

TR 2000/D4 - Income tax: company groups and company subsidiaries: persons in a position to affect rights in relation to a company



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Draft Taxation Ruling

Income tax: company groups and company subsidiaries: persons in a position to affect rights in relation to a company

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Preamble

Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office. DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings that represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.

What this Ruling is about

Class of person/arrangement

1. Section 975-500 of the *Income Tax Assessment Act 1997* ('the ITAA 97') defines 'wholly-owned groups' of companies using the notion of a '100% subsidiary' company. In turn, section 975-505 defines '100% subsidiary' company using the notion of a person in a 'position to affect rights' in relation to a company, and in particular, subsections 975-505(2) and (3) can cause a break-down of that 100% subsidiary relationship if a person is, or will be, in a position to affect certain rights of the holding company in relation to the subsidiary. Finally, section 975-150 describes the circumstances in which a person is in a 'position to affect rights' of a company in relation to another company.

2. This Ruling is primarily concerned with the Commissioner's interpretation of subsections 975-505(2) and (3) and section 975-150.

3. Running foul of these provisions can deprive companies of tax benefits that can be enjoyed by corporate groups, such as:

- deductions for entertainment expenses incurred providing recreational facilities and food and drink in an in-house dining facility or eligible dining facility to employees of a related company (subparagraphs 51AE(5)(f)(ii) and (iii) of the *Income Tax Assessment Act 1936* ('the ITAA 1936'); subsection 32-85(1) ITAA 1997);

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- transfers of losses within group companies (section 80G ITAA 1936; section 170-30 ITAA 1997); and
- transfers of capital losses within group companies (subsections 160ZP(1), (2) and (7) ITAA 1936; subsections 170-105(2) and 170-130(2) ITAA 1997).

4. Running foul of these provisions can also deprive companies of other tax benefits that can be enjoyed, if a 100% subsidiary relationship exists, in the areas of:

- majority underlying interests which will continue if interests are transferred to a 100% subsidiary (160ZZRA and 160ZRRB ITAA 1936; paragraph 149-50(1)(f) ITAA 1997);
- carry forward losses of 100% subsidiaries which are able to be deducted by holding companies (section 80A ITAA 1936; sections 36-15, 165-12 and subsection 166-10(2) ITAA 1997);
- same year losses of 100% subsidiaries which are able to be deducted by holding companies (section 80G ITAA 1936; section 170-30 ITAA 1997); and
- bad debts of a subsidiary which will be deductible if continuity of ownership test is satisfied (63A(3) ITAA 1936; subsections 165-120(1), section 166-45 ITAA 1997).

5. There are also some provisions of the old law which have not yet been rewritten but contain the same concepts as are in the provisions that are the primary subject of this Ruling. They are as follows:

- a Territory company includes a company if (among other things) during the year of income no person or persons is in a position to affect any rights in connection with the company of the holder of a shareholding interest in the company (paragraph 24D(1)(d) and subsection 24D(4) ITAA 1936);
- private companies do not include subsidiaries of public companies if in relation to a year of income no person or persons are in a position to affect the rights of the holding company or the subsidiary (paragraph 103A(4)(c) and subsection 103A(4A) ITAA 1936);
- foreign trading credit transfers may be transferred between group companies which include subsidiary companies if no person or persons are in a position to

affect the rights of the holding company or the subsidiary (subsections 160AFE(3) and (5) ITAA 1936);

- AFI entities includes the 100% subsidiary of another company provided no person or persons are in a position to affect the rights of the subsidiary or the holding company (subsections 326(3) and (5) ITAA 1936); and
- a company may be classed as an FIF wholly-owned subsidiary provided that no person or persons are in a position to affect the rights of the subsidiary or holding company (section 479 ITAA 1936).

6. This Ruling applies also to all of the above mentioned provisions of the old law, and minor differences in wording that may be present are not so significant as to support differing interpretations.

Ruling

7. It is circumstances relating to the beneficial ownership of shares which *prima facie* confers the 100% subsidiary relationship between companies, and this is provided for by subsection 975-505(1). However, in order to safeguard against the possibility of any collateral arrangement being used to circumvent the intended operation of the provision, subsections 975-505(2) and (3) provide that there is a break-down in that 100% subsidiary relationship if a person is, or will be, in a position to affect certain rights in relation to the subsidiary company. Section 975-150 outlines the circumstances in which a person will be in such a position.

