- Tax implications of Inter-bank Offered Rate reform

Australian Government
Australian Taxation Office

Discussion Paper

Tax implications of Inter-bank Offered Rate reform

Common tax consequences of changes made to financial arrangements driven by Inter-bank Offered Rate reform

Purpose and status of this discussion paper

The purpose of this discussion paper is to facilitate consultation between the Australian Taxation Office (ATO) and the community as part of the process of developing advice on the application of the tax law.

This discussion paper is prepared solely for the purpose of obtaining comments from interested parties. All views in this discussion paper are therefore preliminary in nature and should not be taken as representing either an ATO view or that the ATO will take a particular view.

This discussion paper is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this discussion paper does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Table of Contents **Paragraph**

What this discussion paper is about

1. Interest rate benchmarks, including the London Inter-bank Offered Rate (LIBOR), the Euro Inter-bank Offered Rate (EURIBOR), the United States of America's Effective Federal Funds Rate and other Inter-bank Offered Rate (IBOR) benchmarks are at various stages of reform and transitioning to alternative risk-free rates (RFRs). These RFRs, including:

- the Secured Overnight Financing Rate (SOFR), in respect of US Dollar (USD) borrowings
- the Euro short-term rate (€STR), in respect of Euro (EUR) borrowings
- the Sterling Overnight Interbank Average Rate (SONIA), in respect of British pound sterling (GBP) borrowings

are typically administered and published by major central banks worldwide.

2. Transitioning to RFRs will be a complex process for the industry as RFRs are structurally different from IBORs and it is expected most financial arrangements such as loans, bonds and derivatives that provide for IBOR-based payments will need to be modified to accommodate this transition.

3. On 5 March 2021, the United Kingdom's (UK's) Financial Conduct Authority (FCA) announced that the majority of LIBOR settings will cease to be quoted from 31 December 2021. Accordingly, businesses may be looking to modify the contracts of impacted IBOR-based financial arrangements by:

- replacing the existing benchmark rate in the relevant agreement with an alternative RFR
- amending existing fallback clauses, or introducing fallback clauses where they do not currently exist

- making other incidental variations to contracts as a direct consequence of IBOR reform, such as additional payments to be made for the purposes of preserving the parties' economic positions.

4. In making changes to legacy contracts as a result of LIBOR reform, parties may choose to adopt market consensus in terms of standard language and IBOR fallback rate adjustments consistent with published international guidance by relevant industry and regulatory bodies including:

- the Alternative Reference Rates Committee, including its Guiding Principles
- the Working Group on Sterling Risk-Free Reference Rates
- the Working Group on Euro Risk-Free Reference Rates
- the National Working Group on Swiss Franc (CHY) Reference Rates
- the Cross-Industry Committee on Japanese Yen (JPY) Interest Rate Benchmarks
- the International Swaps and Derivatives Association (ISDA), including the ISDA 2020 IBOR Fallbacks Protocol and the Fallback Supplement to the 2006 ISDA Definitions
- Bloomberg, including its IBOR Fallback Rate Adjustment Rule Book
- the Loan Market Association (LMA), including its template terms.

Purpose

5. The ATO is seeking your input through this discussion paper on the tax implications arising from IBOR reform (including the cessation of LIBOR) so that we can provide you with relevant advice and guidance to assist you in complying with your tax obligations. It is currently proposed that the final guidance on the tax implications arising from IBOR reform will be published as higher-level web-based content on the ATO website.

6. The ATO welcomes your feedback on the particular format and structure of the final guidance, as well as any relevant issues or specific concerns about the matters raised in this discussion paper including any areas of tax law arising from IBOR reform which you think are unclear or cause difficulties.

Scope

7. This discussion paper sets out common tax considerations that you should consider with respect to changes made to certain financial arrangements that are driven by IBOR reform. Although this discussion paper refers to LIBOR, it applies equally to other IBORs which are subject to reform. The focus of this discussion paper is on financial arrangements that are capable of being subject to the Taxation of Financial Arrangements (TOFA) regime.[1]

8. While regulatory authorities and working groups in various jurisdictions are considering RFRs to replace IBORs that will cease, there is still uncertainty as to when some RFRs will be available and how they will impact the operation of financial arrangements.

9. The content of this discussion paper therefore reflects the ATO's current understanding of the expected changes as at 30 June 2021.

---

[1] Division 230 of the *Income Tax Assessment Act 1997* (ITAA 1997).

