

TR 2005/5A2 - Addendum - Income tax: ascertaining the right to tax United States (US) and United Kingdom (UK) resident financial institutions under the US and the UK Taxation Conventions in respect of interest income arising in Australia

 This cover sheet is provided for information only. It does not form part of *TR 2005/5A2 - Addendum - Income tax: ascertaining the right to tax United States (US) and United Kingdom (UK) resident financial institutions under the US and the UK Taxation Conventions in respect of interest income arising in Australia*

 View the [consolidated version](#) for this notice.



Addendum

Taxation Ruling

Income tax: ascertaining the right to tax United States (US) and United Kingdom (UK) resident financial institutions under the US and the UK Taxation Conventions in respect of interest income arising in Australia

This Addendum is a public ruling for the purposes of the *Taxation Administration Act 1953*. It amends Taxation Ruling TR 2005/5 to clarify certain aspects of the second limb of the definition of 'financial institution' as used in Australia's Taxation Conventions with the United States and the United Kingdom and to reflect changes in Australian banking law. The aspects clarified include when an enterprise is substantially deriving its profits from carrying on a business of 'spread activities' and whether certain activities constitute the provision of finance. It will also apply to residents of other countries with a double tax agreement that contain an equivalent provision that is on identical terms as the US or UK Conventions.

TR 2005/5 is amended as follows:

1. Preamble

Omit the preamble; substitute:

ⓘ Relying on this Ruling

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

2. Table of contents

Omit the table of contents contained in the left hand margin; substitute:

Table of Contents	Paragraph
Summary – what this Ruling is about	1
Class of persons/arrangements	1
<i>United States and United Kingdom</i>	1
<i>Other countries</i>	2A
Issues discussed in this Ruling	3

Date of effect	9
Ruling	10
PART A: ascertaining whether the US or UK resident is classified as a financial institution under Article 11(3)(b) of the Conventions	11
Banks	12
Other enterprises	15
<i>Raising debt finance in the financial markets</i>	17
<i>Taking deposits at interest</i>	19
<i>Using those funds in carrying on a business of providing finance</i>	22
<i>Substantially deriving its profits</i>	26
PART B: additional conditions for a financial institution to meet to determine whether it will be subject to tax on its interest income arising in Australia	29
<i>Whether the US or UK financial institution is unrelated to, and dealing wholly independently with, the payer of the interest</i>	29
<i>Whether the interest is effectively connected with a permanent establishment in Australia of the US or UK resident</i>	32
<i>Whether the interest is paid as part of an arrangement involving 'back to back' loans</i>	33
Appendix 1 – Explanation	34
Background	34
PART A: ascertaining whether the US or UK resident will be classified as a financial institution under Article 11(3)(b) of the Conventions	38
<i>The meaning of undefined terms within the definition of financial institution</i>	39
Banks	44
<i>The meaning of the term 'bank'</i>	49
Other enterprises	62
<i>The meaning of the term 'raising debt finance in the financial markets'</i>	65
<i>The meaning of the term 'taking deposits at interest'</i>	82
<i>The meaning of the term 'using those funds in carrying on a business of providing finance'</i>	88
<i>The meaning of the term 'substantially deriving its profits'</i>	96
PART B: additional conditions for a financial institution to meet to determine whether it will be subject to tax on its interest income arising in Australia	107
<i>Whether the US or UK financial institution is unrelated to, and dealing wholly independently with, the payer of the interest</i>	107
<i>Whether the interest is effectively connected with a permanent establishment of the beneficial owner in the country in which the interest arises</i>	122
<i>Whether the interest is paid as part of an arrangement involving 'back to back' loans</i>	126
Appendix 2 – Examples	129
Banks	129
<u>Example 1</u>	129

Other enterprises	131
<u>Example 2</u>	131
Substantially deriving profits	135
<u>Example 3</u>	135
<u>Example 4</u>	137
<u>Example 4A</u>	138A
Permanent establishment	139
<u>Example 5</u>	139
<u>Example 6</u>	141
Unrelated	143
<u>Example 7</u>	143
<u>Example 8</u>	145
Back to back arrangements	147
<u>Example 9</u>	147

3. Paragraphs 1 to 33

Omit the page status 'FOI status: **may be released**'; substitute 'Status: **legally binding**'.