Subsections 975-505(2) and (3)

8. Subsections 975-505(2) and (3) read as follows:

- **975-505(2)** the subsidiary company is not a **100% subsidiary** of the holding company if a person is *in a position to affect rights, in relation to the subsidiary company, of:
 - (a) the holding company; or
 - (b) a 100% subsidiary of the holding company.
- **975-505(3)** the subsidiary company is also not a **100% subsidiary** of the holding company if at some future time a person will be * in a position to affect rights as described in subsection (2).

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9. The operation of these subsections can be explained by considering their key phrases.

Key phrase A ‘rights, in relation to the subsidiary company, of the holding company’

10. These rights are limited to rights which attach to shares (in the subsidiary) - that is those rights which together form the bundle of rights which comprise shares. These are (1) the right to dividends, (2) the right to a capital distribution in various circumstances, and (3) the right to vote. While there are other rights which may attach to shares, such as the right to demand a poll and the right to apply for a winding up order by a court, these rights are not covered by this phrase. Furthermore, the expression does **not** extend to cover:

- rights conferred by the **ownership** of shares, most notably the right to dispose of shares;
- informal ‘rights’ (more appropriately termed ‘powers’) that a holding company has to control aspects of the subsidiary’s status and activities. These ‘rights’ are conferred by, most notably, dominant shareholding, but might also be conferred by the holding company’s position as, say, the dominant lender; or
- any rights that the holding company may have in relation to the subsidiary which are not concerned with shareholdings (examples of such rights might include rights of a lessee or rights of a lender).

Key phrase B ‘or a 100% subsidiary of the holding company’

11. Both the holding company and any 100% subsidiaries of the holding company would possess such rights only to the extent to which each is a direct beneficial owner of shares in the (ultimate) subsidiary.

Key phrase C ‘at some future time a person will be in a position’

12. This expression indicates that some certainty of intention is required in the arrangement, and an arrangement under which a person is merely likely to become in a position is not sufficient to trigger degrouping.

Section 975-150

13. Section 975-150 reads as follows:

- **975-150(1)** A person is **in a position to affect rights** of a company in relation to another company if the person has a right, power or option:
 - (a) to acquire those rights from one or other of those companies; or
 - (b) to do something that would prevent one or other of those companies from exercising its rights for its own benefit, or from receiving any benefit arising from having those rights.
- **975-150(2)** It does not matter whether the person has the right, power or option because of the *constitution of one or other of those companies, any agreement or otherwise.

14. This section describes when a person shall be taken to be in the 'position' referred to in subsections 975-505(2) and (3). It qualifies those subsections in two ways, one bearing upon 'position' and the other upon 'affect':

- A person is in a **position** to affect rights 'if that person has a right, power or option' to affect rights; and
- A person is in a position to **affect** rights if that person is in a position to 'acquire those rights' or in a position to 'do something that would prevent (a company) from exercising its rights for its own benefit, or from receiving any benefit arising from having those rights'.

15. The operation of the section can be further explained by considering its key phrases.

Key phrase D 'right, power or option'

16. Such rights, powers and options can have their source in 'the constitution of (a company), any agreement or otherwise'. As such those expressions are susceptible to a broad interpretation.

Key phrase E 'acquire those rights'

17. Because rights of the holding company in relation to the subsidiary are limited to those rights that comprise the share itself, and because share rights are indivisible, this limb means, in effect, acquire the shares. As well as the straight-forward case of a call option on the shares, this expression would also embrace a conditional share sale agreement where the conditions are waivable by the purchaser, and an agreement involving shares as security where it is agreed that there will be a default.

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Key phrase F ‘from one or other of those companies’

18. This phrase indicates that a person will be in a position to affect rights not only when that person has the power to acquire shares in the subsidiary from the beneficial owner, but also when that person has the power to acquire shares in the subsidiary from the subsidiary itself. That is, when that person has entitlement to a share issue.

Key phrase G ‘to do something that would prevent (a company) from exercising its rights for its own benefit’

19. It is considered that this limb exclusively describes the kinds of effects upon voting rights of the holding company in relation to a subsidiary (i.e., as distinguished from dividend rights and rights to a capital distribution) that can trigger de-grouping.

20. Not all potential interferences with the holding company’s ability to vote freely will fall foul of the provision. It is considered that offending potential interferences with voting rights will be those interferences that have the effect of passing some measure of control of the subsidiary company outside the company group.