Background

What is LIBOR?

10. LIBOR is a set of interest rate benchmarks based on the rates at which banks are willing to borrow wholesale unsecured funds. Broadly, it is based on inter-bank transactions and expert submissions from a panel of major global banks. LIBOR is commonly used in financial arrangements, including loans, derivative (including hedging) arrangements, internal pricing and other financial arrangements. It is administrated by the Intercontinental Exchange Benchmark Administration and supervised by the FCA.

Transition from LIBOR

11. In July 2017, the FCA announced that it will no longer persuade or compel banks to make submissions regarding LIBOR following the end of 2021 and that market participants should expect LIBOR to be subsequently discontinued or no longer deemed representative.

12. On 5 March 2021, the FCA formally announced[2] that that all LIBOR settings for all currencies will either cease to be provided by any administrator or no longer be representative immediately after the following dates:

- 31 December 2021 for all GBP, EUR, CHF and JPY LIBOR settings in all tenors (overnight, one-week, and one, two, three, six and 12-month settings), and USD LIBOR one-week and two-month settings
- 30 June 2023 for USD LIBOR overnight and one, three, six and 12-month settings.

13. The FCA also advised that it will consult on the publication and permitted use of a limited number of LIBOR settings[3] on a 'synthetic' basis after the above dates for the purpose of reducing disruption in markets in respect of 'tough legacy' contracts.

14. In Australia, financial regulators have strongly encouraged financial-market participants to prepare for the transition away from LIBOR, for example, by adopting alternative RFRs and including robust fallback clauses in existing contracts.[4] In this regard, the Australian Securities and Investments Commission (ASIC), with the support of the Australian Prudential Regulation Authority (APRA) and the Reserve Bank of Australia (RBA), has strongly advised Australian financial and corporate institutions to adhere to the 2020 IBOR Fallbacks Protocol and associated Supplement released on 23 October 2020.[5]

Australian benchmark reform

Multiple-rate approach

15. For the Australian dollar (AUD), the key interest rate benchmarks are the Bank Bill Swap Rates (BBSW) and the RBA Inter-bank Overnight Cash Rate (Cash Rate or AUD Overnight Index Average (AONIA)). The BBSW is a credit-based short-term interest rate used as a benchmark for the pricing of AUD derivatives and securities, while AONIA is the interest rate on unsecured overnight loans between banks and is considered the (near) RFR for the AUD.

16. Reforms have also been undertaken to enhance the robustness of these benchmarks, including changes in recent years to strengthen the methodology underlying the benchmark

---

[2] FCA 2021, *Announcements on the end of LIBOR*, press release, 5 March.

[3] The relevant LIBOR settings subject to consultation are the one, three and six-month GBP and JPY LIBOR settings for a further period after end-2021. The FCA has advised that it will also continue to consider the case for publication of the one, three and six-month USD LIBOR settings for a further period after the end of June 2023 on a synthetic basis.

[4] APRA, ASIC and RBA 2020, *Regulators Release Feedback on Financial Institutions' Preparation for LIBOR Transition*, joint media release, Sydney, 8 April.

[5] APRA, ASIC and RBA 2020, *Regulators urge Australian institutions to adhere to the ISDA IBOR Fallbacks Protocol and Supplement*, joint media release, Sydney, 13 October.

calculation of the BBSW.[6] Accordingly, the RBA has indicated that regulators in Australia will be facilitating a 'multi-rate' approach, where Australia's local credit-based benchmark (the BBSW) will co-exist with Australia's (near) RFR (AONIA) as the key benchmarks for the AUD.[7]

17. With regard to the transition from LIBOR, the RBA has highlighted the expectation that market participants will need to choose a robust alternative RFR in replacing LIBOR that is best suited to each product and service and appropriate to their clients' need for financing or hedging strategies. In some circumstances, referencing AONIA may be appropriate, for example, floating-rate notes issued by governments, non-financial corporations and securitisation trusts. In other circumstances, a credit-based benchmark like BBSW may be appropriate, for example, floating-rate notes and corporate loans issued by banks.

