

AUSTRALIAN INTEREST WITHHOLDING TAX REDUCING THE COST OF GLOBAL BORROWINGS

As a net capital importer, cheap and easy access to global debt is important for Australian businesses. Australia makes available a wide array of exemptions from Australia’s 10% interest withholding tax (IWHT). Ensuring each transaction meets the letter and the spirit of the exemptions has a real 10% cash flow impact on Australian borrowers. This guide describes the most commonly used exemptions in typical scenarios, including the public offer (“Section 128F”) exemption.

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1 WHEN IS AUSTRALIAN IWHT PAYABLE?

Australian IWHT applies to income derived by any taxpayer in row 1 (Lender) and consists of interest paid by any taxpayer in row 2 (Borrower) of the following table:

Row 1 Lender	Non-resident not lending through an Australian permanent establishment (PE)	Non-resident lending through a foreign PE	Australian resident lending through a foreign PE
Row 2 Borrower	Australian resident not borrowing through a foreign PE		Non-resident borrowing through an Australian PE



What is interest?

Interest is consideration for the use of funds for a period of time. For Australian IWHT purposes, it includes amounts in the nature of or in substitution for interest (for example, discounts on securities or payments of lump sums in place of regular interest), and dividends on shares that are debt for tax purposes. The Australian Taxation Office has expressed the view, which is not commonly shared, that payments made under a guarantee can be interest.



Deemed interest

The transfer of certain types of securities can result in IWHT. A discounted security transferred for more than its issue price has an embedded interest component, which can be subject to IWHT.

Hire purchase and similar arrangements can also be subject to IWHT for the implied interest built into the payments.

Special rules can also apply pursuant to the taxation of financial arrangements (TOFA) regime.

