

Ruling Compendium – TD 2015/2

This is a compendium of responses to the issues raised by external parties to Draft Taxation Determination TD 2014/D18 *Income tax: will paragraph 974-80(1)(d) of the Income Tax Assessment Act 1997 be satisfied merely because a non-resident entity has chosen to invest indirectly in a debt interest issued by an Australian resident company and there is one or more equity interests interposed between the non-resident entity and the entity holding the debt interest?*

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
1	More than one 'ultimate recipient' We agree with the draft Determination¹ subject to clarifying whether there can be more than one 'ultimate recipient' for the purpose of paragraph 974-80(1)(d).² Paragraph 23 of the draft Determination seems to focus on the scenario where the 'ultimate recipient' is the shareholders of UK Co. However, the draft Determination is unclear on whether the 'ultimate recipient' could also be construed as the UK Parent Co or even UK Co, lower down the chain of the scenario in paragraph 2 of the draft Determination. The draft Determination could be enhanced by addressing the issue of whether there is more than one ultimate recipient in Example 1.	The subject of the draft Determination and the final Determination³ is the application of section 974-80 in the circumstances where a non-resident entity decides to invest indirectly in an Australian resident company through one or more interposed entities and the final leg in the chain is a debt interest. Whether there can be more than one 'ultimate recipient' for the purposes of paragraph 974-80(1)(d) is a separate issue which the Commissioner will in this instance only address to the extent to which that is necessary to clearly address the issue subject of this Taxation Determination. On the facts in the Example 1 and 2, the 'ultimate recipient' within the meaning of paragraph 974-80(1)(d) is the shareholders of the ultimate parent entity, that is, the shareholders of UK Co. To make this clear, paragraphs 6 to 13 of the Example 1 in the draft Determination have in the final Determination been replaced with the following:

¹ Draft Taxation Determination TD 2014/D18.

² All legislative references in this Compendium are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated.

³ Taxation Determination TD 2015/2.

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		6. <i>UK Co has decided that the group will acquire a new business in Australia and has determined that the business will be held by Aus Co. In order to finance the acquisition, Aus Co requires \$300 million.</i> 7. <i>UK Co directs UK Parent Co to incorporate a special purpose company in the Netherlands, Dutch Co.</i> 8. <i>UK Parent Co contributes \$300 million to acquire all the issued shares in Dutch Co.</i> 9. <i>Dutch Co uses the funds contributed by UK Parent Co to make a loan with interest to Aus Co for a 9.5 year term.</i> 10. <i>UK Co, UK Parent Co and Dutch Co are connected entities of Aus Co as defined in subsection 995-1(1).</i> 11. <i>Aus Co incurs interest to Dutch Co pursuant to the loan agreement between Dutch Co and Aus Co.</i> 12. <i>Dutch Co in turn pays dividends to UK Parent Co.</i> 13. <i>UK Parent Co pays dividends to UK Co out of a pool of dividends received from subsidiaries, including Dutch Co.</i> 14. <i>UK Co pays dividends to its shareholders.</i> To ensure consistency with the Example 1, minor changes have been made to paragraph 16 of the Example 2 of the final Determination. Paragraph 14 of the final Determination has also been amended (see the ATO Response/Action taken in Issue 3 of this Compendium for detail).
2	Effect of the 'pool of funds' Example 1, and the reasoning outlined in the Explanation in paragraphs 20 to 23 of the draft Determination, make it clear that the Commissioner is of the view that paragraph 974-80(1)(d) will not apply where there is an entity interposed between the Australian company and the ultimate recipient in all circumstances where the interposed entity has other	The draft Determination (and final Determination) confirms that paragraph 974-80(1)(d) will not be satisfied merely because the funding arrangement will result in the returns on the debt interest being a potential source of funds which will ultimately fund returns on what is in substance equity held in the ultimate parent entity. The draft Determination (and final Determination) does not express the view that paragraph 974-80(1)(d) will fail to be satisfied where there is an entity

