



***TD 2007/25 - 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 Ruling has been reviewed as part of a project to review public rulings. The ATO view expressed in this Ruling is current as of 8 January 2018.



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## Taxation Determination

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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 has been reviewed as part of a [project](#) to review public rulings. The ATO view expressed in this Ruling is current as of 8 January 2018.

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This publication (excluding appendices) is a public ruling for the purposes of the *Taxation Administration Act 1953*. A public ruling is an expression of the Commissioner's opinion about the way in which a relevant 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. If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

### Ruling

1. No. Section 160ZZZJ of the *Income Tax Assessment Act 1936* (ITAA 1936)<sup>1</sup> 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 to have been provided by the foreign bank to the Australian branch. A 'notional borrowing' will only be taken to have been provided to the Australian branch if an amount has been 'made available' by the foreign bank for use by the Australian branch.

2. In order for an amount to have been 'made available' to the Australian branch 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. This will be a question of fact to be determined having regard to all the circumstances of the particular case including, but not limited to, the way the borrowing is treated in the books of account of the Australian branch.

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<sup>1</sup> All subsequent legislative references in this Determination are to the ITAA 1936 unless otherwise indicated.

3. In circumstances where it may be demonstrated that the real effect of what has taken place is that the branch has borrowed directly from a third party rather than accessed funds borrowed by the foreign bank, no amount will have been made available by the foreign bank for use by the Australian branch within the relevant sense. This is so even if, for example, the borrowed funds were deposited in the branch's nostro account with the foreign bank.

**Example 1**

4. *A foreign bank carries on business through a permanent establishment in Sydney, Australia. The foreign bank's Head Office is located in Hong Kong. The Australian branch has a nostro account with the Head Office. Typically the Australian branch does not fund its operations from the Head Office and relies principally on publicly offered debentures under a global issuance program. The debentures are free from interest withholding under section 128F. On occasions the Australian branch borrows from non-resident lenders directly where favourable loan terms can be negotiated.*

5. *On 1 May 2006, the Australian branch borrowed a sum of money from a third party lender located in Singapore for use by the bank in its banking business in Australia. The loan was obtained directly from the third party lender, and at the direction of the Australian branch the funds were transferred to the Australian branch's nostro account in Hong Kong. The Australian branch was able to draw down the funds on the same day they were deposited into the nostro account. In its double entry books of account, the Australian branch records the credit side of this transaction as a liability owing to a third party.*

6. *In these circumstances it could not be said that an amount was made available by the Head Office to the Australian branch. Part IIIB would not apply to the borrowing. Section 128B would operate to impose interest withholding tax on the interest paid by the Australian branch to the third party lender.<sup>2</sup> The lender is a non-resident that has derived interest incurred by the foreign bank in carrying on business through its Australian branch.*

**Example 2**

7. *On 1 June 2006, the Hong Kong Head Office of the foreign bank determines that it has AUD \$10 million surplus funds arising from its trading activities. On the same day the Australian branch requests an advance of AUD \$10 million to balance its trading books for the day. The Head Office agrees to loan the Australian branch AUD \$10 million out of its pool of funds. The interest rate is limited to the London Inter Bank Offer Rate (LIBOR) that is applicable at the beginning of the relevant interest calculation period.*

8. *The Head Office transfers the funds into the Australian branch's nostro account in Hong Kong on 2 June 2006. On the same day, the Australian branch was able to draw down the funds from its nostro account for use in its banking operations in Australia. In its double entry books of account the Australian branch records the credit side of this transaction as giving rise to an inter-company loan.*

9. *In these circumstances it could be said that an amount was made available by the Head Office to the Australian branch. There is a notional borrowing to which Part IIIB can apply. The borrowing was 'made available' to the Australian branch when the branch was able to draw down the funds from its nostro account on 2 June 2006. At this time the branch had control of the funds and was able to direct the use to which the funds were to be put.*

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<sup>2</sup> Subject to the possible operation of subsection 128B(3) and section 128F.