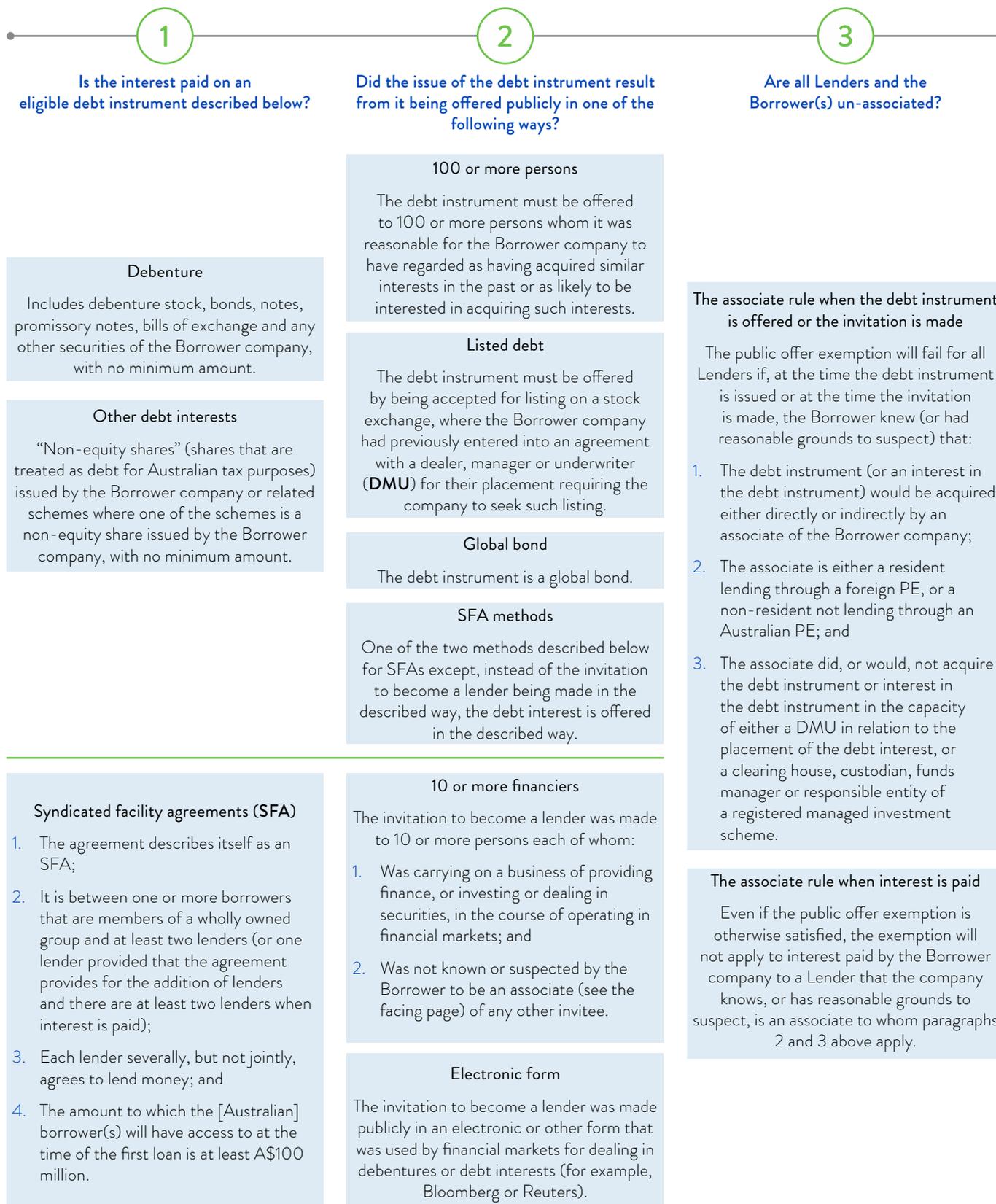


Only a guide

Not surprisingly, the world of international financing is complex, with new and innovative arrangements arising frequently. It may also not be possible to shoe-horn any particular transaction into a static set of provisions. The IWHT provisions contain many nuances, prescriptions and exceptions. This guide is no substitute for considered tax advice that takes into account the particular circumstances of the transaction and arrangements.

2 NAVIGATING THE PUBLIC OFFER EXEMPTION

To facilitate a reduction of Australian IWHT, particularly in large borrowings, the public offer exemption (sometimes referred to as the “128F exemption”) is the most widely used concession. The requirements to satisfy the public offer exemption are summarised below.





Associates

Broadly, an associate is an entity that holds majority voting interests in, or “sufficiently influences”, another entity.

A company is “sufficiently influenced” by another entity if it (or its directors) are accustomed or under an obligation (whether formal or informal) to act in accordance with the directions, instructions or wishes of the other entity.

The associate rules operate by reference to actual knowledge, reasonable suspicion or suspicion. These different thresholds should be considered in practical situations.



Sequencing

The sequencing of various steps in obtaining financing is important to the public offer exemption applying.

Debt instrument	Offer/Invitation	Negotiation	Agreement	Issue
Debentures	Make the offer. If you are not using the SFA methods, you will need reasonably well settled terms and the full suite of documents.	None or very little.	Generally, on acceptance of the offer.	Issue debentures.
Other debt interests	Make the offer. If you are not using the SFA methods, you will need reasonably well settled terms and the full suite of documents.	None or very little.	Generally, on acceptance of the offer.	Issue other debt interests.
SFA	Make the invitation. You may only need basic but key terms of facilities, such as amounts, duration, interest rates and repayment.	On receipt of responses from potential Lenders, detailed terms are negotiated.	Agreement is reached following negotiation. Not all interested parties will enter into the SFA.	Drawdowns in accordance with the SFA.

But I am using a dealer, manager or underwriter

There are two possible roles that a DMU can play in relation to the offer or invitation.

Firstly, the DMU can act as the agent for the Borrower in making the offer or invitation. In that case, the above sequencing applies.

Alternatively, the DMU can take all risk associated with the debt instrument. If so, the sequencing changes as follows (using the SFA to demonstrate).

Debt instrument	Agreement	Issue	No later than 30 days of the DMU entering into the SFA	Agreement
SFA	Enter into agreement with a DMU. The agreement must include a term requiring the DMU to invite potential Lenders under the SFA within 30 days.	Drawdowns in accordance with the SFA can occur.	The DMU must invite Lenders in the manner otherwise applicable to SFAs (for example, to at least 10 unassociated financial institutions).	Incoming Lenders accede to the SFA.