21. Control **will** be ceded where:

- there is an arrangement that allows a third party to direct the way the holding company is to exercise its vote; or
- there is interference in the ability of the holding company to vote freely in matters affecting directors (this is a special case because directors themselves are agents of control, and any compromise on their appointment or dismissal by the holding company is a compromise on control).

Key phrase H ‘to do something that would prevent (a company) from receiving any benefit arising from having (its) rights’

22. It is considered that this limb exclusively describes the kinds of effects upon dividend rights and rights to a capital distribution that can trigger de-grouping. This can be taken to mean ‘prevent the holding company from receiving for its own benefit any dividends or capital distributions that might be paid’. Generally speaking it means that any dividends or capital distributions that are made must be available to the holding company, and must be for the benefit of the holding company.

Sections 975-150 and 975-505 taken together

23. Generally, common beneficial ownership is enough to allow two companies to sustain a 100% subsidiary relationship. This is not the case, however, where a person is or will be in a position to affect the relationship between them in one or more of the following three ways:

- the person can deprive the holding company of the **required 100% ownership of the subsidiary** by demanding that the holding company or the subsidiary effect a disposal to him or her of shares in the subsidiary;
- the person can deprive the holding company of the **control of the subsidiary** company by requiring that the voting rights not be exercised according to the holding company's wishes; and
- the person can deprive the holding company of **enjoyment of the riches of the subsidiary** by causing the benefit of any income or capital distributions to flow elsewhere than to the holding company.

Date of effect

24. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does 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 the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

Background

25. The concept of a person in a position to affect the rights of a holding company in relation to a subsidiary ('person in a relevant position') is an anti-avoidance device that is included in a number of provisions of the old law (see 'What this Ruling is about'). These provisions deliver various kinds of concessional treatment to closely linked companies, but in each case the concession ceases to be available if there is any person in the relevant position.

26. This concept of a person in a relevant position has been carried over into the new law. However those parts of the concessional provisions which set out the particular requirements for a sufficiently

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close linkage (including descriptions of a person in a relevant position) have been replaced with a single, generic set of rules. These are to be found in the Dictionary of the 1997 Act.

27. Even though the above mentioned Dictionary definitions were always intended to have many applications across the 1997 Act, the trigger for their introduction was the rewrite of the company loss transfer provisions, formerly found in section 80G. The accompanying Explanatory Memorandum ('EM') made it clear that both '100% subsidiary' and 'in a position to affect rights' are concepts drawn from section 80G (which in turn borrowed from, and is harmonious with, section 103A) and that in both cases the concepts have not been changed. And section 1-3 provides that the ideas in the new law are not to be taken as different just because different forms of words are used. In view of this, the interpretation of the aforementioned dictionary terms should, if possible, be consistent with the interpretation of the equivalent provisions, namely paragraph 80G(2)(b) and subsection 80G(4). In a similar vein, the rationale applied in arriving at a proper interpretation of section 80G, including having regard to section 103A, is valid in arriving at a proper interpretation of the Dictionary terms.

The relationship between the sections

28. It has been suggested that section 975-150 only particularises **some** of those circumstances that would fall within subsections 975-505(2) and (3). That is, there may be circumstances where a person is in a relevant position for the purposes of section 975-505 even if not for the purposes of section 975-150. Such a reading would be inappropriate, however, because an examination of the EM at the time of the introduction of section 80G shows that section 975-150 is intended to 'qualify' (limit) section 975-505 and it '...specifies for the purposes of...(section 975-505)... the circumstances in which a person is to be regarded as being...' in a relevant position.

Key phrase A 'rights, in relation to the subsidiary company, of the holding company'

29. The structure of section 975-150 makes it apparent that 'rights' is limited to rights of the holding company **as a shareholder**. This is because section 975-150 is concerned only with persons being in a position to (1) acquire those rights, (2) interfere with the exercise of those rights, or (3) interfere with receipt of benefits conferred by those rights. That is, it is solely concerned with situations in which the holding company is the possessor of those rights, but they are compromised in some way. There is no attempt to deal with what would seem to be the more profound case of rights that had already

been surrendered or were surrendered during the relevant period to someone outside the group. In view of this, it can reasonably be concluded that section 975-150 is founded upon the supposition that all the relevant rights are of a type (necessarily) retained by the beneficial owner. And it is the rights (of a holding company) as shareholder which bear this characteristic, owing to the indivisibility of the rights which comprise shares (*Re Alex Russell, deceased* [1968] VR 285 at 299-300).

