IT 2226 - Income tax : building societies: co-operative companies deduction of interest on amounts advanced by depositors

Generated on: 3 June 2026, 07:37:02 PM

TAXATION RULING NO. IT 2226

INCOME TAX : BUILDING SOCIETIES: CO-OPERATIVE COMPANIES DEDUCTION OF INTEREST ON AMOUNTS ADVANCED BY DEPOSITORS

F.O.I. EMBARGO: May be released

REF H.O. REF: 85/4155-8 DATE OF EFFECT:

B.O. REF: DATE ORIG. MEMO ISSUED:

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1194294		
	BUILDING SOCIETIES	51(1)
	CO-OPERATIVE COMPANIES	120(1)
	INTEREST - DEDUCTION	

PREAMBLE Division 9 of Part III of the Income Tax Assessment Act contains provisions which apply in the calculation of taxable incomes of co-operative companies, i.e. companies which are co-operative companies for the purposes of the Division.

2. In particular, sub-section 120(1) provides an income tax deduction to co-operative companies for amounts distributed to shareholders as interest or dividends on shares.

3. Permanent building societies may qualify as co-operative companies within the meaning of Division 9. For the purposes of carrying on their businesses they compete for funds with banks and other financial institutions. They offer a wide range of investments, e.g. term deposits for periods of 3, 6, 12, etc. months at varying rates of interest. In many cases, however, an investment in a permanent building society is represented by shares in the Society, i.e. a person who invests $10,000 in a permanent building society will be allotted 10,000 $1 shares in the Society.

4. The question has arisen whether permanent building societies, which qualify as co-operative companies under Division 9, should be allowed an income tax deduction for interest on amounts advanced by depositors under section 51(1), i.e. as losses and outgoings necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income, or under sub-section 120(1), as amounts distributed to shareholders as interest on shares.

RULING 5. In 1967 this Office gave advice to the Australian Association of Permanent Building Societies on the operation of the income tax law relating to them. In relation to sub-section 120(1) it was stated:

> "The important provision is section 120. Its practical effect is that a co-operative company is entitled, in

calculating its taxable income, to set off not only all the usual deductions for expenses incurred in producing assessable income but also any other amounts which are -

(a) distributed among its shareholders as rebates or bonuses based on business done by shareholders with the company; or

(b) distributed among its shareholders as interest or dividends on shares.

The general body of taxpayers is not, of course, allowed to deduct such payments.

Any taxpayer is entitled to a deduction for interest on money that he borrows and uses for the purpose of producing assessable income. The reference to interest in section 120 is directed at a different kind of interest. Under the legislation governing co-operative companies in some areas, the company pays what is described as interest on shares. If it were not for section 120, these payments might be regarded as a form of distribution of profit - in effect a fixed annual dividend - which would not be deductible. However, section 120 ensures that, so long as a company maintains its co-operative status for income tax purposes, these interest payments, and other payments by way of dividends or bonuses, will be allowable deductions. In broad practical effect, this should normally mean that a co-operative is taxed only on its undistributed profits and that, if a company distributes the whole of its profits, it will not be taxed at all. This will not always happen, however, because the profits which are available for distribution, ascertained under the general law, may not always coincide with the distribution which is needed to ensure that the company's allowable deductions, ascertained under the income tax law, will be as great as its assessable income."

6. In the context of the 1967 advice which still applies, it is considered that interest payable by permanent building societies to depositors on the wide range of investments referred to above is not correctly classified as a distribution of profit. Rather, it represents the cost of funds which a permanent building society must obtain to carry on business effectively. It is an expense of carrying on business. It follows, therefore, that interest incurred each year on amounts advanced by depositors is allowable as an income tax deduction under sub-section 51(1).

COMMISSIONER OF TAXATION
26 November 1985

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