IT 2196 - Interest withholding tax - exemption under section 128F of the Income Tax Assessment Act

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TAXATION RULING NO. IT 2196

INTEREST WITHHOLDING TAX - EXEMPTION UNDER SECTION 128F OF THE INCOME TAX ASSESSMENT ACT

F.O.I. EMBARGO: May be released

REF H.O. REF: 84/1465-3 DATE OF EFFECT: Immediate

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F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1199444	INTEREST WITHHOLDING TAX	128F
	- OVERSEAS DEBENTURE ISSUE	128F(4)(a)
	- WIDE DISTRIBUTION	128F(4)(b)
	- USE IN AUSTRALIAN BUSINESS	
	- LARGE DENOMINATION NOTES	

PREAMBLE Any Australian resident company which seeks to treat as exempt from interest withholding tax the interest payable on debentures issued overseas must apply to the Commissioner for a certificate under sub-section l28F(4) of the Income Tax Assessment Act. Before a certificate is issued the Commissioner must satisfy himself, amongst other things, that it is reasonable to regard the debentures as having been issued for the purposes of public subscription or purchase or other wide distribution and that the money borrowed is to be used for or in connection with an Australian business.

FACTS 2. An Australian resident company approached this office for an opinion whether it could obtain the issue of a certificate under sub-section l28F(4) in respect of a debenture issue it proposed to offer on the New York market. The placement was to be handled by a leading United States bank (the dealer). The money borrowed by the Australian resident company was to be used to purchase shares in a company or companies owning mining interests in Australia.

3. The debentures, or commercial paper as it was called, were to be fixed term, unsecured promissory notes with maturities of up to 270 days. They were to be issued in minimum denominations of $100,000. They would not bear interest but were to be issued at a discount with their face value being payable to bearer at maturity.

4. Under United States security legislation the commercial paper cannot be sold to other than "accredited investors". They are also referred to as "qualified commercial paper buyers" and, generally speaking, are large institutions such as insurance companies, pension funds, government authorities, large corporation, banks and finance companies which use these investments as a relatively low-risk outlet for short-term funds. Only financially strong, highly rated borrowers have access to this market and issuers of dealer

placed commercial paper are required to maintain back-up lines of credit at banks.

5. In the ordinary course of events, before the first issue of the commercial paper is made the dealer's sales staff approaches qualified commercial paper buyers on the dealer's list of clients in order to establish whether such buyers are interested in being invited to bid in relation to issues of the commercial paper. There are approximately 1000 qualified commercial paper buyers on the dealer's list of clients and the objective of the dealer's sales staff is to have approximately 200 of the qualified commercial paper buyers accept the commercial paper.

6. When the first issue of the commercial paper is to be made the dealer's sales staff, having established a list of 200 or so potential buyers, will approach the buyers on the list commencing with the buyers thought most likely to be interested in acquiring the commercial paper at that particular time. The dealer's sales staff will continue offering the commercial paper to buyers on the list until the whole of the commercial paper in the issue has been placed.

7. It is possible that the first one or two qualified commercial paper buyers approached could between them bid for the entire issue. If this were to happen, it would indicate, it was suggested, that the discount had been miscalculated. Based upon experience the average quantity of commercial paper taken by a qualified commercial paper buyer in any issue (i.e. the average "ticket") is about $8 million. The market norm for commercial paper is a minimum ticket size of $5 million. Applying these averages to the proposed issue it could be expected that at least 30 to 50 qualified commercial paper buyers will hold the issue at any one time.

RULING

8. The Australian resident company was advised that, provided the arrangements were implemented substantially in the manner outlined above and the requirements of the law were otherwise met, it could be expected that a certificate of exemption from interest withholding tax would be forthcoming at the appropriate time, i.e. when the loan has been raised.

9. The issue of the commercial paper in the above manner under the United States security legislation is accepted as an issue with a view to public subscription or purchase or other wide distribution among investors in terms of paragraph l28F(4)(a) of the Income Tax Assessment Act. The proposed use of the moneys raised from the issue to purchase shares in a company or companies owning mining interests in Australia would satisfy the requirements of paragraph l28F(4)(b).

10. Furthermore it was agreed that if a qualified commercial paper buyer requested that he be issued with a single debenture in a denomination greater than the minimum amount of US $100,000 (effectively a consolidation of a number of debentures) it would not affect the exemption. However, it would be desirable for the documentation governing the

arrangement to formally recognise that such an option is available. This option is considered distinguishable from the situation where notes are offered in such large denominations that public subscription or purchase or other wide distribution among investors is not possible.

COMMISSIONER OF TAXATION
18 September 1985

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