


TD 2016/D7 - Income tax: where an Australian corporate tax entity is a beneficiary of a trust, can the trust be taken to 'hold' a direct control interest (within the meaning of section 350 of the Income Tax Assessment Act 1936) in a foreign company for the purpose of Subdivision 768-A of the Income Tax Assessment Act 1997 ?

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This document has been finalised by TD 2017/22.



Draft Taxation Determination

Income tax: where an Australian corporate tax entity is a beneficiary of a trust, can the trust be taken to ‘hold’ a direct control interest (within the meaning of section 350 of the *Income Tax Assessment Act 1936*) in a foreign company for the purpose of Subdivision 768-A of the *Income Tax Assessment Act 1997*¹?

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Ruling

1. Yes. Therefore, a corporate tax entity that is a beneficiary of a trust (including a discretionary trust) can have a participation interest in a foreign company for the purpose of satisfying the participation test in section 768-15.

Example 1: beneficiary of a unit trust

2. *Unitholder Company is an Australian corporate tax entity and held 60% of the income and capital units in Unit Trust at all times during the 2015 income year.*
3. *Trustee Company is the trustee of Unit Trust.*
4. *Trustee Company was the registered shareholder of 70% of all the shares in Foreign Company at all times during the income year. It held these shares as trustee of the Unit Trust.*

¹ All legislative references in this draft Taxation Determination are references to *Income Tax Assessment Act 1997* unless otherwise indicated.

5. On 1 April 2015 Foreign Company paid a dividend to Trustee Company, in its capacity as trustee.
6. Trustee Company on-paid that dividend by way of distribution out of the net income of Unit Trust to its unitholders on 30 June 2015.
7. Unitholder Company satisfied the participation test in section 768-15 at the time Foreign Company distributed the dividend to Trustee Company (being 1 April 2015). Unitholder Company's participation interest in Foreign Company at that time was greater than 10%.
8. As at 30 June 2015, Unitholder Company was entitled to 60% of the income and capital of Unit Trust. It therefore held a direct control interest in Unit Trust of 60%. Unitholder Company's direct participation interest in the Unit Trust (60%) multiplied by the trust's direct participation interest in Foreign Company (70%) was 42%.

Example 2: beneficiary of a discretionary trust

9. At all times during the 2015 income year Discretionary Company was an Australian corporate tax entity and was a discretionary object of Discretionary Trust.
10. Trustee Company is the trustee of Discretionary Trust.
11. At all times during the 2015 income year Trustee Company was the registered shareholder of 80% of all the shares in Foreign Company. It held the shares as trustee of the Discretionary Trust.
12. On 1 April 2015 Foreign Company paid a dividend to Trustee Company.
13. On 30 June 2015, Trustee Company resolved that Discretionary Company was entitled to all of Discretionary Trust's net income for that income year.
14. Discretionary Company satisfied the participation test in section 768-15 at the time Foreign Company paid the dividend to Trustee Company (being 1 April 2015). Discretionary Company's participation interest in Foreign Company at that time was greater than 10%.
15. As Discretionary Company was entitled to 100% of the net income of Discretionary Trust at the end of the 2015 income year, Discretionary Company was taken to be entitled to 100% of the income of Discretionary Trust at all times during that year. It therefore was taken to hold a direct control interest in Discretionary Trust of 100% at the time the foreign distribution was made (being 1 April 2015). Discretionary Company's direct participation interest in Discretionary Trust (100%) multiplied by the discretionary trust's direct participation interest in Foreign Company (80%) was 80%.
16. If Trustee Company made no resolution in favour of Discretionary Company at the end of the 2015 income year, Discretionary Company would not have been taken to hold a direct control interest in Discretionary Trust at the end of the 2015 income year and could not have satisfied the participation test at the time Foreign Company made its equity distribution.

Example 3: increasing interests in a unit trust

17. Unitholder Company B is an Australian corporate tax entity. As at 1 July 2015 it held 5% of all the income and capital units in Unit Trust.
18. Trustee Company is the trustee of Unit Trust.

