TR 2007/D8 - Income tax: application of the transferor trust and controlled foreign company measures where property or services are transferred to a non-resident company owned by a non-resident trustee

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Draft Taxation Ruling

Income tax: application of the transferor trust and controlled foreign company measures where property or services are transferred to a non-resident company owned by a non-resident trustee

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This publication is a draft for public comment. It represents the Commissioner's preliminary view about the way in which a relevant taxation 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.

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What this Ruling is about

Class of entities

1. This draft Ruling applies to an Australian resident entity that transfers property or services to a non-resident company that is wholly or partly owned directly or indirectly by a non-resident trustee.

Scheme

2. The draft Ruling deals with situations where the transfer of property or services by a resident entity to a non-resident company that is wholly or partly owned directly or indirectly by a non-resident trustee falls for consideration under Division 6AAA of Part III (the transferor trust provisions) or Part X (controlled foreign company (CFC) provisions) of the *Income Tax Assessment Act 1936* (the ITAA 1936).[1]

[1] All subsequent legislative references in this draft Ruling are to the ITAA 1936 unless otherwise stated.

Background

3. An objective of the transferor trust provisions is to set out rules relating to 'an accruals system of taxation of certain non-resident trust estates.[2] A key requirement under these provisions is determining whether an Australian resident entity has transferred property or services to the trust estate at a time before or during the entity's current year of income.[3] Whilst for these purposes 'transfer' is inclusively defined at section 102AAB, section 102AAJ further clarifies the meaning of the expression 'transfer of property or services' in relation to the application of Division 6AAA'.[4] Similar requirements also arise under the CFC provisions when ascertaining whether a trust estate is a controlled foreign trust and the range of transfers of property and services to a non-resident trust estate that fall within these provisions is essentially the same as in the transferor trust provisions.

4. Accordingly, the draft Ruling discusses the interpretation and application of subsections 102AAJ(3) and 344(3), the equivalent provision in the CFC rules. It examines whether the transfer of property or services by an Australian resident entity to a non-resident company that is wholly or partially owned by a non-resident trustee constitutes property or services 'applied for the benefit of' the trustee. It also examines situations where the trustee owns the company indirectly through a chain of entities. The draft Ruling does not deal with transfers of property or services other than those by an Australian resident entity to a non-resident company that is wholly or partly owned, either directly or indirectly, by a non-resident trustee.

5. The draft Ruling then examines the circumstances where the tests are satisfied for the Commissioner to exercise the relevant discretions when applying the relevant transferor trust and CFC provisions.

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[2] See paragraph 102AAA(c).
[3] Refer to subsubparagraph 102AAT(1)(a)(i)(C) in respect of discretionary trusts and similar requirement at subsubparagraph 102AAT(1)(a)(ii)(B) in respect of non-discretionary trusts.
[4] Explanatory Memorandum to the Taxation Laws Amendment (Foreign Income) Bill 1990 (House of Representatives) page 76.

6. The transferor trust and controlled foreign trust (CFT) rules only operate to attribute income to an Australian resident entity where that resident entity meets all the requirements relating to the applicable provisions of section 102AAT,[5] and sections 346 to 348, respectively. For example, subparagraph 102AAT(1)(a)(i) requires all of subsubparagraphs (A) to (F) to be met before the transferor will be an attributable taxpayer. Under the applicable provisions, transfers of property or services do not lead to the application of the transferor trust or CFC provisions where they are made to:

(i) a discretionary trust estate in the course of carrying on a business and satisfy the relevant arm's length transaction requirements;[6]

(ii) a discretionary trust estate not in the course of carrying on a business, but are arm's length transactions and the transferor is not in a position to control the trust estate;[7] or

(iii) a non-discretionary trust estate for arm's length consideration.[8]

7. The draft Ruling does not deal with any transfer pricing aspects of the transfer of property or services.

Ruling

8. A transfer of property or services by an Australian resident entity to a non-resident company that is wholly or partly owned by a non-resident trustee is considered to be property or services applied for the benefit of the non-resident trustee.

