



CR 2007/51 - Income tax: Telstra Corporation Limited Tranche 3 Instalment Receipts

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Class Ruling

Income tax: Telstra Corporation Limited Tranche 3 Instalment Receipts

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ⓘ This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- Division 6 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936);
- subsection 128A(3) of the ITAA 1936;
- section 128B of the ITAA 1936;
- subparagraph 128B(3)(ga)(i) of the ITAA 1936;
- section 128D of the ITAA 1936;
- section 160APHL of the ITAA 1936;
- section 160APHO of the ITAA 1936;
- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 8-1 of the ITAA 1997;

- section 104-10 of the ITAA 1997;
- section 106-60 of the ITAA 1997;
- section 109-5 of the ITAA 1997;
- section 110-25 of the ITAA 1997;
- section 110-55 of the ITAA 1997;
- subsection 112-30(1) of the ITAA 1997;
- section 116-20 of the ITAA 1997;
- section 116-55 of the ITAA 1997;
- section 118-20 of the ITAA 1997;
- section 118-25 of the ITAA 1997;
- section 130-40 of the ITAA 1997;
- subsection 130-45(2) of the ITAA 1997;
- section 136-10 of the ITAA 1997;
- section 136-25 of the ITAA 1997;
- section 855-10 of the ITAA 1997;
- section 855-15 of the ITAA 1997; and
- subsection 3(11) of the *International Tax Agreements Act 1953* (Agreements Act).

Class of entities

3. The class of entities to which this Ruling applies is all Investors (IR holders) other than those who are temporary residents under Subdivision 768-R of the ITAA 1997 who:

- (a) successfully applied to the Commonwealth of Australia (Commonwealth) to purchase a share in Telstra Corporation Limited (Telstra) (Sale Share), and who received a Tranche 3 Instalment Receipt (IR) as evidence of ownership of that share; or
- (b) acquire a Telstra Tranche 3 IR by subsequent transfer.

In this Ruling entities are described as Investors or IR holders depending on whether the context of the discussion is before or after the transfer of the Sale Share by Telstra Sale Company Limited (TSCL) as trustee of the trust. It is upon the transfer of the Sale Share to TSCL, that the Investor receives an Instalment Receipt and becomes an IR holder.

4. The class of entities to which this Ruling applies does not include TSCL. The Ruling does not deal with how the taxation law applies to TSCL in relation to the scheme that is the subject of this Ruling.

Qualifications

5. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

6. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 14 to 35 of this Ruling.

7. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

9. This Ruling applies from 1 July 2006 to 30 June 2009. However, the Ruling continues to apply after this date to all entities within the specified class who entered into the specified scheme during the term of the Ruling, subject to there being no change in the scheme or in the entities involved in the scheme.

10. The Ruling does 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 Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

11. If this Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

12. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

13. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

14. The scheme that is the subject of this Ruling is described from paragraph 14 to 35 in this Ruling. This description is based on the documents listed below. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the scheme are:

- the application for a Class Ruling from Greenwoods & Freehills dated 27 July 2006;
- deed between the Commonwealth and TSCL (the Trust Deed);
- constitution of TSCL; and
- the amendments to the application for a Class Ruling from Greenwoods & Freehills dated 3 October 2006.

Note: Certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under the Freedom of Information legislation.

The Sale

15. The Commonwealth sold shares in Telstra (Sale Shares).

16. The Commonwealth sold the Sale Shares by means of:

- (a) a retail and institutional offering in Australia and New Zealand; and
- (b) a sale to certain international underwriters or their nominees for on sale by them of the resulting Instalment Receipts (IR) by means of public and institutional offerings outside Australia and New Zealand.

17. Interested Investors applied to the Commonwealth to purchase Sale Shares. The application formed a contractual offer to purchase the Sale Shares applied for. The Commonwealth considered the applications and accepted the offers on 19 November 2006.

18. The purchase price of the Sale Shares is to be paid to the Commonwealth in two instalments:

- (a) \$2.00 per share was to be paid with the application under the retail offer and \$2.10 under the institutional offer (First Instalment); and
- (b) subject to receiving the prepayment discount referred to in paragraph 19, below, \$1.60 per share is to be paid on or before 29 May 2008 (Final Instalment).

19. IR holders who pay the Final Instalment before 31 March 2008 will receive a prepayment discount. The amount of the discount will depend on when the Final Instalment is paid and will be calculated by applying a specified discount rate.

The Security Arrangement

20. Until the Final Instalment has been paid to the Commonwealth in respect of a particular Sale Share, that share will be held by TSCL as trustee in order to secure payment of the Final Instalment (Security Interest).

21. After accepting an offer from an Investor to purchase a Sale Share, including having received payment of the First Instalment, the Commonwealth (at the direction of the Investor, contained in each Application Form) transferred that share to TSCL, creating the Security Interest.

22. The Commonwealth holds the Security Interest as security for the payment of the Final Instalment. Subject to the Security Interest, TSCL as trustee holds the Sale Share for the IR holder.

Instalment Receipts

23. While a Sale Share is held by TSCL the relevant IR holder will not be entitled to require the transfer (to itself or any other person) of the share prior to paying the Final Instalment; that is, until the IR holder has made the payment for which the share is security. However, the IR holder receives an IR which will evidence the IR holder's interest in the Sale Share, its payment of the First Instalment and its obligation to pay the Final Instalment and will carry a separate IR number corresponding to the particular Sale Share.

24. The IRs will be transferable and listed on the Australian Stock Exchange (ASX). If an IR is traded the transferee will acquire an interest in the Sale Share and the obligation to pay the Final Instalment (together with the other rights and obligations evidenced by an IR).

25. The IR holder will have the ability to pay the Final Instalment for some or all of their registered holdings on or before the due date and will receive a prepayment discount if they do so before 31 March 2008.

26. Upon the due date for the Final Instalment, the holder at that time of each IR will be obliged to make payment of the Final Instalment to the Commonwealth.

27. If the Final Instalment is paid in respect of a Sale Share, TSCL will transfer the Sale Share to the IR holder within 12 business days (or a longer period if the ASX permits).

28. If the Final Instalment is not paid by the due date, TSCL may sell some or all of the Sale Shares. TSCL shall, after subtracting its costs, the administration charge, any taxes outstanding, and interest owing on the outstanding debt, pay the amount of the Final Instalment to the Commonwealth. Any balance will be paid to the IR holder.