10. *In accordance with 160ZZZJ, interest withholding tax applies to 50% of any interest taken to have been paid by the Australian branch to the foreign bank in respect of the notional borrowing.*

**Date of effect**

11. This Determination applies to years of income commencing both before and after its date of issue. However, the Determination does 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 (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

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**Commissioner of Taxation**22 August 2007

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## Appendix 1 – Explanation

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

### Explanation

12. One of the reasons Part IIIB was introduced was the difficulty foreign banks can have calculating the taxable income referable to their Australian branches when they do not know the precise cost of funding used by their branches. Foreign banks may not know the precise cost of the branch funding because intra-bank funding is generally provided from a pool of funds formed by a bank from an aggregation of deposits and other loans from many sources and with different costs.<sup>3</sup> Part IIIB is designed to overcome this difficulty by recognising certain intra-bank loans as if they were transactions between separate legal entities.

13. Under section 160ZZZ of Part IIIB, an amount made available by a foreign bank for use by its Australian branch and recorded in the branch's accounts as having been provided to the branch is taken to have been borrowed by the branch. Where the branch records in its accounts interest in respect of the notional borrowing, interest is taken under section 160ZZZA to have been paid by the branch to the bank, and derived by the bank in respect of the borrowing (capped at the appropriate LIBOR rate<sup>4</sup>). The notional interest which is thereby deemed to have been paid between two separate legal entities is subject to non-resident interest withholding tax.<sup>5</sup>

14. 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 is set out in section 160ZZZJ. Where section 160ZZZJ applies, interest withholding tax is calculated on 50% of the interest amounts deemed by Part IIIB to have been paid by the Australian branch to the foreign bank.

15. Part IIIB is not, however, an exclusive code in relation to withholding tax on interest paid by foreign banks. Section 128B 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.<sup>6</sup>

<sup>3</sup> See paragraphs 11.9 to 11.11 of the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 3) 1994.

<sup>4</sup> 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).

<sup>5</sup> Subsection 160ZZVA(2) and section 160ZZW.

<sup>6</sup> Subparagraph 128B(2)(b)(ii).

***‘ ... made available by a foreign bank for use by its Australian branch ... ’***

16. The use of the expression ‘made available’ in section 160ZZZ means that the real effect of what has taken place must be that another part of the bank has placed an amount at the disposal of the Australian branch.<sup>7</sup> This will be a question of fact to be determined having regard to all the circumstances of the particular case, including but not limited to the accounting treatment. If funding obtained by an Australian branch through another branch of the bank is recorded in the branch’s books of account as giving rise to a debt to a third party rather than to an inter-company loan then, prima facie, Part IIIB will have no application to the transaction.

17. The time at which funds are ‘made available’ will be the time at which the branch obtains control of the funds and is able to direct how the funds are to be used or disposed of. This will typically occur when the branch is able to draw down funds in its accounts (for example an offshore nostro account) for its own use.

**Section 128B**

18. Where a borrowing has been obtained from a third party non-resident, interest paid by the bank to the non-resident in carrying on the business of the Australian branch will be subject to withholding tax in accordance with subparagraph 128B(2)(b)(ii) (this would be subject to exemption under section 128F, where applicable, or possible application of subsection 128B(3)<sup>8</sup>). Accordingly, an Australian branch will not be taken to have borrowed an amount from the foreign bank where the Australian branch has itself obtained a borrowing directly from a third party.

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<sup>7</sup> *Gosling v. McCombie* (1972) 126 CLR 487; *Thompson v. Smith* (1976) 135 CLR 102.

<sup>8</sup> See, by way of illustration only, Taxation Ruling TR 2006/9.

## References

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*Previous draft:*

TD 2006/D16

*Related Rulings/Determinations:*

TR 2006/9; TR 2006/10

*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 128F
- ITAA 1936 Pt IIIB

- ITAA 1936 160ZZVA(2)
- ITAA 1936 160ZZW
- ITAA 1936 160ZZZ
- ITAA 1936 160ZZZA
- ITAA 1936 160ZZZA(1)(c)
- ITAA 1936 160ZZZJ
- TAA 1953

*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

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ATO references

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