# *TD 2011/24EC - Compendium*

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# Ruling Compendium – TD 2011/24

This is a compendium of responses to the issues raised by external parties to draft Taxation Determination TD 2010/D7 – Income tax: is 'Australian source(s)' in subsection 6-5(3) of the *Income Tax Assessment Act 1997* dependent solely on where purchase and sale contracts are executed in respect of the sale of shares in an Australian corporate group acquired in a leveraged buyout by a private equity fund?

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 | ATO response/action taken |
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| 1 | **Collective treatment improper**<br>The Draft TD makes no distinction between the private equity firm acting in its capacity as a partner as opposed to acting in its capacity as the manager of the fund (or its subsidiaries).<br>As a matter of law, it is not possible to conflate the activities and attributes of separate taxpayers in the manner in which the Draft TD seeks to do.<br>Consideration should be given to whether the private equity firm is:<br>• acting in its capacity as general partner for the fund and therefore as an agent, or<br>• acting as the manager of the fund and merely an independent service provider.<br>If the private equity firm is acting as an independent service provider, it should not be permissible to attribute the activities of that entity to the fund itself.<br>The focus of the enquiry should be on the activities of the fund itself and of its employees and dependent agents. | The taxpayer is the limited partnership treated as a company for Australian domestic tax purposes.<br>The TD is confined to one set of facts and is based on an actual case.<br>The ATO acknowledges that there are different transactions with different arrangements and the outcome in each case will depend on its facts. |
| 2 | **A TR is more appropriate**<br>Given the potential wide reaching implications of this TD (ie. investment in Australia by non-residents), the ATO should consider withdrawing the draft TD and replacing it with a draft TR to provide full guidance to foreign investors in Australian shares on Australia's source rules. | The TD is intended to deal only with one set of facts. It is not intended to provide comprehensive guidance in all cases nor is it intended to be a comprehensive view on the question of source. Rather, it is intended to express the Commissioner's view that in complex transactions such as a leveraged buyout, the place of the execution of the contracts will not be the sole consideration in determining source. |

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| 3 | **Lacking analysis of case law**<br>The Draft TD should contain a much more detailed and in-depth analysis of the complex decision of the High Court in *Australian Machinery & Investment Co Ltd v DCT*[1] (*AMI*), which is the main authority in Australia for the source of income or profits arising from the disposal of shares. The Draft TD should also discuss the High Court's decision in *Esquire Nominees Ltd v FCT*,[2] which is the most relevant authority of more recent times. | The purpose of the TD is to point out that while case law is helpful in providing some guidance, it will always come down to the facts.<br>*Esquire Nominees* is now discussed in the TD. |
| 4 | **Source of profits rule**<br>Having regard to the main Australian authorities, the better view is that the source of profits arising on the purchase and sale of shares is where the taxpayer's activity takes place. In this regard, it is necessary to characterise the nature of the activities of the taxpayer and of its dependent agents, and to identify where those activities are carried on. Where those activities are carried on in multiple countries, it may be necessary to apportion the profits between the various sources. | The ATO agrees that certain facts may give rise to questions of apportionment. The final TD acknowledges this in paragraph 38. |
| 5 | **Draft TD too narrow**<br>The draft TD needs to consider wider factual circumstances, for example:<br>• If the fund is merely a passive investor;<br>• If the fund (through its employees or dependent agents) actively creates a market or organises a float of shares into which shares are sold;<br>• If the fund is a passive investor but has given a mandate to another entity to manage the investment on its behalf as a dependent agent having the authority to bind the investor. | See response to issue 2. |
| 6 | **Inconsistent with pre-existing ATO view**<br>The conclusion and the reasoning of the Draft TD is inconsistent with the conclusions and reasoning of a series of ATO Interpretative Decisions that considered the source of profits from the sale of shares, options and other financial instruments. In those ATO IDs, the ATO expressed the view that the profits from the sale of the securities were sourced in the country where the contracts for the purchase and the sale of the securities were executed (not where the decisions to purchase and sell were made). Some of those ATO IDs also referred to a number of overseas cases in support of this proposition. | Those previous ATO IDs have been determined on their own facts and, in each case, the investment was not on all fours with the leveraged buyout example in the TD.<br>These ATO IDs do not advise that locus of contract is the sole determinative factor in all cases involving purchase and sale of shares.<br>The ATO does not agree that there is any inconsistency. |

[1] (1946) 180 CLR 9.
[2] (1973) 129 CLR 177.