30. The discussion in the paragraph above has proceeded upon the basis that the beneficial owner of shares is the shareholder. This is clearly not always the case - the shareholder is often a nominee of the beneficial owner. But because the Parliament has set the primary test of a subsidiary relationship as one of mere beneficial ownership (and not necessarily legal ownership) of shares, it is clear that it was not Parliament's intention that the existence of a 100% subsidiary relationship would be compromised merely because a nominee holds shares in the subsidiary on behalf of the beneficial owner.

31. However, whatever the intention, where the beneficial owner of shares is not the shareholder, the beneficial owner does not possess the 'rights in relation to another company' as described in paragraph 10. In such a situation, those rights are possessed by the nominee shareholder, who is bound '... to hold and use the rights which the law gives him in accordance with the obligations which equity has imposed upon him... to use them in some particular way for the benefit of (the beneficial owner)' (per Hope JA in *DKLR Holding Co. (No. 2) Pty Limited v. Commissioner of Stamp Duties (NSW)* (1981-1982) 149 CLR 431 at 519). The Commissioner considers that in such a case, taking into account Parliament's intention and the context of these provisions, it is proper to treat the beneficial owner and the shareholder as one. This is significant in two ways:

- companies which are mere beneficial owners of shares can be considered as having relevant 'rights in relation to the subsidiary company'; and
- the nominee cannot qualify as a (separate) person who might be in a position to affect relevant rights of a beneficial owner.

32. The ability of a 100% owner to influence or even dominate the affairs of a company does not of itself confer 'rights'. Such an ability might be more suggestive of 'powers'. That is not to say that the provisions are blind to the question of real control of the subsidiary. It is through the medium of voting rights that the provisions are able to ensure that degrouping results if real control can be exercised from outside the group.

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33. For reasons explained above, rights of a holding company other than rights as a shareholder do not fall within the paragraph. For example, if the subsidiary leased out office space to the holding company, and the holding company's rights as lessee (to occupancy, say) were compromised to a third party, the provisions would not be attracted.

Key phrase B 'or a 100% subsidiary of the holding company'

34. It is not every 100% subsidiary of the holding company that might be said to have 'rights in relation to the subsidiary'. This phrase should be read in the context of subsection 975-505(1). It is only those subsidiaries that are beneficial owners (either directly or through interposed subsidiaries) of shares in the ultimate subsidiary that the phrase countenances.

Key phrase C 'at some future time a person will be in a position'

35. Even though certainty is required, it is not the case that all contracts conditional in any way will be free from subsection 975-505(3) complications. For example, if a contract is subject to a condition that is highly likely to be satisfied, it may be that there exists an understanding between the parties, but outside the strictures of the contract, that the results countenanced in the contract will be achieved. In such a case it would not be necessary that the contract be capable of being construed as a sham in order that the arrangement cause the 100% subsidiary relationship to be broken.

Key phrase D 'right, power or option'

36. See paragraph 15 above.

Key phrase E 'acquire those rights'

37. It might be noted that this paragraph of subsection 975-150(1) protects against compromises to the continued existence of beneficial ownership of the shares by the holding company. This contrasts with the second paragraph which protects against compromises to the rights and benefits usually conferred by beneficial ownership.

Key phrase F 'from one or other of those companies'

38. This is a phrase that did not appear in section 80G. However Parliament has indicated clearly that no new ideas are expressed in these new provisions, and so the addition of this phrase merely serves to clarify the meaning of this aspect of section 80G. It is evident that

the mischief that might be done if a person is in a position to acquire shares from a beneficial owner can substantially be duplicated if a person is in a position to acquire shares from the company itself.

39. It might be argued that a person who has an option to purchase unissued share capital from a subsidiary cannot be said to be ‘in a position to affect rights’ of the existing shareholder. This is because the rights of the new shareholder would not affect the rights of the holding company in the subsidiary or prevent the holding company from exercising those rights. It will merely ‘...[affect] the enjoyment of, and the capacity to make effective, those rights...’ (per Sir R. Evershed, M.R. in *White v. Bristol Aeroplane Co. Ltd.* [1953] 1 All ER 40 at 44), because the new shareholder will have a right to share in ‘any of the advantages to which the other shareholders would be entitled’ (per Lindley LJ in *Re South African Trust & Co. Ltd.; Ex parte Hirsch & Co.* (1896) 74 LT 769 at 774). This argument proposes that the rights of the new shareholder created by the share issue will exist in addition to the pre-existing, continuing and undiminished rights of the holding company, although it is true that they will reduce the proportion of dividends or return of capital which it will be likely to receive in the future as well as dilute the holding company’s voting power.

