



TD 2021/D4 - Income tax: aggregated turnover - application of the public entity exception to the indirect control test

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 There is a Compendium for this document: **TD 2022/6EC** .



Status: **draft only – for comment**

Draft Taxation Determination

Income tax: aggregated turnover – application of the public entity exception to the indirect control test

❶ Relying on this draft Determination

This publication is a draft for public comment. It represents the Commissioner's preliminary view on how a relevant provision could apply.

If this draft Determination applies to you and you rely on it reasonably and in good faith, you will not have to pay any interest or penalties in respect of the matters covered, if this draft Determination turns out to be incorrect and you underpay your tax as a result. However, you may still have to pay the correct amount of tax.

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Ruling

1. For the purposes of determining 'control' within the meaning of section 328-125 of the *Income Tax Assessment Act 1997*¹, where an entity (the first entity) controls another entity (the second entity), and the second entity directly or indirectly controls a third entity, the first entity is taken to control the third entity.²
2. However, the 'indirect control test' within the meaning of subsection 328-125(7) does not apply if a public entity is interposed between the first entity and the third entity. In these circumstances, the first entity will not control the third entity merely because of its interest in the interposed public entity.³

¹ All legislative references in this draft Determination are to the *Income Tax Assessment Act 1997* unless otherwise indicated.

² See subsection 328-125(7).

³ See subsection 328-125(8).

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3. As per subsection 328-125(8), a 'public entity' is:
- (a) a company shares in which (except shares that carry the right to a fixed rate of dividend) are listed for quotation in the official list of an approved stock exchange;
 - (b) a publicly traded unit trust
 - (c) a mutual insurance company;
 - (d) a mutual affiliate company;
 - (e) a company (other than one covered by paragraph (a)) all the shares in which are owned by one or more of the following:
 - (i) a company covered by paragraph (a);
 - (ii) a publicly traded unit trust;
 - (iii) a mutual insurance company;
 - (iv) a mutual affiliate company.
4. The mere presence of an interposed public entity does not result in a control chain being broken. If a public entity is interposed in an ownership structure, the first entity may still control the third entity through direct control.⁴

Example 1 – aggregated turnover calculations when applying the public entity exception to the indirect control test

Facts

5. ABC Pty Ltd (ABC) needs to calculate its aggregated turnover for the 2021 income year to determine its eligibility for the loss carry back tax offset.
6. Under section 328-115, ABC's aggregated turnover includes its own annual turnover, together with the annual turnover of any entity that is connected with, or an affiliate of ABC, at any time during the income year.
7. ABC did not have any affiliates within the meaning of section 328-130 during its 2021 income year. To undertake its aggregated turnover calculation, ABC needs to identify any entities connected with it.
8. 62% of ABC's shares are held by Public Holdings Ltd (PHL). These carry the right for PHL to receive 62% of any distributions of income or capital made by ABC.
9. PHL is a public company whose shares are listed for quotation on the Australian Securities Exchange. Its shares do not carry the right to a fixed rate of dividend.
10. 38% of ABC's shares are held by various minority shareholders. Many of these minority shareholders are affiliates of DEF Pty Ltd (DEF). DEF's affiliates have a combined annual turnover of \$1 billion.
11. DEF, together with its affiliates, owns equity interests in PHL that carry between them the right to exercise 55% of the voting power in PHL.
12. DEF, together with its affiliates, also owns equity interests in ABC that carry between them the right to exercise 29% of the voting power in ABC.

⁴ See paragraph 2.58 of the Explanatory Memorandum to the Tax Laws Amendment (Small Business) Bill 2007 (the EM).

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13. ABC has an annual turnover of \$1.2 billion for the 2021 income year. PHL has an annual turnover of \$2.6 billion for ABC's 2021 income year. DEF has an annual turnover of \$2 billion for ABC's 2021 income year.

Control

14. PHL directly controls ABC by virtue of PHL having a control percentage⁵ in ABC of 62%.

15. DEF directly controls PHL by virtue of DEF, together with its affiliates having a control percentage⁶ in PHL of 55%.

16. In the absence of the public entity exception to the indirect control test, DEF would be taken to control ABC indirectly pursuant to subsection 328-125(7). This would be because the first entity (DEF) controls a second entity (PHL), and the second entity controls the third entity (ABC).

