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Ruling Compendium – TD 2013/D3

This is a compendium of responses to the issues raised by external parties to Draft Taxation Determination 2013/D3 - *Income tax: are support payments made by a parent entity to its subsidiary deductible under section 8-1 or section 40-880 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 Determination.

Summary of issues raised and responses

Issue No.	Issue raised¹	ATO Response/Action taken²
1. Scope		
1.1	Characterisation in the hands of the recipient The Draft Determination does not consider the corresponding tax treatment of a support payment in the hands of the recipient; that is the treatment of inbound cross-border support arrangements.	 The tax treatment of a capital support payment for the recipient is beyond the intended scope of the Draft Determination and revised Draft Determination. The revised Draft Determination addresses the deductibility of capital support payments. There is no necessary congruence or symmetry between the character of a sum when received or paid by one taxpayer and its character when received or paid by another. ³

¹ All paragraph references in this column are references to Draft Taxation Determination TD 2013/D3 ('the draft Determination').

² All paragraph references in this column are references Draft Taxation Determination TD 2014/D7 *Income tax: are the capital support payments described in this Draft Determination deductible under section 8-1, section 40-880, subsection 230-15(2) or subsection 230-15(3) of the Income Tax Assessment Act 1997?* ('the revised draft Determination'). The revised Draft Determination takes account of a number of issues raised in submissions and further consultations which had not been canvassed when Draft Tax Determination TD 2013/D3 was issued on 24 April 2013. As the revised Draft Determination sets out the ATO's view on those issues for the first time, it has been issued in draft form.

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Issue No.	Issue raised ¹	ATO Response/Action taken ²
1.2	Taxation of financial arrangements The Draft Determination does not consider the application of Division 230.	The definition of the arrangement to which the Determination applies has been revised in the Draft Determination and now excludes financial arrangements. See paragraphs 4(a), 4(d) and 83 to 87.
1.3	Transfer pricing The Draft Determination does not consider the application of the transfer pricing provisions.	The application of the transfer pricing provisions is beyond the intended scope of the Draft Determination and revised Draft Determination. However, the revised Draft Determination takes into account arrangements which are entered into in order to ensure that the pricing of assets or services reflects arm's length conditions or arm's length consideration. See paragraphs 6 and 10.
1.4	Part IVA The subject of the Draft Determination should be concerned with the application of Part IVA of the <i>Income Tax Assessment Act 1936</i> (ITAA 1936) to support payments which are made without appropriate economic or arm's length basis.	It is not considered necessary to refer to Part IVA, as the capital support payments described in the revised Draft Determination are not considered to be deductible.

³ *Federal Commissioner of Taxation v. Montgomery* (1999) 198 CLR 639 at 671; 99 ATC 4749 at 4766; *Federal Commissioner of Taxation v. Rowe* (1997) 187 CLR 266 at 291-292; 97 ATC 4317 at 4328-4329.

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2. Arrangements to which the Determination applies		
2.1	‘Support payment’ terminology The opening question should • refer to support payments ‘as defined’ in the Draft Determination, to avoid the implication that all ‘support payments’ are at risk; • alert the reader to the distinction between the support payments of concern and payments which are adjustments to consideration for goods or services; • acknowledge that this distinction depends on the facts and circumstances of the particular case; for example Taxation Determination TD 2011/22 paragraph 1.	The opening question in the revised Draft Determination is: ‘are the capital support payments described in this Draft Determination deductible under section 8-1, section 40 880, subsection 230-15(2) or subsection 230-15(3) of the <i>Income Tax Assessment Act 1997</i>?’ The revised Draft Determination employs the term ‘capital support payments’ so as to differentiate between payments covered by the Draft Determination and other amounts which might be labelled ‘support payments’. The revised Draft Determination recognises the distinction referred to through the definition of ‘capital support payment’. This approach enables the deductibility question to be answered with the required ‘yes’ or ‘no’ response. See paragraphs 1, 4 and 7.
2.2	Domestic arrangements The Draft Determination does not consider domestic related party support arrangements.	Such arrangements are covered by the Draft Determination and revised Draft Determination.

