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Practical issues for interest withholding tax and section 128F

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1 Introduction

This paper will provide an overview of:

1. Australian interest withholding tax (**IWT**);
2. the public offer test exemption from IWT under section 128F; and
3. the exemption from IWT available to financial institutions under some of Australia's double tax agreements (**DTAs**).

Rather than being a definitive guide to these matters, the focus of the paper is to consider a number of practical issues through the use of scenarios commonly encountered.

Legislative references in this paper are to the *Income Tax Assessment Act 1936* unless otherwise specified.

2 Overview of interest withholding tax

Australia imposes IWT of 10%[1] on interest paid by:[2]

a. Australian resident borrowers not acting at or through a permanent establishment outside Australia; or

b. non-resident borrowers carrying on business in Australia at or through a permanent establishment in Australia,

(together, **Australian Borrowers**) to either:

c. non-resident lenders not deriving interest in carrying on business at or through a permanent establishment in Australia; or

d. Australian resident lenders deriving interest in carrying on business at or through a permanent establishment outside Australia,

(together, **Offshore Lenders**).

IWT can also apply to interest paid in relation to other relationships, for example, interest paid by an Australian guarantor to an Offshore Lender or interest paid by an Australian debtor to an offshore supplier. The focus of this paper will be on interest paid in respect of borrower/lender relationships.

Although the liability to pay IWT rests with the non-resident payee (e.g. the Offshore Lender),[3] an obligation to withhold and remit to the Australian Taxation Office (the **ATO**) the amount of IWT is imposed on an Australian resident payer of interest (e.g. the Australian Borrower) under Subdivision 12-F of Schedule 1 of the *Taxation Administration Act 1953* (the **TAA**). The payer must withhold an amount under Subdivision 12-F of Schedule 1 of the TAA from a payment of interest if:[4]

a. the payee has an address outside Australia according to any record that is in the payer's possession, or that is kept or maintained on the payer's behalf; or

b. the payer is authorised to pay the interest at a place outside Australia.

However, an amount is not required to be withheld if no IWT is payable in respect of the interest.[5] This would include circumstances where a relevant exemption applies, such as the public offer test exemption under section 128F (discussed further at part 3 below) and the double tax agreement exemption for financial institutions resident in certain jurisdictions (discussed further at part 4 below).

Penalties may be applied against Australian resident payers that fail to withhold and remit the required amounts to the ATO and the payer may also commit an offence.[6] Further, no deduction is

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1 Section 7(b) of the *Income Tax (Dividends, Interest and Royalties Withholding Tax) Act 1974*.

2 Section 128B(2) and (2A).

3 Section 128B(5).

4 Section 12-245 of Schedule 1 of the TAA.

5 Section 12-300 of Schedule 1 of the TAA.

6 Sections 16-25 to 16-43 and 16-80 of Schedule 1 of the TAA.

allowed to the borrower in respect of an interest payment until the relevant amount has been withheld and the withheld amount remitted to the Australian Taxation Office.[7]

[7] Section 26-25 of the *Income Tax Assessment Act 1997* (the **1997 Act**).

3 Section 128F exemption

An exemption from the requirement to pay interest withholding tax is available if the requirements of section 128F are satisfied.

Broadly, the exemption can apply to interest paid by a company (or certain trusts) if the company paying the interest is an Australian Borrower both at the time the relevant debenture or debt interest is issued and at the time the interest is paid. The interest must relate to either a debenture (e.g. note or bond) or a "debt interest" (which includes certain syndicated loans of over $100m). The debenture or debt interest must be offered in a manner that satisfies the "public offer test" (discussed below).

3.1 Meaning of "debenture"

"Debenture" is defined inclusively in sections 6(1) and 128F(9) to include:

a. debenture stock;

b. bonds;

c. notes;

d. promissory notes;

e. bills of exchange; and

f. any other securities of a company.

Typically, a form of notes is issued. Notes may be registered or unregistered,[8] certificated or uncertificated.

3.2 Meaning of "debt interest"

In order for the exemption in section 128F to apply, interest paid other than in respect of a debenture[9] must be paid in respect of a "debt interest" within the meaning of Division 974 of the 1997 Act.[10]

The debt interest must:[11]

1. be a non-equity share (e.g. certain types of redeemable preference shares);

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8 Although we note that unregistered notes may be subject to bearer debenture withholding tax under section 126 in some circumstances.

9 Noting that debentures would typically also be debt interests.

10 ATO Interpretive Decision 2006/274.

11 Section 128F(1). It is also possible for a type of debt interest to be prescribed by regulation. However, no such regulations currently apply.

2. consist of two or more related schemes (within the meaning of section 974-155 of the 1997 Act) where one or more is a non-equity share; or

3. be a syndicated loan.

Syndicated loans are the most commonly used form of debt interest to which the exemption applies, other than debentures.

In order to be characterised as a syndicated loan, the relevant loan or other form of financial accommodation must be provided under a "syndicated loan facility", being a facility with at least two lenders.[12] A syndicated loan facility is a written agreement:[13]

1. that describes itself as a "syndicated loan facility" or "syndicated facility agreement";[14]

2. between one or more borrowers and at least two lenders (or one lender with the ability to add other lenders);

3. under which lenders agree to lend, or provide other financial accommodation, severally but not jointly; and

4. under which at least $100m is available when the first loan or other financial accommodation is to be provided.

Additionally, if there are multiple borrowers, each borrower must be:[15]

a. part of the same wholly owned group;

b. parties to the same joint venture; or

c. associates of each other.

Given the interaction between the definitions of "syndicated loan" and "syndicated loan facility", although a loan might be made under a "syndicated loan facility", the exemption under section 128F will only be available if there are at least two lenders to the syndicated loan facility at the time that interest is paid.

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12 Section 128F(9).

13 Sections 128F(10) and (11).

14 This requirement is strictly interpreted (see Explanatory Memorandum to the *Tax Laws Amendment (2007 Measures No. 3) Act 2007* at paragraph 7.40 and PBR 1011837940581 where the Commissioner held that a loan agreement that was a "Facility Agreement" was not a syndicated loan facility).

15 Section 128F(13).

3.3 Satisfying the public offer test

The methods by which the public offer test requirement in section 128F(1) can be met vary depending on whether the interest is paid in respect of a debenture (or other form of permissible debt interest)[16] or in respect of a syndicated facility agreement.[17] These are discussed separately below.

3.3.1 Debentures

In order to satisfy the public offer test, debentures must be offered in one of the following five ways:[18]

a. to at least 10 unrelated entities that are in the business of providing finance, or investing or dealing in securities, in the course of operating in financial markets;

b. to at least 100 investors who have acquired such interests in the past, or would be likely to be interested in acquiring such interests;

c. as a result of being listed on a stock exchange;

d. as a result of negotiations being initiated publicly in electronic form (e.g. on Reuters or Bloomberg) or in another form used by financial markets for dealing in debentures or relevant debt interests (such as through distribution of an information memorandum); or

e. to a dealer, manager or underwriter who agrees with the issuer to offer the debenture or relevant debt interest for sale within 30 days of having an unconditional obligation to do so[19] in a manner described in a. to d. above.