17. However, because PHL is a public company listed on the Australian Securities Exchange, the indirect control test does not apply pursuant to subsection 328-125(8), such that DEF will not be taken to control ABC indirectly.

18. Nonetheless, the mere presence of an interposed public entity does not result in a control chain being broken. The first entity may still control the third entity through direct control. However, DEF does not control ABC directly because DEF, together with its affiliates, only has a control percentage⁷ of 29%.

Aggregated turnover calculations

19. ABC's aggregated turnover includes its own annual turnover, together with the annual turnover of any entity that is connected with, or an affiliate of, ABC, at any time during its 2021 income year.

20. On the facts, ABC is connected with PHL. Therefore, ABC's aggregated turnover for the 2021 income year is its own annual turnover (\$1.2 billion) plus PHL's annual turnover (\$2.6 billion), which totals \$3.8 billion.

21. If PHL was required to calculate its aggregated turnover in the same scenario, its aggregated turnover would include its own annual turnover (\$2.6 billion) plus the annual turnovers of ABC (\$1.2 billion) and DEF (\$2 billion). This is because PHL directly controls ABC, and PHL is directly controlled by DEF. This scenario would result in PHL having an aggregated turnover of \$5.8 billion.

22. If DEF was required to calculate its aggregated turnover in the same scenario, its aggregated turnover would include its own annual turnover (\$2 billion), the annual turnovers of its affiliates (collectively \$1 billion), and the annual turnover of PHL (\$2.6 billion). This is because DEF directly controls PHL. This would result in DEF having an aggregated turnover of \$5.6 billion.

23. **Note:** It is assumed in Example 1 of this draft Determination that no relevant exclusion amounts pursuant to subsection 328-115(3) apply to the aggregated turnover calculations.

⁵ Within the meaning of subsection 328-125(2).

⁶ Within the meaning of subsection 328-125(2).

⁷ Within the meaning of subsection 328-125(2).

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Example 2 – entity ultimately owned by a listed company through interposed companies

Facts

24. Aus Co needs to calculate its aggregated turnover for the 2021 income year to determine its eligibility for temporary full expensing.
25. Under section 328-115, Aus Co's aggregated turnover includes its own annual turnover, together with the annual turnover of any entity that is connected with, or an affiliate of Aus Co, at any time during the income year.
26. Aus Co did not have any affiliates within the meaning of section 328-130 during its 2021 income year. To undertake its aggregated turnover calculation, Aus Co needs to identify any entities connected with it.
27. 60% of Aus Co's shares are held by US Sub Co 2. These carry the right for US Sub Co 2 to receive 60% of any distributions of income or capital made by Aus Co.
28. 100% of US Sub Co 2's shares are held by US Sub Co 1. These carry the right for US Sub Co 1 to receive 100% of any distributions of income or capital made by US Sub Co 2.
29. 100% of US Sub Co 1's shares are held by US Listed Parent Co. These carry the right for US Listed Parent Co to receive 100% of any distributions of income or capital made by US Sub Co 1.
30. US Listed Parent Co is a public company whose shares are listed for quotation on the New York Stock Exchange (NYSE). Its shares do not carry the right to a fixed rate of dividend.

Control

31. US Sub Co 2 directly controls Aus Co by virtue of US Sub Co 2 having a control percentage⁸ in Aus Co of 60%.
32. US Sub Co 1 directly controls US Sub Co 2 by virtue of US Sub Co 1 having a control percentage⁹ in US Sub Co 2 of 100%.
33. US Sub Co 1 indirectly controls Aus Co pursuant to subsection 328-125(7) because US Sub Co 1 (the first entity) directly controls US Sub Co 2 (the second entity) which directly controls Aus Co.
34. US Listed Parent Co directly controls US Sub Co 1 by virtue of US Listed Parent Co having a control percentage¹⁰ in US Sub Co 1 of 100%.
35. In the absence of the public entity exception to the indirect control test, US Listed Parent Co would also be taken to control Aus Co indirectly pursuant to subsection 328-125(7). This would be because the first entity (US Listed Parent Co) controls a second entity (US Sub Co 1), and the second entity indirectly controls Aus Co (via its direct control of US Sub Co 2 which directly controls Aus Co).
36. However, because US Sub Co 1 (the second entity) is a company, all the shares in which are owned by a company whose shares are listed for quotation on the NYSE (US Listed Parent Co), the indirect control test does not apply pursuant to subsection 328-125(8), such that US Listed Parent Co does not control Aus Co indirectly.