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2.3	Supplies of goods and services The Draft Determination will adversely impact commercial arrangements in place to price international supply and acquisition of goods and services from subsidiaries. The Draft Determination needs to give further consideration to arrangements where a parent company makes support payments to a subsidiary in the context of the sale of goods and/or services by the parent to the subsidiary and to arrangements where the term of the contract between the parties runs for a number of years.	The definition of ‘support payment’ (now referred to as ‘capital support payment’) has been clarified in the revised Draft Determination. Payments which have the character of a price for assets or services or an adjustment to such a price are not capital support payments for the purposes of the revised Draft Determination. See paragraphs 4(c)(ii), 5 and 6.
2.4	Linkage between payment and good or service The Draft Determination should not require a contractually specified linkage between a ‘true up’ payment and the price of a particular good or service. In practice, the documentation supporting true up adjustments may not reflect a precise linkage.	The revised Draft Determination does not necessarily require a contractually specified linkage. However, it must be possible to establish that the payment has the character of a price adjustment. It must therefore be possible to identify what asset or service, or group of assets or services, the payment relates to. See paragraphs 5 to 6.
2.5	Assets and services The Draft Determination should	The revised Draft Determination includes a general description of what is meant

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	provide some generic definitional narrative on the meaning of 'assets' and 'services' for the purposes of excluding payments for services from the concept of support payment.	by the term 'services' for the purposes of paragraph 4. See paragraphs 9, and 46 to 49. No definition has been inserted to address the meaning of 'assets', as the meaning of this term is considered to be sufficiently clear.
2.6	Payment The Draft Determination should define what is meant by a 'payment' for the purposes of the definition of support payment.	The revised Draft Determination describes what is meant by the term 'payment'. See paragraphs 8 and 43.
2.7.	Transfer pricing regimes References in the Draft Determination to transfer pricing should cover both Division 815 of the <i>Income Tax Assessment Act 1997</i> ⁴ and Division 13 of the ITAA 1936.	The application of the transfer pricing provisions is beyond the intended scope of the Draft Determination and revised Draft Determination. However, the revised Draft Determination takes into account transfer pricing arrangements between the parties and makes reference to both Division 815 and Division 13 of the ITAA 1936. See paragraphs 6, 10 and 56.
2.8	Financial arrangements The Draft Determination uses a very fine line to distinguish between support payments and payments which may be deductible under Division 230.	The arrangement identified in the revised Draft Determination reflects arrangements observed by the ATO in practice. Whether a financial arrangement exists depends on the facts of each case. In the absence of paragraphs 4(a) and (d) of the revised Draft Determination it

⁴ All legislative references in this Compendium are to the *Income Tax Assessment Act 1997* unless otherwise indicated.

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	The ATO may wish to note the application of the TOFA indemnity carve out in subsection 230-460(8).	would be necessary to consider whether the arrangement amounted to an indemnity or a derivative for the purposes of subsection 230-460(8). However, these questions are beyond the intended scope of the Draft Determination and revised Draft Determination. The revised Draft Determination notes that in a cross-border context it would be necessary to consider the transfer pricing implications of a financial arrangement which involved a parent agreeing to make a payment based on the losses of insufficient profits of its subsidiary. See paragraph 87.
3. Examples		
3.1	Example 1 - Facts There are insufficient facts and circumstances in Example 1 to enable a conclusion to be drawn as to the income tax consequences. Further facts required are: • The business of Parent Co and its global footprint; • The term of the contract between Parent Co and Sub Co; • The estimated quantum of the licence and service fee relative to the support fee	The additional facts suggested are not considered to be relevant to determining the character of a capital support payment. The character of a capital support payment is determined by reference to an objective assessment of the character of the advantage sought. This aspect is considered to be sufficient to displace any other conclusions which might otherwise be drawn from the factors referred to. See also, Issue No. 4.3.