The IBOR Transformation Australian Working Group

18. The IBOR Transformation Australian Working Group (ITAWG) is the national working group for considering the strategic issues facing Australia as the market is transformed by international developments regarding IBOR transition. The ITAWG was established by industry after consultation with the RBA and liaises regularly with the RBA on its work. For example, it was determined by the ITAWG that reference to the RBA Cash Rate would be changed to a reference to AONIA in ISDA fallback documentation.[8]

Income tax considerations

19. The tax consequences of IBOR reform will largely depend on the legal effect of any amendments made to your legacy contracts in response to IBOR reform and specifically whether the relevant amendments cause a mere variation or rescission to the existing legal contract.

Amending or creating contracts

20. Depending on the terms and conditions of the legal contracts involved, as a matter of contract law, the amendment of a legal contract will form either the:

- continuation of the legal contract (that is, a variation of the existing contract), or
- creation of a new legal contract (that is, a rescission of the existing contract).

21. The intention of the parties as reflected in the amendments to the legal contract[9], and the significance of the amendments in altering the substance of the original contract[10], will be significant factors in determining whether the changes constitute a variation of an existing legal contract, or the redemption and replacement of an existing legal contract under contract law. This is a question of fact to be determined by reference to all the facts and circumstances of each case. The critical question is whether what has been agreed is 'entirely inconsistent' with the first contract or goes to 'the very root' of the first contract so as to discharge it altogether, or whether there has been a variation that qualifies or alters some of the provisions of the first contract but otherwise leaves the rest of it on foot.[11]

22. Where the parties agree to change the terms of the contract for the sole purpose of responding to the withdrawal of LIBOR, from a contract law perspective the ATO expects that in most cases this is likely to be characterised as a variation of the existing contract rather than the creation of a new legal contract.

---

[6] RBA and ASIC 2018, *ASIC and RBA Welcome the New BBSW Calculation Methodology*, media release, Canberra, 21 May.

[7] Kent, C (2021), *The End of Libor and the Australian Market*, keynote address to the ISDA Benchmark Strategies Forum Asia Pacific, online, 18 March.

[8] Minutes to the ITAWG meeting of 29 June 2020.

[9] *Tallerman & Co Pty Ltd v Nathan's Merchandise (Vic) Pty Ltd* [1957] HCA 10.

[10] *Morris v Baron & Co* [1918] AC 1.

[11] *British & Bennington's Ltd v North Western Cachar Tea Co Ltd* [1923] AC 48.

23. This would apply, for example, where the parties agree to replace LIBOR for one of the new RFRs. If the intention of the parties is to maintain the existing legal contract, we would generally expect to also see some amendment to the spread or margin or the requirement of additional payments to be made between the parties to broadly maintain the substance of the arrangement.

24. An amendment to a legal contract should be analysed by determining the position agreed between the parties to the contract and whether this represents a variation to an existing contract or a rescission of an existing contract and the creation of a new contract. Accordingly, the way the amendment is recorded in an internal system (for example, by cancelling an existing entry and booking a new entry in the system) will not determine the legal effect of the amendment.

25. There are a number of tax consequences arising from whether there has been a rescission or a variation of a legal contract. The most common tax consequences that may arise are set out in this discussion paper and illustrated through a number of examples set out in Appendix 1 to this discussion paper. These examples are non-exhaustive and taxpayers should exercise judgment about how the principles in this discussion paper apply to their own facts and circumstances and the nature and extent of documentation appropriate to justify the tax outcome in their particular circumstances.

26. The principles from the examples in this discussion paper should be able to be applied to a wide range of situations.

27. Where fallback provisions come into operation according to the existing terms of the original agreement (that is, there is no amendment to an existing legal contract), this should not be regarded as a variation to the contract and therefore in the absence of any other changes it will not be necessary to consider whether a new contract has been created.

What are the tax considerations if a contract is amended to address LIBOR reform?

28. Amendments to a legal contract to change from IBOR to a new RFR for the purposes of LIBOR reform (an IBOR amendment) may trigger an assessable gain or deductible loss for tax purposes. The more common circumstances where this can occur is explored through a number of illustrative examples set out in Appendix 1 to this discussion paper.

What are the tax implications where changes only vary the original contract?

29. Where an IBOR amendment results in the variation of the contract, and the contract represents a financial arrangement that is subject to the TOFA regime, there may be an assessable gain or deductible loss for tax depending on the particular TOFA tax-timing method(s) which apply.

30. If a taxpayer has made a TOFA tax-timing method election which relies on the way that a financial arrangement is treated under the accounting standards, such as the ‘reliance on financial reports’ (ROFR) method or some other relevant method, the income tax consequences should largely follow the accounting outcomes.