For these purposes, an "offer" does not need to be an offer in the contractual sense. It is sufficient if the "offer" is an invitation to treat, that is, an invitation to potential debenture holders to make an offer to acquire debentures.[20]

Practically, all of the debentures of a particular class must be offered in the required manner.

The issue of a debenture or debt interest in the form of a global bond[21] will also satisfy the public offer test.[22] Relevantly, this requires that an announcement in relation to the creation of rights to a debenture or debt interest is made in one of the above manners. It is beyond the scope of this paper to detail the requirements which must be met in order for a debenture or debt interest to be a global bond.

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16 Section 128F(1)(i).

17 Section 128F(1)(ii).

18 Section 128F(3).

19 Taxation Determination TD 1999/18 *Income Tax: interest withholding tax exemption under section 128F of the Income Tax Assessment Act 1936 – for the purposes of the fifth public offer test, in paragraph 128F(3), in what circumstances is a debenture taken to be 'offered for issue'?*

20 Taxation Determination TD 1999/24 *Income Tax: interest withholding tax exemption under section 128F of the Income Tax Assessment Act 1936 – how may a company satisfy the introductory requirements in paragraphs 128F(3)(a) and (b) that a debenture must be offered on a debenture by debenture basis?*

21 As defined in section 128F(10).

22 Section 128F(4).

3.3.2 Syndicated loans

In order to satisfy the public offer test, an invitation to become a lender under a syndicated loan facility must be made in one of the following three ways:[23]

a. to at least 10 unrelated entities that are in the business of providing finance, or investing or dealing in securities, in the course of operating in financial markets;

b. publicly in electronic form (e.g. on Reuters or Bloomberg) or in another form used by financial markets for dealing in debentures or relevant debt interests (such as through distribution of an information memorandum); or

c. to a dealer, manager or underwriter who agrees with the issuer to make the invitations to become a lender under the facility within 30 days in a manner described in a. or b. above.

Unlike the position with debentures, it may be possible to make invitations in relation to only a proportion of a particular facility and still attract the exemption in respect of the whole facility. This is discussed in more detail in the example in part 3.5.2 below.

3.3.3 Offers/invitations must be genuine

Offers or invitations must be genuine.

So, for example, an offer or invitation made to 10 or more entities in the business of providing finance, or investing or dealing in securities, in the course of operating in financial markets should be made to entities that are likely to be interested in participating in the relevant note issue or syndicated loan facility and should provide sufficient information and time to allow the offeree or invitee to consider whether or not they would like to participate. Equally, an offer or invitation made publicly in electronic form should be electronically listed for a commercially reasonable period of time having regard to the nature of the offering (e.g. 10 business days).

An offer or invitation is unlikely to be genuine if the lenders and their relevant commitments have already been contractually agreed prior to the offer being made.

An offer that is not genuinely made may, depending on the circumstances, either not satisfy the requirements of section 128F(3), (3A) or (4) or may attract the application of the anti-avoidance provisions in Part IVA.[24]

3.3.4 Exemption unavailable in certain circumstances

An offer will always fail the public offer test in respect of all of the debentures issued if, at the time of issue, the company knew, or had reasonable grounds to suspect, that a debenture would be acquired

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[23] Section 128F(3A).

[24] Taxation Determination TD 1999/24 *Income Tax: interest withholding tax exemption under section 128F of the Income Tax Assessment Act 1936 – how may a company satisfy the introductory requirements in paragraphs 128F(3)(a) and (b) that a debenture must be offered on a debenture by debenture basis?*

by an offshore associate (see below) of the company, who was not acting in a permitted capacity (see below).[25] Equally, an invitation to become a lender under a syndicated loan facility will fail the public offer test if, at the time the invitation is made, the company knew, or had reasonable grounds to suspect, that an offshore associate is or will become a lender under the facility and that the associate is not acting in a permitted capacity.[26] Interestingly, the time at which this test is considered differs between debentures (where it is considered at the time of issue rather than offer) and syndicated loan facilities (where it is considered at the time of invitation).

An "offshore associate" is an "associate" (discussed below) who is either a non-resident of Australia not acquiring the debenture or participating in the syndicated loan facility in carrying on business at or through a permanent establishment in Australia or a resident of Australia acquiring the debenture or participating in the syndicated loan facility in carrying on business at or through a permanent establishment outside of Australia.

The test as to whether entities may be associates of the issuer/borrower is broad.[27] However, by way of example, companies will be "associates" if one company has the majority of voting rights in the other, or if it has some other ability to control the other, or if the entities are controlled in this manner by a common third entity.

Permitted capacities include the capacity of a dealer, manager or underwriter in relation to the placement of the debenture, or in the capacity of a clearing house, custodian, funds manager or responsible entity of a registered scheme.[28]

3.4 Interest paid to offshore associates

Even if the public offer test requirements are met, any interest subsequently paid to an offshore associate (as defined in part 3.3.4 above) other than in a permitted capacity will not be exempt from IWT.[29] For these purposes, permitted capacities are the capacity of a clearing house, paying agent, custodian, funds manager or responsible entity of a registered scheme.[30]

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25 Section 128F(5).

26 Section 128F(5AA).

27 See section 318 for the full definition, although note that paragraphs (1)(b), (2)(a) and (4)(a) are disregarded (section 128F(9)).

28 Sections 128F(5)(c) and 128F(5AA)(c).

29 Section 128F(6).

30 Section 128F(6)(c).

3.5 Common scenarios

3.5.1 Scenario 1: Borrower not in existence when invitation made

Facts

- A multinational corporate group is looking to acquire an Australian business by way of a share purchase. The group will establish a new company to make the acquisition. The new company will also be the borrower under a syndicated facility agreement to be entered into to help fund the acquisition.
- An entity within the group engages dealers who make invitations to 10 banks to participate in the syndicated facility agreement.
- The new company is incorporated only after the invitations have been made.

Consideration of treatment under section 128F

Section 128F(3A) requires that:

> An invitation to become a lender under a syndicated loan facility by a company ***satisfies the public offer test*** if the invitation was made:
>
> …
>
> (c) to a dealer, manager or underwriter, in relation to the placement of debentures or debt interests, who, under an agreement with the company, made the invitation to become a lender under the facility within 30 days in a way covered by paragraph (a) or (b).

Accordingly, the section suggests both that the invitation to the dealer must be made by the borrower company and that the dealer, manager or underwriter act under an agreement with that company. If the borrower company has not been incorporated at the time that the invitations are made, the test should not be satisfied since it did not, itself, make the invitations to the dealers or enter into an agreement with the dealers in relation to making the invitations. We consider it unlikely that an invitation made by, and an agreement with, a related company of the borrower would technically satisfy the test, although note that this would comply with the policy behind the law (i.e. that there is still a wide distribution of the invites).