Bonus Loyalty Scheme

29. Australian IR holders will be entitled to Bonus Loyalty Shares when they:

- (a) successfully apply to the Commonwealth to purchase Sale Shares and receive IRs under the Australian retail offer (rather than acquiring the IRs by subsequent transfer);
- (b) hold the requisite number of IRs in the same registered name until 15 May 2008; and
- (c) pay the Final Instalment on or by 29 May 2008.

IR holders who receive a prepayment discount are not eligible to receive Bonus Loyalty Shares.

30. IR holders that are entitled to Bonus Loyalty Shares will receive one Bonus Loyalty Share for every 25 qualifying IRs held for the relevant period. The number of Bonus Loyalty Shares allocated to an eligible IR holder will be based on the lowest number of IRs held in the relevant period. Any fractions will be rounded to the nearest whole number in calculating the entitlement to Bonus Loyalty Shares.

31. The IR holder's rights to Bonus Loyalty Shares (Loyalty Rights) will lapse immediately after any of the conditions in paragraph 29 of this Ruling are not satisfied. There are limited exceptions to the requirement to hold the IRs in the same registered name (for example, where the IR holder's name changes on marriage).

32. The Bonus Loyalty Shares will be held by TSCL on trust for the Commonwealth until they are transferred to entitled IR holders. Any Bonus Loyalty Shares which are not ultimately required to satisfy the IR holders will be transferred to the Future Fund after 29 May 2008.

Dividend and Voting Rights

33. Pursuant to clause 16 of the Trust Deed, if Telstra declares a dividend prior to the due date for the Final Instalment in respect of a Sale Share, TSCL will direct Telstra to pay that dividend directly to the IR holder. TSCL will also arrange, as far as permitted by law, that any franking credit, tax offset or other tax benefit shall be conferred on the IR holder.

34. If for any reason a dividend cannot be paid to an IR holder and there are no reasonable steps which can be taken to vest the dividend in the IR holder, TSCL will hold the dividend as a bare trustee for the IR holder. TSCL shall not retain any dividends for its own account.

35. IR holders will be entitled to exercise all of the voting rights of the Sale Shares. This will be achieved by the IR holders directing TSCL on how to vote on the Sale Shares underlying the IRs.

Ruling

Dividends – resident IR holders

36. Telstra dividends paid directly to a resident IR holder will be included in that holder's assessable income.

37. Resident IR holders that are 'qualified persons' will:

- (a) be required to include any franking credits attached to those dividends in assessable income; and
- (b) will be entitled to a tax offset equal to that amount.

38. IR holders will not have 'materially diminished risks of loss and opportunities for gain' in respect of their interest in a Sale Share for the purposes of former subsection 160APHO(3) of the ITAA 1936 by reason of the IR arrangement.

39. The Commissioner has exercised his power under former subsection 160APHL(14) of the ITAA 1936 in respect of the entitlement of an IR holder to the Sale Share.

40. For the purposes of former section 160APHO of the ITAA 1936, an IR holder will be taken to acquire an interest in a Sale Share when the IR is acquired.

41. Where a Sale Share is transferred into the name of a resident IR holder upon payment of the Final Instalment, the IR holder will be taken to have held the shares for the purposes of former section 160APHO of the ITAA 1936 from the time of acquiring the IR.

Dividends – non-resident IR holders

42. A non-resident IR holder will not be liable to withholding tax under section 128B of the ITAA 1936 on a Telstra dividend to the extent that the dividend is franked.

43. Telstra dividends paid directly to a non-resident IR holder will be non-assessable non-exempt income of that IR holder.

CGT – resident and non-resident IR holders

44. Section 106-60 of the ITAA 1997 will apply to the trust arrangements between TSCL and each IR holder.

45. No CGT event happened to the Investor when the Sale Share was transferred from the Commonwealth to TSCL for the purpose of creating the Security Interest.

46. No CGT event will happen to an IR holder who redeems the security by paying the Final Instalment and receiving the Sale Share.

CGT – resident IR holders

47. The Sale Share is acquired by the Investor at the time the Commonwealth accepted the Investor's application to purchase the Sale Share (section 109-5 of the ITAA 1997). This happened on 19 November 2006.

48. An IR holder that is not the original Investor acquires the Sale Share at the time the contract to acquire the IR was entered into, or if there was no contract, when the IR holder became the owner of the Sale Share (section 109-5 of the ITAA 1997).

49. The first element of the cost base or reduced cost base of the Sale Share acquired by the Investor will be the total of the First Instalment paid to acquire the Sale Share and the amount of the Final Instalment (subsections 110-25(2) and 110-55(2) of the ITAA 1997). However the total of the First Instalment paid to acquire the Sale Share and the amount of the Final Instalment will be reduced by the amount that is reasonably attributable to the acquisition of the Loyalty Right (subsection 112-30(1) of the ITAA 1997). The Commissioner considers it reasonable for IR holders that acquired their Sale Share in the Australian retail offer to attribute 25/26^{ths} of the total of the First and Final Instalments to the acquisition of the Sale Share. For example, if the total of the First Instalment and Final Instalment paid to acquire the Sale Share is \$3.60, the first element of the cost base or reduced cost base of the Sale Share will be \$3.46 (that is, 25/26ths of \$3.60).¹ Other methods can be used if the amount attributed to the acquisition of the Loyalty Rights is reasonable.

¹ The figure in this example does not take into account the prepayment discount. The total of the First Instalment and Final Instalment will reflect the amount paid after taking into account any prepayment discount received by the IR holder.

50. For an IR holder that is not the original Investor, the first element of the cost base or reduced cost base of the Sale Share acquired by the IR holder will usually be the total of the amount paid to acquire the IR and the amount paid for the Final Instalment (subsections 110-25(2) and 110-55(2) of the ITAA 1997).

51. CGT event A1 happens when the IR holder sells a Sale Share (section 104-10 of the ITAA 1997). The capital proceeds received by the IR holder from the sale of the Sale Share will include the amount of the Final Instalment (section 116-55 of the ITAA 1997).

52. CGT event A1 happens to the IR holder when TSCL sells the Sale Share to enforce the Commonwealth's Security Interest (section 106-60 of the ITAA 1997). The capital proceeds from the disposal of the Sale Share will be the amount received by TSCL from the sale of the Sale Share (section 116-20 of the ITAA 1997). The second element of the cost base or reduced cost base of the Sale Share will include any incidental costs incurred by TSCL on the disposal of the Sale Share (subsections 110-25(3) and 110-55(2) of the ITAA 1997).

