


TD 2006/D22 - Income tax: capital gains: are all classes of shares (other than redeemable shares) issued by a company taken into account in determining if the company has a controlling individual under subsection 152-55(1) of the Income Tax Assessment Act 1997 ?

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This document has been finalised by TD 2006/77.



Draft Taxation Determination

Income tax: capital gains: are all classes of shares (other than redeemable shares) issued by a company taken into account in determining if the company has a controlling individual under subsection 152-55(1) of the *Income Tax Assessment Act 1997*?

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Ruling

1. Yes. All classes of shares (other than redeemable shares) issued by a company are taken into account in determining if the company has a controlling individual under subsection 152-55(1) of the *Income Tax Assessment Act 1997* (ITAA 1997).

Example 1

2. *Operating Co carries on a business. Holding Co holds 100% of the shares in Operating Co. Frank owns 100% of the shares in Holding Co.*

3. *Operating Co does not have a controlling individual. This is because Frank does not hold the legal and equitable interests in shares in Operating Co that carry the right to exercise at least 50% of the voting power and receive at least 50% of any income or capital distributions.*

Example 2

4. *Trading Co carries on a business. A discretionary trust holds 100% of the shares in Trading Co. Frances is the only beneficiary of the trust.*

5. *Trading Co does not have a controlling individual. This is because neither the trustee nor the beneficiary of the trust holds both the legal and equitable interests in shares that carry the right to exercise at least 50% of the voting power and receive at least 50% of any income or capital distributions from the company.*

Example 3

6. *Bedrock Co has two different classes of shares, A and B, which have equal distribution rights. Only the A class shares have voting rights. Each class of shares is held by different shareholders – the A class shares being held in equal proportions by Fred and Barney and the B class shares being held in equal proportions by their respective wives, Wilma and Betty.*

7. *The directors of Bedrock Co can decide to make a distribution of income or capital to either class of shares to the exclusion of the other class of shares. There is the possibility of any of the shareholders receiving 50% of a distribution from the company, depending on the exercise of the directors' discretion.*

8. *In this situation, Bedrock Co does not have a controlling individual. There is no specific individual who holds shares that carry between them the right to receive at least 50% of any distribution the company may make. Fred and Barney (who each hold 50% of the voting power) might receive 50% of a distribution or they might not receive anything at all, depending on how the directors exercise their discretion.*

Example 4

9. *A company has two different classes of shares, A and B, which have equal voting and distribution rights. Isaac holds 50% of the shares of each class. The directors can decide to make a distribution of income or capital to either class of shares to the exclusion of the other class of shares.*

10. *In this situation, the company does have a controlling individual. Isaac holds 50% of the voting power and, regardless of how the directors' discretion is exercised, Isaac will always receive 50% of any distribution made by the company.*

Example 5

11. *A company has A class shares and one D class share issued to a key employee. Gus holds 50% of the A class shares, which have full voting and distribution rights. The D class share has dividend rights only, payable at the discretion of the directors.*

12. *The company does not have a controlling individual. Gus may receive 50% of a distribution if the directors do not exercise their discretion to make a distribution to the D class shareholder, but he will receive less than 50% of the distribution if the discretion is exercised. That is, Gus does not hold shares that carry between them the right to receive at least 50% of any distribution made. His 'notional' 50% interest is reduced to below 50% because of the directors' ability to make distributions to the D class shareholder.*

Date of effect

13. 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.

Commissioner of Taxation

14 June 2006

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.*

Explanation

14. An individual is a ‘controlling individual’ of a company if they hold the legal and equitable interests in shares (other than redeemable shares) that carry between them the right to exercise at least 50% of the voting power in the company and the right to receive at least 50% of any distribution of income and any distribution of capital that the company may make (subsection 152-55(1) of the ITAA 1997).

15. The ‘controlling individual’ definition requires the interests in the shares to be held directly by an individual. Therefore, if a company has no individual shareholders, for example, if all the shareholders are trusts or companies, the company does not have a controlling individual. As well, if any individual holds interests in a company indirectly through one or more interposed entities, those indirect interests are ignored in determining whether that individual is a controlling individual.

16. Therefore for a company to have a ‘controlling individual’, an individual must hold direct interests in the company.

17. If a company has more than one class of shares (other than redeemable shares), all classes must be taken into account in determining if the company has a controlling individual. The fact that an individual holds 50% of one class of shares will not be sufficient if the directors have the discretion to make distributions of income or capital to any class of shares to the exclusion of the other classes of shares. Rather, an individual shareholder must be capable of receiving at least 50% of any distribution made regardless of how the directors exercise their discretion.

Note

18. As noted in the Treasurer’s Press Release No. 38 of 2006 (9 May 2006), the Board of Taxation’s report on its Post-Implementation Review of the small business CGT concessions contains a number of legislative recommendations. This Draft Taxation Determination may be affected when the new significant individual 20% test is enacted.

Appendix 2 – Your comments

19. We invite you to comment on this draft Taxation Determination. Please forward your comments to the contact officer by the due date. (Note: The Tax Office prepares a compendium of comments for the consideration of the relevant Rulings Panel. The Tax Office may use a sanitised version (names and identifying information removed) of the compendium in providing its responses to persons providing comments. Please advise if you do not want your comments included in a sanitised compendium.)

Due date: 11 August 2006

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References

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- controlling individual test

Subject references:

- basic conditions for relief
- capital gains
- capital gains tax
- CGT small business relief
- controlling individual

Legislative references:

- ITAA 1997 152-55(1)

Other references

- Treasurer's Press Release No. 38 of 2006
-

ATO references

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