3.5.2 Scenario 2: Onshore arranger commits to part of syndicated facility agreement

Facts

- The borrower approaches an Australian resident bank (not acting through an offshore permanent establishment) about obtaining a loan of $200m.
- The Australian resident bank commits to providing $50m (and intends to continue to hold that commitment) and to act as arranger in respect of offering the remaining $150m.

- The parties wish the remaining $150m to be offered in a manner compliant with section 128F(3A) such that it is suitable to be offered to offshore banks, or Australian banks that may wish to sell down their commitment in the future, in each case without the new lender incurring IWT. The offer may be made by the bank either as agent for the borrower or as dealer, manager or underwriter.
- The loan is part of a single facility. The agreement is documented as a syndicated facility agreement.

Consideration of treatment under section 128F

The opening words of section 128F(3A) provide that:

> An invitation to become a lender under a syndicated loan facility by a company ***satisfies the public offer test*** if the invitation was made …

This phrase appears to contemplate a single invitation being made to multiple parties. Accordingly, there is a question about whether invitations made subsequent to discussions with the initial lender(s) can together form "an invitation" for the purposes of section 128F(3A) such that the whole of the debt is publicly offered. This is on the basis that, in the facts outlined above, there is a clear difference in the time at which the invitations are made and the fact that allocations of the initial commitment may be made before further invitations are issued.

However, section 128F(3A) only requires that an invitation be made to a lender under a syndicated loan facility in one of the approved manners (e.g. to 10 or more unrelated financiers or by listing on Bloomberg). It does not expressly require that all lenders under a facility be invited in this way.

Section 128F(1) relevantly states that the section applies to interest paid on a debt interest that is a syndicated loan. A syndicated loan is relevantly defined to mean a loan provided under a syndicated loan facility.

On the basis that each advance provided by each lender gives rise to a separate debt interest, we consider that, provided that a genuine offer is made in a public offer test compliant manner, it should be possible for the section 128F exemption to apply at least to that part of the facility under a syndicated loan facility that is publicly offered. On that basis, we consider that interest on at least the $150m in respect of which the resident bank made invitations in a public offer test compliant manner should be eligible for the section 128F exemption. Unlike an issue of fungible notes, it should be possible to track amounts loaned under a syndicated loan facility that are either section 128F compliant or non-compliant.

It is not entirely clear whether the $50m retained by the arranger may also be regarded as meeting the public offer test. Depending on the circumstances, it may meet the test if the additional invitations are made by the borrower, or the arranger as agent for the borrower, and the initial invitation can be treated as part of the invitation meeting the requirements of section 128F(3A)(a). In other circumstances, there may be some arguments that the $50m retained by the arranger may be treated as meeting the public offer test on the basis that section 128F(12) contemplates an initial one to one relationship between a lender and borrower, with additional lenders to be subsequently added. We note that this position is also consistent with the policy intent of section 128F, being to enable Australian borrowers to access cost effective financing from within Australia or overseas in

circumstances where the public offer test has, in fact been met. However, this outcome would be inconsistent with the position in respect of notes.[31]

Clearly it is preferable to meet the public offer test prior to having any legally binding commitments in place.

3.5.3 Scenario 3: Commitments finalised – Bloomberg notice

Facts

- Three initial lenders have been identified and an allocation of the commitment/notes has been made.
- Variation 1: One of the lenders (who is a non-resident) suggests putting a Bloomberg notice up to ensure section 128F is satisfied:
    - for half an hour; or
    - for 10 business days.
- Variation 2: Another lender suggests offering the notes or syndicated facility agreement commitment to some "friendly" banks in order to meet the section 128F test. The intention is that the relevant banks would not take up any of the commitment.

Consideration of treatment under section 128F

Variation 1

The bank has proposed satisfying the public offer test through publication of details of the relevant commitments on Bloomberg. Section 128F(3)(d) states (in respect of a debenture issue):

> The issue of a debenture or debt interest by a company satisfies the public offer test if the issue resulted from the debenture or debt interest being offered for issue:
> …
> (d) as a result of negotiations being initiated publicly in electronic form, or in another form, that was used by financial markets for dealing in debentures or debt interests;

Equally, section 128F(3A)(b) states (in respect of a syndicated facility agreement):

> An invitation to become a lender under a syndicated loan facility by a company satisfies the public offer test if the invitation was made:
> …
> (b) publicly in electronic form, or in another form, that was used by financial markets for dealing in debentures or debt interests;

In circumstances where a facility or tranche of notes is fully committed and such commitments have been accepted prior to an invitation being made, a genuine offer will not be able to be made. If this has occurred, it is difficult to see how the requirements of sections 128F(3)(d) and 128F(3A)(b) could be met since it is clear that the offers/invitations were not made publicly in electronic form. We note

[31] See part 3.5.6 below.

the Commissioner's statement in Taxation Determination TD 1999/16 *Income tax: interest withholding tax exemption under section 128F of the Income Tax Assessment Act 1936 – does the public offer test in paragraph 128F(3)(d) require a company to demonstrate that negotiations in respect of a particular debenture actually resulted from negotiations being initiated publicly in electronic form?*:[32]

> It is not considered necessary for investors to confirm with the issuing company that they acquired the debentures as a result of having seen the publicity initiated by the issuer. The publicity itself, in the manner described above, constitutes satisfaction of this aspect of the public offer test.

Although the second sentence could be interpreted as meaning that mere listing on a relevant electronic source is sufficient to meet the requirements of sections 128F(3)(d) and 128F(3A)(b), we consider the above statement needs to be read in the context of the first sentence. That is, it is not necessary to seek confirmation from investors that they acquired the notes or participation as a result of the electronic listing, but mere listing without any intent to make a genuine offer would not meet the requirements of the clause. This interpretation would be consistent with the purpose of the provisions and also the Commissioner's statement in Taxation Determination TD 1999/24 *Income tax: interest withholding tax exemption under section 128F of the Income Tax Assessment Act 1936 – how may a company satisfy the introductory requirements in paragraph 128F(3)(a) and 128F(3)(b) that a debenture must be offered on a 'debenture by debenture basis?*, which should apply equally to offers under sections 128F(3)(d) and 128F(3A)(b):[33]

> However, where the advertisements, invitations or inducements are not genuine, the Commissioner will consider the application of Part IVA to the arrangement.

However, if commitment letters have been received from some potential lenders, but not yet accepted by the borrower (i.e. binding allocations have not been made), it may be possible to satisfy the public offer test by listing on Bloomberg provided that the offer or invitation made in this way is genuine and the borrower is open to considering interest expressed by new potential noteholders/lenders. Such a listing would need to be undertaken for a commercially reasonable period of time, for example, 10 business days. A listing for a few seconds or half an hour is unlikely to be considered the making of a genuine offer on the basis that it does not give potential lenders a reasonable opportunity to see, consider and respond to the listing.