53. The first element of the cost base or reduced cost base of each Loyalty Right will be that part of the total of the First Instalment paid and the Final Instalment that is reasonably attributable to the acquisition of the Loyalty Right (subsection 112-30(1) of the ITAA 1997). The Commissioner accepts it is reasonable for IR holders that acquired their Loyalty Right in the Australian retail offer to attribute $\frac{1}{26}$ th of the total of the First and Final Instalments to the acquisition of the Loyalty Right. For example, if the total of the First Instalment and Final Instalment paid to acquire the Sale Share is \$3.60, the first element of the cost base or reduced cost base of the Loyalty Right will be \$3.46 (that is, $\frac{1}{26}$ of \$3.60 multiplied by 25).²

54. Under subsection 130-45(2) of the ITAA 1997, the IR holder acquires the Bonus Loyalty Share at the time the share is allocated to the IR holder by the Commonwealth.

55. The first element of the cost base or reduced cost base of the Bonus Loyalty Share will be equal to the cost base or reduced cost base of the Loyalty Right at the time the IR holder receives the Bonus Loyalty Share (item 1 in the table in subsection 130-40(6) of the ITAA 1997).

CGT – non-resident IR holders

56. CGT event A1 will happen when a non-resident IR holder disposes of the Sale Share.

57. If CGT event A1 happened before 12 December 2006, the disposal would only have had CGT consequences if the Sale Share has the necessary connection with Australia (section 136-10 of the

² The figure in this example does not take into account the prepayment discount. The total of the First Instalment and Final Instalment will reflect the amount paid after taking into account any prepayment discount received by the IR holder.

ITAA 1997). Until payment of the Final Instalment, a Sale Share would have the necessary connection with Australia, because the non-resident IR holder would have had an interest in a resident trust for CGT purposes (item 4 in the table to section 136-25 of the ITAA 1997).

58. If CGT event A1 happens on or after 12 December 2006, the disposal will only have CGT consequences if the Sale Share is taxable Australian property. A Sale Share will only be taxable Australian property where the non-resident shareholder carries on business through a permanent establishment in Australia (item 3 in the table to section 855-15 of the ITAA 1997).

Sale Shares and Loyalty Rights held on revenue account by resident IR holders

59. Where a resident IR holder acquires Sale Shares and Loyalty Rights under the Australian retail offer as revenue assets, profits from the disposal of the Sale Shares would be included in assessable income under section 6-5 of the ITAA 1997 and losses from the disposal of Sale Shares or from the realisation of Loyalty Rights would be allowable deductions under section 8-1 of the ITAA 1997.

60. Resident IR holders who hold Sale Shares and Loyalty Rights as revenue assets are subject to both the ordinary income provisions and the capital gains tax provisions. The amount of any capital gain from the disposal of a Sale Share would be reduced to the extent that the profit from the disposal of the Sale Share is included in assessable income under section 6-5 of the ITAA 1997 (section 118-20 of the ITAA 1997). Where the disposal of a Sale Share causes the IR holder to cease to own a Loyalty Right and the amount of the loss in respect of the realisation of the Loyalty Right has or can be deducted under section 8-1 of the ITAA 1997, the reduced cost base of the Loyalty Right for CGT purposes would not include the amount of the loss (subsection 110-55(4) of the ITAA 1997).

61. A resident IR holder who holds Sale Shares and Loyalty Rights as revenue assets may allocate the cost of acquiring these assets on a reasonable basis that is consistent with the method of tax accounting adopted in working out the profit or loss arising from the disposal or realisation of these assets.

Tax treaties – non-resident IR holders

62. In instances where a non-resident IR holder holds the Sale Shares as trading stock or as revenue assets, and the non-resident IR holder does not have a permanent establishment in Australia for the purposes of the Permanent Establishment Article of Australia's tax treaties, the Business Profits Articles of Australia's tax treaties will not permit Australia to tax an IR holder that is both a resident of a country with which Australia has a tax treaty and is entitled to receive

the benefits of that tax treaty, on profits from the disposal of the Sale Shares.

63. Subsection 3(11) of the Agreements Act and the provisions specified in the table in Appendix 2 that for present purposes correspond to that subsection, do not apply to the scheme which is the subject of this Ruling.

Commissioner of Taxation

13 June 2007

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Dividends

64. Because TSCL will hold each Sale Share on a separate trust (Separate Trust) for the relevant IR holder all dividends paid on such shares will be included in the net income of each Separate Trust, and the dividends will be taxed in accordance with Division 6 of Part III of the ITAA 1936. Any franking credit attached to the dividend will also be included in the net income of the Separate Trust under subsection 207-35(1) of the ITAA 1997.

65. Each Telstra franked dividend will flow indirectly to the relevant IR holder as described in subsection 207-50(3) of the ITAA 1997. The requirements in that section are satisfied because:

- (a) as the registered owner of the Sale Share, TSCL is entitled to a dividend declared by Telstra in respect of that Sale Share, even though TSCL will direct that a dividend payment is to be made directly to the IR holder;
- (b) the IR holder will be presently entitled to that dividend as a beneficiary of the Separate Trust so that the income will be covered by either paragraph 97(1)(a) or subsection 100(1) of the ITAA 1936; and
- (c) the IR holder's share of the distribution under section 207-55 of the ITAA 1997 will be a positive amount as the IR holder's share of the franked distribution will be the whole dividend pursuant to their dividend entitlement under the Trust Deed.

66. Because the franked distribution will flow indirectly to the IR holder and that IR holder will include the amount of that dividend in assessable income under either section 97 or 100 of the ITAA 1936, the IR holder must also include its share of the franking credit in assessable income under subsection 207-35(3) of the ITAA 1997. Under section 207-45 of the ITAA 1997 the IR holder will be entitled to a tax offset equal to the same amount.

Qualified person rules

67. Subsection 207-150(1) of the ITAA 1997 provides that a beneficiary of a trust estate to whom a franked distribution flows indirectly is not entitled to a franking credit and tax offset if the beneficiary is not a 'qualified person' in relation to the distribution for the purposes of former Division 1A of Part IIIA of the ITAA 1936. Under former Division 1A of Part IIIA of the ITAA 1936, a person is a qualified person if the person is not under an obligation to make a

related payment and satisfies the 'qualification period' in the former subsection 160APHO(2) of the ITAA 1936. Under that subsection the taxpayer must hold its interest in the shares for at least 45 continuous days. Days during which the taxpayer had materially diminished risks of loss or opportunities for gain are not counted for these purposes under former subsection 160APHO(3) of the ITAA 1936.

