IT 2423 - Withholding tax : whether rental income constitutes proceeds of business - permanent establishment - deduction for interest

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TAXATION RULING NO. IT 2423

WITHHOLDING TAX : WHETHER
RENTAL INCOME CONSTITUTES PROCEEDS OF BUSINESS -
PERMANENT ESTABLISHMENT - DEDUCTION FOR INTEREST

F.O.I. EMBARGO: May be released

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F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1206380	LIABILITY TO WITHHOLDING TAX RENTAL INCOME : PERMANENT ESTABLISHMENT DEDUCTIONS FOR INTEREST PAYABLE TO OVERSEAS LENDER	51(1) 128B 221YRA

PREAMBLE This Ruling considers the liability to interest withholding tax in circumstances where a non-resident of Australia borrows moneys from financial institutions outside Australia for the purchase of properties in Australia from which rental income is derived. Interest payments on the loans might be made either from funds outside Australia or from funds in Australia, i.e. from the rental income derived from the properties.

RULING 2. Sub-paragraph 128B(2)(b)(ii) imposes liability to withholding tax on interest paid to a non-resident by another non-resident where the interest is an outgoing incurred by the other non-resident in carrying on a business in Australia through a permanent establishment in Australia.

3. Whether the letting of property amounts to the carrying on of a business will depend on the circumstances of each case, (Californian Copper Syndicate (Limited and Reduced) v. Harris (1904) 5 TC 159). Generally, it is easier for a company that derives income from the letting of property to show that it carries on a business than it is for an individual. If a company's objects are business objects and are, in fact, carried out it carries on business, (IRC v. Westleigh Estates [1924] 1 KB 390 at pp 408, 409 per Sir Ernest Pollock, M.R.). In American Leaf Blending Co. Sdn Bhd v. Director-General of Inland Revenue (Malaysia) [1978] 3 All E.R. 1185 at p 1189 Lord Diplock concluded that it would be difficult to displace the prima facie inference that the gainful use of a company's property in letting it out for rent would constitute the carrying on of a business.

4. More recently in the Federal Court, Pincus J, in Lilydale Pastoral Co. Pty. Ltd. v. FCT 87 ATC 4235;

18 ATR 508, held, in the context of the withholding tax provisions, that the purchase of property to rent out, whether or not after renovating it, and the proprietorship of that property, constitute an undertaking of a business or commercial kind.

5. A conclusion that an individual is carrying on a business of letting property would depend largely upon the scale of operations. An individual who derives income from the rent of one or two residential properties would not normally be thought of as carrying on a business. On the other hand if rent was derived from a number of properties or from a block of apartments, that may indicate the existence of a business.

6. Before withholding tax is payable by either a company or an individual it is necessary to show that the non-resident is carrying on business in Australia at or through a permanent establishment of the non-resident in Australia. In this connection the definition of "permanent establishment" in sub-section 6(1) specifically excludes a place where the person is engaged in business dealings through a bona fide commission agent or broker. This means that in the case of rental properties managed by a real estate agent acting as a commission agent it could not generally be said that the non-resident has a permanent establishment in Australia unless there are other factors.

7. If the facts of a particular case lead to the conclusion that a non-resident company or individual is carrying on a business of letting properties in Australia through a permanent establishment in Australia it will follow that interest paid by the non-resident to a non-resident lender on moneys borrowed to purchase rental property in Australia is liable to withholding tax under sub-paragraph 128B(2)(b)(ii). If the requirements of section 221YRA are met (i.e. the withholding tax is paid) an income tax deduction would be allowed to the borrower under sub-section 51(1) for the interest paid.

COMMISSIONER OF TAXATION
24 December 1987