19. *At all times during the 2015 income year, Trustee Company was the registered shareholder of 70% of all the shares in Foreign Company. It held these shares as trustee of the Unit Trust.*
20. *On 1 April 2015 Foreign Company paid a dividend to Trustee Company.*
21. *On 1 June 2015 Unitholder Company B acquired a further 20% of the units in Unit Trust.*
22. *On 30 June 2015, Trustee Company resolved to distribute all of the net income of Unit Trust to its unitholders based on their proportionate share in all the units in the trust.*
23. *Unitholder Company B satisfied the participation test in section 768-15 at the time Foreign Company paid the dividend to Trustee Company (being 1 April 2015). Unitholder Company B's participation interest in Foreign Company at that time was greater than 10%.*
24. *As Unitholder Company B was entitled to 25% of the income of Unit Trust at the end of the 2015 income year, Unitholder Company B will be taken to be entitled to 25% of the income of Unit Trust at all times during the 2015 income year. It therefore held a direct control interest in Unit Trust of 25% at the time the foreign distribution was made (being 1 April 2015). Unitholder Company B's direct participation interest in Unit Trust (25%) multiplied by Unit Trust's direct participation interest in Foreign Company (70%) was 17.5%.*

Example 4: decreasing interests in a unit trust

25. *Unitholder Company C is an Australian corporate tax entity. As at 1 July 2015 it held 60% of all the income and capital units in Unit Trust.*
26. *Trustee Company is the trustee of Unit Trust.*
27. *At all times during the 2015 income year Trustee Company was the registered shareholder of 70% of all the shares in Foreign Company. It held these shares as trustee of the Unit Trust.*
28. *Foreign Company paid a dividend to Trustee Company on 1 April 2015.*
29. *On 1 June 2015, Unitholder Company C sold 80% of the units it held in Unit Trust leaving it with a holding of 12% of the units in Unit Trust.*
30. *On 30 June 2015 Trustee Company resolved to make a distribution of the net income of Unit Trust to its unitholders on 30 June 2015 based on their proportionate share of all the units in the trust.*
31. *Unitholder Company C did not satisfy the participation test in section 768-15 at the time Foreign Company paid the dividend to Trustee Company (being 1 April 2015). Unitholder Company C's participation interest in Foreign Company at that time was less than 10%.*
32. *As Unitholder Company C was entitled to 12% of the income of Unit Trust at the end of the 2015 income year, Unitholder Company C is taken to be entitled to 12% of the income of Unit Trust at all times during the year. It therefore held a direct control interest in Unit Trust of 12% at the time the foreign distribution was made (being 1 April 2015). Unitholder Company C's direct participation interest in Unit Trust (12%) multiplied by Unit Trust's direct participation interest in Foreign Company (70%) was only 8.4%.*

Example 5: decreasing interests in a unit trust and multiple distributions

33. Unitholder Company D is an Australian corporate tax entity. On 1 July 2015 it held 25% of all the income and capital units in Unit Trust.
34. Trustee Company is the trustee of Unit Trust.
35. At all times during the 2016 income year, Trustee Company was the registered shareholder of 70% of the shares in Foreign Company. It held these shares as trustee of the Unit Trust.
36. On 1 October 2015 Foreign Company paid a dividend of \$100 to Trustee Company.
37. Under Unit Trust's trust deed, unitholders are made presently entitled to the income of the Trust immediately before the end of 30 June and 31 December of each year.
38. On 31 December 2015 Trustee Company on paid the dividend and made a distribution of the income of Unit Trust to its unitholders based on their proportionate share of all the units in the trust.
39. On 1 March 2016 Unitholder Company D sold 60% of the units that it held in Unit Trust leaving it with a holding of 10% of the units in Unit Trust.
40. On 1 April 2016 Foreign Company paid a second dividend to Trustee Company of \$300.
41. On 30 June 2016 Trustee Company on paid the dividend and made a second distribution of the income of Unit Trust to its unitholders on 30 June 2016 based on their proportionate share in all of the units in Unit Trust.
42. Unitholder Company D does not satisfy the participation test in section 768-15 at the times Foreign Company distributed the dividends to Trustee Company (being 1 October 2015 and 1 April 2016). Unitholder Company C's participation interest in Foreign Company at those times was less than 10%.
43. As Unitholder Company D was entitled to 13.75% of the income of Unit Trust at the end of the income year, Unitholder Company D is taken to hold that percentage at all times during the 2016 income year. Unitholder Company D therefore holds a direct control interest in Unit Trust of 13.75% at the time the foreign distributions were made (being 1 October 2015 and 1 April 2016). Unitholder Company D's direct participation interest in Unit Trust (13.75%) multiplied by Unit Trust's direct participation interest in Foreign Company (70%) is 9.62%.

Date of effect

44. When the final Determination is issued, it will apply to foreign equity distributions made on or after 17 October 2014, being the date Subdivision 768-A commenced operation.

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's preliminary view has been reached. It does not form part of the proposed binding public ruling.*

45. Subdivision 768-A provides that in certain circumstances an equity distribution made by a foreign company to an Australian resident corporate tax entity is not assessable and not exempt income (NANE income).

