



Taxation Determination

Income tax: can the attribution regime relating to controlled foreign companies apply to an Australian entity that is a member of a foreign company limited by guarantee?

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This publication (excluding appendices) is a public ruling for the purposes of the *Taxation Administration Act 1953*. A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes. If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

Ruling

1. Yes.
2. An Australian entity that is a member of a foreign company limited by guarantee (a 'guarantee company') is a shareholder of that company for income tax purposes. Thus, the tests relating to a shareholder which apply when determining whether the entity has an associate inclusive control interest, or an attribution interest can apply to the Australian entity. These interests are relevant to determining:
 - whether the foreign guarantee company is a controlled foreign company (CFC);
 - whether the Australian entity is an attributable taxpayer in relation to that CFC; and
 - whether it will have attributed to it an attribution percentage of the attributable income of the CFC.

TD 2007/20

Example

3. *X, an Australian individual, has the sole guarantee interest in P Co, a guarantee limited company incorporated in a tax haven. The Articles of Association indicate that X is entitled to distributions of all of the income or capital of P Co. From the facts, X would satisfy the direct control interest and direct attribution interest tests on the basis that it has 100% of the total rights of shareholders to participate in any decision-making concerning the making of distributions of capital or profits of the company to its shareholders.*

4. *In an alternative scenario, X asserts it is unable to obtain any company documentation and claims that while it has a guarantee interest; it does not have any control or rights over the company. However, evidence indicates that all distributions from P Co are made to X's bank account at X's direction or wishes. In such a case, X would satisfy the direct control interest and direct attribution interest tests on the basis that it has 100% of the total rights of shareholders to participate in any decision-making concerning the making of distributions of capital or profits of the company to its shareholders.*

Date of effect

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

Commissioner of Taxation

27 June 2007

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.*

Background

6. A company is a company limited by guarantee where the liability of its members is limited to the amount that they have undertaken to contribute to the assets of the company in the event of the company being wound up. A guarantee company is different to a company limited by shares in that a member of a guarantee company is not required to pay in any capital while the company is a going concern. Guarantee companies have traditionally been used in the non-profit sector, rather than as trading entities which usually raise initial capital and working capital from their members. However, guarantee companies may also be used for commercial purposes and may distribute dividends to members, or members may be entitled to assets on the winding up of the company. A company may be limited both by shares and by guarantee.

7. Arrangements have been identified involving the use of foreign guarantee companies located in unlisted countries, especially nil or low tax jurisdictions. The use of guarantee companies has been promoted on the basis that they do not come within Australia's income attribution regime relating to CFCs.

CFC regime

8. Broadly, Australia's CFC regime operates to attribute income to an Australian entity where that entity is an attributable taxpayer in relation to a CFC, and has an attribution interest in the CFC. The amount of the CFC's attributable income attributed to the entity is determined by the attributable percentage of the attribution interest held in the CFC.

9. A key consideration when determining whether the CFC regime would apply to an Australian entity that is a member of a guarantee company is whether that entity satisfies the tests used to determine the relevant interest of the Australian entity. These are the direct control interest test in section 350 of the *Income Tax Assessment Act 1936* (ITAA 1936) for the purposes of determining an associate inclusive control interest, and the direct attribution interest test in section 356 of the ITAA 1936.¹

10. Section 350 provides that an entity holds a direct control interest in a company at a particular time, which is equal to the percentage that the entity holds, or is entitled to acquire, at that time of:

- (a) the total paid-up share capital of the company; or
- (b) the total rights of shareholders to vote, or participate in any decision-making, concerning any of the following:
 - (i) the making of distributions of capital or profits of the company to its shareholders;
 - (ii) the constituent document of the company;²

¹ All legislative references in this Ruling are to the ITAA 1936 unless otherwise indicated.

² 'Constituent document' in relation to a company, is defined in subsection 6(1) to mean the memorandum and articles of association of the company, or any rules or other document constituting the company or governing its activities.

- (iii) any variation of the share capital of the company; or
- (c) the total rights to distributions of capital or profits of the company to its shareholders on winding-up; or
- (d) the total rights to distributions of capital or profits of the company to its shareholders, otherwise than on winding up;

or, if different percentages are applicable under the preceding paragraphs, the greater or greatest of those percentages.