40. However such an argument presupposes that it is the common law meaning of ‘affect rights’ which applies. That is not the case here. A person can be ‘in a position to affect rights’ of a holding company even when the rights of the holding company are not ‘affected’ in the common law sense exemplified in *Bristol Aeroplane*. For example, if a holding company agreed to pass on any dividends to which it may become entitled to ‘a person’, the person is in a position to affect the rights of the holding company in relation to the subsidiary for the purposes of these provisions. It is because that person can prevent the holding company from receiving for its own benefit any dividends to which it might become entitled, even though the dividend rights are not ‘affected’ in the classical sense (paragraph 975-150(1)(b)). So it is neither the intent nor the effect of the legislation that a person will be in a relevant position only if that person is, in the common law sense, in a position to affect rights.

41. The question is not whether a person is in a position to affect rights according to common law – it is whether a person is in a position to affect rights in any of the ways countenanced in section 975-150 (but in no other ways – see paragraph 28 above). And as discussed at paragraph 27, it can be appropriate to have regard to section 103A in the process of arriving at the proper interpretation of these Dictionary definitions. Within that section, which deals with public company status, is a legislative device very similar to that which is the subject of this Ruling. In particular, subsection 103A(4A) bears many similarities to section 975-150. Further, when

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subsection 103A(4A) is read in conjunction with paragraph 103A(4)(c), it is quite evident that 'exercising those rights for its own benefit' refers to 'the whole of the voting power...'. It is true that subsection 975-505(2) differs somewhat from its precursor paragraph 103A(4)(c) in that it does not contain a rider qualifying the expression 'affect rights'. Even so, it is sensible to interpret section 975-150 in the same way as the near identical subsection 103A(4A). As such, and amongst other things, a person is 'in a position' for the purposes of section 975-150 if a person can prevent a holding company from exercising for its own benefit the **whole** of the voting power. A person who has an entitlement to be issued shares in a subsidiary company is in such a position. (An analysis analogous to that concerning the whole of the voting power can be done concerning the whole of dividends and capital repayments). The 100% subsidiary status will always be lost if a person has an entitlement to be issued shares in the subsidiary.

Key phrase G 'to do something that would prevent (a company) from exercising its rights for its own benefit'

42. As mentioned above, subsection 103A(4A) is a legislative device very similar to that which is the subject of this Ruling. In particular, the subsection bears many similarities to section 975-150. When subsection 103A(4A) is read in conjunction with paragraph 103A(4)(c), it is quite evident that 'exercising those rights for its own benefit' concerns **only** voting rights and that 'receiving any benefits accruing by reason of those rights' concerns **only** dividend and capital distribution rights. Subsection 975-505(2) differs somewhat from its precursor paragraph 103A(4)(c) in that it does not contain a rider limiting the fatal effects upon rights to effects upon particular aspects of voting, dividend and capital distribution rights. Even so, it is sensible to interpret section 975-150 in the same way as the near identical subsection 103A(4A).

43. This Ruling adopts the position that there will be a break-down in the 100% subsidiary relationship when a third party can direct the way that a holding company is to exercise its vote. However it should be kept in mind that, depending upon the circumstances of the case, there can be a wide range of company decisions that **may** be subject to a vote by shareholders. It may be that a holding company has, for normal business reasons, agreed with a third party to procure that its subsidiary does, or does not, pursue some course of action (not encroaching upon a certain market, perhaps). If the matter came to a vote in the subsidiary, the holding company is bound to vote consistently with its agreement. This, of course, has nothing to do with the break-down of a true holding company/subsidiary relationship, and agreements of this kind cannot be taken to disqualify

the claimant company from enjoying the particular concession. That a holding company has (say contractually) made an undertaking, and that a third party is able to enforce compliance with the undertaking if the matter comes to a vote, cedes no more control to a third party than any other commercial contract. There may be considered three classes of arrangement which might compromise the voting rights of the holding company:

- (a) undertakings or procurements which might require the holding company to vote in a certain way (e.g., procuring that the subsidiary not pay a dividend over the period during which a sale contract was conditional would require the holding company to vote in a certain way **if** a dividend declaration is put up for approval);
- (b) agreements that specifically require the holding company to vote in a manner pre-determined by the agreement; and
- (c) agreements that the holding company will subject itself to vote according to the wishes of another person.