Variation 2

A second bank has suggested making offers to 10 or more "friendly" banks, seeking to satisfy section 128F(3)(a) or section 128F(3A)(a). These banks might be known to be unlikely to express interest in the offer, or may be encouraged not to do so. For the reasons outlined above in relation to variation 1, such an offer is unlikely to be considered genuine where commitments have been received and accepted at the time at which the further purported "offer" is made and, accordingly, the exemption in section 128F is unlikely to apply. Similar to the above analysis, it may be possible to make a genuine offer where binding allocations have not been agreed to at the time at which the further offers are made.

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32 At [5].

33 At [5].

3.5.4 Scenario 4: Offers to 11 investors

Facts

- The borrower has had discussions/made offers to 11 investors comprising small private equity funds, high wealth individuals and SMSFs. Is this sufficient?
- Would an offer to an entity that has not previously invested in securities be counted?

Consideration of treatment under section 128F

Sections 128F(3)(a) and 128F(3A)(a) require, respectively:

> The issue of a debenture or debt interest by a company ***satisfies the public offer test*** if the issue resulted from the debenture or debt interest being offered for issue:
>
> (a) to at least 10 persons each of whom:
>
> (i) was carrying on a business of providing finance, or investing or dealing in securities, in the course of operating in financial markets; and
>
> (ii) was not known, or suspected, by the company to be an associate (see subsection (9)) of any of the other persons covered by this paragraph;
>
> An invitation to become a lender under a syndicated loan facility by a company ***satisfies the public offer test*** if the invitation was made:
>
> (a) to at least 10 persons each of whom:
>
> (i) was carrying on a business of providing finance, or investing or dealing in securities, in the course of operating in financial markets; and
>
> (ii) was not known, or suspected, by the company to be an associate (see subsection (9)) of any of the other persons covered by this paragraph;

Assuming the proposed offerees/invitees are not associates of each other or the borrower, it may be possible to meet the tests set out in sections 128F(3)(a) and 128F(3A)(a) by offering to 11 potential investors comprising small private equity funds, high wealth individuals and SMSFs. However, it would be necessary to consider whether each of these entity types is carrying on a business and whether that business is of a relevant type. This may be more difficult to satisfy for these types of entities, particularly SMSFs which, although not prohibited from carrying on business provided the sole purpose test is met and the trust deed allows it,[34] would often invest passively and may not be carrying on business. The issuer/borrower could rely on a representation from the offeree/invitee as to whether or not they are carrying on a relevant business.[35]

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[34] https://www.ato.gov.au/super/self-managed-super-funds/investing/carrying-on-a-business-in-an-smsf/

[35] Taxation Determination TD 1999/13 *Income tax: interest withholding tax exemption under section 128F of the Income Tax Assessment Act 1936 – for the purposes of the public offer test in paragraph 128F(3)(a) (the 'first public offer test'): (a) are pension funds and other 'qualified institutional buyers' considered to be carrying on the business of*

In terms of an offer to an entity that has not previously invested or dealt in securities (i.e. for which this is the first investment), provided that it can be shown that the entity has commenced carrying on business and that this is merely its first investment, it should be able to be counted as one of the 10 offerees/invitees meeting the relevant criteria. However, showing that this is the case may pose some difficulties, particularly if the entity is a special purpose entity that is only intended to hold the particular debentures or commitment being offered. If it is not possible to show that the entity is carrying on business of the relevant type, it should still be possible to make an offer to that entity, provided that genuine offers are also made to 10 other entities meeting the criteria.

3.5.5 Scenario 5A: Underwriting notes

Facts

- The borrower approaches an entity about arranging and underwriting notes of $200m.
- The entity commits to underwriting 100% of the notes and offering them in accordance with section 128F(3)(e). The notes will be fungible.
- Variations:

    a. The entity is a bank. It intends to provide all of the funding itself.

    b. The entity is a bank. It intends to provide $100m and find other noteholders for the remaining $100m. It may wish to sell down its interests in the future, including to offshore parties.

    c. The entity is a private equity entity. It wishes to place all of the notes with offshore funds it manages.

Consideration of treatment under section 128F

Variation A

If the underwriting bank intends to provide all the funding itself, it is likely that the exemption in section 128F will not apply because the relevant provision relating to the type of offer is not satisfied. In circumstances where any purported offer is not genuine, the Commissioner may seek to apply the general anti-avoidance rules in Part IVA.[36]

Variation B

If the underwriting bank essentially only makes a genuine offer in respect of $100m of the notes to be issued, it is not possible for interest on the whole of the $200m to be exempt from IWT. However, in

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providing finance, or investing or dealing in securities? (b) what is required of a company to establish that the persons to whom the debentures are offered are carrying on business in the manner required by the legislation? (c) when is a company taken to know or suspect that such a person is an associate? at [6].

[36] Taxation Determination TD 1999/24 *Income Tax: interest withholding tax exemption under section 128F of the Income Tax Assessment Act 1936 – how may a company satisfy the introductory requirements in paragraphs 128F(3)(a) and (b) that a debenture must be offered on a debenture by debenture basis?*

this circumstance, the parties could consider offering the notes in an alternative manner, as outlined in Scenario 5(B) below.

Variation C

Provided that there are more than 10 funds which are not associates of each other or the borrower, and each is carrying on a business of providing finance, or investing or dealing in securities, in the course of operating in financial markets, the requirements of section 128F(3)(a) should be able to be satisfied. However, if this is not possible, additional genuine offers would need to be made.

Where genuine offers are made that satisfy the requirements of section 128F(3)(a), the fact that the notes are ultimately acquired by less than 10, or even one, entity should not of itself impact the application of section 128F. That is, provided that a genuine offer was made in compliance with section 128F(3), this should not prevent the exemption from applying. However, the ATO may look at the offer process more closely if there is only one lender if it were ever to investigate IWT compliance by that borrower.

3.5.6 Scenario 5B: Dealer wishes to retain some notes

Facts

- The borrower approaches an entity about acting as dealer in relation to the placement of notes of $200m.
- The dealer wishes to retain some of the notes.

Consideration of treatment under section 128F

In this scenario, whether the exemption can apply will depend on the manner in which the notes are offered.

In particular, if the dealer seeks to offer the notes in a manner that complies with section 128F(3)(e), the public offer test should not be met in respect of all of the notes if the dealer does not make a genuine offer in respect of all of the notes, that is, if the dealer determines to retain a certain number of notes for itself. However, the exemption will be met if the dealer genuinely offers all of the notes in a compliant manner but, being unable to place all of the notes, retains some of them.

