

***TD 2009/21 - Income tax: to obtain a deduction under section 25-90 of the Income Tax Assessment Act 1997 for a cost in relation to a debt interest does the taxpayer have to actually derive a dividend to which section 23AJ of the Income Tax Assessment Act 1936 applies in the same income year as that in which the cost is incurred?***

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! This ruling is being reviewed as a result of a recent court/tribunal decision. Refer to Decision Impact Statement: Noza Holdings Pty Ltd and Ors v Federal Commissioner of Taxation; Federal Commissioner of Taxation v Noza Holdings Pty Ltd (Published 17 September 2012).

! There is a Compendium for this document: TD 2009/21EC .

! This document has changed over time. This is a consolidated version of the ruling which was published on *20 February 2013*



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## Taxation Determination

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Income tax: to obtain a deduction under section 25-90 of the *Income Tax Assessment Act 1997* for a cost in relation to a debt interest does the taxpayer have to actually derive a dividend to which section 23AJ of the *Income Tax Assessment Act 1936* applies in the same income year as that in which the cost is incurred?

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This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

**[Note:** This is a consolidated version of this document. Refer to the ATO Legal Database (<http://law.ato.gov.au>) to check its currency and to view the details of all changes.]

### Ruling

1. No. To obtain a deduction under section 25-90 of the *Income Tax Assessment Act 1997* (ITAA 1997) it is not necessary for a taxpayer to actually derive a dividend to which section 23AJ of the *Income Tax Assessment Act 1936* (ITAA 1936) applies in the same income year as that in which the cost is incurred.

2. However, there must be a sufficiently clear nexus, at the time the cost is incurred, between the relevant cost and either the production of an actual section 23AJ dividend<sup>1</sup> or an expected section 23AJ dividend.<sup>2</sup> Where a section 23AJ dividend has not actually been derived, a deduction under section 25-90 would be available for a relevant cost if there was a reasonable expectation, together with a more than theoretical potential, for such a dividend to be paid to the taxpayer incurring the cost, along with a sufficiently clear nexus at the time the cost is incurred between the incurring of that cost and that reasonable expectation. This is a question of fact that requires a careful consideration of all the objective circumstances of each particular case.

3. This Determination does not address the question of the amount of the deduction (if any) available under section 25-90 of the ITAA 1997: this is a question of fact to be decided by having regard to all the objective circumstances of each situation.

### **Date of effect**

4. This Determination applies to years of income commencing both before and after its date of issue. However, this Determination will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

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**Commissioner of Taxation**

16 December 2009

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<sup>1</sup> In this Determination a reference to a section 23AJ dividend is a reference to a dividend that is non-assessable, non-exempt income by reason of the application of section 23AJ of the ITAA 1936.

<sup>2</sup> The other requirements of section 25-90 of the ITAA 1997 must also be satisfied.

## Appendix 1 – Explanation

❶ ***This Appendix is provided as information to help you understand how the Commissioner’s view has been reached. It does not form part of the binding public ruling.***

### Explanation

5. Section 25-90 of the ITAA 1997 provides:

An \*Australian entity can deduct an amount of loss or outgoing from its assessable income for an income year if:

- (a) the amount is incurred by the entity in deriving income from a foreign source; and
- (b) the income is \*non-assessable non-exempt income under section 23AI, 23AJ or 23AK of the *Income Tax Assessment Act 1936*; and
- (c) the amount is a cost in relation to a \*debt interest issued by the entity that is covered by paragraph (1)(a) of the definition of **debt deduction**.

6. Section 25-90 of the ITAA 1997 is a standalone deduction provision concerned with losses and outgoings that are particular types of ‘costs’ in relation to debt interests.<sup>3</sup> The words of the provision must not be read in isolation, but in context, in the widest sense of that word. Therefore it is necessary to consider the words in the textual context of the tax law, and also in the context of the law before the provision was enacted, and to discover the mischief intended to be remedied.<sup>4</sup>

7. In paragraph 25-90(a) of the ITAA 1997, the phrase ‘in deriving’<sup>5</sup> creates a requirement for a specific type of nexus between the ‘cost’ that has been incurred in relation to the debt interest and the foreign source income covered by paragraph 25-90(b) of the ITAA 1997 (for example, section 23AJ dividends). The use of the verb form ‘in deriving’ suggests that the nexus is concerned with identifying costs that form part of the process of income derivation, rather than being concerned with a particular occasion of actual derivation. If deductions under section 25-90 of the ITAA 1997 were intended to be limited to income years in which the relevant foreign income was actually derived, one would have expected to see a different emphasis in the wording of the provision.

<sup>3</sup> There is nothing in the wording of section 25-90 of the ITAA 1997 that allows the section to be read as if it was subject to the express or implied limitations to be found in section 8-1 of the ITAA 1997 but see *Commissioner of Taxation v. Noza Holdings Pty Ltd* [2012] FCAFC 43 at [42] and [44]. Section 25-90 must be read on its own terms. That is the words of the provision should be interpreted in the context in which they appear having regard to the intention of Parliament in using those words, rather than by analogy with another provision that may use somewhat similar wording. This does not mean that the conclusion reached will necessarily be different from the conclusion reached in respect of that other provision, it merely acknowledges that a different process of reasoning has been used.

<sup>4</sup> The purposive approach to statutory interpretation had its origins in the ‘mischief rule’ (Pearce, DC and Geddes, RS, 2006, *Statutory interpretation in Australian*, 6<sup>th</sup> edn, Butterworths, Australia, p. 27. It is well established that the mischief intended to be remedied by an enactment is a relevant part of the context to be taken into account in interpreting a provision, and for this purpose, reference may be made to extrinsic materials (*CIC Insurance Ltd v. Bankstown Football Club Ltd* [1997] HCA 2; (1997) 187 CLR 384).