4. Paragraph 1

(a) Omit the headings before the paragraph; substitute:

Summary – what this Ruling is about

Class of persons/arrangement

United States and United Kingdom

(b) Omit 'United States and the United Kingdom'; substitute 'United States (US) and the United Kingdom (UK)'.

5. Paragraph 2

(a) Omit 'United States (US) or United Kingdom (UK)'; substitute 'US or UK'.

(b) After the paragraph, insert new paragraphs 2A and 2B, including heading:

Other countries

2A. This Ruling also applies to residents of another country with which Australia has a double tax agreement (DTA) that includes a financial institution interest withholding tax rates exemption or reduction on identical terms as the US or UK Conventions^{A1} and are classified as financial institutions for the purposes of the DTA. In applying this Ruling, references to the US or UK should be read as references to that other country and references to the US or UK Convention should be read as references to the relevant DTA.

2B. This Ruling applies to those arrangements where interest arises in Australia within the meaning of the relevant DTA and:

(i) the interest is treated as interest for the purposes of the DTA;

- (ii) it is derived by residents of that country that are financial institutions for the purposes of the DTA; and
- (iii) the residents of that country beneficially own, or are beneficially entitled to, the interest for the purposes of the DTA.

(c) In paragraph 2A, in the first sentence after 'US or UK Conventions', insert new footnote A1:

^{A1} The protocol must be considered in determining whether a DTA provides for a financial institution interest withholding tax rates exemption or reduction on identical terms as the US or UK Conventions. The protocol may include provisions that clarify or modify the DTA.

6. Paragraph 7

In footnote 1, after '*Income Tax Assessment Act 1936*', insert 'and sections 12-245 and 12-300 of Schedule 1 to the *Taxation Administration Act 1953*'.

7. Paragraph 9

Omit '21 and 22 of Taxation Ruling TR 92/20; substitute '75 and 76 of Taxation Ruling TR 2006/10 *Public Rulings*'.

8. Paragraph 10

(a) Omit the last sentence; substitute:

Accordingly, payers of interest of this type have no obligation under section 12-245 of Schedule 1 to the *Taxation Administration Act 1953* (TAA)^{1A} to withhold tax from such payments made to these US or UK residents. This is because no withholding tax is payable in respect of the interest under section 128B of the *Income Tax Assessment Act 1936* (ITAA 1936).^{1B}

(b) After '(TAA)', insert new footnote 1A:

^{1A} In conjunction with section 12-300 of Schedule 1 to the TAA.

(c) At the end of the sentence, insert new footnote 1B:

^{1B} Following application of subsection 4(2) of the *International Tax Agreements Act 1953*.

9. Paragraph 14

Omit the wording of footnote 2, substitute:

See the historical PRA-regulated bank list published by the Bank of England at [Which firms do we regulate?](#)

10. Paragraph 25

At the end of the sentence, insert 'of providing finance'.

11. Paragraph 26

Omit 'comprise'; substitute 'constitute'.

12. Paragraph 27

- (a) In the first sentence, after 'such activity', insert ' , when compared to all other activities combined.'.
- (b) At the end of the second sentence, insert 'The calculation of operating income or operating profit should take into account direct expenses and overhead costs in accordance with accounting principles.'.

13. Paragraph 29

In the second heading, omit 'independently with'; substitute 'independently with,'.

14. Paragraph 31

Omit 'TR 2002/2'; substitute 'Taxation Ruling TR 2002/2 *Income tax: meaning of "Arm's Length" for the purpose of subsection 47A(7) of the Income Tax Assessment Act 1936 (ITAA 1936) dividend deeming provisions*'.

15. Paragraph 32

In the heading, omit the words 'The interest'; substitute 'Whether the interest'.

16. Paragraphs 34 to 128

Omit the page status 'FOI status: **may be released**'; substitute 'Status: **not legally binding**'.

