TD 2008/23EC - Compendium

Ruling Compendium – TD 2008/23

This is a compendium of responses to the issues raised by external parties to draft Tax Determination TD 2007/D6 – Income tax: are the active assets of a partnership, in which a foreign company is a partner, active foreign business assets of the foreign company for the purposes of the capital gains tax participation exemption provisions contained in Subdivision 768-G of the *Income Tax Assessment Act 1997*?

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	Tax Office Response/Action taken
1.	The Commissioner's conclusion that neither the foreign company's interest in each asset of the partnership, nor its residual interest in the partnership, constitute active foreign business assets, is incorrect. The correct view is that only the residual interest in the partnership in not an active foreign business asset. This is because: • Division 768 of the *Income Tax Assessment 1997* (ITAA 1997) applies only to 'CGT assets'; • The definition of a 'CGT asset' has two limbs relating to partnerships, namely: *(c) an interest in an asset of a partnership;* *(d) an interest in a partnership that is not covered by paragraph (c).* • The definition recognises that (c) and (d) are separate CGT assets;	The Commissioner considers the view in the Determination to be the better view for two reasons. Firstly, the Commissioner cannot reconcile the alternative view with the general statement in paragraph 1.120 of the Explanatory Memorandum to the *New International Tax Arrangements (Participation Exemption and Other Measures) Act 2004* (the Explanatory Memorandum) that 'the characterisation of interests in partnerships and trusts as not active means that these entities will not be looked through for the purpose of calculating the active foreign business asset percentage of a foreign company'. The Commissioner has considered the argument that paragraph 1.120 of the Explanatory Memorandum can be read narrowly as simply saying that if a share in a foreign company is held by a partnership, the assets of that foreign company will not contribute to the active foreign business asset percentage. The Commissioner has explained why paragraph 1.120 of the Explanatory Memorandum cannot be read so narrowly in the Determination. Secondly, the provisions in Subdivision 768-G of the ITAA 1997 need to be construed having regard to the controlled foreign company (CFC) provisions contained in Part X of the *Income Tax Assessment Act 1936* (ITAA 1936) and section 23AJ of the ITAA 1936. The Commissioner's view outlined in the Determination is consistent with his interpretation of the CFC rules and section 23AJ of the ITAA 1936. The Commissioner has explained his reasoning in the Determination.

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	Accordingly, the reference in subsection 768-540(2) of the ITAA 1997 to an interest in a partnership is only a reference to one of those CGT assets; namely, a residual interest in the partnership itself.	
2.	The reasoning in paragraphs 17 and 18 does not support the ATO view. It is argued that shares are completely different to partnership interests. That is, a shareholder has no direct proportionate interest in the assets of the company, unlike a partner who holds a fractional interest in every partnership asset. The argument appears to be that because a partner has a fractional interest in every partnership asset for CGT purposes, the active assets of a partnership can be taken into account when calculating the active foreign business asset percentage of a foreign company.	The Commissioner is making a general proposition in paragraph 16 of the Determination that certain CGT assets were not intended to be taken into account as active assets for the purposes of calculating the active foreign business asset percentage. The rationale for excluding certain assets was that they were passive in nature and any reduction in a capital gain or loss under Division 768 of the ITAA 1997 was only intended to be in respect of active foreign business assets. Accordingly, an interest in a partnership should be excluded because it is a passive asset. Paragraphs 17 and 18 of the Determination expand on the proposition made in paragraph 16. The point is made that an interest in a partnership (be it an interest in each asset of the partnership or the residual interest) was not intended to be treated as active for the purposes of calculating the active foreign business asset percentage. The Determination highlights that the treatment of an interest in a partnership is expressly different to the treatment of a share. Although an investment in a share is ordinarily passive in nature, a share is specifically included in the definition of active foreign business asset, whilst an interest in a partnership is expressly excluded.

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3.	The Commissioner's references to the Explanatory Memorandum do not assist the Commissioner's contentions and cannot fill what does not exist in the statute itself.	The Commissioner has not sought to rely on the Explanatory Memorandum to 'fill what does not exist in the statute itself'. Rather the phrase 'an interest in a partnership' has been construed having regard to its statutory context, and the purpose of the provision in which the phrase is found. Extrinsic materials such as an Explanatory Memorandum can be referred to under the common law independently of being permitted to do so by section 15AB of the *Acts Interpretation Act 1901* to ascertain the purpose of the legislation under consideration: see *Newcastle City Council v. GIO General Limited* (1997) 191 CLR 85 per Toohey, Gaudron and Gummow JJ at 99. The references to the Explanatory Memorandum in the Determination support the Commissioner's construction of the phrase in subsection 768-540(2) of the ITAA 1997. The quotes from the Explanatory Memorandum in paragraphs 16 and 17 of the Determination have been included because they explain the rationale for expressly excluding certain CGT assets from the definition of active foreign business asset, that is, the assets are passive in nature. The quote from the Explanatory Memorandum in paragraph 18 of the Determination is relevant to the conclusion reached in the Determination. The first sentence in the quote is of particular relevance. It reads as follows: > Characterisation of interests in partnerships and trusts as not active means that these entities will not be looked through for the purpose of calculating the active foreign business asset percentage of a foreign company.

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4.	The Commissioner has been asked for his view on how the modified rules for foreign wholly-owned groups in section 768-535 of the ITAA 1997 apply where there is a chain of wholly-owned foreign companies which includes a foreign hybrid company (as defined in section 830-15 of the ITAA 1997). A foreign hybrid company is treated as a partnership for tax purposes. The submission contends that under section 768-535, a foreign hybrid company can be looked-through so that the companies held directly or indirectly by the foreign hybrid company, are treated as part of the top foreign company for the purposes of calculating the active foreign business asset percentage of the top foreign company.	The Commissioner is of the view that the question raised cannot be addressed in this Determination and it is proposed to consult with the Business and Service Lines in the Tax Office and the National Tax Liaison Group Foreign Source Income Sub-Committee to ascertain whether another Determination which specifically addresses this question is warranted.