

TD 2007/D6 - Income tax: do the active assets of a partnership, in which a foreign company is a partner, constitute active foreign business assets of the foreign company for the purposes of the capital gains tax participation exemption provisions contained in Subdivision 768-G of the Income Tax Assessment Act 1997?

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This document has been finalised by [TD 2008/23](#).

 There is a Compendium for this document: [TD 2008/23EC](#).



Draft Taxation Determination

Income tax: do the active assets of a partnership, in which a foreign company is a partner, constitute active foreign business assets of the foreign company for the purposes of the capital gains tax participation exemption provisions contained in Subdivision 768-G of the *Income Tax Assessment Act 1997*?

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Ruling

1. No. The active assets of a partnership, in which a foreign company is a partner, do not constitute active foreign business assets of the foreign company for the purposes of the CGT participation exemption provisions contained in Subdivision 768-G of the *Income Tax Assessment Act 1997* (ITAA 1997).¹

Example

2. *Dinky Co, an Australian resident company, acquired a share (that is not an eligible finance share or a widely distributed finance share) in Notoz Co (a foreign resident company) in January 2005 and holds a direct voting percentage of 55% in Notoz Co.*
3. *Notoz Co is a partner in a foreign partnership which carries on a business.*
4. *On 30 November 2006 Dinky Co disposed of its share in Notoz Co, giving rise to a capital gain.*

¹ All legislative references are to the ITAA 1997 unless otherwise stated.

5. *Dinky Co's capital gain is reduced by the active foreign business asset percentage of Notoz Co in relation to Dinky Co.*

6. *In calculating Notoz Co's active foreign business asset percentage in relation to Dinky Co, Notoz Co's active foreign business assets do not include any assets of the foreign partnership in which Notoz Co has an interest.*

Date of effect

7. 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 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation

24 April 2007

Appendix 1 – Explanation

1 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

8. Section 768-505 can reduce a capital gain or loss made by an Australian resident company and their controlled foreign companies (the holding company), when certain CGT events² happen to shares (other than eligible finance shares or widely distributed finance shares)³ that the holding company owns in a foreign company. Section 768-505 applies when the holding company holds a direct voting percentage of 10% or more in the foreign company for a specified period before the CGT event happens.

9. The capital gain or loss is reduced by the 'active foreign business asset percentage' of the foreign company in relation to the holding company,⁴ which reflects the degree to which the assets of the foreign company are used in an active business. In broad terms, this is the value of 'active foreign business assets' owned by the foreign company as a percentage of the value of the 'assets included in the total assets' of the foreign company.

10. Section 768-545 sets out when an asset is included in the total assets of a foreign company at a particular time. The section requires that the asset must be a CGT asset owned by the foreign company at the particular time.

11. A CGT asset is defined in subsection 108-5(1) to be any kind of property or a legal or equitable right that is not property. For the avoidance of doubt, subsection 108-5(2) specifies particular CGT assets including:

- (c) an interest in an asset of a partnership;
- (d) an interest in a partnership that is not covered by paragraph (c).

12. Subsection 768-540(1) specifies when an asset will be an 'active foreign business asset' of a foreign company. The asset must be included in the total assets of the company, and it must not be an asset of the kind covered by subsection 768-540(2). An interest in a trust or partnership is an asset that is covered by paragraph 768-540(2)(c).

² CGT events A1, B1, C2, E1, E2, G3, J1, K4, K6, K10 or K11: see paragraph 768-505(1)(c).

³ Eligible finance shares (within the meaning of Part X of *Income Tax Assessment Act 1936*) and widely distributed finance shares (within the meaning of that Part) are specifically excluded from the CGT participation exemption: see paragraph 768-505(1)(b).

⁴ Section 768-510.

13. Where a foreign company is a partner in a partnership, the company's total assets, for the purposes of section 768-545, will include the foreign company's beneficial interest in each asset of the partnership, as well as the residual interest the company has in the partnership, because both interests are CGT assets that are owned by the foreign company. The partnership's assets themselves are not included in the foreign company's total assets because the foreign company does not have absolute ownership of each of the assets. When an asset is owned by a partnership, full ownership of the asset resides with the partners jointly. Each partner, therefore, has only an equitable or beneficial interest in the asset, and not absolute ownership of the asset.⁵

14. Although the foreign company's interest in each asset of a partnership and its residual interest in a partnership are included in the total assets of the foreign company, neither of these interests constitute an active foreign business asset of the foreign company pursuant to section 768-540.