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3.2	Example 1 - Conclusions drawn from the facts The facts included in the Example illustrate that the purpose and effect of the arrangement is to facilitate the carrying on of the parent's business in the form of deriving licence and service fees. The statement that 'the payment is objectively made because Sub Co made a loss, and its effect is to maintain the capital value of Parent Co's investment in Sub Co' is not supportable by the facts. Refer paragraph 9.	The revised Draft Determination acknowledges that, in the facts described in Example 1, the payment may be incurred in undertaking the parent's business or the gaining or producing of its income. However, this does not prevent the payment from being of a capital nature. The statement referred to is considered to be supported by the facts. The character of a payment as a capital contribution by a parent is not affected by how the money is subsequently spent by the subsidiary. See further, Issue No 4.3.
3.3	Example 1 – price adjustment It can be argued that Example 1 covers a fact situation where the price of the services and intellectual property has been set at a level which is greater than arm's length. On this basis, the support payment satisfies paragraph 4(c)(ii)(B) because it is designed to adjust the prices to an arm's length level.	The revised Draft Determination states that a payment is not a genuine price adjustment where no such price is payable. Further, a payment cannot have the effect of reducing a price to the extent that it exceeds that price. See paragraphs 6 and 18.

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3.4	Example 1 – insurance contract It can be argued that the facts in Example 1 are akin to a 'loss or profits' insurance contract. The parent has agreed to assume a financial risk in return for receiving compensation, which is paid in the form of higher license and service fees. It is reasonable to assert that a payout under such a contract would be deductible.	In the arrangement identified in the revised Draft Determination the consideration provided by the subsidiary is in respect of the things identified in paragraph 4(a). Further, the view is taken in the revised Draft Determination is that a capital support payment as defined would have the character of a capital contribution whether or not it is directly connected to the parent's right to receive the consideration referred to in paragraph 4(b). See paragraph 79. See further, Issue No. 2.8.
3.5	Example 3 Example 3 of the Draft Determination describes an arrangement which bears similarity to arrangements entered into by entities as the result of transfer pricing analysis in order to manage transfer pricing risks.	Example 3 has been revised. The definition of capital support payment has been clarified in order to address arrangements which are designed to ensure that assets and services are priced on arm's length conditions. See paragraphs 6 and 10
3.6	Market penetration strategies The Draft Determination should include an example involving a market penetration fact pattern identified in the Decision Impact statement for <i>Commissioner of Taxation v. SNF Australia Pty Ltd</i> [2011] FCAFC 74;	Example 5 in the revised Draft Determination involves a market penetration strategy. See paragraphs 32 and 49.

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	2011 ATC 20-265; 193 FCR 149; 82 ATR 680 (' <i>SNF Australia</i> ') 	
3.7	Cost compensation arrangements The Draft Determination should include an example in which the parent is compensating the subsidiary for a portion of its costs, in the expectation that the subsidiary's presence in the jurisdiction will assist the parent in earning future assessable income.	Examples 3 and 5 in the Draft Determination address arrangements of this kind.
3.8	Deductible 'support payments' The Determination should include examples where support payments are deductible. The examples should expressly state that the payments are deductible.	Examples 3, 4, 5 and 6 in the revised Draft Determination address payments which are considered to be deductible.
4. Characterisation – section 8-1		
4.1	Relevant facts and circumstances There is no case law to support the proposition that support payments can be characterised simply on the basis that they are made because of losses or insufficient profits. Rather, all of the	The approach in the revised Draft Determination is considered to reflect a correct application of the principles identified by Dixon J in <i>Sun Newspapers Ltd v. Federal Commissioner of Taxation</i> (1938) 61 CLR 337; 1 AITR 403; 5 ATD 87. The position in the revised Draft Determination is also considered to be