31. For example, a spread adjustment, or different term structure of the financial arrangement to reflect the new RFR may result in a credit or debit adjustment to the profit and loss of the parties and this may trigger an assessable gain or deductible loss for tax under the TOFA regime.

32. If a taxpayer has not elected the ROFR method and instead relies on the default methods for example, it may need to reassess or reestimate its loans under the TOFA accruals/realisation method in Subdivision 230-B of the ITAA 1997.

33. If the relevant financial arrangement is not subject to the TOFA regime, the income tax consequences of a variation to the contract will depend on provisions outside the TOFA regime, such as the ordinary income and deduction provisions (Divisions 6 and 8 of the ITAA 1997) and Division 16E of the *Income Tax Assessment Act 1936* (ITAA 1936).

What are the tax implications where changes rescind the original contract and create a new one?

34. Where an IBOR amendment to the contract results in all the taxpayer's rights and/or obligations under the relevant financial arrangement ceasing, this will give rise to a balancing adjustment under Subdivision 230-G of the ITAA 1997.

35. If the financial arrangement is not subject to the TOFA rules, you may need to consider the tax implications in sections 26BB and 70B, or Division 16E, of the ITAA 1936, where the financial instrument is a traditional security or qualifying security (which requires consideration of whether there has been a redemption of the security).

36. Where the impacted financial arrangement is held on capital account, the termination of the original contract may also result in consequences under the CGT rules, for example, CGT event C2.

What are the interest withholding tax implications if additional payments are required as a result of a variation or rescission of a cross-border loan contract?

37. In some circumstances, parties may be required to make additional one-off or a series of payments to the counterparty for the purposes of preserving the parties' economic positions where the financial arrangement is amended in response to IBOR reform.

38. In the case of a loan, this payment or payments may be required by either the lender or the borrower, depending on the how the expected cash flows under LIBOR compare with the expected cash flows under the alternative RFR and result from the spread adjustment or different term structure of the new RFR.

39. The tax impact of providing and/or receiving such a payment(s), regardless of whether there has been a variation or rescission of the existing contract, will depend on the source and character of the payment which may result in a potential assessable gain or deductible loss for tax purposes. You should consider the nature of this payment, which will depend on the nature of the underlying contract and the party making the payment.

40. Where a borrower is required to pay an amount to the lender, we would generally expect this payment to be compensation to the lender for being kept out of the use and enjoyment of the principal sum and therefore be in the nature of interest.[12]

41. Where a lender is required to pay an amount to the borrower, we would generally expect that this payment cannot represent compensation to the borrower for being kept out of the use and enjoyment of the principal sum and would not be in the nature of interest.

What are the tax implications on the availability of existing withholding tax exemptions?

42. Some impacted lending arrangements may benefit from an existing concessional treatment for the purposes of withholding tax. For example, the issuer of a debenture may be exempt from the requirement to pay interest withholding tax under the public officer test in section 128F of the ITAA 1936.

43. Where this is the case, the eligible lending arrangements will continue to receive section 128F concessional treatment where the relevant contract amendment due to IBOR transition does not result in the termination and creation of a new financing arrangement. This concessional treatment under section 128F would extend to any additional payments arising as a result of IBOR reform that are in the nature of interest. As above, we would generally expect this to be the case where a borrower is required to pay an amount to the lender as a result of IBOR reform.

---

[12] *Commissioner of Taxation v Myer Emporium Ltd* [1987] HCA 18.

44. If an arrangement is modified in a manner that results in a new financial arrangement, the arrangement will be treated as reissued or a new loan facility and therefore subject to the operation of the withholding tax provisions.

What are the transfer pricing considerations when making amendments to cross-border financial arrangements to transition from LIBOR?

45. A transfer pricing benefit may arise when a cross-border financial arrangement is amended to transition from LIBOR. This will generally be relevant where the parties to the cross-border financial arrangement are related.

46. In determining whether an amendment might result in a transfer pricing benefit, it will first be necessary to consider whether the amended financial arrangement is consistent with what arm's length parties would do. Generally, we would not expect a transfer pricing benefit to arise from an amendment to transition from LIBOR where the amendment is:

- in line with market practice and the most recent recommendations published by the relevant industry and regulatory body – see paragraph 4 of this discussion paper
- consistent with the transitioning of your relevant third-party financing arrangements and those of other members of your multinational group
- limited to the contractual terms necessary to implement the transition.