⁸ Within the meaning of subsection 328-125(2).

⁹ Within the meaning of subsection 328-125(2).

¹⁰ Within the meaning of subsection 328-125(2).

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37. *The public entity exception to the indirect control test does not apply to US Sub Co 1's indirect control of Aus Co. This is because US Sub Co 2 (the second entity) is not a company covered by subsection 328-125(8). Specifically, US Sub Co 1, which owns all the shares in US Sub Co 2, is not a company whose shares are listed for quotation on an approved stock exchange.*

Conclusion

38. *On the facts, Aus Co is directly controlled by US Sub Co 2 and indirectly controlled by US Sub Co 1. It is therefore connected with US Sub Co 2 and US Sub Co 1.*

39. *Therefore, Aus Co will need to include its annual turnover, as well as the annual turnover of US Sub Co 2 and US Sub Co 1 in its aggregated turnover calculation.*

40. **Note 1:** *In accordance with paragraphs 328-115(3)(a) and (b), Aus Co's aggregated turnover does not include amounts derived by Aus Co, US Sub Co 2 or US Sub Co 1 from dealings between each other.*

41. **Note 2:** *This example does not examine whether US Sub Co 2 is an affiliate of US Listed Parent Co within the meaning of section 328-130, and therefore whether US Listed Parent Co directly controls Aus Co under subsection 328-125(2) via an affiliate.*

Date of effect

42. *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 *Public Rulings*).*

Commissioner of Taxation

13 October 2021

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Appendix 1 – Explanation

❶ *This Explanation 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.*

Background to Subdivision 328-C

43. Pursuant to Subdivision 328-C¹¹, an entity will be a small business entity for an income year if it carries on a business and its aggregated turnover is under the relevant threshold.¹² An entity’s aggregated turnover for an income year is comprised of its annual turnover¹³, together with the annual turnover of each entity (including foreign resident) that is connected with¹⁴ it, or is an affiliate¹⁵ of it, at any time during the income year.¹⁶

44. The concepts of small business entity and aggregated turnover in Subdivision 328-C are utilised in a number of provisions in the taxation law, including the temporary loss carry back¹⁷ and temporary full expensing¹⁸ measures. These measures extend the small business entity definition to include entities that would be a small business entity if the aggregated turnover threshold was \$5 billion (instead of \$10 million).¹⁹ As a result, the aggregation rules in Subdivision 328-C now apply to a broader range of business structures and entities, including large businesses and multinational entities.

Meaning of ‘connected with’ an entity

45. An entity is ‘connected with’ another entity if either entity controls the other entity in a way described in section 328-125, or both entities are controlled in a way described in that section by the same third entity.²⁰ Subsection 328-125(2) sets out the test for determining whether an entity directly controls another entity, other than a discretionary trust²¹, as follows:

An entity (the **first entity**) controls another entity if the first entity, its affiliates, or the first entity together with its affiliates:

- (a) except if the other entity is a discretionary trust - own, or have the right to acquire the ownership of, interests in the other entity that carry between them the right to receive a percentage (the **control percentage**) that is at least 40% of:
 - (i) any distribution of income by the other entity; or

¹¹ Subdivision 328-C applies in relation to the 2008 income year and subsequent income years; refer to paragraphs 1.37 and 2.69 of the EM.

¹² Section 328-110.

¹³ ‘Annual turnover’ is defined in section 328-120.

¹⁴ An entity is connected with another entity within the meaning of section 328-125.

¹⁵ An entity is an affiliate of yours within the meaning of section 328-130.

¹⁶ Section 328-115. This is subject to the excluded amounts listed in subsection 328-115(3).

¹⁷ The temporary loss carry back provisions are contained in Division 160.

¹⁸ The temporary full expensing provisions are contained in Subdivision 40-BB of the *Income Tax (Transitional Provisions) Act 1997* (ITTP Act).

¹⁹ For temporary loss back, see paragraph 160-20(b)(i) which amends the reference in Subdivision 328-C from \$10 million to \$5 billion. For temporary full expensing, see paragraph 40-155(b)(i) of the ITTP Act which amends the reference in Subdivision 328-C from \$10 million to \$5 billion.

²⁰ Subsection 328-125(1).

²¹ Subsections 328-125(3) to (5) set out the tests for determining whether an entity directly controls a discretionary trust.

