TD 1999/D19 - Income tax: interest withholding tax exemption under section 128F of the Income Tax Assessment Act 1936 - does the exemption from interest withholding tax in section 128F extend to payments made by a guarantor to a lender on behalf of a borrower who defaults?

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Draft Taxation Determination

Income tax: interest withholding tax exemption under section 128F of the *Income Tax Assessment Act 1936* – does the exemption from interest withholding tax in section 128F extend to payments made by a guarantor to a lender on behalf of a borrower who defaults?

Preamble

Draft Taxation Determinations (DTDs) present the preliminary, though considered, views of the Australian Taxation Office (ATO). DTDs may not be relied on; only final TDs are authoritative statements of the ATO.

1. Yes. Payments made on behalf of a company by a guarantor to a lender constitute 'interest' for the purposes of Division 11A. Therefore, where a liability to pay withholding tax arises under section 128B, the exemption from interest withholding tax in section 128F is available to such payments (provided the other requirements of section 128F are satisfied).

2. An amount represents 'interest' for the purposes of Division 11A, where the amount is in the 'nature of interest' or in 'substitution for interest', as defined in subsection 128A(1AB). Subsections 128A(1AC) and 128A(1AD) give examples of what would be included in such definitions.

3. An amount paid by a guarantor arises from a contractual obligation to repay any amounts where there is a default in payment. The explanatory memorandum to *the Taxation Laws Amendment Act (No 2) 1997*, which inserted the current definition of the term 'interest', makes it clear a lump sum paid by the borrower in substitution for interest is interest for the purposes of Division 11A. A lump sum paid by a guarantor in respect of a default in payment by a borrower would be treated in the same way.

4. If the interest component is paid periodically as per the terms of the debenture issue, this amount would fall within the 'nature of interest', as the amount is still as compensation to the lender for not having the principal for the term of the loan – and is, therefore, in the nature of interest. It is simply paid by a third party rather than the principal debtor.

Your comments

5. If you wish to comment on this draft Determination, please send your comments promptly by Friday 26 February 1999 to:

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Commissioner of Taxation
27 January 1999

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Related Rulings/Determinations:

TD 1999/D1; TD 1999/D2; TD 1999/D3; TD 1999/D4; TD 1999/D5; TD 1999/D6; TD 1999/D7; TD 1999/D8; TD 1999/D9; TD 1999/D10; T D 1999/D11; TD 1999/D12; TD 1999/D13; TD 1999/D14; TD 1999/D15; TD 1999/D16; TD 1999/D17; TD 1999/D18

Subject references:

Legislative references:

ITAA 128A(1AB); ITAA 128A(1AC); ITAA 128A(1AD); ITAA 128B; ITAA128F; ITAA Div 11A; TLAA (No 2) 1997

Case references:

ATO References:
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