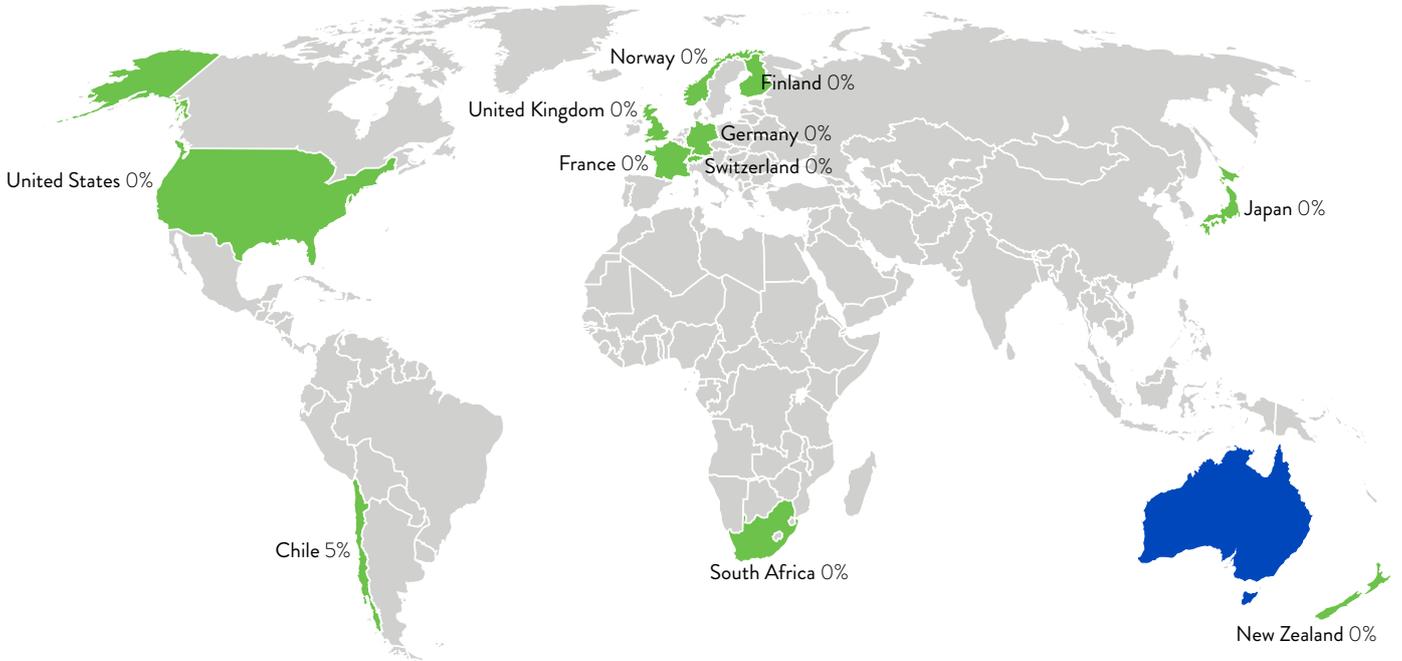


What about non-corporate Borrowers?

The public offer exemption is available to corporate Borrowers and certain unit trusts only. Other types of entities are not able to rely on the exemption.

3 TREATY EXEMPTIONS

Financial institutions that are resident in these countries are subject to a lower rate of Australian IWHT on interest income they derive. A financial institution, for the purposes of these treaties, is broadly 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. Also, each treaty has anti-abuse requirements which should be considered.



4 OTHER EXEMPTIONS

Other exemptions from Australian IWHT apply to interest derived by:



Certain tax exempt entities, including charities.



Foreign banks on nostro accounts.



Certain tax exempt foreign superannuation funds.



Certain foreign sovereign entities, including banks performing central bank functions.

These are only some of the exemptions available.

CONTACTS



MUHUNTHAN KANAGARATNAM

Partner

T +61 2 9263 4184
E mkanagaratnam@gtlaw.com.au



JULIAN LIAN

Tax Consultant

T +61 2 9263 4715
E jlian@gtlaw.com.au



TINA CHEN

Lawyer

T +61 2 9263 4359
E tchen@gtlaw.com.au



MATTHEW CHARMAN

Lawyer

T +61 2 9263 4153
E mcharman@gtlaw.com.au