

TAXATION RULING NO. IT 2050 (as amended 20/7/83)

"INTEREST-SWAPPING" TRANSACTIONS

F.O.I. EMBARGO: May be released

REF H.O. REF: 4 J35/702 P2 F85 DATE OF EFFECT: 10/06/83

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F.O.I. INDEX DETAIL

REFERENCE NO: SUBJECT REFS: LEGISLAT. REFS:

I 1104864	INTEREST WITHHOLDING TAX	128B
	ASSESSABLE INCOME	25(1)
	ALLOWABLE DEDUCTIONS	51(1)

FACTS

Consideration has recently been given to the income tax implications of a form of interest hedging arrangement known as "interest swapping".

2. An Australian resident borrower of moneys from overseas at a floating rate of interest, say London Inter-Bank Offered Rate (LIBOR) + 1%, would ordinarily seek to limit its exposure to fluctuations in interest rates. As an alternative to conventional hedging arrangements involving, as they would usually do, interest rate futures contracts there have developed "interest swapping" transactions.

3. In its simplest form, a foreign banking concern would provide a "swapping" facility to the borrower by itself raising a loan, at a fixed interest rate readily available to it, of an amount equivalent to the amount of floating rate funds which were originally obtained by the borrower from other foreign sources. The Australian resident borrower and the foreign banking concern would then exchange their respective interest commitments, quite independently of the relevant loans with third parties and without affecting those contracts in any way, by undertaking to pay to each other from time to time amounts equal to the other's interest obligations before payment of fees, commissions, margins, etc. to the bank for the facility. The arrangement would usually provide for the corresponding payments to be offset against each other so that only a single net payment would be made by one party to the other.

4. There may also be situations in which one party is unwilling to accept the risk of the other party to the swap arrangement fulfilling its obligations for payment and a third party intermediary, also usually a bank or other financial institution, would be interposed between the parties and would bear the risk of default by either party. In this way performance of all commitments by the parties to each other is effectively guaranteed. This variation does not otherwise alter the swapping techniques nor the income tax consequences.

RULING 5. An "interest swapping" arrangement is a form of

interest hedging facility and is a transaction quite independent of any loan obligations of the parties to which the arrangement might be referable. It does not involve any additional loans between the parties or any disturbance of existing loans and obligations to pay interest as it falls due.

6. The payments made by the parties to each other in accordance with the terms of the agreement are not amounts of interest as the term is defined for withholding tax purposes in section 128A(1).

7. An "interest swapping" arrangement involving an Australian resident borrower would not, in the circumstances which have been described, involve any interest withholding tax liability additional to that which might otherwise exist in respect of the borrower's existing interest obligations.

8. It is also accepted as a general principle that payments made by the parties in accordance with the interest swapping agreement are attributable to existing interest expenses and are themselves revenue in nature. As a consequence the payments would be assessable to the recipient and deductible to the payer as the case may be. The involvement of an intermediary would not alter the character of the payments.

9. It is necessary to say that the advice in the preceding paragraph operates as a general principle. As the arrangements are presently understood it would seem usual for the parties to have raised loans at rates of interest which are more or less comparable, though one is variable and the other fixed. If there were substantial differences between the two at the time that the parties enter into the interest swapping arrangement the particular circumstances would require examination to decide whether they were truly of a revenue nature.

10. Because the various incidental expenses which are associated with an interest swapping transaction relate to an existing interest expense they would ordinarily be deductible in accordance with section 51(1) of the ITAA 1936 in the same way as the incidental costs associated with a conventional interest hedging arrangement. Any payments which might be made by the parties upon early termination of the whole of the arrangements would also be of a revenue nature in the usual case, i.e. assessable or deductible to the parties as the case may be.

11. In the event that interest was to be charged on overdue swap payments, any interest which might be paid to a non-resident would be subject to withholding tax.

COMMISSIONER OF TAXATION

13 July 1983

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