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	sources of income (viz. it has a 'pool of funds').	interposed between the Australian company and the ultimate recipient in all circumstances where the interposed entity has other sources of income. This is because the fact that the interposed entity has other sources of income cannot of itself be determinative as to the application of paragraph 974-80(1)(d). This fact will, however, be relevant in considering whether it is reasonable to conclude that the return paid to ultimate recipient is indirectly a return from the Australian company such that paragraph 974-80(1)(d) applies to the funding arrangement.
3	Paragraph 14 The wording should be amended to more closely reflect...[that 'a "connected entity" cannot also be an "ultimate recipient"' and 'that paragraph 974-80(1)(d) will not apply where there is an entity interposed between Australian company and the ultimate recipient in all circumstances where the interposed entity has other sources of income (viz. it has a 'pool of funds')'] and the text of paragraph 974-80(1)(d), in particular to identify that the shareholders in UK Co are the only 'ultimate recipients' for the purposes of that paragraph. As a result, the paragraph will not apply where interest paid by an Australian company forms part of a pool of funds out of which returns to the ultimate recipients are indirectly sourced. We recommend amending paragraph 14 of the draft Determination as follows (suggested changes marked up): 14. Paragraph 974-80(1)(d) will not be satisfied. Whilst interest payments from Aus Co to Dutch Co (a connected entity of Aus Co) will be a source of funds	The Commissioner disagrees with the view that a 'connected entity' intrinsically cannot be an 'ultimate recipient'. The Commissioner's view is that the categories are not mutually exclusive. The Commissioner's view is that the relevant ultimate recipient will depend on the facts and circumstances of the scheme (see footnote 2 of paragraph 15 of the final Determination; previously paragraph 14 of the draft Determination). As already noted, the subject of this Taxation Determination is the application of section 974-80 in the circumstances where a non-resident entity decides to invest indirectly in an Australian resident company through one or more interposed entities and the final leg in the chain is a debt interest. A comprehensive discussion of how facts and circumstances apply to identify the ultimate recipient is beyond the scope of this Determination. The Commissioner acknowledges that the wording of paragraph 14 of the draft Determination could be amended to clarify that in the circumstances of the particular facts in Example 1 and 2 no 'connected entity' is the 'ultimate recipient'. To address this point, the following changes to paragraph 15 in the final Determination have been made: 15. Paragraph 974-80(1)(d) will not be satisfied. Whilst interest payments from Aus Co to Dutch Co will be a source of funds for Dutch Co which will ultimately be used as part of a pool of funds by UK Parent Co to pay

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	<i>for Dutch Co which will ultimately be used as part of a pool of funds by UK Parent Co to pay dividends to UK Co which in turn pays dividends to shareholders in UK Co (the only ultimate recipients in relation to this scheme), it is an insufficient basis for a conclusion that the scheme or series of schemes is designed to operate so that the return to Dutch Co is used indirectly to fund dividends to UK Parent Co the returns to the ultimate recipients. In order for paragraph 974-80(1) to be satisfied there must be a stronger connection between the payments of interest by Aus Co and payment of dividends to shareholders in UK Co which is evident from the way the scheme is structured such that it is reasonable to conclude that the dividends paid to shareholders in UK Co are indirectly a return from Aus Co.</i>	<i>dividends to UK Co (which in turn pays dividends to its shareholders), it is an insufficient basis for a conclusion that the scheme or series of schemes is designed to operate so that the return to Dutch Co is used to fund dividends to UK Co's shareholders. In order for paragraph 974-80(1)(d) to be satisfied there must be a stronger connection between the payments of interest by Aus Co and payment of dividends to shareholders in UK Co which is evident from the way the scheme is structured such that it is reasonable to conclude that the dividends paid to shareholders in UK Co are indirectly a return from Aus Co.²</i> ² On the facts in the Example the 'ultimate recipient' within the meaning of paragraph 974-80(1)(d) is the shareholders of UK Co. However, this won't be the case in respect of every scheme or series of schemes involving a chain of entities. Whether the 'ultimate recipient' is an entity with an interest in the head entity or an entity further down the chain will depend on the facts and circumstances of a particular scheme or series of schemes.
4	Facts in Example 1 Paragraph 5 of the draft Determination states that UK Parent Co is the holding company for the group's non-UK resident entities. However, in the Example, Aus Co is held directly by UK Co rather than via UK Parent Co which appears to be inconsistent with paragraph 5. It is also not clear what might turn upon the fact that UK Parent Co 'is the holding company for the group's non-UK resident entities' (paragraph 5 of the draft Determination), receives dividends from Dutch Co (paragraph 11 of the draft Determination) and receives dividends from other subsidiaries (paragraph 12 of the draft Determination). We assume that similar conclusions would be reached if, for example, UK	The Commissioner acknowledges the inconsistency between paragraph 5 and the other facts in Example 1 of the draft Determination. To address this inconsistency, paragraph 5 of the Example 1 has been amended in the final Determination as follows: 5. <i>UK Parent Co is the holding company for a number of other group entities, including Aus Co.</i> The Commissioner agrees that, depending on the facts of a particular arrangement, similar conclusions as to the application of paragraph 974-80(1)(d) could be reached if UK Parent Co was providing debt funding to other group entities and/or carrying on an active business in its own right. However, the Commissioner considers that the changes to paragraph 5 of Example 1, together with the replacement of paragraphs 6 to 13 (refer to the ATO Response/Action taken in Issue 1 of this Compendium) sufficiently