15. The phrase 'an interest in a trust or partnership' in paragraph 768-540(2)(c) is broad in its coverage and encompasses both a partner's interest in the assets of a partnership and the partner's residual interest in the partnership itself. Although 'an interest in an asset of the partnership' and 'an interest in a partnership' are distinguished in subsection 108-5(2) as separate CGT assets, the specific reference in that section to both types of partnership interests is for the avoidance of doubt that both are CGT assets. The inclusion of the words 'that is not covered by paragraph (c)' at the end of paragraph 108-5(2)(d), indicates that, in the absence of the additional words, an interest in an asset of a partnership would be covered by the phrase 'an interest in a partnership' in paragraph 108-5(2)(d).

16. The Commissioner considers that the exclusion in paragraph 768-540(2)(c) was intended to cover both an interest in an asset of a partnership and the residual interest in a partnership, as well as an interest in a trust, because such interests are passive, rather than active, in nature. The Explanatory Memorandum to the New International Tax Arrangements (Participation Exemption and Other Measures) Bill 2004 explains the rationale for excluding certain CGT assets.

Certain assets have been specifically excluded from the definition of active foreign business asset for the purposes of this measure **[Schedule 1, item 3, paragraph 768-540(1)(d) and subsection 768-540(2)]**. These specific exclusions have been broadly based on existing provisions in the income tax law that deal with the distinction between active and not active assets or income. In particular, consideration was given to the definition of 'tainted asset' in section 317 of the ITAA 1936 and the definition of 'active asset' in section 152-40 of the ITAA 1997.

⁵ The nature of a partner's interest in the assets of the partnership is discussed in *Canny Gabriel Castle Jackson Advertising Pty Ltd and Fourth Media Management Pty Ltd v. Volume Sales (Finance) Pty Ltd* (1974) 3 ALR 409 at 412.

17. If it had been intended that interests in partnerships were to be treated as active so that the active assets of the partnership or trust contributed to the active foreign business asset percentage, then an interest in a partnership would have needed to have been specifically included in the definition of active foreign business assets in the same way as shares are specifically included. The Explanatory Memorandum elaborates on this point at Paragraph 1.108:

Although shares are not normally considered to have an active character, they have been included within the definition of active foreign business assets for the purposes of this measure in order to facilitate the testing of subsidiary foreign companies for the presence of an active business [**Schedule 1, item 3, subparagraph 768-540(1)(b)(iii)**]. If shares were not treated as active for the purposes of this measure, then the active foreign business asset percentage of subsidiary foreign companies could not contribute to the active foreign business asset percentage of their foreign parent company [**Schedule 1, item 3, subsections 768-520(2) and 768-525(4)**].

18. Subdivision 768-G was clearly not intended to afford the same treatment for shares in a foreign company when the shares are held indirectly via an interest in a partnership. Paragraph 1.120 of the Explanatory Memorandum states that:

Characterisation of interests in partnerships and trusts as not active means that these entities will not be looked through for the purpose of calculating the active foreign business asset percentage of a foreign company. Consequently, where the foreign company being disposed of holds an interest in a subsidiary company through a partnership or a trust, the active assets of that subsidiary company will not contribute to the active foreign business asset percentage of the foreign company. Therefore, any interest that the foreign company holds in that subsidiary company through the partnership or trust will effectively be treated as not active as the interest held by the company in the partnership or trust is a non-active asset.

19. Therefore, where a partnership is interposed between the foreign company and the active business assets, the active assets of the partnership will not be included in the 'active foreign business assets' for the purposes of calculating the foreign company's active foreign business asset percentage.

Appendix 2 – Your comments

20. 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: **25 May 2007**

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- active foreign business asset
- active foreign business asset percentage
- capital gains tax
- CGT asset
- CGT participation exemption
- company
- foreign company
- interest in a partnership
- interest in an asset of a partnership
- interest in a trust
- partnership
- share
- trust

- ITAA 1997 152-40
- ITAA 1997 Subdiv 768-G
- ITAA 1997 768-505
- ITAA 1997 768-505(1)(c)
- ITAA 1997 768-510
- ITAA 1997 768-520(2)
- ITAA 1997 768-525(4)
- ITAA 1997 768-540
- ITAA 1997 768-540(1)
- ITAA 1997 768-540(1)(b)(iii)
- ITAA 1997 768-540(1)(d)
- ITAA 1997 768-540(2)
- ITAA 1997 768-540(2)(c)
- ITAA 1997 768-545

Case references:

- Canny Gabriel Castle Jackson Advertising Pty Ltd and Fourth Media Management Pty Ltd v. Volume Sales (Finance) Pty Ltd (1974) 3 ALR 409

Other references:

- Explanatory Memorandum to the New International Tax Arrangements (Participation Exemption and Other Measures) Bill 2004

Legislative references:

- ITAA 1936 Pt X
- ITAA 1936 317
- ITAA 1997 108-5(1)
- ITAA 1997 108-5(2)
- ITAA 1997 108-5(2)(d)

ATO references

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 Income Tax ~~ Entity specific matters ~~ partnerships