17. Paragraph 34

- (a) In the major heading, before Explanation, insert 'Appendix 1 – '.
- (b) Insert preamble:

This Explanation 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.

18. Paragraph 39

In the heading, omit 'Financial Institution'; substitute 'financial institution'.

19. Paragraph 43

Omit the first sentence; substitute:

Paragraphs 63 to 76 of Taxation Ruling TR 2001/13 *Income tax: Interpreting Australia's Double Tax Agreements* sets out the Commissioner's approach to the interpretation of undefined terms in a treaty.

20. Paragraph 47

At the end of the paragraph, insert 'of this Ruling'.

21. Paragraph 49

In the heading, omit 'Bank'; substitute 'bank'.

22. Paragraph 51

Omit the wording of footnote 7; substitute 'Section 8 of the *Banking Act 1959*'.

23. Paragraph 52

- (a) Omit the wording of footnote 8; substitute 'Section 5 and subsection 9(3) of the *Banking Act 1959*'.
- (b) Omit the wording of footnote 10; substitute:
Section 5 of the Banking Act 1959 and Commissioners of the State Savings Bank of Victoria v Permewan, Wright and Company Limited [1914] HCA 83; 19 CLR 457 at pages 470–471; *Melbourne v Commonwealth* [1947] HCA 26; 74 CLR 31 per Latham CJ at page 63, per Rich J at pages 64–65 and per Starke J at page 69; *Bank of NSW v Commonwealth* [1948] HCA 7; 76 CLR 1, per Latham CJ at pages 193–194; *Australian Independent Distributors Ltd v Winter* [1964] HCA 78; 112 CLR 443 at pages 454–455.

24. Paragraph 53

- (a) Omit the first the first 3 sentences (excluding footnotes); substitute: 'All ADIs are permitted to use the word 'bank'¹¹ unless APRA has made a written determination prohibiting them from doing so.¹²'.
- (b) Omit the wording of footnote 11; substitute 'Section 66 of the *Banking Act 1959*'.
- (c) Omit the wording of footnote 12; substitute 'Section 66AA of the *Banking Act 1959*'.

25. Paragraph 54

Omit the paragraph.

26. Paragraph 60

Omit '58of'; substitute '58 of'.

27. Paragraph 61

Omit the wording of footnote 15; substitute:

See the historical PRA-regulated bank list published by the Bank of England at [Which firms do we regulate?](https://www.bankofengland.co.uk/which-firms-do-we-regulate)

28. Paragraph 65

In the heading, omit ' of 'raising debt-finance'; substitute 'of the term 'raising debt finance'.

29. Paragraph 67

- (a) Omit the wording of footnote 16; substitute 'Note 1 to subsection 974-10(1) of the ITAA 1997.'
- (b) Omit the wording of footnote 17; substitute 'Subsection 974-10(2) of the ITAA 1997.'
- (c) Omit the wording of footnote 18; substitute 'Note 1 to subsection 974-10(2) of the ITAA 1997.'
- (d) Omit the wording of footnote 19; substitute 'Paragraph 1.9 of the Explanatory Memorandum to the New Business Tax System (Debt and Equity) Bill 2001.'

30. Paragraph 82

Omit the comma after 'phrase'.

31. Paragraph 88

- (a) In the heading, omit 'Using'; substitute 'using'.
- (b) In the first sentence, omit 'Convention requires'; substitute 'Conventions require'.

32. Paragraph 92

- (a) Omit 'Convention'; substitute 'Conventions'.
- (b) After the paragraph, insert new paragraph 92A:

92A. Financial advisory services provided by an enterprise would not constitute the provision of finance as no funds or assets are provided by the enterprise. To be the provision of finance the activities must, at the time, involve the supply of funds or assets to a recipient. An arrangement, where finance may be provided if a contingent event happens, is itself not the provision of finance. For example, underwriting is not the provision of finance as, at the time the underwriting takes place, no funds or assets are provided by the enterprise. If the contingencies to which the underwriting pertains occur, and it is necessary to provide funds, then this may constitute the provision of finance at that time. However, it is then only that part of the arrangement that would constitute the provision of finance; it is not the whole arrangement. The characterisation of the original underwriting does not change.