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| 7 | **Inconsistent with pre-existing ATO view**<br>In Taxation Ruling TR 2004/15, the Commissioner considers that, in determining the tax residence of a company where a company's activity is passive investment, the company's business is carried on where high-level strategic decisions are made in respect of its assets (which is also where its central management and control is located). Applying this logic, it would appear to follow that, if the only activity of the fund is passive investment carried out in the one place, the source of the income of the fund should be where that activity occurs. | The TD is confined to its facts in which the limited partnership takes an active role in the leveraged buyout. |
| 8 | **Interpretation of *Thorpe* and *Spotless***<br>The Full Federal Court's decision in *Thorpe Nominees Pty Ltd v FCT* is not authority for the proposition that, in all cases, it is necessary to examine the substance of a transaction and the motives of the parties in determining the source of income or profits derived from the transaction.<br>The Federal Court decision in *Spotless Services Limited v FCT* gives greater weight to the form (rather than the substance) of the transaction.<br>The final Determination should analyse *Spotless Services* and explain the ATO's view of the relevance (if any) and correctness of this decision, and how it is to be reconciled with the seemingly different approach adopted in *Thorpe Nominees*. | *Thorpe* is used in the TD as authority for the proposition that where tax avoidance is involved, the place of execution may become irrelevant. It was not intended to be read as a general principle extending to all cases. The reference has been amended. |
| 9 | **Use Part IVA instead**<br>If the Commissioner considers that, in a particular case, a taxpayer has entered into a scheme designed to ensure that profits arising from the disposal of private equity investments are not sourced in Australia, then the appropriate course of action would be for the Commissioner to consider whether Part IVA should apply (as discussed in paragraphs 35 to 38 of the Draft TD), rather than relying on a vague notion of substance to determine the source of the profits.<br>Accordingly, the comments in paragraphs 30 and 31 of the Draft TD (regarding the relevance of substance) should be deleted. | Determining source is one of the first steps in terms of the proper application of Australian tax law. Questions of substance may be relevant in that analysis. |
| 10 | **Inconsistent application to private equity arrangement**<br>The approach adopted by the ATO in paragraphs 32 to 34 of the Draft TD (in weighing up the factors considered relevant) has been applied to the particular circumstances of a private equity arrangement in a manner inconsistent with the ATO's reasoning in Taxation Determination TD 2010/21 (which addresses the tax character of the profits from the realisation of private equity investments). | Determining source and whether a gain is on income or capital account are different issues. |

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| 11 | **'LP' more appropriate**<br>There is a clear legal difference between "limited liability partnerships" ("LLP") and "limited partnerships" ("LP"), which is well understood overseas, and the entities used for private equity investments are limited partnerships which are referred to internationally as LPs (not LLPs). | The terminology has been changed to limited partnerships. |
| 12 | **Change Advice Co in the example**<br>Typically, Advice Co is a subsidiary of the private equity firm (which acts as the general partner/manager of the fund), rather than a subsidiary of the fund itself. Therefore, the Example should be amended to refer to Advice Co as an Australian resident entity controlled by the general partner/manager of Priveq LP. | The example represents the arrangement that is being ruled upon and is based on an actual case. |
| 13 | **Date of effect**<br>The Professional Bodies submit that the Draft TD should only apply on a prospective basis, given that the cases in this area are inconsistent, and given that the approach adopted by the ATO in the Draft TD represents a significant departure from its stance in earlier Interpretative Decisions. | See response to issue 6. |