9. Accordingly, the transfer will be treated as having been made by the resident entity to the non-resident trustee under subsection 102AAJ(3) and subsection 344(3).

Attribution to Australian resident entities – Division 6AAA

10. If the other requirements of the transferor trust provisions are satisfied, the resident entity will be an attributable taxpayer in respect of the non-resident trust estate and will be required to include the whole of the attributable income of the trust estate in its assessable income.

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[5] Subparagraph 102AAT(1)(a)(i) contains the requirements for discretionary trust estates, and subparagraph 102AAT(1)(a)(ii) deals with the requirements for non-discretionary trust estates.
[6] Refer to subsubparagraph 102AAT(1)(a)(i)(D), section 346 and subparagraph 347(1)(a)(ii).
[7] Refer to subsubparagraph 102AAT(1)(a)(i)(E) and subparagraph 347(1)(a)(iii).
[8] Refer to subsubparagraph 102AAT(1)(a)(ii)(C) and paragraph 348(1)(b).

11. Where there are no other assets held by the non-resident trustee and there is no distribution from the non-resident company, then provided there is sufficient information to determine that the non-resident trust estate has no attributable income, Division 6AAA will not operate to include any amount in the assessable income of the resident entity.

12. Where other entities have transferred property or services to the non-resident trust estate concerned (including deemed transfers) and the resident entity provides the necessary information, the Commissioner will exercise his discretion provided under subsection 102AAZD(3) to reduce any amount to be included in that resident entity's assessable income having regard to the extent to which an amount is attributable to the property or services transferred by the resident entity. The necessary information will include documents and records relating to all the relevant transfers (including deemed transfers) showing the identities of all the transferors, dates and details of their transfers and the percentage of attributable income that is attributable to those transfers.

Attribution to Australian resident entities – Part X

13. If the other requirements of the CFC provisions are satisfied, the non-resident trust estate will be a CFT and the non-resident company will be a CFC. The resident entity will be an attributable taxpayer in respect of the CFC and will be required to include in its assessable income its share of the CFC's attributable amount in accordance with its attribution percentage. Given that the taxpayer is deemed to have a 100% attribution tracing interest in the CFT, the attributable amount could be equivalent to the whole of the CFT's share of the CFCs attributable income.

14. However, the Commissioner will exercise discretion to reduce the attribution percentage in the CFC to reflect only the resident entity's share of attributable income from the CFC if the information and other requirements of subsection 362(3) are met. This will include the provision of documents and records relating to all the relevant transfers (including deemed transfers) showing the identities of the other transferors, dates and details of their transfers and the percentage of attributable income that is attributable to those transfers.

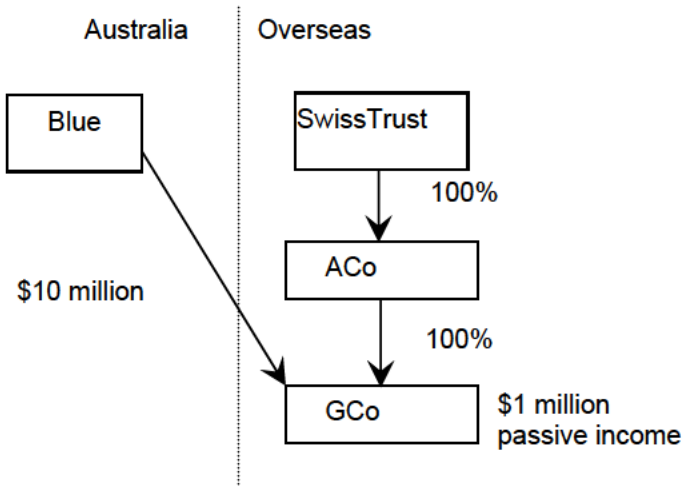
Effect of distributions made by CFC's to non-resident trusts on calculating the non-resident trusts attributable income

15. Where a dividend distribution is subsequently made to the non-resident trust estate from a CFC, that amount will not be included in the attributable income of the non-resident trust pursuant to Division 6AAA if the resident entity has already had an amount included in its assessable income in respect of the attributable income of the CFC under the CFC provisions (subparagraph 102AAU(1)(c)(vii)).