Alternatively, if there is a particular level of notes that the dealer wishes to retain (but a binding commitment and allocation has not been made), the exemption could be met by having the borrower offer the notes in a way that satisfies one of sections 128F(3)(a) to (d), which could include an offer being made to the dealer. For example, the borrower could choose to meet the requirements of section 128F(3)(a) by making an offer to the dealer, then appointing the dealer as its agent to make an additional nine offers to relevant entities. In this case, the borrower itself will have satisfied section 128F(3)(a) and it would not be relying on section 128F(3)(e).

This position is confirmed in Taxation Determination TD 1999/18 *Income tax: interest withholding tax exemption under section 128F of the Income Tax Assessment Act 1936 - for the purposes of the fifth*

public offer test, in paragraph 128F(3)(e), in what circumstances is a debenture taken to be 'offered for issue'? which states:[37]

> If dealers, managers or underwriters subscribe for the debentures on their own behalf and not on the basis they are to be onsold in accordance with paragraph 128F(3)(e), the public offer test is satisfied if the debentures are offered for issue by the company in accordance with any of paragraphs (a) to (d) of subsection 128F(3). In such a case, the debentures are not required to be offered for issue in accordance with paragraph 128F(3)(e).

3.5.7 Scenario 6: Tap issue

Facts

- An issuer has successfully completed a note offering under a new programme following satisfaction of the public offer test.
- Variations:
  a. The issuer decides to issue a further tranche.
  b. There is a reverse enquiry from an existing lender wishing to acquire additional notes.
  c. There is a reverse enquiry from a third party wishing to acquire notes.

Consideration of treatment under section 128F

The question in this scenario is whether future issues of notes can be treated as meeting the public offer test based on the original satisfaction of the public offer test.

Section 128F(3) requires:

> The issue of a debenture or debt interest by a company satisfies the public offer test if the issue ***resulted from*** the debenture or debt interest being offered for issue: (emphasis added)

Although the conservative position would be for the issuer to satisfy the public offer test every time it seeks to issue new notes under an existing programme, this may not be essential in all cases. In particular, it should not be necessary to satisfy the public offer test again if there is a sufficient connection between the original offering and the new issue. A sufficient connection might exist, for example, if:

a. the original offer related to multiple tranches, with some tranches to be issued at a later date;
b. the issuer indicated in the original offer that it may issue other notes based on the original acceptances;
c. acceptances of the original offer gave the right to the noteholder to participate in future tranches; or

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[37] At [4].

d. a reverse enquiry is made where the enquiry bears some link to the original offer (e.g. an existing lender seeks further notes; a new lender who heard about the offer seeks to be issued with notes under the programme).[38]

However, whether a sufficient connection arises in a particular case should be considered on a case by case basis.

This position is supported by Taxation Determination TD 1999/8 *Income tax: interest withholding tax exemption under section 128F of the Income Tax Assessment Act 1936 - when will an issue of debentures be taken to have 'resulted from' the debentures being 'offered for issue' for the purposes of the public offer test in subsection 128F(3)?*, which states:[39]

> 3. The requirements in subsection 128F(3) are, of course, directed at ensuring an adequate dissemination of the details of the relevant issue to the markets. To adopt a strict view that reverse enquiries would be excluded from the public offer test would frustrate the operation of section 128F.
>
> 4. Accordingly, subsection 128F(3) will be administered on the basis that a debenture will be taken to have 'resulted from' being 'offered for issue' if the debenture otherwise satisfies one of the paragraphs set out in subsection 128F(3).

Additionally, ATO Interpretive Decision ATO ID 2006/272 provides that, in relation to certificates of deposit, a rollover on maturity or the addition of new funds either by the purchase of an additional certificate or on a rollover (in each case creating a new debt interest) may be eligible for the section 128F exemption on the basis of the original satisfaction of the public offer test. In particular, it notes:

> There is no requirement in subsection 128F(3) that there be a separate offer for each issue of debentures or debt interests to the same non-resident investors in order for any subsequent debt interest to satisfy the public offer test. In such cases any subsequent debt interest which results from the original offer would be regarded as having the necessary connection between that debt interest and the original offer. Any new Certificate of Deposit that is acquired or further funds provided by non-resident investors at maturity has this necessary connection and will result from the original offer.

ATO Interpretive Decision ATO ID 2006/231 also notes:

> To satisfy the public offer test, there still needs to be some nexus between the offer and the issue. There is, however, no requirement, within subsection 128F(3) of the ITAA 1936, that there has to be a separate offer for each issue of debentures or debt interests.

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[38] Although reverse enquiries where the potential noteholder has not seen the relevant publicity in respect of the offered notes should generally be acceptable (Taxation Determination TD 1999/8 *Income Tax: interest withholding tax exemption under section 128F of the Income Tax Assessment Act 1936 – when will an issue of debentures be taken to have 'resulted from' the debentures being 'offered for issue' outside Australia for the purposes of the public offer test in subsection 128F(3)?*), it may become more difficult to establish a link to an earlier offering if the potential noteholder was not aware of the previous offering.

[39] At [3] – [4].

3.5.8 Scenario 7: Listing pricing grid on Bloomberg

Facts

- A bank lists a pricing grid on Bloomberg which contains indicative pricing for the issue of notes under existing programmes based on the term and amount of the investment.

Consideration of treatment under section 128F

The listing of a pricing grid on Bloomberg should satisfy the public offer test under section 128F(3)(d), provided that the offer is genuine. In particular, we do not expect that the public offer test would be met if the listing is made only after receiving a reverse enquiry in relation to a private placement. Typically, this form of offer is most likely to suit issuers with ongoing fundraising needs in respect of existing programmes, such as banks.

The Explanatory Memorandum to the *Taxation Laws Amendment Act (No 2) 1997* notes that the information that is required to be displayed for an electronic listing is the name of the issuer and the name of the programme. Taxation Determination TD 1999/16 *Income Tax: interest withholding tax exemption under section 128F of the Income Tax Assessment Act 1936 - does the public offer test in paragraph 128F(3)(d) require a company to demonstrate that negotiations in respect of a particular debenture actually resulted from negotiations being initiated publicly in electronic form?* notes that the programme name may be substituted for the maturity date and principal amount of the debentures. We consider that a pricing grid including the name of the issuer and indicative pricing for various terms and principal amounts should satisfy this requirement.

We note that as the section only requires that negotiations commence as a result of the listing, the parties may vary the indicative pricing on the pricing grid in respect of the notes actually issued.

3.5.9 Scenario 8: Amending an existing SFA

Facts

- The borrower and lenders have entered into a syndicated facility agreement (**SFA**) that meets all the requirements to have interest paid under it be exempt under section 128F.
- The parties now wish to amend the SFA by adding a new revolving facility and changing the maturity date of existing term facilities.

Consideration of treatment under section 128F

Whether or not amendments to an existing SFA will require the public offer test to be satisfied again will depend on the intention of the parties, having regard to the circumstances, particularly the extent of the changes.

