IT 2652 - Income tax: interest withholding tax - company - issues debentures - acting through an agent who does not disclose existence of principal

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TAXATION RULING IT 2652

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I 1012832	**AGENT** **EXEMPTION CERTIFICATE** **INTEREST WITHHOLDING TAX** **UNDISCLOSED PRINCIPAL**	**128F**

OTHER RULINGS ON THIS TOPIC: IT 2196, IT 2205, IT 2238, IT 2332.

TITLE: INCOME TAX: INTEREST WITHHOLDING TAX - COMPANY - ISSUES DEBENTURES - ACTING THROUGH AN AGENT WHO DOES NOT DISCLOSE EXISTENCE OF PRINCIPAL

NOTE: . Income Tax Rulings do not have the force of law.

. Each decision made by the Australian Taxation Office is made on the merits of each individual case having regard to any relevant Ruling.

PREAMBLE

This Ruling considers:

(a) whether a debenture issued outside Australia by a non-resident agent for the purpose of raising a loan outside Australia on behalf of a principal (i.e. an Australian resident company) whose existence is not disclosed, constitutes a debenture issued by the Australian resident company or a debenture issued by the non-resident agent in its own right; and

(b) how the interest withholding tax provisions of the Income Tax Assessment Act 1936 apply to that situation.

2. This Ruling concludes (in paragraphs 17 and 18) that, provided all other requirements of the interest withholding tax provisions are satisfied, an interest withholding tax exemption certificate may be issued in respect of:

(a) debentures issued by way of bills of exchange or promissory notes, provided the agent discloses on the face of the bill or note that it is issuing the bill or note on behalf of the Australian company; and

(b) other debentures, provided that in issuing the debentures the agent is acting within his or her authority (no disclosure of the agency being necessary) and evidence that the agent is so acting is supplied with the application for the certificate.

3. Consideration of Corporations Act 1989 requirements falls outside the scope of this Ruling.

4. This preamble outlines under appropriate headings various matters and defines certain terms that are relevant to the content of this Ruling.

Withholding tax provisions

5. The Income Tax Assessment Act provides for a withholding tax on both dividends and interest paid to non-residents. The withholding tax is designed to be deducted by an Australian resident who pays the dividends or interest and is borne by the non-resident recipient. No liability for withholding tax arises for certain types of income specified in subsection 128B(3) including interest paid by a company in respect of debentures where:

(i) the company was a resident of Australia at the time the debentures were issued and the time the interest was paid;

(ii) the debentures were issued by a company outside Australia for the purposes of raising a loan outside Australia;

(iii) the interest was paid outside Australia; and

(iv) the Commissioner is satisfied that the conditions in subsection 128F(4) for the issue of an exemption certificate have been met and has issued such a certificate (subparagraph 128B(3)(h)(iv), subsection 128F(1) and subsection 128F(4)).

Debenture

6. "Debenture", in relation to a company, is defined in subsection 6(1) to include "debenture stock, bonds, notes and any other securities of the company, whether constituting a charge on the assets of the company or not." Because this is an inclusive definition, the term "debentures" in subsection 128F(1) also bears its ordinary meaning.

7. According to the Macquarie Dictionary, a "debenture" is:

> "a note or certificate acknowledging a debt as given by an incorporated company; a bond or one of a series of bonds".

The ordinary meaning of "debenture" is broad and, having regard to the inclusive definition of the term in subsection 6(1), it is considered wide enough to cover certain documents or instruments other than bills of exchange and promissory notes e.g. eurobonds and euronotes.

What "issue" of debentures means

8. The terms of section 128F require that, provided all the other tests are satisfied, an exemption certificate can only be issued to a resident company that issues debentures. As the term "issue" is not defined for the purposes of the withholding tax provisions (viz. Division 11A of Part 3 of the Act), its ordinary meaning must be adopted. In discussing an agreement to issue debentures in Levy v. Abercorris Slate and Slab Company (1887) 37 Ch 260, Chitty J of the Chancery Division stated at p.264 :

> "'issued' is not a technical term, it is a mercantile term well understood; 'issue' here means the delivery over by the company to the person who has the charge".

9. The ordinary meaning of the word "issue" according to the Macquarie Dictionary is "to put out; deliver for use, sale, etc.; put into circulation". To put out or deliver debentures to subscribers in an offshore market, is to "issue" the debentures for the purposes of paragraph 128F(1)(b) of the Act.