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- (ii) if the other entity is a partnership - the net income of the partnership; or
 - (iii) any distribution of capital by the other entity; or
- (b) if the other entity is a company - own, or have the right to acquire the ownership of, equity interests in the company that carry between them the right to exercise, or control the exercise of, a percentage (the **control percentage**) that is at least 40% of the voting power in the company.

46. The control test is based on legal ownership of an interest in an entity, rather than who benefits from the interest.²²

The indirect control test

47. An entity will also be connected with another entity if it indirectly controls that entity (or vice versa) within the meaning of subsection 328-125(7).

48. Subsection 328-125(7) states:

This section applies to an entity (the **first entity**) that directly controls another entity (the **second entity**) as if the first entity also controlled any other entity that is directly, or indirectly by any other application or applications of this section, controlled by the second entity.

49. Subsection 328-125(7) therefore provides the principle that where a first entity controls a second entity, and the second entity directly or indirectly controls a third entity, the first entity is taken to control the third entity.²³

50. The indirect control test is designed to look through business structures that include interposed entities.²⁴

The public entity exception to the indirect control test

51. Subsection 328-125(8) states:

However, subsection (7) does not apply if the second entity is an entity of any of the following kinds:

- (a) a company shares in which (except shares that carry the right to a fixed rate of dividend) are listed for quotation in the official list of an approved stock exchange;
- (b) a publicly traded unit trust;
- (c) a mutual insurance company;
- (d) a mutual affiliate company;
- (e) a company (other than one covered by paragraph (a)) all the shares in which are owned by one or more of the following:
 - (i) a company covered by paragraph (a);
 - (ii) a publicly traded unit trust;
 - (iii) a mutual insurance company;

²² See the Tax Laws Amendment (2013 Measures No.1) Bill 2013, which amended subsections 328-125(2)(a) and (b) by omitting 'beneficially own, or have the right to acquire the beneficial', and substituting it with 'own, or have the right to acquire the' and amended subsection 328-125(8)(e) by omitting 'beneficially'.

²³ Section 328-125(7). Also see paragraph 2.54 of the EM.

²⁴ See paragraph 2.55 of the EM.

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(iv) a mutual affiliate company.

52. Subsection 328-125(8) therefore provides an exception to the indirect control test, providing a list of specific entities (broadly, public entities), the interposition of which results in the indirect control test not having application.

53. In other words, if a public entity is interposed between a first and a third entity, the first entity will not control the third entity merely because of its interest in the interposed public entity.²⁵

54. The reasoning behind the public entity exception to the indirect control test is that the very diffuse and regularly traded ownership of such entities means that it can be a complicated and difficult process to trace interests through such entities.²⁶

²⁵ See paragraph 2.56 of the EM.

²⁶ See paragraph 2.56 of the EM.

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Appendix 2 – Your comments

55. You are invited to comment on this draft Determination including the proposed date of effect. Please forward your comments to the contact officer by the due date.

56. A compendium of comments is prepared when finalising this Determination, and an edited version (names and identifying information removed) is published to the Legal database on ato.gov.au

57. Please advise if you do not want your comments included in the edited version of the compendium.

Due date: 12 November 2021

Contact officer: Contact officer details have been removed following publication of the final determination.

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Legislative references:

- ITAA 1997 Div 160
- ITAA 1997 Subdiv 328-C
- ITAA 1997 328-110
- ITAA 1997 328-115
- ITAA 1997 328-115(3)
- ITAA 1997 328-115(3)(a)
- ITAA 1997 328-115(3)(b)
- ITAA 1997 328-120
- ITAA 1997 328-125
- ITAA 1997 328-125(1)
- ITAA 1997 328-125(2)

- ITAA 1997 328-125(2)(a)
- ITAA 1997 328-125(2)(b)
- ITAA 1997 328-125(3)
- ITAA 1997 328-125(4)
- ITAA 1997 328-125(5)
- ITAA 1997 328-125(7)
- ITAA 1997 328-125(8)
- ITAA 1997 328-125(8)(e)
- ITAA 1997 328-130
- IT(TP)A 1997 Subdiv 40-BB

Other references:

Explanatory Memorandum to the Tax Laws
Amendment (Small Business) Bill 2007
Tax Laws Amendment (2013 Measures No.1)
Bill 2013

ATO references

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