In *FCT v Sara Lee Household and Body Care (Australia) Pty Ltd*,[40] the High Court found that an amendment to an existing contract does not necessarily mean that the previous contract is terminated

[40] [2000] HCA 35

and a new contract brought into existence. In that case, the court referred[41] with approval to *Tallerman & Co Pty Ltd v Nathan's Merchandise (Victoria) Pty Ltd*:[42]

> It is firmly established by a long line of cases ... that the parties to an agreement may vary some of its terms by a subsequent agreement. They may, of course, rescind the earlier agreement altogether, and this may be done either expressly or by implication, but the determining factor must always be the intention of the parties as disclosed by the later agreement.

Accordingly, it is necessary to consider the extent of the amendments made and the expressed intention of the parties (if any) to determine whether the amendments resulted in a mere variation (in which case the public offer test will continue to apply) or to the rescission of the existing contract and its replacement by a new contract (in which case the public offer test exemption will only apply if the public offer test is complied with again). This will be a question of fact to be considered on a case by case basis.

For example, an amendment made in circumstances where:

- the existing agreement provided for amendments to be made in the future by consent of the parties;
- the deed of amendment expressly stated that the amendments were intended to amount to a variation of the existing contract and that all terms (other than those amended) were intended to continue in full force and effect; and
- the amendments themselves were relatively minor, for example changing the termination date of a facility or adding a new facility but relying on the existing mechanical provisions as to payment etc. in relation to the new facility,

should be able to be characterised as a mere variation, in which case the public offer test exemption will continue to apply.

The Commissioner has acknowledged this position in several private binding rulings, including PBR 1012538441402 and PBR 95007.

3.5.10 Scenario 9 – New lenders

Facts

- A financial institution acquires either notes (by way of transfer) or a commitment under a syndicated facility agreement (by way of novation) from another financier.
- Assuming the section 128F exemption applied prior to the transfer/novation in respect of the original notes/facility, will the exemption continue to apply to the new financier?

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41 At [23].

42 (1957) 98 CLR 93 at 144.

- Are there any practical steps the new note holder/lender could take to ensure interest it receives is exempt from IWT?

Consideration of treatment under section 128F

Provided that the section 128F exemption applied immediately prior to the transfer/novation, and there has been no amendments to the documents, the exemption should continue to apply to interest paid to the new financier. The public offer test applies to the relevant notes or the syndicated loan facility respectively.

In respect of notes, the note itself is transferred such that the identity of the note remains the same.

In respect of a syndicated facility agreement, section 128F(14) confirms that a change in lenders (including as a result of a novation) does not result in a different agreement. This clause is required on the basis that, legally, a novation gives rise to a new agreement.

Practically, it may be difficult to determine whether the public offer test was met in respect of the original note issue/syndicated facility agreement. In this case, the lender may seek comfort in a number of ways, including:

- ensuring that any representations in the original documentation relating to satisfaction of the public offer test will apply to it;
- ensuring that any gross up for IWT will apply following the novation/transfer;
- relying on protection under a DTA that provides an exemption for interest paid to a financial institution (see part 4 below);
- obtaining reliance on any advice or opinion given in relation to the original facility; requesting evidence of satisfaction of the public offer test; or
- requesting a private binding ruling or class ruling.

In our experience, requesting a private binding ruling or class ruling would be relatively uncommon.

4 Double tax agreement exemptions

4.1 Overview of double tax agreement exemptions

The DTAs between Australia and selected other countries provide for an exemption from IWT for interest paid to "financial institutions" (as defined). The relevant countries with which a DTA including the exemption exists are:[43]

a. the United States of America;[44]

b. the United Kingdom;[45]

c. France;[46]

d. Norway;[47]

e. Finland;[48]

f. Germany;[49]

g. Switzerland;[50]

h. South Africa;[51]

i. Japan;[52]

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43 The double tax agreement between Australia and Chile also provides for a reduced rate of IWT of 5% in similar circumstances to the circumstance in which the financial institutions exemptions apply.

44 Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income dated 6 August 1982 as amended by the United States Protocol (No 1) dated 27 September 2001 (**US DTA**).

45 Convention between the Government of Australia and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains dated 21 August 2003 (**UK DTA**).

46 Convention between the Government of Australia and the Government of the French Republic for the Avoidance of Double Taxation with Respect to Taxes on Income and the Prevention of Fiscal Evasion dated 20 June 2006 (**French DTA**).

47 Convention between Australia and the Kingdom of Norway for the Avoidance of Double Taxation with respect to Taxes on Income and the Prevention of Fiscal Evasion dated 8 August 2006.

48 Agreement between the Government of Australia and the Government of Finland for the Avoidance of Double Taxation with respect to Taxes on Income and the Prevention of Fiscal Evasion dated 20 November 2006.

49 Agreement between Australia and the Federal Republic of Germany for the Elimination of Double Taxation with respect to Taxes on Income and on Capital and the Prevention of Fiscal Evasion and Avoidance dated 12 November 2015 (**German DTA**).

50 Convention between Australia and Swiss Confederation for the Avoidance of Double Taxation with respect to Taxes on Income dated 30 July 2013 as amended by the Protocol (**Swiss DTA**).

51 Agreement between the Government of Australia and the Government of the Republic of South Africa for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income dated 1 July 1999 as amended by the South African Protocol (No 2) dated 12 November 2008.

52 Convention between Australia and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income dated 31 January 2008 (**Japanese DTA**).

j. New Zealand,[53]

(together, the **Relevant Countries**).

The IWT exemption in the DTAs is in recognition that a 10% withholding may be excessive given the cost of funds for financial institutions.[54] The exemption is designed to reduce the cost of funds to borrowers who typically are required to gross up for IWT.[55] The exemption is consistent with the exemption under section 128F.[56]

Although the wording differs slightly between some of the DTAs, the exemptions essentially apply in the same circumstances. By way of example, the DTA between Australia and Germany[57] provides, at Articles 11(3) and (4):

> 3 ... interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State may not be taxed in the first-mentioned State if:
>
> …
>
> (b) the interest is derived by a financial institution which is unrelated to and dealing wholly independently with the payer. For the purposes of this Article, the term "financial institution" means a bank or other enterprise substantially deriving its profits by raising debt finance in the financial markets or by taking deposits at interest and using those funds in carrying on a business of providing finance.
>
> 4 Notwithstanding paragraph 3, interest referred to in subparagraph (b) of that paragraph may be taxed in the State in which it arises at a rate not exceeding 10 per cent of the gross amount of the interest if the interest is paid as part of an arrangement involving back-to-back loans or other arrangement that is economically equivalent and intended to have a similar effect to back-to-back loans.

The DTAs exclude from the exemption:

a. financial institutions that derive the interest through a permanent establishment in the country in which the interest arises; and

b. the amount of any interest that exceeds the amount that would have been payable if a special relationship did not exist between the parties or between each party and a third party.