33. Paragraph 93

- (a) Omit the wording of the paragraph; substitute:

A US or UK resident share trader who may sell securities to an Australian resident would also not be providing finance as there is no obligation on the recipient to return these shares.

- (b) After the paragraph, insert new paragraph 93A:

93A. An arrangement involving a US or UK resident entity making an upfront payment to another entity, for the right to collect receivables from third parties where they have no recourse to that entity for non-payment of the receivables, would not constitute the provision of finance. This is because the US or UK resident

entity has not provided any funds or assets to the third parties as part of the arrangement.

34. Paragraph 95

- (a) Omit the last 2 sentences.
- (b) After the paragraph, insert new paragraphs 95A to 95C:

95A. While the indicia of carrying on a business set out in the case law are relevant to companies, companies are typically formed for the purpose of carrying on a business.^{21A} In *Inland Revenue Commissioners v Westleigh Estates Co Ltd* [1924] 1 KB 390 (*Westleigh*) and *American Leaf Blending Co Sdn Bhd v Director-General of Inland Revenue* [1979] AC 676 (*American Leaf*), it was observed that where a company aims to make, and has a prospect of, profit, it is presumed that the company intends to, and does in fact, carry on a business. In *American Leaf*, Diplock LJ observed that this means any gainful use to which a company puts its assets will, on its face, amount to the carrying on of a business. However, this presumption can be rebutted if it can be shown that, on the facts, the company had no aim or prospect of making a profit.^{21B}

95B. Although there is a presumption that certain companies carry on a business, it is necessary to determine whether the presumption is maintained or rebutted. This requires consideration of the specific circumstances of, and activities carried out by, the company having regard to the indicia of carrying on a business. A range of indicia are relevant in determining whether a business is carried on, including:

- whether the person intends to carry on a business;
- the nature of the activities, particularly whether they have a profit-making purpose;
- whether the activities are:
 - repeated and regular;
 - organised in a business-like manner, including the keeping of books, records and the use of a system;
- the size and scale of the activities including the amount of capital employed in them, and
- whether the activity is better described as a hobby, or recreation.

95C. These indicia are further discussed in the following rulings and the approaches outlined in these rulings are considered applicable in the context of determining whether the US or UK resident is carrying on a business of providing finance:

- Taxation Ruling TR 2019/1 *Income tax: when does a company carry on a business?*
- Taxation Ruling TR 97/11 *Income tax: am I carrying on a business of primary production?*

- (c) At the end of the first sentence in paragraph 95A, insert new footnote 21A:
^{21A} *Brookton Co-operative Society Ltd v Commissioner of Taxation (Cth)* [1981] HCA 28, per Aickin J.
- (d) At the end of paragraph 95A, insert new footnote 21B:

^{21B} *Westleigh* at [408-409], per Pollock MR; *Spassked Pty Limited v Commissioner of Taxation* [2003] FCAFC 282.

35. Paragraph 97

- (a) Omit ‘*Commissioner of Superannuation v Scott* (1987) 71 ALR 408’; substitute ‘*Commissioner for Superannuation v Scott, F.O.* [1987] FCA 98’.
- (b) Omit the wording of footnote 22; substitute: ‘(1987) 71 ALR 408 at [413]; [1987] FCA 98 at [14].’.

36. Paragraph 98

- (a) Omit ‘*Commissioner of Taxation v. Comcorp* (1996) 70 FCR 356 at 395,’; substitute ‘*Deputy Commissioner of Taxation of the Commonwealth of Australia v Comcorp Australia Ltd & Ors* [1996] FCA 848; (1996) 70 FCR 356 at [395],’.
- (b) Omit ‘Justice Carr’; substitute ‘Carr J’.
- (c) In footnote 23, omit ‘at 395’; substitute ‘at [395]’.