68. For the purposes of former subsection 160APHO(3) of the ITAA 1936, an IR holder will have 'materially diminished risks of loss or opportunities for gain' in respect of a Sale Share if its delta in respect of that share is less than +0.3 pursuant to the former subsection 160APHM(2) of the ITAA 1936. Because TSCL will hold each Sale Share on trust for the IR holder, the IR holder's delta in respect of the Sale Share must be determined under former section 160APHL of the ITAA 1936. In applying that section, each Separate Trust will be a trust other than a widely held trust because each Separate Trust will not be a widely held trust pursuant to the definition of that term in former section 160APHD of the ITAA 1936.

69. Former subsection 160APHL(1) of the ITAA 1936 provides that if certain requirements are satisfied, former section 160APHL will determine how a taxpayer's interest in a share held through a trust other than a widely held trust is to be calculated. The requirements are satisfied because each Separate Trust will hold the Sale Share, the dividend will be included in the net income of the Trust and the IR holder will include the dividend in its assessable income.

70. Under former section 160APHL(7) of the ITAA 1936 the IR holder's interest in the Sale Share will be a long position with a delta of +1. TSCL as trustee of a Separate Trust will not have any other positions in respect of the Sale Shares so no additional positions will be taken to be a position of an IR holder pursuant to the former subsection 160APHL(8) of the ITAA 1936.

71. However, the position provided for in former subsection 160APHL(7) of the ITAA 1936 will be offset by a short position under former subsection 160APHL(10) of the ITAA 1936 to the extent that an IR holder's interest in each Sale Share held through each Separate Trust is not a fixed interest. To be a fixed interest the IR holder's interest must be a vested and indefeasible interest pursuant to former subsection 160APHL(11) of the ITAA 1936. Having regard to all of the terms and conditions under which the IR holder obtains their interest in the Separate Trust, and in particular having regard to the consequences of the IR holder failing to pay the Final Instalment, it is considered that the IR holder does not have a vested and indefeasible interest in the Sale Share.

72. Under former subsection 160APHL(14) of the ITAA 1936, the Commissioner may determine an interest in a Sale Share to be taken to be vested and indefeasible. The former subsection includes a number of criteria that the Commissioner must have regard to when exercising this power. These criteria include 'any other matter the Commissioner considers relevant'. In the present circumstances and having regard to the underlying purpose of former Division 1A of Part IIIAA of the ITAA 1936, it is considered relevant to also consider the extent to which the IR holder is both entitled to benefit from the economic gains, and bears the economic risks of loss, from variations in the market value of the Sale Shares.

73. The IR holders will bear all risks of loss and opportunities for gain in respect of the Sale Shares. If the IR holder pays the Final Instalment then the IR holder will receive the Sale Share. If the IR holder fails to pay the Final Instalment then TSCL will sell the underlying shares and:

- (a) if the sale proceeds exceed the Final Instalment and costs of default – TSCL will pay the excess to the IR holder; or
- (b) if the sale proceeds are less than the Final Instalment and costs of default – the IR holder will remain liable to pay the shortfall to the Commonwealth.

74. Having regard to all of the criteria set out in former subsection 160APHL(14) of the ITAA 1936, including the risks of losses and opportunities for gain in respect of the Sale Share, the Commissioner has exercised his power to determine that an IR holder is to be taken to have a vested and indefeasible interest in so much of the corpus of the Separate Trust as is comprised by the Sale Share.

75. Therefore, the IR holder will be taken to have a vested and indefeasible interest in the Sale Share for the purposes of former subsection 160APHL(11) of Part IIIAA of the ITAA 1936. Accordingly, the IR holder will have a net position of +1 in respect of each Sale Share held through a Separate Trust. This net position would not constitute 'materially diminished risks of loss or opportunities for gain' for the purposes of former subsection 160APHO(3) of the ITAA 1936.

76. Former subsection 160APHG(3) of the ITAA 1936 provides that where a trust other than a widely held trust acquires a share, each beneficiary of the trust is taken to acquire an interest in the share at that time for the purposes of the holding period rules of former Division 1A of Part IIIAA of the ITAA 1936. As explained above each Separate Trust will be a trust other than a widely held trust. Therefore each IR holder will be taken to acquire and hold an interest in the relevant Sale Share when TSCL acquires and holds the Sale Share. The IR holder's interest in the Sale Share will be 100% because it will be entitled to the entire amount of any dividend paid on that share pursuant to former subsection 160APHL(5) of the ITAA 1936.

77. Similarly, where a Sale Share is subsequently transferred the transferee will become a beneficiary of the Separate Trust and will be taken to acquire an interest in the Sale Share for the purposes of the holding period rules of former Division 1A of Part IIIAA of the ITAA 1936 at that time pursuant to former subsection 160APHG(4) of the ITAA 1936. The transferor will also be taken to dispose of its interest in the share at that time.

78. Former subsection 160APHH(3) of the ITAA 1936 provides that if a taxpayer holds an interest in shares under a trust and the shares are distributed to the taxpayer in satisfaction of the interest in the shares, the taxpayer is taken for the purposes of former Division 1A of Part IIIAA of the ITAA 1936 to have held the shares from the time when the taxpayer acquired the interest in the shares. Accordingly, an IR holder that receives a Sale Share upon payment of the Final Instalment will be taken to have held that share since it acquired the relevant IR for the purposes of the holding period rules of former Division 1A of Part IIIAA of the ITAA 1936.

79. Having regard to all of the terms and conditions described in this Ruling, it is clear that TSCL will hold each Sale Share directly and will not enter into any other positions in respect of the Shares. It will therefore have a delta of +1 in relation to each Sale Share. Accordingly, TSCL as trustee of a Separate Trust will not have materially diminished risks of loss or opportunities to gain in respect of the Sale Shares for the purposes of former Division 1A of Part IIIAA of the ITAA 1936.

Withholding tax – non-resident IR holders

80. Subsection 128A(3) of the ITAA 1936 provides that a beneficiary who is presently entitled to a dividend included in the income of a trust estate shall be deemed to have derived income consisting of that dividend at the time of becoming so entitled. Accordingly, non-resident IR holders will be deemed for the purposes of Division 11A of Part III of the ITAA 1936 to have derived the income that is the dividend, even though the non-resident IR holders will receive the dividend as beneficiaries of each Separate Trust.

81. Subparagraph 128B(3)(ga)(i) of the ITAA 1936 provides that section 128B does not apply to income that consists of the franked part of a dividend. This means that the franked part of a dividend is income that is not subject to withholding tax under subsection 128B(4).

82. Section 128D of the ITAA 1936 provides that income subject to withholding tax, or upon which withholding tax would, but for subparagraph 128B(3)(ga)(i) of the ITAA 1936, be payable, is not assessable income and is not exempt income of a person. Accordingly, under section 128D, Telstra dividends will be non-assessable, non-exempt income of the non-resident IR holders.