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53 Convention between Australia and New Zealand for the Avoidance of Double Taxation with respect to Taxes on Income and Fringe Benefits and the Prevention of Fiscal Evasion dated 26 June 2009.

54 See, e.g. Explanatory Memorandum to the *International Tax Agreements Amendment Act (No.1) 2008* at [2.34].

55 Ibid.

56 See, e.g. Explanatory Memorandum to the *International Tax Agreements Amendment Act (No.1) 2008* at [1.168].

57 German DTA.

Some DTAs also specifically refer to the exemption not applying if one of the main purposes of entering into the debt claim or assignment was to take advantage of the exemption[58] or if anti-avoidance provisions apply.[59]

The ATO has issued a tax ruling in relation to the financial institutions exemption in Australia's DTAs with the US and the UK: Taxation Ruling TR 2005/5 *Income tax: ascertaining the right to tax United States (US) and United Kingdom (UK) resident financial institutions under the US and the UK Taxation Conventions in respect of interest income arising in Australia* (**TR 2005/5**). Given the similarities between the US and UK DTAs and the DTAs with the other Relevant Countries, TR 2005/5, although not technically legally binding, should provide useful guidance in respect of those other DTAs.

4.1.1 Meaning of "beneficial owner"

The meaning of "beneficial owner"[60] is discussed in the OECD's commentary on the model tax convention.[61] The commentary indicates[62] that it is not intended that the term take on a narrow technical meaning, such as in trust law. Rather, it is intended to exclude conduit type arrangements such as agents, nominees and conduit companies acting as fiduciary or administrator.

The Japanese DTA includes a specific restriction on when an entity will be treated as a beneficial owner in certain circumstances in Article 11(9).

4.1.2 Meaning of "financial institution"

As outlined above, a "financial institution" includes both:

a. banks; and

b. other enterprises substantially deriving their profits through conducting spread activities, that is, by raising debt finance in the financial markets or by taking deposits at interest and using those funds in carrying on a business of providing finance.

These are considered in turn.

"Banks"

In TR 2005/5,[63] the ATO indicates that a "bank" must be authorised or licensed to carry on a banking business in the country of residence and must satisfy the capital adequacy requirements to be characterised as a bank (as opposed to a credit union, building society etc. which may have lower capital adequacy requirements). A banking business is one that involves taking deposits (other than

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58 E.g. Article 11(9) of the UK DTA.

59 E.g. Article 11(4)(b) of the US DTA.

60 Which should also apply to “beneficial ownership".

61 https://www.keepeek.com//Digital-Asset-Management/oecd/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2017/commentary-on-article-11_mtc_cond-2017-14-en#page1.

62 At paragraphs 9 to10.2. of the Commentary on Article 11 concerning the taxation of interest.

63 At [12].

in part payment for identified goods and services) and making advances.[64] A bank does not need to satisfy the other requirements of the paragraph.

TR 2005/5 notes that, in relation to the UK, entities appearing on the list of banks maintained by the UK Prudential Regulation Authority[65] will constitute "banks".[66]

Note that a member of a corporate group that contains a separate entity that is a "bank" must also meet the requirements to be a bank itself if it wishes to rely on this limb of the requirements for the exemption.[67]

Other enterprises

"Other enterprises" would typically include:[68]

a. credit unions;

b. building societies;

c. savings banks; and

d. saving and loans institutions,

on the basis that these types of entities:

e. raise debt finance in the financial markets; or

f. take deposits at interest; and

g. use those funds in carrying on a business of providing finance; and

h. substantially derive their profits from the above activities.

Raising debt finance in financial markets

TR 2005/5 indicates that an entity will be considered to be raising debt finance in financial markets if:

a. the funds obtained give rise to an "effectively non-contingent obligation" to return an amount at least equal to the amount received, as interpreted in Division 974[69] (e.g. traditional loans, securities lending arrangements and repurchase agreements);[70] and

b. the finance is raised through financial markets (retail or wholesale),[71] being facilities through which:[72]

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64 At [13] and [52].
65 https://www.bankofengland.co.uk/prudential-regulation/Authorisations/which-firms-does-the-pra-regulate.
66 At [14].
67 At [60].
68 TR 2005/5 at [16].
69 At [17].
70 At [65] and [70].
71 At [73].
72 At [18].

a. offers to acquire or dispose of debt finance products are regularly made or accepted (including offering loans); or

b. offers and invitations are regularly made to acquire or dispose of debt finance products that are intended to result or may reasonably be expected to result in the making (or acceptance) of offers to acquire or dispose of such debt finance products (including offering loans).

The terms on which the funds are raised must be normal commercial terms.[73]

Although it is possible for an enterprise to be considered to be raising finance through financial markets if it raises the funds from a related party lender that regularly provides finance to the public, raising finance from a corporate treasury entity or other group member that performs financing services for the group that does not lend to the public will not meet this requirement.[74] Raising finance through a pure conduit entity (not retaining a margin) established for the sole or principal purpose of acquiring debt finance in the financial markets for the enterprise may still be considered to be raising finance through financial markets.[75]

Taking deposits at interest

The phrase "taking deposits at interest" refers to the receipt of amounts of money into an account with the enterprise upon which interest is paid. The enterprise needs to be authorised under the relevant regulatory regime in the country of residence to receive money into such an account.[76] Provided that the enterprise is so authorised, deposits can also be received from related parties.[77]

Use funds in carrying on a business of providing finance

In order to qualify as a "financial institution", the entity must use the funds raised to conduct activities amounting to the carrying on of a business,[78] and that business must be one of providing finance. "Finance" in this sense is broader than the debt finance referred to in relation to obtaining debt finance in financial markets. Rather, it requires the provision of "funds or assets with an obligation (either contingent or non-contingent) on the recipient to return these funds or assets in the future."[79] Accordingly, it can apply to the provision of both debt and equity finance[80] and can include arrangements involving:[81]

a. securities lending arrangements (providing cash collateral or lending a security if there is an obligation to return it);

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73 TR 2005/5 at [18].

74 TR 2005/5 at [75] – [76]. This is also confirmed in Note 6(a) of the UK DTA and in some of the Explanatory Memorandums amending the *International Tax Agreements Act 1953*, for example Explanatory Memorandum to the *International Tax Agreements Amendments Act (No. 1) 2007* at [1.128].

75 TR 2005/5 at [77] to [80].

76 TR 2005/5 at [20].

77 TR 2005/5 at [86]

78 TR 2005/5 at [25]; Taxation Ruling TR 97/11 *Income tax: am I carrying on a business of primary production?* contains the Commissioner's views on when an entity is carrying on business.

79 TR 2005/5 at [23].

80 TR 2005/5 at [89].

81 TR 2005/5 at [91] –[92].

b. repurchase agreements if the seller has a non-contingent obligation to repurchase at a higher price;

c. redeemable preference shares; and

d. leasing under a finance lease.