37. Paragraph 100

- (a) Omit ‘spread activities’; substitute “spread activities”.
- (b) Omit ‘any other activity’; substitute: ‘all other activities combined’.
- (c) After the paragraph insert new paragraphs 100A to 100C:

100A. The ‘spread activities’ will constitute the main business activity if, when compared with all the other activities carried on by the enterprise, they are the main contributor to the enterprises’ overall profits. This involves determination of the extent to which the ‘spread activities’ are the source or generator of the enterprise’s overall profits.

100B. Whether an enterprise substantially derives its profits from the ‘spread activities’ is not by its nature a bright-line test. The question of whether the spread activities are the main contributor to the enterprise’s profits requires consideration of the relationship between the spread activities and the enterprise’s profits. This includes the extent to which underlying economic factors impact on the profitability of the spread activities over a reasonable period of time. However, where the spread activities are the source of 50% or more of the overall accounting profits, this is a strong indicator that the enterprise substantially derives its profits from the spread activities (refer to paragraph 103 of this Ruling in regard to situations where an enterprise is deriving less than 50% of its profits from spread activities).

100C. The text, purpose and context of Article 11(3)(b) shows that it is intended to be limited to enterprises that, at the very least, are focused on and operate largely in the banking and finance industry. It is not an exemption that should provide benefits to enterprises who are not in the banking and finance industry, or only participate in it in a small or non-substantial way.

38. Paragraph 101

At the end of the paragraph, insert 'The calculation of operating income or operating profit should take into account direct expenses and overhead costs in accordance with accounting principles.'

39. Paragraph 103

Omit 'if its main source of profits over time is from its spread activities, it will constitute a financial institution.'; substitute:

an enterprise may be a financial institution if due consideration shows that its main source of profits over a 5-year period is from spread activities. This would take into account the trend of the enterprise's accounting profits and the underlying economic factors that have led this to occur. The factors may include, but are not limited to, movements in any of the following:

- loan balances outstanding;
- bad debts;
- foreign exchange rates;
- numbers of full-time equivalent employees involved;
- technological costs; and
- profit forecasts.

40. Paragraph 104

Omit the wording of footnote 24; substitute 'See discussion of the interpretative value of Technical Explanations in paragraph 125 of TR 2001/13 *Income tax: Interpreting Australia's Double Tax Agreements*'.

41. Paragraph 107

In the second heading, after 'independently with', insert ','.

42. Paragraph 109

Omit the wording of footnote 26; substitute 'Paragraph 1.31 of the Explanatory Memorandum to the International Tax Agreements Amendment Bill 2003, Chapter 1: The 2003 United Kingdom Convention.'

43. Paragraph 110

In footnote 27, after 'Refer', insert 'to'.

44. Paragraph 111

In footnote 28, omit the first sentence; substitute 'Paragraph 205 of the Explanatory Memorandum to the Taxation Laws Amendment (Foreign Income) Bill 1990.'

45. Paragraph 112

Omit the wording of footnote 29; substitute 'Subsections 128F(6) and (9) of the ITAA 1936.'

46. Paragraph 116

Omit the wording of footnote 30; substitute 'Paragraph 1.31 of the Explanatory Memorandum to the International Tax Agreements Amendment Bill 2003, Chapter 1: The 2003 United Kingdom Convention.'

47. Paragraphs 118 and 119

Omit 'Taxation Ruling TR 2002/2'; substitute 'TR 2002/2'.

48. Paragraph 120

Omit the wording of footnote 31; substitute 'Refer to *Collis, Marion Elizabeth v Commissioner of Taxation of the Commonwealth of Australia; Collis, Stephen John v Commissioner of Taxation of the Commonwealth of Australia* [1996] FCA 733.'

49. Paragraph 122

Omit the wording of footnote 32; substitute 'Paragraph 1.139 of the Explanatory Memorandum to the International Tax Agreements Amendment Bill 2003, Chapter 1: The 2003 United Kingdom Convention.'