Capital gains tax

Section 106-60

83. Until the Final Instalment has been paid the Sale Share will be held by TSCL as security for the Commonwealth. Any actions done by TSCL in relation to the Sale Share, including holding the Sale Share, will be for the purpose of enforcing or giving effect to the security or as redemption of the security. Consequently under section 106-60 of the ITAA 1997, the IR holder will be taken to have done these acts of TSCL for the purpose of enforcing or giving effect to the security.

84. The policy of the CGT provisions, to which section 106-60 of the ITAA 1997 gives effect, is to disregard the effect on the taxpayer's ownership of an asset by the rights of security holders over the relevant asset. Security holders are treated, in effect, as agents of the taxpayer. In this case, the security is given effect by arrangements having the form of a trust. However, for the purpose of the CGT provisions, these arrangements, because they are by way of security, must be treated as if they were no more than a kind of agency.

85. The acts of receiving, holding, and distributing the Sale Shares must therefore be treated as if they were acts of the IR holder. And because all of the relevant dealings between the IR holder and TSCL are also, in effect, deemed to be dealings of the IR holder with himself, which is to say, not to be dealings at all, we consider that the dealings have no CGT consequences. This result conforms with the policy of the law in regard to Security Interest over CGT assets.

Transfer of a Sale Share to create the Security Interest

86. The Investor acquired a Sale Share at the time the Commonwealth accepted the Investor's application form to purchase the Sale Share. That occurred on 19 November 2006. In accordance with the direction of the Investor contained in the Application Form, the Commonwealth transferred the Sale Share to TSCL for the purpose of creating the Security Interest.

87. As the transfer of the Sale Share was done to provide a security to the Commonwealth, no CGT event happened.

Transfer of a Sale Share to redeem the Security Interest

88. Upon payment of the Final Instalment, TSCL will transfer the Sale Share to the IR holder. As the transfer of the Sale Share upon payment of the Final Instalment is done to redeem the security, no CGT event will happen (Taxation Determination TD 98/25).

Date of acquisition of a Sale Share

89. Under section 109-5 of the ITAA 1997, the Sale Share is acquired at the time the contract is entered into for the acquisition of the Sale Share, or if there is no contract, when the taxpayer becomes its owner.

90. Accordingly, the Investor acquires the Sale Share on the acceptance by the Commonwealth of the Investor's application to purchase the Sale Share. That occurred on 19 November 2006.

91. Upon transfer of the Sale Share to TSCL, the Investor received an IR. The IR evidences the IR holder's interest in the Sale Share together with the IR holder's obligation to pay the Final Instalment.

92. Accordingly, when the IR holder disposes of the IR, the IR holder transfers the Sale Share to the purchaser along with the obligation to pay the Final Instalment.

93. Therefore, an IR holder that is not the original Investor acquires the Sale Share at the time the contract to acquire the IR was entered into, or if there was no contract, when the IR holder became the owner of the IR.

Cost base and reduced cost base of a Sale Share

94. Under subsections 110-25(1) and 110-55(1) of the ITAA 1997, the cost base or reduced cost base of the Sale Share consists of five elements.

95. Subsections 110-25(2) and 110-55(2) of the ITAA 1997 state that the first element of the cost base or reduced cost base of a CGT asset is the total of any money paid, or required to be paid, and the market value of any other property given or required to be given in respect of acquiring the asset.

96. Accordingly, the first element of the cost base or reduced cost base of the Sale Share acquired by the Investor will be the total of the First Instalment paid to acquire the Sale Share and the amount of the Final Instalment.

97. However, under subsection 112-30(1) of the ITAA 1997, the first element of the cost base or reduced cost base of the Sale Share will be reduced by the amount that is reasonably attributable to the acquisition of the Loyalty Right. See paragraph 120 of this Ruling onwards for a description of the cost base of the Loyalty Rights.

98. In this instance, the Commissioner considers that $1/26^{\text{th}}$ of the total of the First Instalment and the Final Instalment for IRs acquired under the Australian retail offer is reasonably attributable to the acquisition of the Loyalty Rights. For example, if the total of the First Instalment and Final Instalment paid to acquire the Sale Share is \$3.60, the first element of the cost base or reduced cost base of the Sale Share will be \$3.46 (that is, $25/26^{\text{th}}$ of \$3.60). Alternatively, if the Final Instalment is prepaid so that the total of the First Instalment and Final Instalment paid to acquire the Sale Share might be \$3.30, the first element of the cost base or reduced cost base of the Sale Share will be \$3.17 (that is, $25/26^{\text{th}}$ of \$3.30). However, other methods can be used if the amount attributable to the acquisition of the Loyalty Right is reasonable.

99. For an IR holder that is not the original Investor, the first element of the cost base or reduced cost base of the Sale Share acquired by the IR Holder will be the total of the amount paid to acquire the IR and the amount of the Final Instalment.

100. In addition to the first element of the cost base or reduced cost base, the other elements of the cost base or reduced cost base, as determined under sections 110-25 and 110-55 of the ITAA 1997, may be taken into account in working out the cost base or reduced cost base of the Sale Share.

Sale of a Sale Share

101. Upon transfer of the Sale Share to TSCL, the Investor received an IR. The IR evidences the IR holder's interest in the Sale Share together with the IR holder's obligation to pay the Final Instalment.

102. Accordingly, for CGT purposes when an IR holder transfers an IR, the IR holder is disposing of the Sale Share together with the IR holder's obligation to pay the Final Instalment to the purchaser.

103. CGT event A1 happens when the IR holder sells a Sale Share. The capital gain or capital loss made from the disposal of the IR will be calculated in accordance with subsection 104-10(4) of the ITAA 1997.

104. The IR holder will make a capital gain if the capital proceeds from the disposal of the Sale Share are more than the cost base of the Sale Share. If the capital proceeds are less than the reduced cost base of the Sale Share, the IR holder will make a capital loss.

105. Under section 116-20 of the ITAA 1997, the capital proceeds from the disposal of the Sale Share will be the total of the money and the market value of any property that the IR holder receives or is entitled to receive in respect of CGT event A1 worked out at the time of the event.

106. However, under section 116-55 of the ITAA 1997, the capital proceeds are increased if another entity acquires the CGT asset subject to a liability by way of security over the asset. The capital proceeds are increased by the amount of the liability.

107. Accordingly, as the purchaser assumes the liability to pay the Final Instalment, the capital proceeds received by the IR holder will include the amount of the Final Instalment.

