TD 2017/22 - Income tax: where an Australian corporate tax entity is a beneficiary of a trust, can the trust '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 ?

Taxation Determination

Income tax: where an Australian corporate tax entity is a beneficiary of a trust, can the trust '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, the Australian corporate tax entity can have an indirect participation interest in the foreign company through the trust for the purpose of satisfying the participation test in section 768-15.[2]

Example 1: beneficiary of a unit trust

2. *Unitholder Company (the beneficiary) 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.*

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[1] All legislative references in this Taxation Determination are references to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated.
[2] Provided that the trust is not a public trading trust and therefore not a corporate tax entity within the meaning of section 960-115.

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.*

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 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 paid the dividend to Trustee Company (being 1 April 2015) because Unitholder Company's participation interest in Foreign Company at that time was greater than 10%.*

8. *At all times during the income year (that is, including 1 April 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% at the test time. Unitholder Company's direct participation interest in Unit Trust (60%) multiplied by Unit Trust's direct participation interest in Foreign Company (70%) was 42%.*

Example 2: increasing interests in a unit trust

9. *Unitholder Company B is an Australian corporate tax entity. As at 1 July 2014 it held 5% of all the income and capital units in Unit Trust.*

10. *Trustee Company is the trustee of Unit Trust.*

11. *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.*

12. *On 1 April 2015 Foreign Company paid a dividend to Trustee Company.*

13. *On 1 June 2015 Unitholder Company B acquired a further 20% of the units in Unit Trust.*

14. *On 30 June 2015, Trustee Company distributed the income of Unit Trust to its unitholders based on their proportionate share of all the units in the trust.*

15. *Unitholder Company B 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) because Unitholder Company B's participation interest in Foreign Company at that time was less than 10%.*

16. *Unitholder Company B was entitled to 5% of the income of Unit Trust at 1 April 2015. It therefore held a direct control interest in Unit Trust of 5% at the test time. It does not matter that it subsequently acquired further units in Unit Trust.*

17. *Therefore Unitholder Company B's direct participation interest in Unit Trust (5%) multiplied by Unit Trust's direct participation interest in Foreign Company (70%) was only 3.5% at the test time.*

Example 3: decreasing interests in a unit trust

18. *Unitholder Company C is an Australian corporate tax entity. As at 1 July 2014 it held 60% of all the income and capital units in Unit Trust.*

19. *Trustee Company is the trustee of Unit Trust.*

20. *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.*

21. *Foreign Company paid a dividend to Trustee Company on 1 April 2015.*

22. *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.*

23. *On 30 June 2015 Trustee Company distributed the income of Unit Trust to its unitholders based on their proportionate share of all the units in the trust.*

24. *Unitholder Company C 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 C's participation interest in Foreign Company at that time was greater than 10%.*

25. *Unitholder Company C was entitled to 60% of the income of Unit Trust at 1 April 2015. It therefore held a direct control interest in Unit Trust of 60% at the test time. It does not matter that it subsequently sold 80% of its units in Unit Trust.*

26. *Therefore Unitholder Company C's direct participation interest in Unit Trust (60%) multiplied by Unit Trust's direct participation interest in Foreign Company (70%) was 42% at the test time.*

Example 4: decreasing interests in a unit trust and multiple distributions

27. *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.*

28. *Under Unit Trust's trust deed, the income of the trust is distributed to unitholders (based on their proportionate share of the units in the trust) immediately before the end of 30 June and 31 December of each year.*

29. *Trustee Company is the trustee of Unit Trust.*

30. *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.*

31. *On 1 October 2015 Foreign Company paid a dividend of $100 to Trustee Company.*

32. *On 31 December 2015 Trustee Company distributed the income of Unit Trust to its unitholders based on their proportionate share of all the units in the trust. Unitholder Company D received $25 as a result.*

33. *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.*

34. *On 1 April 2016 Foreign Company paid a second dividend to Trustee Company of $300.*

35. *On 30 June 2016 Trustee Company made a second distribution of the income of Unit Trust to its unitholders based on their proportionate share of all the units in the trust. Unitholder Company D received $30 as a result.*

36. *Unitholder Company D satisfied the participation test in section 768-15 at the time Foreign Company paid the first dividend of $100 (being 1 October 2015). Unitholder Company C's participation interest in Foreign Company at that time was greater than 10%.*

37. *Unitholder Company D was entitled to 25% of the income of Unit Trust at 1 October 2015. It therefore held a direct control interest in Unit Trust of 25% at the time the first dividend was paid. Unitholder Company D's direct participation interest in Unit Trust (25%) multiplied by Unit Trust's direct participation interest in Foreign Company (70%) was 17.5%.*

38. *However Unitholder Company D did not satisfy the participation test in section 768-15 at the time the second dividend was paid (being 1 April 2016). At that time, Unitholder Company D was entitled to 10% of the income of Unit Trust and therefore held a direct control interest of 10%. Unitholder Company D's direct participation interest in Unit Trust (10%) multiplied by Unit Trust's direct participation interest in Foreign Company (70%) was only 7%.*

Example 5: beneficiary of a discretionary trust

39. *At all times during the 2015 income year Discretionary Company was an Australian corporate tax entity and was a discretionary object of Discretionary Trust.*

40. *Trustee Company is the trustee of Discretionary Trust.*

41. *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.*

42. *On 1 April 2015 Foreign Company paid a dividend to Trustee Company.*

43. *On 30 June 2015, Trustee Company resolved that Discretionary Company was entitled to all of Discretionary Trust's income for that income year.*

44. *Discretionary Company 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) because Discretionary Company's participation interest in Foreign Company at that time was less than 10%.*