47. You should keep contemporaneous documentation which records and explains the amendments made to your cross-border related-party financing arrangements and why they are consistent with the arm's length principles.[13] This may include support for the commercial rationale and appropriateness of the approach applied and alignment with the factors listed above.

Specific questions for consideration

48. The ATO invites interested parties to provide written submissions on any relevant issues or specific concerns about matters raised in this discussion paper, as well as the particular form and structure of the final guidance. In particular, the ATO is interested in views regarding the following:

a) Does this discussion paper appropriately reflect industry practice in relation to the most likely changes which have, or will be, made to financial arrangements that are driven by IBOR reform?

b) The examples in Appendix 1 to this discussion paper are predominately based around IBOR-based cash products such as loans. Are there any additional common IBOR-reform scenarios which would arise in relation to cash products or other financial products such as derivatives?

c) Is it practical for industry to determine economic equivalence for each of its financial arrangements transitioning from LIBOR? For example, can industry rely on the 'substantially similar' test used for accounting to make that assessment? If not, how else is industry able to determine whether each of its financial arrangements remain substantially the same post-IBOR transition?

d) How will industry determine whether all its contracts that underpin individual financial arrangements remain substantially the same post-IBOR transition from a contract law perspective?

e) How is industry able to calculate whether IBOR transitioning may result in a change in the value of its related-party financial arrangements?

f) Are there scenarios where debt and its corresponding hedging derivatives may not result in the post-transition derivative being effective for accounting purposes? For

[13] See Taxation Ruling TR 2014/8 *Income tax: transfer pricing documentation and Subdivision 284-E*, and Subdivision 284-E of Schedule 1 to the *Taxation Administration Act 1953*.

example, we understand that at first instance on the 'Benchmark Replacement' waterfall, the Alternative Reference Rates Committee has recommended a simple (instead of compounded) SOFR for syndicate loans. We understand however that ISDA-compliant derivatives would use a compounded SOFR.

g) Are there scenarios where a lender is required to pay an amount to the borrower as compensation for a negative spread adjustment due to the structure of the replacement RFR, or is it more likely that the lender would reduce the principal balance owing? What is the typical fact pattern for derivatives that are impacted by negative spread adjustments?

h) How prevalent, and in what circumstances, are one-off payments likely to be made in lieu of credit spread adjustments as part of the IBOR transition process?

i) Are there any other areas of uncertainty under tax law arising from IBOR transition which are not covered by the discussion paper?

Date of issue: 12 August 2021

Appendix 1 – Scenario and examples

In order to illustrate some of the more common tax issues that may arise as a result of changes made to financial arrangements driven by IBOR, the principles discussed in this discussion paper are provided in a series of examples in Appendix 1 of this discussion paper which build upon the following high-level scenario.

Responding to LIBOR reform – scenario

49. In response to IBOR reform, ABC Bank, an Australian entity, has made changes to contracts underpinning its financial arrangements which contain references to any IBOR-related benchmark rates (IBOR-impacted arrangements), such as those included in paragraph 3 of this discussion paper.

50. ABC Bank has undertaken an assessment of all changes made to its financial arrangements in response to IBOR reform, including the contracts for its loan and derivative portfolios and has determined that:

- in most circumstances, the changes made to the contract for IBOR reform are minor and would be considered a variation to the original contract
- the amendments are intended to ensure that the fair value of the original transaction is substantially equivalent, and the economic position of each party is broadly maintained
- in certain circumstances, the changes made to a contract are significant, inconsistent with the original contract and reflect the intention of both parties to rescind the original transaction and create a new contract.

Example 1 – contract variations consistent with market standard terms

51. *One of the various IBOR-impacted arrangements identified by ABC Bank is a four-year GBP floating rate facility provided to XYZ PLC (its UK subsidiary) in 2020. The interest rate for this debt facility is 3M GBP LIBOR +5%. The existing fallback language in the facility agreement contains a historic standard LMA rate calculation clause which defaults to the last LIBOR screen rate in the event that LIBOR is no longer available. That is, in the absence of any legislative or prudential remedies dealing with legacy contracts, the existing fallback language will change the facility into a fixed-rate facility based on the last published LIBOR rate on 31 December 2021.*