46. A foreign equity distribution can be NANE income whether or not the Australian corporate tax entity receives the distribution 'directly or indirectly through one or more interposed trusts or partnerships'.²

47. For the distribution to be NANE income the Australian corporate tax entity must satisfy the participation test in relation to the foreign company at the time the distribution is made.³

48. The Australian corporate tax entity will satisfy the participation test if the sum of its direct and indirect participation interests in the foreign company is at least 10%.⁴

49. Where the Australian corporate tax entity holds its interest in the foreign company indirectly, section 960-185 states that its indirect participation interest is worked out by multiplying its direct participation interest in the intermediate entity by the intermediate entity's direct participation interest in the foreign company.

50. Where the Australian corporate tax entity holds its interest in the foreign company indirectly through a trust, the intermediate entity for the purposes of section 960-185 will be the trust. A trust is recognised as an entity.⁵

51. The trust's direct participation interest is then worked out by reference to the trustee's direct control interest in the foreign company under section 350 of the *Income Tax Assessment Act 1936* (ITAA 1936).

52. The direct control interest the trustee holds in the foreign company 'at a particular time' is equal to the percentage of share capital, rights to distributions or rights to vote that the trustee holds in the foreign company at that time.

53. The 'particular time' when applying section 350 of the ITAA 1936 for the purpose of paragraph 768-5(2)(d) will be the time the foreign equity distribution is made.⁶

54. It is then necessary to work out the direct participation interest that the Australian corporate tax entity (beneficiary) holds in the trust. This is worked out by determining its direct control interest in the trust under section 351 of the ITAA 1936.

55. The direct control interest the beneficiary holds in the trust 'at a particular time' is equal to the percentage share of income or capital of the trust to which the beneficiary is entitled or entitled to acquire at that time. The 'particular time' will be the time the foreign equity distribution is made.

² Section 768-1.

³ Paragraph 768-5(2)(d).

⁴ Section 768-15.

⁵ Section 960-100.

⁶ In calculating the percentage of rights to distributions, the percentage needs to be calculated at the end of the statutory accounting period (subsections 350(3) and 350(4) of the ITAA 1936).

56. A discretionary beneficiary's direct control interest in the trust is equal to the percentage share of the income or capital to which it is entitled or entitled to acquire at the time the foreign equity distribution is made.

57. Usually, the trustee will exercise its discretion concerning the income and capital of the trust at the end of the income year, and the discretionary beneficiary would not have an entitlement at the time the foreign equity distribution is made (assuming the distribution is made before the end of the income year).

58. However, subsection 351(2) of the ITAA 1936 provides that in working out the beneficiary's share of income or capital at a particular time (being the time of distribution):

- ascertain the share of income or capital to which the beneficiary is entitled at the end of the income year, and
- assume that this is the share to which the beneficiary is entitled at all other times during that income year.

59. In this way, a discretionary beneficiary can 'hold' a direct control interest in the trust at the time the foreign equity distribution is made (notwithstanding that the beneficiary has no entitlement at that time), provided that by the end of the income year in which the distribution is made, the beneficiary has an entitlement to a share of income or capital of the trust.

60. If the beneficiary has a fixed interest in the trust, subsection 351(1) of the ITAA 1936 provides that the beneficiary's direct control interest in the trust is equal to the fixed percentage share of income or capital to which it is entitled at the time the foreign equity distribution is made.

61. However, as subsection 351(2) of the ITAA 1936 applies to fixed as well as discretionary beneficiaries, the relevant percentage will be taken to be the percentage share that the fixed beneficiary is entitled or entitled to acquire at the end of the income year.

62. If the beneficiary's fixed share of income or capital of the trust changes between the time the foreign equity distribution is made and the end of the income year, it is the percentage share entitled or entitled to be acquired by the beneficiary at the end of the income year that is taken to be the beneficiary's direct control interest in the trust.

63. Examples 3 to 5 illustrate how the participation test applies where a beneficiary's holding of fixed interests in the trust change during the income year.

Appendix 2 – Your comments

64. You are invited to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date.

65. A compendium of comments is prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments, and
- be published on the ATO website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date:	20 January 2017
Contact officer:	Andrew Phlorides
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References

Previous draft:

Not previously issued as a draft

- ITAA 1936 351
- ITAA 1936 351(1)
- ITAA 1936 351(2)

Related Rulings/Determinations:

TD 2008/25; TR 2006/10; TR 2016/D2

- ITAA 1997
- ITAA 1997 Subdiv 768-A
- ITAA 1997 768-1
- ITAA 1997 768-5(2)(d)

Legislative references:

- ITAA 1936
 - ITAA 1936 350
 - ITAA 1936 350(3)
 - ITAA 1936 350(4)
 - ITAA 1997 768-15
 - ITAA 1997 960-100
 - ITAA 1997 960-185
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ATO references

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