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	facts and circumstances need to be taken into account. Additional features would have to be present for payments to be capital in nature. The Draft Determination should be revised to identify additional features that make the payment capital other than the profit based approach. No consideration are given to the cautionary words of Barwick CJ in <i>Cliffs International Inc v. Federal Commissioner of Taxation</i> (1979) 142 CLR 140 at 148 and adopted by Crennan J in <i>Commissioner of Taxation v. Citylink Melbourne Limited</i> [2006] HCA 35 at 98.	supported by the Federal Court's decision in <i>Bell & Moir Corporation Pty Ltd v. Federal Commissioner of Taxation</i> [1999] FCA 1009; 99 ATC 4738; (1999) 42 ATR 421. The approach in the revised Draft Determination is considered to be consistent with Barwick CJ's statement in <i>Cliffs International</i>. There his Honour noted that the characterisation of a payment was dependent upon the particular facts and circumstances of each case; but that it is also possible to draw valid generalisations from the decided cases. The revised Draft Determination identifies facts and circumstances which enable a conclusion to be drawn as to characterisation. In reaching this conclusion the revised Draft Determination also has regard to principles drawn from decided cases.
4.2	Connection between parent and subsidiary businesses The Draft Determination fails to consider the degree and extent to which the business operations of the subsidiary are intermingled and	The character of a capital support payment is not affected by the extent of any connection between the business of the payer and that of the payee. The business carried on by a subsidiary is legally separate from that carried on by its parent. From the parent's perspective, the subsidiary represents a profit-

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	connected to the business of the parent. An arrangement may be motivated towards the maintenance and enhancement of a subsidiary, rather than part of carrying on the business of the parent, where the business of the subsidiary is unrelated to that of the parent. Where a subsidiary is conducting business activities that are essentially divisions or extensions of the parent's business, the advantage sought by a support payment is the carrying on of the income producing activities of the parent's business.	yielding structure rather than a part of the parent's business. In determining the legal effect of a transaction for taxation purposes, the separate identity of an incorporated company from that of its shareholders must be respected.⁵ The revised Draft Determination recognises that a capital support payment may have a nexus with the parent's business or the gaining or producing of its income. However, this does not prevent the payment from being of a capital nature.
4.3	Sun Newspapers: second and third tests The Draft Determination should give fuller consideration to the two other tests in <i>Sun Newspapers Ltd v. Federal Commissioner of Taxation</i> (1938) 61 CLR 337; 1 AITR 403; 5 ATD 87, being: • The manner used, relied upon or	Although the tests referred to are a relevant factor to be taken into account in the characterisation of a loss or outgoing, they carry limited weight in circumstances where the loss or outgoing is objectively designed to preserve or enlarge a profit-yielding structure. In this regard, a capital support payment is analogous to a subscription for shares. The capital nature of the subscription price is not affected by the regularity with which subscriptions occur or the rate at which additional share capital is consumed.

⁵ *Steinberg v. Federal Commissioner of Taxation* 75 ATC 4221 at 4225; (1975) 134 CLR 640 at 682; *Hobart Bridge Co. Ltd. v. Federal Commissioner of Taxation* (1951) 82 CLR 372 at 386.

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	enjoyed test; and • The means adopted to obtain test	
4.4	Payments between unrelated entities Based on a wide interpretation of the Draft Determination, 'support payments' made between unrelated parties would not be deductible. For example, where a company pays or reimburses the marketing expenses of an unrelated distributor.	The Draft Determination and revised Draft Determination do not apply to payments made between unrelated entities. The revised Draft Determination recognises that in some cases a subsidiary may provide a service to its parent by undertaking additional marketing or advertising activities, a payment for which may be deductible. See paragraph 49.
4.5	Apportionment The Draft Determination should provide guidance on how a payment is to be split in circumstances where only part of it is of a capital nature for the purposes of section 8-1.	The revised Draft Determination recognises that apportionment may be required in some circumstances. However, what will be appropriate in such cases will essentially be a question of fact, to be determined in each case. See paragraphs 81 to 82. In some cases, a basis of apportionment may be readily apparent from the terms of the relevant agreement; see Example 3.
4.6	Transfer pricing The Draft Determination fails to recognise that market penetration strategies are an important transfer	Example 5 in the revised Draft Determination involves a market penetration strategy. See paragraphs 32 and 49.