52. *In response to LIBOR reform, ABC Bank and XYZ PLC agree to amend the relevant contract by inserting standard LMA provisions relating to the transition from LIBOR to SONIA. The amendments include replacement of the existing LIBOR reference rate with SONIA, as well as the inclusion of industry-accepted fixed credit spread adjustments and a methodology to calculate the compounded SONIA rate. The fair value of the amended facility (at the time of amendment) is substantially equivalent to the original facility (just before the amendment). The changes are consistent with the transitioning of ABC Bank's similar arrangements with third-party customers.*

TOFA consequences

53. Based on the fact pattern in Example 1 of this discussion paper, the ATO considers that the amendment is a variation and does not rescind the original contract. If ABC Bank is subject to the TOFA regime, there is no balancing adjustment gain or loss under Subdivision 230-G of the

ITAA 1997. However, there may be an assessable gain or deductible loss for tax depending on the specific rules applicable to ABC Bank under the TOFA regime.[14]

Transfer pricing

54. The changes were considered to be in line with market practice, consistent with the transitioning of ABC Bank's third-party arrangements and limited to variation of contractual terms necessary to implement the transition. The ATO will generally view the changes as posing low transfer pricing risk. ABC Bank should maintain contemporaneous documentation which records and explains the changes made and compliance with the arm's length principle.

Example 2 – third-party contract amendments consistent with market standard terms

55. *One of the various IBOR-impacted arrangements identified by ABC Bank is a nine-year cross-currency interest rate swap entered into with its Australian third-party customer DCE Pty Ltd. The cross-currency interest rate swap is used by DCE Pty Ltd to hedge a EUR exposure arising from a EUR -denominated term funding raised offshore.*

56. *ABC Bank and DCE Pty Ltd pay interest rates inclusive of margins based on 3M BBSW and 3M EURIBOR respectively.*

57. *In response to LIBOR reform, ABC Bank and DCE Pty Ltd agree to amend the terms of the relevant contract in accordance with the terms of the ISDA 2020 IBOR Fallbacks Protocol relating to the transition from EURIBOR to €STR. The fair value of the amended facility (at the time of amendment) is substantially equivalent to the original facility (just before the amendment).*

TOFA consequences

58. Based on the fact pattern in Example 2 of this discussion paper, the ATO considers that the amendment is a variation and does not rescind the original contract. If ABC Bank is subject to the TOFA regime, there is no balancing adjustment gain or loss under Subdivision 230-G of the ITAA 1997. However, there may be an assessable gain or deductible loss for tax depending on the specific rules applicable to ABC Bank under the TOFA regime.[15]

Example 3 – contract amendments that are inconsistent with market standard terms

59. *One of the various IBOR-impacted arrangements identified by ABC Bank is an eight-year GBP floating rate facility provided to XYZ PLC (its UK subsidiary) in 2019. The interest rate for this debt facility is 3M GBP LIBOR +5%.*

60. *The existing terms of the contract do not contain fallback language that would operate if the underlying reference rate in the product is permanently discontinued, ceases to be available or there has been a pre-cessation announcement that the rate is no longer (or will at some point in the future no longer be) representative.*

61. *ABC Bank and XYZ PLC agree to amend the terms of the contract to include fallback language that may not be in line with market practice and will change the floating-rate facility into a fixed-rate facility based on the last quoted 3M GBP LIBOR rate screen rate as at 31 December 2021.*

[14] If the TOFA regime does not apply, see paragraph 33 of this discussion paper.
[15] If the TOFA regime does not apply, see paragraph 33 of this discussion paper.

TOFA consequences

62. If the amendment materially alters the substance of the facility under the fact pattern in Example 3 of this discussion paper (for example, there is a significant change to the fair value or to the risks or rewards associated with the facility), having regard to the contract law principles in paragraphs 20 and 21 of this discussion paper, the ATO may consider the contract has been rescinded and replaced by a new contract. If that is the case and ABC Bank is subject to the TOFA regime, there would be a balancing adjustment gain or loss under Subdivision 230-G of the ITAA 1997.[16]

Transfer pricing

63. The changes to the related-party arrangement may not be in line with market practice and the recommendations published by the relevant industry and regulatory body. Further, the conversion to a fixed-rate facility by reference to the last-published LIBOR may materially change the anticipated interest payments between ABC Bank and XYZ PLC and the risks assumed by the parties. The ATO may view these changes as posing a higher transfer pricing risk.

64. ABC Bank should maintain contemporaneous documentation which records and explains the changes made and compliance with the arm's length principle. This would include evidence to demonstrate that independent entities dealing wholly independently with one another in comparable circumstances would have agreed to transition their arrangements in this manner.