Doctrine of undisclosed principal

10. In cases involving an undisclosed principal, an agent may deliver debentures to, and contract with, investors in an offshore market without disclosing that it is acting for an Australian principal. In determining whether in so doing the agent's acts are its own or the principal's, it is necessary to consider the relationship between principal and agent having regard to the agency agreement and to agency law.

11. The agency law doctrine of undisclosed principal states that generally in these circumstances the principal can sue and be sued in its own name on a contract entered into on its behalf by an agent so long as the agent was acting within the scope of its actual authority or (perhaps) within the authority usually confided to an agent of that character (Bowstead on Agency, 15th ed., p312 and Fridman's Law of Agency 5th ed. pp.221-229). In other words, provided the agent has actual or (perhaps) usual authority and the principal's rights to sue and be sued are not inconsistent with the terms of the contract, the actions of the agent are considered to be those of the principal. Evidence must be able to be introduced to prove the existence of, and identify the undisclosed principal, so as to enable the principal to sue or be made liable. The principal must also be able to demonstrate that investors did not contract with the agent for reasons personal to the agent to the exclusion of the principal or anyone else.

Bills of exchange - definition

12. "Bill of exchange" is defined in subsection 8(1) of the Bills of Exchange Act 1909 as:

> "an unconditional order in writing, addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand, or at a fixed and determinable future time, a sum certain in money to or to the order of a specified person, or to bearer".

Promissory note - definition

13. "Promissory note" is defined in subsection 89(1) of the Bills of Exchange Act as:

> "an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay, on demand or at a fixed or determinable future time, a sum certain in money, to or to the order of a specified person, or to bearer".

Bills of exchange and promissory notes

14. In respect of bills of exchange and promissory notes, the Courts have consistently held that a person who puts his or her

name to a bill becomes personally liable unless he or she states upon its face that he or she subscribes it for another or by procuration of another (Wilson v. Joshua (1867) 6 S.C.R.(N.S.W.) 319; English, Scottish & Australian Chartered Bank v. Gunn (1871) 10 SCR (N.S.W.) 244; Imperial Land Building & Deposit Co. v. Melvey (1889) 6 W.N. (N.S.W.) 14).

15. The law relating to bills of exchange is now codified in the Bills of Exchange Act which applies equally to bills and promissory notes - section 95. Both sections 8 and 89 of the Bills of Exchange Act (which define a bill of exchange and a promissory note respectively) require that the bill or note be signed by the maker. The requirement that the bill or note be signed by the maker or issuer is emphasised further in section 28 which provides that a person is not liable on a bill or note if he or she has not signed it as drawer, indorser or acceptor. Although a bill or note may be signed by an agent on behalf of the principal, the agent is personally liable unless "he adds words to his signature indicating that he signs for or on behalf of a principal, or in a representative capacity"(section 31).

RULING

16. Debentures may be issued by a non-resident agent on behalf of an undisclosed Australian principal in either of two forms :

(a) debentures issued by way of bills of exchange or promissory notes;

(b) other debentures.

Debentures issued by way of bills of exchange or promissory notes.

17. In this situation, the non-resident agent would be considered by this Office to be acting on its own behalf unless the agent disclosed on the face of the note or bill that it was issuing the note or bill on behalf of the Australian company (the principal). Unless such disclosure is made, the Australian company would not be considered to have issued the debentures in terms of paragraph 128F(1)(b) and a withholding tax exemption certificate would not be issued (refer Example 1 in paragraphs 23 to 26).

Debentures other than bills of exchange or promissory notes.

18. In this situation, provided that :

(a) the non-resident agent has actual or (perhaps) usual authority to put out or deliver the debentures to investors;

(b) the principal's rights to sue and be sued are not inconsistent with the terms of the contract issuing the debentures; and

(c) evidence that the non-resident is acting as an agent and within the scope of its authority is supplied to this Office with the application for an exemption certificate,

the actions of the agent would be considered by this Office to be those of the Australian company (the principal). The Australian company would be considered in these circumstances to have issued the debenture in terms of paragraph 128F(1)(b) and a withholding tax exemption certificate may be issued.