Examples

Example 1

16. Blue, an Australian resident taxpayer establishes a non-resident discretionary trust, 'SwissTrust', in Switzerland, on 1 January 2005. The terms of the trust deed have the effect that, apart from a named charitable institution, only members of Blue's family can be added as beneficiaries. SwissTrust owns 100% of the shares in 'ACo' which owns 100% of the shares in 'GCo', both companies being incorporated in Guernsey. SwissTrust does not have any other assets. On 1 April 2005, Blue gives $10 million to GCo for nil consideration. GCo derives $1 million of passive income during the relevant income year but at no stage does it declare any dividends.

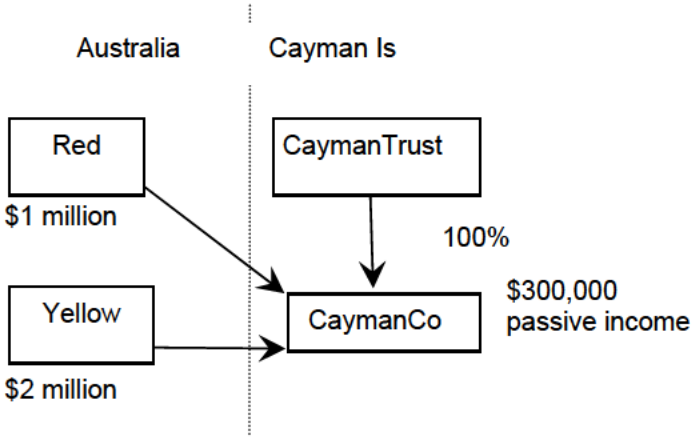


17. Even though the transfer has not been made directly to a non-resident trust estate, the transfer of $10 million by Blue to GCo for nil consideration is applied for the benefit of SwissTrust so that subsection 102AAJ(3) applies to treat the $10 million as having been transferred by Blue to SwissTrust for the purposes of the transferor trust provisions. The implications for Blue of this outcome are considered at paragraphs 66 to 69 of this draft Ruling.

18. The fact that the transfer to GCo for nil consideration is applied for the benefit of SwissTrust also means that subsection 344(3) applies to treat the $10 million to have been transferred by Blue to SwissTrust for the purposes of ascertaining whether SwissTrust is a CFT under the CFC provisions. The implications for Blue of this outcome are also considered at paragraphs 66 to 69 of this draft Ruling.

Example 2

19. Red and Yellow, two Australian resident entities, establish 'CaymanTrust', a non-resident discretionary trust in the Cayman Islands on 1 April 1988. CaymanTrust sets up 'CaymanCo', a 100% owned foreign company in the Cayman Islands on 1 May 1988. Red provides a $1 million interest free loan to CaymanCo on 20 December 1990, and Yellow, provides a $2 million interest free loan to CaymanCo on 31 December 1990. CaymanCo derives $300,000 passive income in the relevant year. However, there is no distribution from CaymanCo to Cayman Trust.



20. As the transfer by Red of $1 million and the transfer by Yellow of $2 million involves interest free loans, they are applied for the benefit of CaymanTrust, and subsection 102AAJ(3) will apply to treat the $1 million and $2 million to have been transferred by Red and Yellow respectively to CaymanTrust for the purposes of the transferor trust provisions. The implications for Red and Yellow of this outcome are considered at paragraphs 79 to 84 of this draft Ruling.

21. As the transfers by Red of $1 million and Yellow of $2 million to CaymanCo are applied for the benefit of CaymanTrust, subsection 344(3) will also apply to treat the $1 million and $2 million to have been transferred by Red and Yellow respectively to CaymanTrust for the purposes of establishing whether CaymanTrust is a CFT under the CFC provisions. The implications for Red and Yellow of this outcome are also considered at paragraphs 79 to 84 of this draft Ruling.

