly or indirectly from the loan moneys, were intended to be used.

10. To facilitate a wide distribution it is expected that the interests of investors in a global note or certificate would be registered by a major securities clearance and settlement system such as that operated by Morgan Guaranty Trust Company in Brussels (Euro-clear) or by Centrale de Livraison de Valeurs Mobilieurs S.A.(CEDEL). This procedure accords with current financial market practice.

Global note facilities

11. What this Ruling provides in relation to global notes or global certificates does not affect consideration of applications for section 128F exemption certificates in respect of debentures issued under a global note facility. For interest paid on these debentures, a withholding tax exemption is conferred only if a certificate under subsection 128F(4) has issued in respect of the debenture to which the interest relates. A certificate must therefore be obtained for each issue of debentures under a global note facility if the exemption is to apply to interest paid on the entire series of debenture issues made under the facility. Arrangements for applications to be made on a regular and periodic basis in respect of debentures issued under a particular facility during a specific period may be made with the Deputy Commissioner of Taxation at the office at which applications for certificates are lodged.

Date of effect

12. This Ruling sets out the current practice of the Australian Taxation Office. It applies (subject to any limitations imposed by statute) for years of income commencing both before and after the date on which it is issued.

Explanations

Global notes and global certificates

13. A global note or global certificate of deposit is a single instrument which evidences the indebtedness of the issuing company arising from a loan raised in a particular currency with a particular maturity date. An issue of debentures may be represented, however, by more than one global note or global certificate.

14. Originally, global notes performed a temporary function until individual or definitive notes could be prepared and issued. A temporary global note ceased to exist when the holders were issued with definitive notes. A definitive note evidences the indebtedness of the issuing company to the particular investor. A definitive note is generally issued in bearer form and entitles the bearer to payment of the face amount when the note is surrendered on maturity.

15. With the widespread adoption of computer-based clearance and settlement systems, the global note concept offered advantages over physical paper issues in:

(a) reducing the costs of producing and trading short-term notes; and

(b) minimising security risks in holding debt in documentary form where title passes by delivery.

16. The practice now prevailing is not to exchange the global note or global certificate for definitive notes or definitive certificates. A permanent global note exists until the loan is repaid unless there is a default in payment by the issuing company. If default occurs, definitive notes are issued to each of the investors who are recorded as holding an interest in the global note. If the borrowing agreement permits, definitive notes are sometimes issued at the request of the investor. In this case, the aggregate amount of the interests represented by the permanent global note is reduced accordingly.

17. Loans raised by the issue of debentures in Europe usually involve the distribution of debentures through a network of dealers and underwriters to a large number of individual investors using the facilities of either or both of the two major European securities clearance systems for internationally traded debt securities, namely, Euro-clear and CEDEL. A global note or global certificate is held by a depositary, usually a financial institution, for one or both of the clearance systems.

18. Marketing arrangements for the distribution of interests in a global note are the same as those for the distribution of conventional debentures. Investors who subscribe to the loan each hold an interest in the global note. The clearing system registry records their respective interests. Interests held by investors are fungible so that a purchaser acquires an interest which is interchangeable with any other interest of equivalent value held in the global note. Secondary trading in those interests is also recorded by the clearance system.

Global note facilities

19. Instead of raising a loan of a fixed amount for a fixed term of, say, 5 years, a borrowing company may enter into an arrangement to issue short-term debentures with a tenor of, say, 90 days, which may be rolled-over or increased to an aggregate limit specified in the borrowing agreement in accordance with its funding needs. Such an arrangement for the issue of debentures, which may continue for more than 5 years, is usually described as a note issuance facility.

20. A note issuance facility may be expressed in its documentation as being global. In this context, the term 'global' describes the geographic scope of the facility rather than the single piece of paper evidencing the debt. For example, debentures issued by the borrowing company under a global note facility may be distributed in either or all of the major capital markets; Europe, North America, or South-East Asia. Several separate borrowings by way of issue of debentures may be made under such a facility. Each borrowing operation may be evidenced by one or more global notes.

21. Global note facilities are also referred to at times as 'offshore commercial paper facilities'. Examples are Euro Commercial Paper, Asian Commercial Paper and US Commercial Paper facilities..

22. For the purpose of securing an exemption from withholding tax for interest, or amounts in the nature of interest, paid on debentures issued under a note issuance facility, a borrowing company must apply for a subsection 128F(4) certificate in respect of each drawdown or separate issue of debentures. With the consent of the Deputy Commissioner of Taxation at the office at which applications for certificates are lodged applications may be made on a regular and periodic basis in respect of debentures issued under a particular facility during a specific period.

23. Even though a wide distribution among investors may occur in respect of an initial issue of debentures under a global note facility, this does not necessarily imply that an exemption certificate will be issued for later issues under the facility. It will be necessary for the wide distribution criterion, and the other requirements of section 128F, to be satisfied at the time an application for an exemption certificate is made for each issue of debentures under the facility.

Commissioner of Taxation

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