Substantially deriving its profits

In order to meet the requirement that the entity is substantially deriving its profits from the relevant activities, these activities must constitute its main business activity, based on their contribution to overall profit.[82] This is confirmed in item 14(b) of the Protocol in respect of the DTA with Japan. The "main" activity need not account for the majority of the overall profit. It would be sufficient, for example, if 40% of profit was derived from the relevant activities while two other activities accounted for 30% each of the remaining profit.[83]

Profit should be measured using accounting principles, with gross profit, net operating income and operating profit being acceptable measures, evaluated over a reasonable timeframe.[84] The activities of the whole entity, including permanent establishments, must be considered.[85]

4.1.3 Meaning of "unrelated to and dealing wholly independently with"

"Unrelated to"

The term "unrelated" is not defined in the relevant DTAs. In TR 2005/5, the ATO considers that this term should not be interpreted literally such that even a minimal ownership interest would give rise to a relationship between the parties. Rather, it states that it is intended that the treatment of interest paid to a financial institution should mirror that afforded to publicly offered debt securities under Australia's domestic legislation.[86] These provisions provide an exemption from IWT, provided that the issuer of the security and the acquiring entity, or recipient of the interest, are not "associates" as that term is defined in section 318, as amended by section 128F.

As it is intended that a similar approach should be applied to the DTA exemption for financial institutions, TR 2005/5 explains that for the purposes of the exemption, two companies will be associates if one company is sufficiently influenced by the other and that on this basis "the Commissioner considers that a financial institution will be unrelated to the interest payer where, in considering the level of participation in the ownership or control of either the financial institution or the Australian payer by the other party, it can be concluded that neither is able to exert sufficient influence over the other party".[87] The ruling notes that one party holding redeemable preference shares with

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82 TR 2005/5 at [27].
83 TR 2005/5 at [138].
84 TR 2005/5 at [101] – [102].
85 TR 2005/5 at [28].
86 At [109].
87 At [112].

limited rights to direct the other party may not be able to exert sufficient influence over that other party and, accordingly, the parties may be unrelated.[88]

This position is confirmed in Item 14(a) of the Protocol in respect of the Japanese DTA.

"Dealing wholly independently with"

TR 2005/5 requires that, in order for the payer to be dealing wholly independently with the payer, the terms must be "arm's length" within the meaning of Taxation Ruling TR 2002/2:[89]

> Whether a loan satisfies the arm's length test will ultimately be determined by reference to the facts of each particular case and the outcome that might have been expected to arise between independent parties in comparable circumstances.

TR 2005/5 notes that if parties enter into multiple transactions that, alone, are not arm's length, but are arm's length if combined, those parties will not be treated as acting wholly independently.[90] However, the mere provision of credit support (e.g. in the form of a parent company guarantee) does not necessarily mean that the parties are not dealing wholly independently with one another.[91]

4.1.4 Back to back loans

If the exemption was available for back to back loans or similar arrangements, financing arrangements could be structured in a manner that would allow interest to be exempt in unintended circumstances.[92] For example, a UK parent company could enter into a back to back arrangement with a UK financial institution to lend to an Australian subsidiary and avoid IWT. Equally, a lender resident in a country other than a Relevant Country could structure a back to back loan through a financial institution in a Relevant Country to Australia. Accordingly, interest paid on back to back arrangements are, to the extent of the back to back arrangement, excluded from the exemption.[93]

We consider that there must be some element of traceability to give rise to a back to back arrangement. It should not be sufficient to be regarded as a back to back arrangement that a financial institution that otherwise meets the requirements for the exemption obtains some of the debt finance used generally in its business from financial institutions resident in a country other than a Relevant Country.

We note that the provision of a related party guarantee should not give rise to a back to back arrangement that would prevent the exemption applying.[94]

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88 At [114]. See also ATO ID 2009/2.

89 TR 2005/5 at [117] – [118] and TR 2002/2 *Income tax: meaning of 'Arm's Length' for the purposes of subsection 47A(7) of the Income Tax Assessment Act 1936 (ITAA 1936) dividend deeming provisions* at [4]. Paragraphs [23] and [24] of TR 2002/2 are also relevant.

90 At [120].

91 TR 2005/5 at [121].

92 TR 2005/5 at [127].

93 Explanatory Memorandum to the *International Tax Agreements Amendment Act 2003*, Chapter 1: the 2003 United Kingdom Convention at [1.133].

94 E.g. see the Explanatory Memorandum to the *International Tax Agreements Amendment Act (No.1) 2007* at [1.131].

4.2 Scenario 9: Application of DTA

Facts

- An Australian Borrower wishes to enter into a syndicated facility agreement (**SFA**) for $70m.
- It has identified three lenders:
    - a bank resident in the United Kingdom entering into the SFA through its Singapore branch (**Lender A**);
    - a subsidiary of a UK bank resident in Singapore (**Lender B**); and
    - a US fund that issues notes in commercial markets to fund loans it provides to commercial borrowers operating in a particular industry (**Lender C**).

Consideration of treatment under relevant DTA

Article 1 of the UK DTA provides that:

> This Convention shall apply to persons who are residents of one or both of the Contracting States.

Accordingly, the financial institutions exemption from IWT under the UK DTA may be applicable to Lender A,[95] but will not be applicable to Lender B as it is resident in Singapore.

Lender A should be eligible for the benefit of the financial institutions exemption in the UK DTA provided that the following criteria are met:

- it is a "financial institution", being a bank or other enterprise substantially deriving profits by raising debt finance in the financial markets or by taking deposits at interest and using those funds in carrying on a business of providing finance;
- it is unrelated and dealing wholly independently with the borrower;
- the interest is not paid as part of an arrangement involving a back-to-back loan or another arrangement that is economically equivalent and intended to have a similar effect to a back-to-back loan; and
- the anti-avoidance provisions do not apply.

In respect of Lender B, there is no applicable exemption from IWT under the DTA between Australia and Singapore. Accordingly, IWT will apply to any payment of interest made by the Australian Borrower to Lender B.

In respect of Lender C, whether or not the exemption for financial institutions in the US DTA will apply will require consideration of a variety of factors, including:

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[95] TR 2005/5 confirms that a financial institution resident in a Relevant Country that lends through a permanent establishment in a third country (not being a Relevant Country) can be eligible for the exemption (at [124]).

- the type of entity used and whether it is eligible for the benefit of the US DTA (in this regard, note that a partnership can have the benefit of the US DTA provided that the partnership itself or the partners are subject to US tax on the partnership's income and the limitation of benefits requirements are met); and
- if it is a fiscally transparent entity and is not eligible for the benefit of the US DTA, whether it may, through its members/partners be eligible for the benefit of another relevant DTA and, if so, whether the members/partners could relevantly be considered to be financial institutions for the purposes of the exemption.