Date of effect

22. It is proposed that when the final Ruling is issued, the Ruling will apply to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Commissioner of Taxation
22 August 2007

Appendix 1 – Explanation

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.

Background and objectives of the transferor trust measures

23. The transferor trust measures were designed to attribute income of non-resident trust estates in low-tax countries to Australian residents who have, either directly or indirectly transferred property or services to the trusts.[9] These measures were enacted to redress a gap in the law that would enable the accruals tax measures to be easily avoided if Australia was not to tax the foreign sourced income of non-resident trusts until it was distributed to resident beneficiaries. In particular, it was considered that a non-resident trust used to that effect was seldom more than a vehicle for the indefinite deferral or avoidance of Australian tax, the tax benefits of which far outweighed any commercial advantage that could be said to be available by the use of such arrangements.[10]

24. The transferor trust measures apply to all forms of trusts for taxation law purposes, including express, constructive, implied or resulting trusts.[11] The provisions effectively tax the income of a non-resident trust estate at the time it is derived. Rather than targeting the beneficiaries, the provisions principally target Australian residents that transfer property or services to the non-resident trust estate, subject to certain conditions.

25. A transfer of property or services to a non-resident trust estate covers both a transfer of property to create a trust[12] as well as ongoing transfers. It also includes situations where property or services are applied for the benefit of the non-resident trust estate or in accordance with the directions of the trust estate (subsection 102AAJ(3)).

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[9] Taxation Laws Amendment (Foreign Income) Bill 1990 Second Reading Speech, 13 September 1990.

[10] See in particular 'Taxation of foreign source income' an Information Paper, April 1989, paragraph 10.5, page 119.

[11] However, the transferor trust measures do not apply to certain transfers to a trust estate made by the trustee of a deceased estate (section 102AAL). Nor will interest under subsection 102AAM(1B) apply to certain distributions that are attributable to income or profits of a deceased estate.

[12] Subsection 102AAJ(1).

Background and objectives of the controlled foreign company (CFC) measures

26. The CFC provisions were introduced to provide an accruals system of taxing foreign source income that has been derived in low-tax countries by Australian controlled entities and has been accumulated offshore.[13] The broad aim of the CFC measures is to attribute to Australian residents income, other than active business income, derived by foreign companies that are controlled by Australian residents other than in the case of a company that is subject to a tax system comparable to Australia's or is predominantly engaged in active business.[14]

27. The CFC provisions include tracing provisions for underlying interests which are primarily relevant to determining whether a foreign company, owned through a series of other foreign entities is a CFC.[15] In relation to tracing through non-resident trust estates these provisions concern ascertaining whether the trust estate is a CFT for these purposes.

28. The sections dealing with CFTs were also designed to deal with arrangements that might otherwise have avoided the accruals provisions by hampering the establishment of control or ownership of a trust and potentially precluding the use of Part X to access the underlying CFCs. For example, they address arrangements where minimal assets are directly held by the offshore trusts themselves. The trusts are simply holding entities for the underlying entities (predominantly companies) which held all the income producing assets and undertook all the offshore activities.

29. Sections 344 and 345 ensure that the range of transfers of property and services to a non-resident trust estate that fall within Part X is essentially the same as that for Division 6AAA of Part III.[16] In this regard, subsection 344(3) mirrors subsection 102AAJ(3).

References to 'trustee', 'trust estate', 'trust' and 'entity'

30. The transferor trust and CFC provisions contain references to the terms 'trustee', 'trust estate' and 'trust'. For the purposes of this Ruling, the term 'trustee' is used where the reference is to the ownership of property or services or the term is specifically used in the relevant provisions. In all other cases, the term 'trust estate' is used and includes references to a trust.