<sup>5</sup> The word derive and its cognate expressions take their meaning from the statutory context in which they appear, rather than from reliance upon past authorities which considered a different statutory context; *FC of T v. Sun Alliance Investments Pty Ltd (in liq)* [2005] HCA 70 at [45]; (2005) 225 CLR 488 at 505; 2005 ATC 4955 at 4964; (2005) 60 ATR 560 at 572. Consequently, while there may be a general presumption that a word will be used consistently within the same legislative enactment that presumption is easily rebutted; *Commissioner of Taxes (Vic) v. Lennon* (1921) 29 CLR 579 at 590 Higgins J and more recently *McGraw-Hinds (Aust) Pty Ltd v. Smith* (1978) 144 CLR 633 at 643 per Gibbs ACJ.

8. Such a conclusion finds additional support in the overall structure and wording of the provision. For example, section 25-90 of the ITAA 1997 does not expressly require a temporal nexus between the incurring of the cost and the actual derivation of a section 23AJ dividend. Nor does it expressly state the income year in which the deduction is available. As a general rule the tax system recognises a deduction in the year in which the expense arises or is otherwise incurred. If an alternative result is intended then the legislation will generally specify the year or years in which the deduction is recognised. All this suggests that a temporal matching to the actual receipt of income is not intended.

9. Section 25-90 of the ITAA 1997 was introduced at the same time as the broader thin capitalisation regime, and was intended to operate in the context of that regime. Prior to the enactment of these provisions the tax law imposed limitations on debt deductions incurred in funding foreign subsidiaries through the general deduction rule in section 8-1 of the ITAA 1997. That provision denied deductions for costs incurred in earning exempt foreign income. There were also provisions that quarantined certain types of deductions. All of these provisions were prone to circumvention by careful tax planning.<sup>6</sup> The fundamental intention of section 25-90 was that, in respect of certain categories of foreign source income, taxpayers should be able to achieve in a straight-forward manner what they could already practically achieve in a roundabout manner under the existing law.

10. Therefore on balance it is considered that section 25-90 of the ITAA 1997 does not require a form of temporal matching between expenses and specific income.

11. Specifically in relation to section 23AJ dividends, the section does not require that such a dividend actually be derived in the income year in which the cost is incurred. It is enough if, at the time the cost is incurred, there is a sufficiently clear nexus between the relevant cost and either the production of an actual section 23AJ dividend or an expected section 23AJ dividend. The existence of such a nexus is a question of fact to be decided by having regard to all the objective circumstances in each case.

12. Additionally, an expectation of a section 23AJ dividend must be reasonable and not a mere theoretical possibility; that is there must be a reasonable prospect of section 23AJ dividends. In this context it is necessary to consider whether there was an expectation and intention as well as the potential for dividends of the relevant kind to be paid to the taxpayer incurring the costs, albeit in the future. Whether such an intention and potential exists is a question of fact to be decided having regard to all the objective circumstances in each particular case.

13. While by no means exhaustive, it is considered that at a practical level all of the elements set out below would usually be present before there can be a reasonable expectation that a section 23AJ dividend will be derived in a future income year.

- If an amount was paid by a company in respect of interests held by the taxpayer in that company, then that amount would be a section 23AJ dividend.
- The company in which the interests are held currently has the capacity to legally pay a dividend, or is likely to have such a capacity in the future, in respect of the interests held by the taxpayer. For example, the company has retained profits (or other funds out of which dividends can legally be paid) that could be used to pay a section 23AJ dividend in respect of the interests held by the taxpayer.
- There are objective reasons to believe that the company is more likely than not to pay a dividend in the future in respect of the interests held by the taxpayer.

## References

*Previous draft:*

TD 2009/D8

*Related Rulings/Determinations:*

TR 2006/10

*Subject references:*

- debt deductions
- deductions & expenses
- derived
- incurred
- international tax
- loss or outgoing

*Legislative references:*

- ITAA 1936 23AJ
- ITAA 1997 8-1
- ITAA 1997 25-90
- ITAA 1997 25-90(a)
- ITAA 1997 25-90(b)
- TAA 1953

*Case references:*

- CIC Insurance Ltd v. Bankstown Football Club Ltd [1997] HCA 2; (1997) 187 CLR 384
- Commissioner of Taxes (Vic) v. Lennon (1921) 29 CLR 579
- Commissioner of Taxation v Noza Holdings Pty Ltd [2012] FCAFC 43; (2012) 201 FCR 445; 2012 ATC 20-313; (2012) 82 ATR 567
- Federal Commissioner of Taxation v. Sun Alliance Investments Pty Ltd (in liq) [2005] HCA 70; (2005) 225 CLR 488; 2005 ATC 4955; (2005) 60 ATR 560
- McGraw-Hinds (Aust) Pty Ltd v. Smith (1979) 144 CLR 633; (1979) 24 ALR 175

*Other references:*

- Explanatory Memorandum to the New Business Tax System (Thin Capitalisation) Bill 2001
- Pearce, DC and Geddes, RS, 2006, Statutory interpretation in Australian, 6<sup>th</sup> edn, Butterworths, Australia

## ATO references

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<sup>6</sup> Paragraph 1.9 of the Explanatory Memorandum to the New Business Tax System (Thin Capitalisation) Bill 2001 refers to deficiency in the previous rules meaning that the rules could be easily circumvented.