Example 4 – contract amendments that are solely not related to IBOR reform

65. *Same as Example 1 of this discussion paper (that is, in response to IBOR reform), ABC Bank and XYZ PLC agree to amend the relevant contract by inserting standard LMA provisions relating to the transition from LIBOR to SONIA.*

66. *The fair value of the amended facility (at the time of amendment) is substantially equivalent to the original facility (just before the amendment). The changes are consistent with the transitioning of ABC Bank's similar arrangements with third-party financing arrangements.*

67. *In addition to these changes, the parties also agree to extend the term of the facility by another five years. The fair value of the amended facility (at the time of amendment) is substantially different to the original facility (just before the amendment).*

TOFA consequences

68. If the substance of the facility has been materially altered due to the term extension, having regard to the contract law principles in paragraphs 20 and 21 of this discussion paper, the ATO may consider the rights and obligations under the existing facility to have ceased and give rise to a balancing adjustment gain or loss under Subdivision 230-G of the ITAA 1997.

Transfer pricing

69. The changes made by ABC Bank and XYZ PLC are not limited to the variations of contractual terms necessary to implement the transition. The term extension may be regarded as a material change to the facility and the risks assumed by the parties. The ATO may view these changes as posing higher transfer pricing risks.

---

[16] If the TOFA regime does not apply, see paragraphs 35 and 36 of this discussion paper.

70. ABC Bank should maintain contemporaneous documentation which records and explains the changes made and compliance with the arm's length principle. This should include evidence to demonstrate that independent entities dealing wholly independently with one another in comparable circumstances would have agreed to extend the term of the loan.

Appendix 2 – Your comments

71. You are invited to comment on this discussion paper. Please forward your comments to the contact officer by the due date.

72. Note that your submission (including name and address details if included) may be published on the ATO website unless you indicate that you do not wish this to occur. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain unpublished should provide this information marked as such in a separate attachment.

Due date: 10 September 2021

Contact officer details have been removed as the comments period has ended.

References

Related Rulings/Determinations:

TR 2014/8

Legislative references:

- ITAA 1936 Div 16E
- ITAA 1936 26BB
- ITAA 1936 70B
- ITAA 1936 128F
- ITAA 1997 Div 6
- ITAA 1997 Div 8
- ITAA 1997 Div 230
- ITAA 1997 Subdiv 230-B
- ITAA 1997 Subdiv 230-G
- TAA 1953 Sch 1 Subdiv 284-E

Cases relied on:

- British & Bennington's Ltd v North Western Cachar Tea Co Ltd [1923] AC 48
- Commissioner of Taxation v Myer Emporium Ltd [1987] HCA 18; (1987) 163 CLR 199; 87 ATC 4363; 18 ATR 693
- Morris v Baron & Co [1918] AC 1
- Tallerman & Co Pty Ltd v Nathan's Merchandise (Vic) Pty Ltd [1957] HCA 10; (1957) 98 CLR 93; [1957] ALR (CN) 1198; 57 SR (NSW) 466; 74 WN (NSW) 383; 31 ALJ 176

Other references:

- FCA 2021, *Announcements on the end of LIBOR*, press release, 5 March
- APRA, ASIC and RBA 2020, *Regulators Release Feedback on Financial Institutions' Preparation for LIBOR Transition*, joint media release, Sydney, 8 April.
- APRA, ASIC and RBA 2020, *Regulators urge Australian institutions to adhere to the ISDA IBOR Fallbacks Protocol and Supplement*, joint media release, Sydney, 13 October.
- RBA and ASIC 2018, *ASIC and RBA Welcome the New BBSW Calculation Methodology*, media release, Canberra, 21 May.
- Kent, C (2021), *The End of Libor and the Australian Market*, keynote address to the ISDA Benchmark Strategies Forum Asia Pacific, online, 18 March.
- Minutes to the ITAWG meeting of 29 June 2020

ATO references

NO:	1-QECLRNE
BSL:	PGI
ATOlaw topic:	Income tax ~~ Taxation of financial arrangements (TOFA) ~~ Application of TOFA – other
	Income tax ~~ Taxation of financial arrangements (TOFA) ~~ Transitional balancing adjustment
	International issues ~~ Transfer pricing ~~ Documentation
	Withholding tax ~~ Royalties / interest / unfranked dividends ~~ Foreign resident