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[13] Taxation Laws Amendment (Foreign Income) Bill 1990 Second Reading Speech, 13 September 1990.
[14] Supra.
[15] Pages 222 to 225 of the Explanatory Memorandum to the Taxation Laws Amendment (Foreign Income) Bill 1990 (House of Representatives).
[16] Page 228 of the Explanatory Memorandum to the Taxation Laws Amendment (Foreign Income) Bill 1990 (House of Representatives).

31. Both subsections 102AAJ(3) and 344(3) refer to the term 'entity'. In relation to the matters addressed in this draft Ruling, it means a person in the capacity of trustee.[17] It is considered that property or services can be applied for the benefit of a trustee as the transfer would benefit the trustee in its capacity as trustee, that is, as the legal owner of the trust estate.

Meaning of 'applied for the benefit of'

32. A key consideration for this ruling is the interpretation of the phrase 'applied for the benefit of' contained in subsections 102AAJ(3) and 344(3).

33. In respect of subsection 102AAJ(3), the Explanatory Memorandum to the Taxation Laws Amendment (Foreign Income) Bill 1990[18] provides no elaboration on the meaning of 'applied for the benefit of'. In respect of subsection 344(3), the Explanatory Memorandum[19] merely indicates that subsection 344(4), which refers to the use of property or services to discharge a debt of an entity, is an example of the application of subsection 344(3) and does not limit the application of that subsection.

34. The expression 'for the benefit of' has been considered in the context of United Kingdom tax legislation where it has been held in *Dale v. Mitcalfe*[20] that:

> Now the term 'for the benefit of' I do not think is a phrase of art at all, but a general phrase which has to be interpreted in view of the general nature of the subject matter which is being dealt with by the section.

35. For present purposes, the subject matter that subsections 102AAJ(3) and 344(3) deal with is to address the avoidance of Australian tax through the transfer of property or services as an element of complex structures that might otherwise avoid control identification and tracing mechanisms. It is reasonable that in this context 'for the benefit of' would need to have a wide meaning. Otherwise, the anti-avoidance provisions would be rendered ineffective by merely creating a separate entity to hold the property or receive the services.

[17] Refer to sections 102AAB and 317, definition of 'entity'.
[18] At page 76.
[19] At page 229.
[20] 13 TC 41 at 56

36. Property or services that are transferred for nil or less than full consideration to a non-resident company owned by a non-resident trustee are applied for the benefit of the trustee as they result in an improvement in the material situation of the trustee. Property or services that are transferred for full consideration to a non-resident company owned by a non-resident trustee are also applied for the benefit of the trustee, as the effect of the transfer is that the property or services come within the control or influence of the trustee. This is consistent with the wide scope of the phrase 'applied for the benefit of', particularly in the context of anti-avoidance measures aimed at addressing complex structures that might otherwise avoid control identification and tracing mechanisms.

37. The transfer is also considered to be applied for the benefit of the trustee because the trustee, through its ownership of the recipient entity, is now in the position to benefit, as trustee, from any income or gains that arise in respect of the property or services. This is also consistent with the wide scope of the phrase, particularly as the transferor trust and CFC measures are aimed at ensuring income or gains from assets do not escape Australian tax by being held through complex offshore structures in low or nil tax jurisdictions.

38. A transfer would be applied for the benefit of the non-resident trustee irrespective of the proportion of the trustee's shareholding in the company. The trustee does not need to have a majority interest, or even a non-portfolio interest in the company.[21] Nor does the fact that the shares are held through a series of intermediaries lessen the fact that the transfer is applied for the benefit of the trustee.

39. A further consideration is the influence of the word 'applied'. In *Max Factor & Co Inc. v. FC of T*[22] the High Court when considering the phrase 'applied to his own use' stated that:

> The word 'applied' in no way contracts the sense of the phrase in which it appears; that word simply means 'devoted to' or 'employed for the special purpose of' (*Williams v. Papworth* (1900) AC 563 at p.567, cited in *Davies v. Perpetual Trustees Executors and Agency Company of Tasmania Ltd* (1935) 52 CLR 604 at p.608). The phrase 'applied to his own use' is of broad import, and is equivalent in meaning to 'employed for his own purposes'.