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	Parent Co was providing debt funding to other group entities and/or carrying on an active business in its own right. This because, in all of these examples, the connected entity would have a 'pool of funds' and therefore the requirements of paragraph 974-80(1)(d) would not be satisfied. The important point for the purposes of the conclusions reached by the Commissioner in the draft Determination is that UK Parent Co has a pool of funds out of which dividends can be paid and that pool of funds is not restricted to cash received indirectly from Aus Co. Therefore, we recommend that paragraph 5 of the draft Determination be amended as follows: 5. <i>UK Parent Co is the holding company for a number of other group entities. It may also provide funding to other group entities or carry on an active business in its own right.</i>	address the inconsistency and lack of clarity which was identified. The Commissioner has therefore not included the words '<i>It may also provide funding to other group entities or carry on an active business in its own right</i>' in the Final Taxation Determination.
5	The text of the draft Determination and paragraph 974-80(1)(d) We note that the wording in paragraph 1 of the draft Determination does not accurately reflect the text of section 974-80. We suggest the following amendment to more closely reflect the text of the provision and the two conclusions outlined above that form the basis of the draft Determination: 1. <i>No. The fact that a non-resident entity has decided to invest indirectly in an Australian resident company through one or more entities and the final leg in the chain is a debt interest will not of itself be</i>	It is noted that the wording in paragraph 1 of the draft Determination does not entirely reflect the text of paragraph 974-80(1)(d). This is because the wording of paragraph 1 is intended to take into account application of paragraph 974-80(1)(d) in the context of section 974-80 as a whole. The proposed alternative wording is based on the application of paragraph 974-80(1)(d) in isolation from the remainder of the section. In that sense, the alternative wording, though precisely reflecting paragraph 974-80(1)(d), is incomplete for the purposes of the draft Determination and the final Determination. To more closely reflect the text of the provision in the context of this

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Page status: **not legally binding**

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	<i>sufficient to form a conclusion under paragraph 974-80(1)(d) that there is a scheme, or series or schemes, designed to operate so that the returns on the debt interest are used to fund returns to another person (the 'ultimate recipient').</i>	Taxation Determination, the Commissioner has made the following changes to paragraph 1 of the final Determination: 1. No. The fact that a non-resident entity has decided to invest indirectly in an Australian resident company through one or more interposed entities and the final leg in the chain is a debt interest will not of itself be sufficient to form a conclusion under paragraph 974-80(1)(d) that there is a scheme, or a series of schemes, designed to operate so that the returns on the debt interest are used to fund returns on what is in substance equity held by another person (the 'ultimate recipient').
6	Application date of the final Determination We submit that the final Determination should apply from 1 July 2001 being the date when Division 974 commenced.	Noted. Paragraph 17 of the draft Determination states: 17. <i>When the final Determination is issued, it is proposed to apply 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 to 76 of Taxation Ruling TR 2006/10).</i> The proposed application of the Taxation Determination both before and after its date of issue in the final Determination includes the application from the 1 July 2001 being the date when Division 974 commenced.