Disposal of a Sale Share by TSCL in a default situation

108. On its face, CGT event A1 happens when TSCL sells the Sale Share to enforce the security or interest of the Commonwealth following the default in payment of the Final Instalment by the IR holder.

109. However, section 106-60 of the ITAA 1997 states that for the purposes of Part 3-1 and Part 3-3 of the ITAA 1997, any act done by an entity in relation to a CGT asset for the purpose of enforcing or giving effect to a security the entity holds over the asset, the act will be taken to have been done by the person who provided the security.

110. As TSCL holds the Sale Share as security for the Final Instalment, any sale of the Sale Share following a default in payment of the Final Instalment will be in order to enforce that security.

111. Accordingly, under section 106-60 of the ITAA 1997, the IR holder will be taken to have disposed of the Sale Share and not TSCL.

112. Consequently, CGT event A1 happens to the IR holder when TSCL sells the Sale Share following a default in payment of the Final Instalment.

113. Under subsection 104-10(4) of the ITAA 1997, the IR holder will make a capital gain if the capital proceeds from the disposal of the Sale Share are more than the cost base of the Sale Share. If the capital proceeds are less than the reduced cost base of the Sale Share, the IR holder will make a capital loss.

114. The capital proceeds from the disposal of the Sale Share will be the amount received by TSCL from the sale of the Sale Share.

115. Under subsections 110-25(3) and 110-55(2) of the ITAA 1997, the second element of the cost base or reduced cost base of the Sale Share will include the incidental costs incurred by TSCL on the sale of the Sale Share.

Necessary connection with Australia or taxable Australian property

116. CGT event A1 will happen when a non-resident IR holder disposes of a Sale Share. However, under section 136-10 of the ITAA 1997, the non-resident IR holder would only have made a capital gain or capital loss if the Sale Share had the necessary connection with Australia and CGT event A1 happened before 12 December 2006.

117. Until payment of the Final Instalment, a Sale Share would have had the necessary connection with Australia, because the non-resident IR holder's interest in that Sale Share was an interest in a resident trust for CGT purposes (item 4 in the table to section 136-25 of the ITAA 1997).

118. Under section 855-10 of the ITAA 1997, if CGT event A1 happens on or after 12 December 2006 the non-resident will only make a capital gain or capital loss if the Sale Share is taxable Australian property. A Sale Share will only be taxable Australian property if the non-resident has used the Sale Share in carrying on a business through a permanent establishment in Australia (item 3 of the table in section 855-15 of the ITAA 1997).

Bonus Loyalty Scheme

119. Under the terms of the Australian retail offer, in addition to acquiring Sale Shares, an Investor also acquired a right to Bonus Loyalty Shares (Loyalty Rights) when the Commonwealth accepted the Investor's offer to purchase Sale Shares on 19 November 2006. These Loyalty Rights are separate CGT assets from the Sale Shares.

120. Under subsection 112-30(1) of the ITAA 1997, the first element of the cost base or reduced cost base of each Loyalty Right acquired on 19 November 2006 is that part of the total of the First Instalment and Final Instalment that is reasonably attributable to the acquisition of the Loyalty Right.

121. In this instance, the Commissioner considers that $1/26^{\text{th}}$ of the total of the First Instalment and the Final Instalment is reasonably attributable to the acquisition of the Loyalty Right. For example, if the total of the First Instalment and Final Instalment paid to acquire the Sale Share is \$3.60, the first element of the cost base or reduced cost base of the Loyalty Right will be \$3.46 (that is, $1/26^{\text{th}}$ of \$3.60 multiplied by 25). Alternatively, if the Final Instalment is prepaid so that the total of the First Instalment and Final Instalment paid to acquire the Sale Share might be \$3.30, the first element of the cost base or reduced cost base of the Loyalty Right will be \$3.17 (that is, $1/26^{\text{th}}$ of \$3.30 multiplied by 25). However, other methods can be used if the amount attributable to the acquisition of the Loyalty Right is reasonable.

122. CGT event C2 in section 104-25 of the ITAA 1997 will happen if a Loyalty Right lapses. Any capital loss made from the lapse of the Loyalty Right will be calculated in accordance with subsection 104-25(3) of the ITAA 1997.

123. A Loyalty Right would lapse if a prepayment discount is received for paying the Final Instalment before the due date, the Final Instalment is not paid on or by 29 May 2008, or the IR is not held in the same registered name until 15 May 2008.

124. An IR holder would not receive any capital proceeds from the lapse of the Loyalty Right. Consequently the IR holder would make a capital loss. The market value substitution rule in subsection 116-30(1) of the ITAA 1997 would not apply. It is accepted that the lapse of the Loyalty Right (in accordance with the Australian Retail Offer rules) constitutes an expiry under subsection 116-30(3) of the ITAA 1997.

Example

125. An IR holder who purchased 1,000 IRs for \$3.60 would acquire 1,000 Sale Shares with a cost base of \$3.46 each and 40 Loyalty Rights with a cost base of \$3.46 each.

126. If 500 Sale Shares are sold for \$2.50, 20 Loyalty Rights will lapse.

127. CGT event C2 will happen on the lapse of the Loyalty Rights. As the IR holder does not receive anything for the lapse of those rights a capital loss of \$69.23 (that is, $20 \times \$3.46$) will be made.

128. CGT event A1 will also happen in respect of the disposal of the 500 Sale Shares. The capital proceeds for each Sale Share will be \$4.10 (the \$2.50 sale price plus \$1.60, being the amount of the obligation to pay the Final Instalment assumed by the purchaser). Therefore, the IR holder will have a capital gain of \$0.64 per Sale Share sold ($\$4.10 - \3.46) and a total capital gain from CGT event A1 of \$319.23 (that is, $500 \times \$0.64$), assuming the CGT discount is not available.

129. The IR holder will therefore have a net capital gain from these transactions of \$250 ($\$319.23 - \69.23).

130. This example assumes that:

- there are no other acquisitions or disposals of Sale Shares by the IR holder; and
- there are no incidental costs associated with the disposal of the 500 Sale Shares.

Note: The figures in this example are only shown to two decimal places. Also the figures in this example do not take into account the prepayment discount. The total of the First Instalment and Final Instalment will reflect the amount paid after taking into account any prepayment discount received by the IR holder.

131. Under subsection 130-40(7) of the ITAA 1997, any capital gain or capital loss made by the IR holder from the exercise of the Loyalty Right will be disregarded.