11. A member of a foreign guarantee company does not hold or have any right to acquire 'paid up share capital' as defined in subsection 6(1) and is not within the first test in paragraph 350(1)(a).

12. However, whether the remaining tests contained in paragraphs 350(1)(b) to (d) apply will depend on whether the taxpayer holds, or is entitled to acquire, specified rights as a 'shareholder' (as defined in subsection 6(1)) of the foreign company.

Meaning of 'shareholder'

13. Subsection 6(1) of the ITAA 1936 provides that a 'shareholder' of a company 'includes a member or stockholder' of the company. A person who has undertaken to contribute a limited amount to the company upon its winding up is a member of that company and is, accordingly, a 'shareholder' as defined. Under section 9 of the *Corporations Act 2001*, 'a company limited by guarantee' is defined as 'a company formed on the principle of having the liability of its members limited to the respective amounts that the members undertake to contribute to the property of the company if it is wound up'.

Application of tests

14. A member of a guarantee company may acquire certain rights against the company, such as the rights to a dividend. These specific rights will generally be set out in the rules of the company. Alternatively, for a member of a guarantee company, these rights may be inferred from information such as the conduct of the parties involved, or cash flows between the company and its members.

15. If a member of a foreign guarantee company has the right to vote or participate in any decision-making concerning the distribution of capital or profits or its constituent documents, then that member will have a direct control interest in the foreign company in accordance with paragraph 350(1)(b).

16. In addition, if a member of a foreign guarantee company has a right to any distributions from the company, whether on the winding up of the company or otherwise, then that member will have a direct control interest in the foreign company in accordance with either paragraph 350(1)(c) or paragraph 350(1)(d) respectively.

17. The extent of a direct control interest held will be determined by the greatest of the percentage of total rights³ the member holds and this will depend on the particular circumstances of the case. Where there is only one member of the guarantee company we consider the member holds 100% of the total rights and has a 100% direct control interest.

³ Considered under paragraphs 350(1)(b) to (d).

18. The direct control interest established under any of paragraphs 350(1)(b) to (d) will be relevant in determining whether the guarantee member has an 'associate-inclusive control interest' under section 349 – and consequently whether the foreign company is a CFC under paragraphs 340(a) or (b).

19. The direct control interest established under any of paragraphs 350(1)(b) to (d) will also be relevant in determining whether a guarantee member is an 'attributable taxpayer' under paragraph 361(1)(a). Paragraph 361(1)(a) provides that an entity is an 'attributable taxpayer' in relation to a company which is a CFC if:

the entity is an Australian entity whose 'associate-inclusive control interest' in the CFC is at least 10%.

20. Thus, if a guarantee member holds an 'associate inclusive control interest' in a foreign company which is a CFC of at least 10%, where such an interest has arisen from a direct control interest established under paragraphs 350(1)(b) to (d), the guarantee member will be an 'attributable taxpayer' of the foreign company under section 361.

21. Section 356 (direct attribution interest) has similar tests to section 350 and the same considerations that apply for paragraphs 350(1)(b) to (d) will also apply for paragraphs 356(1)(b) to (d) when determining the direct attribution interest in a CFC.

22. This Taxation Determination does not deal with other considerations that may arise in respect of a member or foreign guarantee company, including the application of Part IVA.

References

Previous draft:

TD 2007/D2

Related Rulings/Determinations:

TR 2006/10

Subject references:

- control of entities
- controlled foreign companies
- foreign income attribution & control interests
- international tax
- non-resident companies
- ownership, interests, control & rights

- ITAA 1936 Pt IVA
- ITAA 1936 340(a)
- ITAA 1936 340(b)
- ITAA 1936 349
- ITAA 1936 350
- ITAA 1936 350(1)(a)
- ITAA 1936 350(1)(b)
- ITAA 1936 350(1)(c)
- ITAA 1936 350(1)(d)
- ITAA 1936 356
- ITAA 1936 356(1)(b)
- ITAA 1936 356(1)(c)
- ITAA 1936 356(1)(d)
- ITAA 1936 361(1)(a)
- TAA 1953
- Corporations Act 2001 9

Legislative references:

- ITAA 1936 6(1)
-

ATO references

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