45. *Being merely a potential object of the trustee's discretionary power, Discretionary Company was not entitled to (or entitled to acquire) a share of the income or corpus of the trust estate at 1 April 2015. It therefore held a direct control interest in Discretionary Trust of 0% at the test time. It does not matter that Trustee Company subsequently made a resolution in Discretionary Company's favour.*

46. *Discretionary Company's direct participation interest in Discretionary Trust (0%) multiplied by the trust's direct participation interest in Foreign Company (80%) was 0%.*

Date of effect

47. This Determination applies to foreign equity distributions made on or after 17 October 2014, being the date Subdivision 768-A commenced operation. However, to the extent that this Determination provides a less favourable outcome than the view outlined in Taxation Determination 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?*,

taxpayers will be entitled to rely on the view in TD 2016/D7 for foreign equity distributions made up until the date of issue of this Determination.~~However, to the extent that this Determination provides a less favourable outcome than the view outlined in Taxation Determination TD 2016/D7~~ ~~*Income tax: where an Australian corporate tax entity is a beneficiary of a trust, can the trust '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?*~~~~, taxpayers will be entitled to rely on the view in TD 2016/D7 up until the date of issue of this Determination.~~

48. This Determination will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
18 October 2017

Appendix 1 – Explanation

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

49. 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).

50. A foreign equity distribution can be NANE income where the Australian corporate tax entity receives the distribution 'directly or indirectly through one or more interposed trusts or partnerships'.[3]

51. 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.[4]

52. The Australian corporate tax entity will satisfy the participation test if the sum of its direct and indirect participation interests in the foreign company (disregarding certain rights on winding up) is at least 10%.[5]

53. 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.

54. 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.[6] A trust is recognised as an entity.[7]

55. The trust's direct participation interest is 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).[8]

56. 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.[9]

57. 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 (the test time).[10]

[3] Section 768-1.
[4] Paragraph 768-5(2)(d).
[5] Section 768-15.
[6] However a public trading trust cannot be an intermediate entity for the purposes of applying the participation test in section 768-15. Where the intermediate entity is a partnership refer to Taxation Determination TD 2017/21 *Income tax: where an Australian corporate tax entity is a partner in a partnership, can the partnership '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?*.
[7] Section 960-100.
[8] Item 1 of subsection 960-190.
[9] Where these percentages differ, the greater percentage is used (subsection 350(1) of the ITAA 1936). 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).
[10] See reference to 'at the time the distribution is made' in paragraph 768-5(2)(d), 'at a time' in section 768-15 and 'at a particular time' in subsection 960-185(1) and section 350 of the ITAA 1936. See also Taxation

58. 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 item 2 of subsection 960-190(1) and section 351 of the ITAA 1936.

59. The direct control interest the beneficiary holds in the trust 'at a particular time' is equal to the percentage share of income or corpus to which the beneficiary is entitled or entitled to acquire at that time.[11] Again, the 'particular time' for the purpose of paragraph 768-5(2)(d) will be the time the foreign equity distribution is made (the test time).

60. Although subsection 351(1) of the ITAA 1936 requires the beneficiary's interest at the test time to be measured as a percentage of total income or corpus entitlements, it may be that its entitlement cannot be expressed as a percentage until the end of the year when the accounts of the trust are taken and the total trust income for the year is known. In such cases, subsection 351(2) of the ITAA 1936 enables the beneficiary's interest to be expressed as a percentage. It provides that the percentage concerned is to be ascertained at the end of the income year instead of the test time, on the assumption however, that the relevant share to which the beneficiary is entitled (or entitled to acquire) at the test time was the same at all other times during the year of income.

61. Where a beneficiary is entitled to (or entitled to acquire) a fixed percentage share of trust income or corpus at the test time, its direct control interest will be equal to that percentage.

62. A beneficiary's direct control interest in a discretionary trust is similarly equal to the percentage share of the income or corpus to which it is entitled or entitled to acquire at the test time. However the trustee will usually only exercise its discretion concerning the income and corpus of the trust at the end of the income year, and therefore the discretionary beneficiary would not have an entitlement at the test time (assuming the foreign equity distribution is made before the end of the income year). At the test time the beneficiary is merely a potential object of the trustee's discretionary power.

63. Examples 2 to 4 illustrate how the participation test applies where a beneficiary's fixed entitlement to trust income changes during the income year and Example 5 illustrates how the participation test applies to a discretionary trust.

Ruling TR 2017/3 *Income tax: distributions from foreign companies – meaning of 'at the time the distribution is made' when applying the participation test* for guidance on the meaning of 'at the time the distribution is made' when applying the participation test.

[11] Section 351 of the ITAA 1936. Where these percentages differ, the greater percentage is used (subsection 351(1) of the ITAA 1936).

References

Previous draft:

TD 2016/D7

Related Rulings/Determinations:

TD 2008/25; TD 2017/21; TR 2006/10; TR 2017/3

Legislative references:

- ITAA 1936
- ITAA 1936 350
- ITAA 1936 350(1)
- ITAA 1936 350(3)
- ITAA 1936 350(4)
- ITAA 1936 351
- ITAA 1936 351(1)
- ITAA 1936 351(2)
- ITAA 1997
- ITAA 1997 Subdiv 768-A
- ITAA 1997 768-1
- ITAA 1997 768-5(2)(d)
- ITAA 1997 768-15
- ITAA 1997 960-100
- ITAA 1997 960-115
- ITAA 1997 960-185
- ITAA 1997 960-185(1)
- ITAA 1997 960-190
- ITAA 1997 960-190(1)
- TAA 1953

ATO references

NO:	1-9M7IA94
ISSN:	2205-6211
BSL:	PGI
ATOlaw topic:	Income tax ~~ Assessable income ~~ Non assessable non exempt ~~ Distributions on foreign investments - Subdivision 768-A