132. Under subsection 130-45(2) of the ITAA 1997, the IR holder will acquire the Bonus Loyalty Share at the time the share is transferred to the IR holder by TSCL.

133. Under item 1 in the table in subsection 130-40(6) of the ITAA 1997, the first element of the cost base or reduced cost base of the Bonus Loyalty Share will be equal to the cost base or reduced cost base of the Loyalty Right at the time the IR holder acquires the Bonus Loyalty Share.

Sale Shares and Loyalty Rights held on revenue account by resident IR holders

134. Resident IR holders may dispose of, cease to own, or otherwise realise, Sale Shares and Loyalty Rights that are held as revenue assets (section 977-50 of the ITAA 1997). Profits from the disposal or realisation of these assets would be included in assessable income under section 6-5 of the ITAA 1997 and losses would be allowable deductions under section 8-1 of the ITAA 1997.

135. Resident IR holders who hold IRs and Loyalty Rights as revenue assets will be subject to both the ordinary income provisions and the capital gains tax provisions. These IR holders will generally have the amount of any capital gain from the disposal of a Sale Share reduced to the extent that the profit from the disposal of the IR is included in assessable income under section 6-5 of the ITAA 1997 (section 118-20 of the ITAA 1997). Where the disposal of a Sale Share causes the IR holder to cease to own a Loyalty Right and the amount of the loss in respect of the realisation of the Loyalty Right has or can be deducted under section 8-1 of the ITAA 1997, the reduced cost base of the Loyalty Right for CGT purposes would not include the amount of the loss (subsection 110-55(4) of the ITAA 1997).

136. A resident IR holder who holds Sale Shares and Loyalty Rights as revenue assets would have to allocate the cost of acquiring these assets on a basis that is consistent with the method of tax accounting adopted in working out the profit or loss arising from the disposal or realisation of these assets. For example, an individual IR holder who worked out his income on a cash basis, could acquire Sale Shares and Loyalty Rights for the purpose of profit making by sale and dispose of these assets before paying the Final Instalment. In these circumstances the IR holder would calculate his profit or loss in respect of the disposal of the Sale Shares as the difference between the cash received from the disposal less 25/26ths of the cash paid as the First Instalment (assuming no other transaction costs). The IR holder would also claim a deduction for a loss in respect of the lapse of the Loyalty Right, being an amount equal to 1/26th of the First Instalment. A taxpayer who calculated income on an

accruals basis could recognise the obligation to pay the Final Instalment as a cost of acquiring the Sale Share and Loyalty Right, but would also recognise the defeasance of that obligation upon the disposal of the Sale Share as part of the consideration received.

Effect of tax treaties on trading stock and revenue account gains/losses

137. This section explains the effect of the Business Profits Articles of Australia's tax treaties in instances where the IRs are trading stock or revenue assets in the hands of the non-resident IR holder. It does not deal with the effect of Australia's tax treaties in other situations.

138. Australia's tax treaties allocate source and residence country taxing rights in respect of the profits of an enterprise.

139. By way of an example, Article 7(1) of Schedule 1 to the Agreements Act (the 2003 UK Convention) (the Business Profits Article) states as follows:

The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated in that other State. If the enterprise carries on business in that manner, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

140. Each of Australia's other tax treaties has a similar article which limits the right of one Contracting State to tax the business profits of enterprises that are residents of the other Contracting State.

141. The Permanent Establishment Articles of each of Australia's tax treaties, states the meaning of 'permanent establishment' is for the purposes of the tax treaty, in particular the Business Profits Article. The Permanent Establishment Article is supplemented by provisions such as subsection 3(11) of the Agreements Act or equivalent provisions in Australia's tax treaties (see paragraphs 153 to 155 of this Ruling).

142. The exact wording of the Business Profits Article may vary in some tax treaties.³ Nevertheless, the interpretation provided in this class ruling will apply in respect of all of the Business Profits Articles of Australia's tax treaties.

143. In *Thiel v. Federal Commissioner of Taxation*,⁴ the High Court held that 'profits of an enterprise' in Article 7 of the Swiss tax treaty has to be given a wide meaning, not being limited just to profits derived from the carrying on of any business, but to also include any

³ Most of the Business Profits Articles refer to 'profits of an enterprise' but the US Convention refers to 'business profits of an enterprise', the Japanese Agreement refers to 'industrial or commercial profits' and the Malaysian Agreement refers to 'income or profits of an enterprise'.

⁴ (1990) 64 ALJR 516; (1990) 94 ALR 647; (1990) 90 ATC 4717; (1990) 21 ATR 531; (1990) 171 CLR 338.

profit of a business nature or commercial character, or profit from an adventure in the nature of trade.

144. Accordingly, the term 'enterprise' includes a business activity together with an isolated commercial activity, even if the activity does not amount to a business.⁵

145. In relation to trading stock, for present purposes, the term is defined in section 70-10 of the ITAA 1997 to include:

anything produced, manufactured or acquired that is held for purposes of manufacture, sale or exchange in the ordinary course of a business.

146. Given the reference to 'in the ordinary course of business' in this definition, the thing that is produced, manufactured or acquired and held for the relevant purpose must be so held in the context of the holder of the trading stock conducting a business. Therefore, profits from the sale of trading stock are 'profits of an enterprise' for the purposes of the relevant Business Profits Article.

147. In relation to 'revenue assets', section 977-50 of the ITAA 1997 provides that a CGT asset (as defined in section 108-5 of the ITAA 1997) is a revenue asset only if:

- the profit or loss on the disposal of the asset would be taken into account in calculating assessable income or tax loss other than as a capital gain or loss; and
- the asset is neither trading stock nor a depreciating asset.

148. Accordingly, for a non-resident IR holder, an IR will be a revenue asset where any profit on the disposal of the IR is ordinary income of the IR holder and included in their assessable income under section 6-5 of the ITAA 1997.

149. Judicial authorities have established that the concept of ordinary income includes:

- (a) 'a profit or gain made in the ordinary course of carrying on a business'; and
- (b) receipts from 'an isolated business operation or commercial transaction ... so long as the taxpayer entered into the transaction with the intention or purpose of making a relevant profit or gain from the transaction'.⁶

⁵ The High Court in *Thiel*, supra held that an activity, as well as a framework within which activities are engaged in may constitute an 'enterprise' for the purposes of the tax treaty.

⁶ For example, *FC of T v. Myer Emporium Limited* (1987) 61 ALJR 270; (1987) 71 ALR 28; (1987) 87 ATC 4363; (1987) 18 ATR 693; (1987) 163 CLR 199.