19. The evidence necessary to prove that the non-resident agent has authority to issue the debentures for the purposes of paragraph 18 includes:

- an agency agreement between agent and principal specifically authorising the agent to issue the debentures; or
- in the case of a related company acting as overseas agent, minutes of the Australian company's meetings and copies of correspondence between the Australian company and the non-resident agent containing specific reference to the agent's authority to issue the debentures; or
- in the case of an unrelated company acting as overseas agent (for example, the overseas branch of an Australian bank) evidence of communication between the Australian company and the non-resident agent authorising the agent to issue the debentures.

20. Taxation officers must exercise care in ensuring that the undisclosed agency does not disguise what is in essence a group loan from a non-resident company to a related Australian company in the expectation that the non-resident company will be able to raise funds, for example, by way of public distribution of its debentures. In this case, the purported issue of debentures should be challenged as a sham and a withholding tax exemption certificate not issued.

21. Care must also be exercised to ensure that the overseas company is in fact acting as an agent rather than acting on its own behalf. In a situation where liability to pay interest under the debentures may in some circumstances be assumed by the overseas company, no agency relationship is considered to exist. In addition, if, at some time in the future, the overseas company assumes liability for the payment of interest on the

debentures, the exemption given by section 128F would not extend to interest paid on the debentures by the overseas company. The exemption is limited to interest paid by an Australian resident company on debentures issued by that company. An exemption certificate under section 128F would therefore not be issued (refer Example 2 in paragraphs 27 and 28)

Subsection 128F(6).

22. This Ruling does not apply to the type of situation dealt with in subsection 128F(6), that is, where an offshore loan is raised by a non-resident subsidiary on behalf of an Australian parent company. In that case, the legislation requires that the non-resident borrowing subsidiary must be wholly owned and controlled by the Australian resident company and that the only business of the subsidiary is the borrowing of money and the lending of that money to its parent company on terms that do not result in a profit to the subsidiary. In those circumstances, the legislation envisages that the non-resident subsidiary, being the borrower and issuer of the debentures, will act in its own right as principal and will enter into a separate loan agreement with the Australian parent company to on-lend to it the borrowed funds.

Example 1

23. An Australian company proposed to raise funds in the commercial paper market of the United States of America (the "USA") by issuing promissory notes through its better known U.S. parent company. In essence, it proposed to issue debentures by way of promissory notes. In order to reduce administration costs and to gain greater investor acceptance in the USA through the use of the parent company's name, the Australian company intended to issue the notes in the name of, and as part of, a larger issue of notes by the US parent company. The Australian company's borrowing component was to be indistinguishable from that larger issue. The loan was to be raised in U.S. dollars , all notes were to be issued outside Australia and all interest on the notes was to be paid to investors who were outside Australia.

24. The agency agreement provided that the agent would issue the notes as agent for, and for the benefit of, the principal and that the principal would be liable on any debt issued by the agent during the term of the agreement.

25. The question which arose was whether, all the other requirements of section 128F being satisfied, a withholding tax exemption certificate could be issued in respect of interest payable on the notes given that the U.S. agent did not disclose to note subscribers that it was issuing the notes on behalf of the Australian principal. The central question was whether in

the circumstances it could be said that the notes were issued by the Australian resident company and therefore satisfied the requirements of paragraph 128F(1)(b).

Result:

26. The company was advised that unless its existence was disclosed to note subscribers on the face of the notes, it could not be said that the Australian company rather than its U.S. agent issued the notes, and therefore no withholding tax exemption certificate was issued in respect of the interest payable on the notes.

Example 2

27. An Australian company applied for an interest withholding tax exemption certificate under section 128F in respect of interest payable on certificates of deposit which it had issued outside Australia through a related U.K. company. Because of perceived reluctance on the part of overseas investors to invest in the less known Australian company, the U.K. company did not disclose to investors that it was acting on behalf of the Australian company. By the terms of the debentures, the U.K. company was liable to pay interest on the debentures and to repay the deposit. The arrangement between the companies was that the payment of interest and the repayment of the deposits would actually be made by the Australian company but if it defaulted, the U.K. company would be liable to make these payments.

Result:

28. In issuing the debentures in the overseas market, the U.K. company was considered to be not acting as an agent for the Australian company but rather to be acting on its own behalf. No interest withholding tax exemption certificate was issued to the Australian company in respect of the interest payable on the deposits.

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