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	pricing issue. No analysis of the interaction between revenue/capital distinction and the application of accepted transfer pricing methodologies. Payments made to apply arm's length transfer pricing methodologies involve payments with reference to profits of the counterparty. In particular cost plus and resale price applied with reference to the profits of a subsidiary. There is no consideration of how the Draft Determination would treat compensating adjustments made to achieve the arm's length level of profit required by different tax jurisdictions.	The application of the transfer pricing provisions is beyond the scope of the revised Draft Determination. However, the revised Draft Determination takes into account arrangements which are entered into in order to ensure that the pricing of assets or services reflects arm's length conditions. The definition of the arrangement to which the Draft Determination applies has been clarified in the revised Draft Determination. See paragraphs 4 to 6, and 10.
4.7	SNF (Australia) The Draft Determination seems to be at odds with the Decision Impact Statement issued following <i>SNF (Australia)</i>, particularly the following statement: <i>"instead of seeking lower prices for the goods it bought, the taxpayer, had it been dealing at arm's length, would have sought separate compensation for the special costs and risks it</i>	The Decision Impact Statement refers to compensation payments directly referable to expenses being incurred for a service being provided by the subsidiary to the parent. Such payments do not fall under the definition of capital support payments contained in the revised Draft Determination. See paragraphs 4(c)(ii)(A), and Example 5.

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	<i>incurred in prosecuting for the chief long-term benefit of the SNF Group the strategy of building market share in Australia.</i>	
5. Other issues		
5.1	Date of effect The retrospective application of the Draft Determination is inappropriate given that the ATO has previously indicated that it considered such payments to be deductible in the context of : • advance pricing arrangements (APAs); • private binding rulings (PBRs); • audits; • National Tax Liaison group meetings (NTLG) This causes uncertainty to those who have relied upon the ATO's publicly stated position. Refer Practice Statement Law Administration PS LA 2011/27.	The ATO does not accept that the matters referred to have facilitated or contributed to taxpayers adopting the view that capital support payments are deductible. The ATO has not previously stated a view in relation to the deductibility of support payments at the NTLG. Existing PBRs and APAs continue to apply in accordance with their terms.

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5.2	Appropriate advice product There are a number of complex issues associated with this topic. As such a Determination may not be the best product. It is suggested that the Tax Office considers issuing a draft Tax Ruling that comprehensively covers the relevant issues.	Subject to further consultation on the revised Draft Determination, a Determination is considered to be the most appropriate way to deal with the deductibility of capital support payments.
5.3	Use of support payment arrangements internationally The use of support payment arrangements is internationally recognised as a means of obtaining arm's length outcomes. The position in the Draft Determination gives a structural disadvantage to Australian companies seeking to expand offshore. Entities headquartered in foreign jurisdictions will commonly be entitled to deduct support payments made to their subsidiaries.	The revised Draft Determination recognises that capital support payments do not include payments which have the character of an adjustment to the price of an asset or service. Refer paragraph 4(c)(ii)(B) and 6. This comment raises policy considerations which are beyond the scope of the Commissioner's role as an administrator of the taxation law.
5.4	OCED concerns The Draft Determination fails to recognise the OECD's current concerns regarding 'international	This comment raises policy considerations which are beyond the scope of the Commissioner's role as an administrator of the taxation law.

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	mismatches' between entity and instrument characterisation.	
5.5	New transfer pricing legislation The position in the Draft Determination will undermine new transfer pricing legislation which requires consideration of the overall arrangement.	The application of the transfer pricing provisions is beyond the intended scope of the Draft Determination and revised Draft Determination. It is considered that the revised Draft Determination has appropriate regard to the arrangement as a whole.
5.6	Other legislation The Draft Determination should be harmonised with proposed thin capitalisation measures by the introduction of a de minimis threshold for allowable deductions for support payments.	This comment raises policy considerations which are beyond the scope of the Commissioner's role as an administrator of the taxation law.
5.7	IDS disclosures Changes proposed by the Draft Determination may affect whether support payments are required to be disclosed on the IDS.	This comment raises issues which are beyond the intended scope of the Determination.