44. Instances of the first and second types of agreement would generally imply no loss of control to an entity outside of the group. Even though the group may have limited itself in some way, it has been a limitation decided upon by the group and the only power passing outside the group is the power to make sure that the group does indeed do that which the group itself had decided to do. In contrast, instances of the third type of arrangement would, for obvious reasons, generally imply a loss of control to an entity outside of the group.

45. The special case of a voting power which bears in any way upon the appointment of directors, other than a way which simply conforms with the wishes of the existing shareholders of the holding company, is a most important exception to the general rule about the first and second types of agreement (see Examples 3-5).

Key phrase H ‘to do something that would prevent (a company) from receiving any benefit arising from having (its) rights’

46. As described above, an examination of section 103A makes it apparent that this limb exclusively describes the kinds of effects upon dividend rights and rights to a capital distribution that can trigger degrouping.

47. The expression ‘receiving any benefits arising from having (its) rights’ when considered in isolation might be open to various interpretations. As a result it is again useful to have recourse to the parallel provisions within section 103A. Subsection 103A(4A)

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employs the phrase ‘.... receiving any benefits accruing by reason of those rights’, and it is clear from paragraph 103A(4)(c) that this can be taken to mean ‘receiving for its ... own benefit the whole of any dividends that might be paid by the (subsidiary) company or of any distribution that might be made of capital of the (subsidiary) company.’ In view of the above it is reasonable to conclude that the phrase ‘... receiving any benefit arising from having (its) rights’ where it occurs in section 975-150 carries the same meaning.

Examples

Example 1

48. Fawltly Holdings Ltd has a number of subsidiaries within its group including Manuel Ltd, in which it owns 100% of the shares. Manuel Ltd is the owner of a warehouse which it leases to Fawltly Holdings. As a cost cutting exercise, Fawltly Holdings decides to assign its interest as lessee of the warehouse to Sybil Ltd.

49. This situation would not alter Manuel’s status as a 100% subsidiary of Fawltly Holdings. Although Sybil Ltd can be said to be in a position to affect the rights of Fawltly Holdings as lessee in relation to its lessor subsidiary, these rights are not part of the bundle of rights which comprise shares and which are the rights referred to in subsection 975-505(2) ITAA 1997. As a result, Manuel Ltd will remain a 100% subsidiary of Fawltly Holdings Ltd.

Example 2

50. Later, Fawltly Holdings decides to sell all of its shares in Manuel Ltd to Polly Inc. The sale agreement provides that the sale will be conditional for a period of two months upon the written consent of the Torquay Monopolies Commission. During the conditionality period the agreement provides that a stand-still clause will operate to prevent any dividends from Manuel from being paid.

51. In these circumstances Manuel will still be considered to be a subsidiary of Fawltly Holdings during the conditionality period. Polly Inc will not be ‘**in a position to affect rights**’ of Fawltly in relation to Manuel as Polly does not have the power to deprive Fawltly of its enjoyment of the riches of the subsidiary by causing the benefit of any dividend distributions to flow elsewhere. The fact that the stand-still clause prevents a declaration of dividends is not sufficient to place Polly Inc ‘**in a position to affect rights**’ for the purposes of paragraph 975-150(1)(b) ITAA 1997. If a sale subject to conditions were generally to give rise to a transgression of the 100% subsidiary requirements, the ability to transfer losses within a corporate group,

for example, would be lost even in the case where conditions are not met and the sale does not proceed. This kind of outcome would appear unreasonable.

52. However, if the sale agreement provided that Manuel could declare dividends during the conditionality period, and any such dividends would be paid to Polly Inc, this would be sufficient to trigger degrouping. Polly would be **‘in a position to affect rights’** of Fawltly Holdings in Manuel as it could prevent Fawltly from enjoying the riches of its subsidiary. Consequently, Manuel Ltd would not be considered a subsidiary of Fawltly Holdings during the conditionality period of the sale agreement.

