

MEDIA RELEASE

SOLVENCY IS NOT A PRE-CONDITION FOR OBTAINING A GENERAL DEDUCTION AGAINST ASSESSABLE INCOME

The Commissioner of Taxation has exhausted his rights of appeal against a claim that a taxpayer (in this case a company) could not claim deductions for interest charged (but not paid) over many years.

The facts of the case were simply that the company, soon after acquiring a commercial property, was financially incapable of meeting payments for interest expense, from its own resources. The mortgagor was compelled to rely on the grace of the mortgagee which capitalised interest, at default rates, after reducing the mortgage debt (however marginally) from rent applied against the mortgage debt.

The basic thrust of the Commissioner's case was that the interest expense charged by the mortgagee could not be claimed as an allowable deduction, notwithstanding that the taxpayer did not meet the cost from its own resources and the control of the property had passed to the mortgagee when it became a "mortgagee in possession".

The case debunks, once and for all, any notion that there is a *Doctrine of Economic Equivalence* which was the de-facto argument the courts were asked to consider. Neither the Federal Court, at first instance, nor the Federal Court of Appeal agreed with this posture. Further, in respect of the Commissioner's application for special leave to appeal to the High Court Justice Gleeson (on behalf of the court) gave short shrift to the Commissioner's contention in this regard, and dismissed the Commissioner's application insofar as there were insufficient prospects of success.

The case is a salutary reminder that a taxpayer is not required to remain solvent (that is to say, be able to pay its debts as and when they fall due for payment each month) in order to be entitled to claim an allowable deduction for interest expense where all other conditions are satisfied (such as the derivation of assessable income (even where the income derived is hopelessly inadequate to meet the growing interest liability)).

31 March 2008