150. Thus, these judicial authorities have established that, if the sale of an asset is an act done in carrying on a business or carrying out a business operation or commercial transaction, then the profit arising on the sale will be of an income character.⁷ Such an asset will be a revenue asset and profits from the disposal of a revenue asset will be 'profits of an enterprise' for the purposes of the Business Profits Articles.

151. Therefore, profits made on the disposal of IRs held by a non-resident IR holder as either trading stock or revenue assets are 'profits of an enterprise' for the purposes of the Business Profits Article in each of Australia's tax treaties.

152. Accordingly, provided that the non-resident IR holder does not have a permanent establishment in Australia as defined in each of Australia's tax treaties, the relevant Business Profits Article does not permit Australia to tax the IR holder on profits realised on the disposal of IRs in instances where:

- the IRs are held as trading stock or as revenue assets; and
- the IR holder is a resident of a country with whom Australia has entered into a tax treaty and is entitled to claim the benefits of the relevant tax treaty.

Subsection 3(11) and equivalent treaty provisions

153. Even if the non-resident IR holder does not carry on business in Australia through a permanent establishment situated in Australia for the purposes of the Permanent Establishment Article in each of Australia's tax treaties, subsection 3(11) of the Agreements Act (or corresponding provisions in the Business Profits Article of, or Protocols or notes to, Australia's tax treaties) must also be considered. Where such provisions have application, a non-resident beneficiary of a trust is, amongst other things, deemed to have a permanent establishment in Australia.

154. Subsection 3(11) of the Agreements Act provides that, where:

- a trust beneficiary who is a resident of a Treaty Country is presently entitled to a share of the income of a trust estate derived from the carrying on by the trustee in Australia of a business through a permanent establishment in Australia; and
- under the tax treaty the income is to be dealt with in accordance with the Business Profits Article,

⁷ Refer to *Californian Copper Syndicate (Limited and Reduced) v. Harris* (1904) 5 TC 159 and *London Australia Investment Co Ltd v. Federal Commissioner of Taxation* 7 ATR 757.

then for the purposes of determining whether the beneficiary's share of the income may be taxed in Australia in accordance with the business profits article:

- the beneficiary shall be deemed to carry on in Australia, through a permanent establishment in Australia, the business carried on in Australia by the trustee; and
- the beneficiary's share of the income shall be deemed to be attributable to that permanent establishment.

155. Subsection 3(11) of the Agreements Act applies only in relation to the tax treaties entered into before 19 October 1984. However, the provisions or notes that, for present purposes, correspond with subsection 3(11) apply to the tax treaties entered into after that date. The table in Appendix 2 of this Ruling sets out the treaties to which subsection 3(11) applies and those treaties, protocols and notes that contain provisions corresponding to subsection 3(11).

156. Whether the holding of each Sale Share and the receipt of Telstra dividends by each Separate Trust constitutes the carrying on of a business is a question of fact and degree to be determined on balance according to the facts and circumstances of each case.⁸

157. TSCL will merely hold the Sale Shares as security pending receipt of the Final Instalment and will direct Telstra to pay any dividend to the IR holder. It will be a passive holder of the Sale Share(s) not setting out to make a profit from that holding. Given the nature of the activities of TSCL⁹ and the lack of a profit-making motive,¹⁰ the Commissioner considers that the TSCL is not conducting a business.

158. Accordingly, neither subsection 3(11) of the Agreements Act nor the equivalent articles or notes apply to the non-resident IR holders because, for the purposes of that subsection, the income of each Separate Trust (that is, the Telstra dividends) is not derived from the carrying on by TSCL of a business.

⁸ In *Ferguson v. Commissioner of Taxation* (Cth) (1979) 26 ALR 307; (1979) 79 ATC 4261 at 471; (1979) 9 ATR 873 at 884; (1979) 37 FLR 310, it was considered that the question of whether a taxpayer's activities should be characterised as a business is primarily a matter of general impression and degree.

⁹ Brennan J in *Inglis v. FC of T* 80 ATC 4001 at 4004-4005; (1979) 10 ATR 493 at 496-497, stated that 'The carrying on of a business is not a matter merely of intention. It is a matter of activity. ... At the end of the day, the extent of activity determines whether the business is being carried on. That is a question of fact and degree.'

¹⁰ The carrying on of a business is usually such that the activities are '... engaged in for the purpose of profit on a continuous and repetitive basis' per Mason J in *Hope v. Bathurst City Council* (1980) 80 ATC 4386 at 4390; (1980) 144 CLR 1 at 8-9. Subject to all the circumstances of a case, where an overall profit motive appears absent and the activity does not look like it will ever produce a profit, it is unlikely that the activity will amount to a business (see paragraph 17 of Taxation Ruling TR 97/11).

Appendix 2 – Table of provisions corresponding to subsection 3(11) of the *International Tax Agreements Act 1953*

159. The following is a detailed tax treaty table for this Ruling:

Schedule to the Agreement Act	Treaty Country	Subsection 3(11) applies?	Article equivalent to subsection 3(11)
1	UK	No	Paragraph 3 of the Notes to the 2003 UK Convention
2	US	Yes	7(9)
3	Canada	Yes	7(8)
4	NZ	No	7(7)
5	Singapore	Yes	5(8)
6	Japan	Yes	none
9	Germany	Yes	none
10	Netherlands	Yes	none
11	France	Yes	none
13	Belgium	Yes	none
14	Philippines	Yes	none
15	Switzerland	Yes	none
16	Malaysia	Yes	7(8)
17	Sweden	Yes	none
18	Denmark	Yes	none
20	Ireland	Yes	none
21	Italy	Yes	none
22	Korea	Yes	none
23	Norway	Yes	none
24	Malta	Yes	none
25	Finland	Yes	none
27	Austria	No	7(9)
28	China	No	7(9)
29	Papua New Guinea	No	7(8)
30	Thailand	No	7(8)
31	Sri Lanka	No	7(9)
32	Fiji	No	7(8)
33	Hungary	No	7(9)
34	Kiribati	No	7(8)
35	India	No	7(9)
36	Poland	No	7(8)
37	Indonesia	No	7(8)
38	Vietnam	No	7(8)
39	Spain	No	7(8)
40	Czechoslovakia	No	7(8)

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41	Taipei	No	7(8)
42	South Africa	No	7(8)
43	Slovak Republic	No	7(8)
44	Argentina	No	7(8)
45	Romania	No	7(8)
46	Russia	No	Article 5(c) of the Protocol
47	Mexico	No	Article 2 of the Protocol

Appendix 3 – Detailed contents list

160. The following is a detailed contents list for this Ruling:

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