Example 3

53. Chalk & Cheese Pty Ltd is an Australian corporate joint venture owned by two international shareholders – Chalk PLC as to 60% and Cheese Inc as to 40%. Chalk & Cheese Pty Ltd have a subsidiary Cheddar (Australia) Pty Ltd. In ordinary circumstances, the dominance of the shareholding of Chalk PLC in Chalk & Cheese Pty Ltd would mean that it would be able to elect a majority of the directors of the board of Chalk & Cheese Pty Ltd and, so Chalk PLC would be able to control the operations of Cheddar (Australia) Pty Ltd against the wishes of Cheese Inc. In order to avoid this, an agreement is reached between Chalk & Cheese requiring that any subsidiary of Chalk & Cheese Pty Ltd should be so constituted that directors reflect the respective shareholding interests of the ultimate parent companies in that subsidiary. Accordingly, Cheddar (Australia) Pty Ltd has a requirement in its constitution that directors should be drawn from the nominees of Chalk PLC and Cheese Inc in the ratio of 3:2.

54. This arrangement would not be seen as the doing of something that would prevent Chalk & Cheese Pty Ltd from exercising its rights as shareholders in Cheddar (Australia) Pty Ltd for its own benefit.

Example 4

55. Curds Ltd (“Curds”) is an Australian public company. It has a wholly owned subsidiary Will Pty Ltd (“Will”). An unrelated associate of Curds, Whey Pty Ltd (“Whey”) reaches an agreement with Curds to ensure the appointment only of nominees of Whey on the board of Will. This arrangement is driven from a commercial arrangement whereby the operations of Will are to be applied to the commercial advantage of Whey as consideration for other unrelated advantages passing from Whey to Curd.

56. In these circumstances, it would be apparent that, whilst Curds is benefiting from this arrangement, something has been done that

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prevents it from exercising its rights as a shareholder in Will for its own benefit.

Example 5

57. Pail Pty Ltd (“Pail”) is experiencing financial difficulties. As part of a refinancing arrangement with its new banker, Pail’s shareholders acquiesce to the appointment of a nominee of the bank on the board of directors of Pail as, inter alia, a watch dog of the bank’s interests. This arrangement would not be seen as something done to prevent the exercise of the rights of shareholders in Pail for their own benefit.

Detailed contents list

58. Below is a detailed contents list for this draft Taxation Ruling:

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Your comments

59. We invite you to comment on this draft Taxation Ruling. We are allowing 6 weeks for comments before we finalise the Ruling. If you want your comments to be considered, please provide them to us within this period.

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Commissioner of Taxation

12 April 2000

Previous draft:

- ITAA 1936 79E(3)
- Not previously issued in draft form
 - ITAA 1936 80A
 - ITAA 1936 80G(2)(b)

Subject references:

- beneficial ownership
 - ITAA 1936 80G(4)
 - ITAA 1936 80G(6)
- companies
 - ITAA 1936 103A
 - ITAA 1936 103A(4)(c)
- rights in relation to companies
 - ITAA 1936 103A(4A)
- shareholders
 - ITAA 1936 160AFE(3)(b)
- subsidiaries
 - ITAA 1936 160AFE(5)

Legislative references:

- ITAA 1997 1-3(2)
- ITAA 1997 32-85(1)
- ITAA 1997 36-15
- ITAA 1997 149-50(1)(f)
- ITAA 1997 165-12
- ITAA 1997 165-120(1)
- ITAA 1997 166-10(2)
- ITAA 1997 166-45
- ITAA 1997 170-30
- ITAA 1997 170-105(2)
- ITAA 1997 170-130(2)
- ITAA 1997 975-150
- ITAA 1997 975-150(1)
- ITAA 1997 975-150(1)(b)
- ITAA 1997 975-150(2)
- ITAA 1997 975-500
- ITAA 1997 975-505(1)
- ITAA 1997 975-505(2)
- ITAA 1997 975-505(3)
- ITAA 1936 24D(1)(d)
- ITAA 1936 24D(4)
- ITAA 1936 51AE(5)(f)(ii)
- ITAA 1936 51AE(5)(f)(iii)
- ITAA 1936 63A(3)

Case references:

- DKLR Holding Co. (No. 2) Pty Limited v. Commissioner of Stamp Duties (NSW) (1981-1982) 149 CLR 431
- Re Alex Russell, deceased [1968] VR 285
- Re South African Trust & Co. Ltd.; Ex parte Hirsch & Co. (1896) 74 LT 769
- White v. Bristol Aeroplane Co. Ltd. [1953] 1 All ER 40

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