50. Paragraph 128

- (a) Omit the words 'UK Convention which states the following'; substitute 'UK Convention, which states'.
- (b) Omit the wording of footnote 33; substitute 'Paragraph 1.33 of the Explanatory Memorandum to the International Tax Agreements Amendment Bill 2003, Chapter 1: The 2003 United Kingdom Convention.'

51. Paragraph 129

- (a) In the major heading, before Examples, insert 'Appendix 2 – '.
- (b) Insert preamble

❶ This Appendix provides examples which illustrate the principles in the Ruling. Decisions on individual cases will depend on the overall circumstances of that case. Consequently, the conclusions reached in the following examples are not necessarily determinative of the Commissioner's views on cases with similar, but different, facts.

52. Paragraphs 129 to 148

Omit the page status 'FOI status: **may be released**'; substitute 'Status: **not legally binding**'.

53. Paragraph 130

Omit 'As Company A,'; substitute 'As Company A'.

54. Paragraph 135

Omit 'three'; substitute '3'.

55. Paragraph 137

Omit the wording of the paragraph; substitute:

Over a period of 3 years, Company H has derived 40% of its profit from spread activities and 60% of its profit from underwriting activities. Under the underwriting arrangement, Company H commits to provide a required level of financing over a certain period in return for a fee, but does not provide any funds or assets.

56. Paragraph 138

(a) Omit the wording of the paragraph; substitute:

Company H is not a financial institution as its main business activity does not involve undertaking spread activities (only 40% of its profits) but rather underwriting activities. The income derived from the underwriting activities does not constitute income from spread activities as no funds or assets are provided by Company H (see paragraph 92A of this Ruling).

(b) After the paragraph, insert new paragraphs 138A to 138C, including headings:

Example 4A

138A. Over a period of 5 years, Company P has derived 60% of its profit from spread activities (30% from lending activities, 20% from hire purchase activities and 10% from other finance leasing activities) and 40% of its profits from non-spread activities (35% from operating lease activities and 5% from underwriting activities).

138B. When compared to Company P's other activities (40%) over a reasonable time, its main business is from its spread activities (60%) and, as such, it is a financial institution (see paragraphs 26 to 27 and 99 to 102 of this Ruling). Although the operating lease activities produce the largest amount of profit when compared to each other activity carried on by Company P, the operating lease activities are not its main business as its combined spread activities produce greater profits than its other activities.

138C. If Company P's profit from its spread activities constitute less than half of its overall profits in a particular year, then it is necessary to carefully consider its situation on a case-by-case basis to examine whether it satisfies the test (see paragraph 103 of this Ruling).

57. Paragraph 141

Omit 'Japan. The Japanese'; substitute 'Singapore. The Singapore'.

58. Paragraph 142

Omit 'Japanese'; substitute 'Singapore'.

59. Paragraph 148

Omit 'as the arrangement is considered to be 'back to back"'; substitute 'of the UK Convention due to application of Article 11(4) a 'back to back loan arrangement'.

60. Paragraph 149

- (a) Omit the Detailed contents list, including headings
- (b) Move the Commissioner's name and date block to following paragraph 33.

This Addendum applies both before and after its date of issue.

For the 2018-2019 and earlier income years the Commissioner does not intend to take compliance action to the extent a taxpayer assessed it was not liable to interest withholding taxes before 28 November 2018, the date of issue of the first draft Addendum TR2005/5DC, where the taxpayer:

- (i) determined it was a financial institution on the basis that its spread activities was the largest contributor to its overall profits when compared with each of its other activities separately rather than combined, and
- (ii) has not undertaken or entered into an artificial or contrived arrangement affecting its interest withholding tax obligations or a tax avoidance scheme whose outcome depends, in whole or part, on reduced or no withholding taxes.

Commissioner of Taxation

17 May 2023

ATO references

NO: 1-B97Z35Q
ISSN: 1039-0731
BSL: PGI

© AUSTRALIAN TAXATION OFFICE FOR THE COMMONWEALTH OF AUSTRALIA

You are free to copy, adapt, modify, transmit and distribute this material as you wish (but not in any way that suggests the ATO or the Commonwealth endorses you or any of your services or products).