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TD 1999/26 - Income tax: interest withholding tax exemption under section 128F of the Income Tax Assessment Act 1936 - does the exemption from interest withholding tax in section 128F extend to payments made by a guarantor to a lender on behalf of a borrower who defaults?

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Taxation Determination

Income tax: interest withholding tax exemption under section 128F of the *Income Tax Assessment Act 1936* – does the exemption from interest withholding tax in section 128F extend to payments made by a guarantor to a lender on behalf of a borrower who defaults?

Preamble

*This Taxation Determination is a 'public ruling' for the purposes of Part IVAAA of the **Taxation Administration Act 1953** and is legally binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Determination is a public ruling and how it is legally binding.*

Date of effect

This determination applies to years commencing both before and after its date of issue. However, this Determination does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

1. Yes. Payments made on behalf of a company by a guarantor to a lender constitute 'interest' for the purposes of Division 11A. Therefore, where a liability to pay withholding tax arises under section 128B, the exemption from interest withholding tax in section 128F is available to such payments (provided the other requirements of section 128F are satisfied).
2. An amount represents 'interest', for the purposes of Division 11A, where the amount is in the 'nature of interest' or in 'substitution for interest', as defined in subsection 128A(1AB). Subsections 128A(1AC) and 128A(1AD) give examples of what would be included in such definitions.
3. An amount paid by a guarantor arises from a contractual obligation to repay any amounts where there is a default in payment. The explanatory memorandum to the *Taxation Laws Amendment Act (No 2) 1997*, which inserted the current definition of the term 'interest', makes it clear a lump sum paid by the borrower in substitution for interest is interest for the purposes of Division 11A. A lump sum paid by a guarantor in respect of a default in payment by a borrower would be treated in the same way.
4. If the interest component is paid periodically as per the terms of the debenture issue, this amount would fall within the 'nature of interest', as the amount is still compensation to the lender for not having the principal for the term of the loan - and is, therefore, in the nature of interest. It is simply paid by a third party rather than the principal debtor.

Commissioner of Taxation

12 May 1999

Previous draft:

TD 1999/D19

Related Rulings/Determinations:

TD 1999/8; TD 1999/9; TD 1999/10; TD 1999/11; TD 1999/12; TD 1999/13; TD 1999/14; TD 1999/15;
TD 1999/16; TD 1999/17; TD 1999/18; TD 1999/19; TD 1999/20; TD 1999/21; TD 1999/22; TD 1999/23;
TD 1999/24; TD 1999/25

Subject references:

Legislative references:

ITAA 128A(1AB); ITAA 128A(1AC); ITAA 128A(1AD); ITAA 128B; ITAA128F; ITAA Div 11A; TLAA (No 2)
1997

Case references:

ATO references:

NO 97/6464-0; 99/658-1

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