40. It is arguable that the same proposition would apply to the term 'applied' in the phrase 'applied for the benefit of' and that it would not impact on the broad meaning of the phrase.

41. The phrase 'applied for the benefit of' also indicates an objective approach to determining whether the property or services produce a benefit for the non-resident trustee or the non-resident trust estate. Therefore, there does not appear to be any scope for arguing that there needs to be an intention to benefit the non-resident trustee before subsections 102AAJ(3) and 344(3) would apply.

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[21] However, the CFC measures would not apply where other levels of control and ownership interests are not met, for example, see Example 3(c).
[22] 71 ATC 4136 at 4138; 124 CLR 353 at 362.

42. A final consideration is whether there is a policy reason to limit the broad nature of the phrase 'applied for the benefit of'. In fact as the policy intent of the provisions is to prevent tax avoidance by the use of non-resident trusts, it points strongly to the opposite view: that the phrase needs to be broad to operate effectively.

43. Given the broad scope of the phrase 'applied for the benefit of' and the policy intent of the provisions of addressing tax avoidance and deferral using non-resident trusts, any transfer of property or services to an entity held by a non-resident trustee is applied 'for the benefit of' that trustee.

44. Thus, where property or services are transferred to a non-resident company that is owned wholly or partially, and directly or indirectly by the trustee of a non-resident trust estate, then the transfer is applied to the benefit of the trust estate. Subsections 102AAJ(3) and 344(3) apply to deem that the transfer is taken to have been made to the trust estate for the purposes of Division 6AAA and Part X respectively.

Implications of transfer

45. Subsections 102AAJ(3) and 344(3) are merely deeming provisions for the purposes of determining whether a transfer of property or services has taken place where that requirement arises under the transferor trust and CFC provisions. Whether or not the transferor trust and CFC provisions apply in respect of the transfer still needs to be determined in accordance with the specific requirements of those provisions.

Subsection 102AAJ(3)

46. The effect of a transfer of property or services within subsection 102AAJ(3) is that it provides one of the preconditions for the accruals provisions under Division 6AAA to potentially attribute income to the Australian resident transferor in respect of the non-resident trust estate.

47. Subsection 102AAJ(3) operates to deem the transfer of property and services to the non-resident company to be a transfer to the non-resident trust estate for the purposes of determining whether the resident entity transferor is an attributable taxpayer under section 102AAT. However, the resident entity will only be an attributable taxpayer if the transferor satisfies all the relevant conditions contained within section 102AAT. For example, a resident entity will not constitute an eligible transferor where the transfer is to a non-discretionary trust estate for arm's length consideration. Nor will a resident entity constitute an eligible transferor where the transfer is made to a discretionary trust estate in the course of carrying on a business and satisfies the relevant arm's length transaction requirements, or is not made in the course of carrying on a business but is an arm's length transaction and the transferor is not in a position to control the trust estate.[23]

48. If the resident entity is an attributable taxpayer, then the whole of the attributable income of the non-resident trust estate would be included in its assessable income (section 102AAZD).

No distribution by the non-resident company

49. In most situations involving a deemed transfer of property or services to a non-resident trust estate, it has been found that there are minimal assets directly held by the trust estate (other than shares held either in the underlying company, or in an intermediate holding company) as most assets will be held by the underlying company. Where there is sufficient information to determine that the non-resident trust estate has no attributable income, Division 6AAA will not operate to include any amount in the assessable income of the resident entity.

50. However, where the Australian entity could not reasonably be expected to obtain information required to determine the attributable income of the non-resident trust estate, then subsection 102AAZD(4) will apply to include an amount in the entity's assessable income based on a deemed rate of return on the value of the transfer.

Distribution by the non-resident company

51. Where a dividend distribution is made to the non-resident trust estate from a non-resident company, that amount may be attributable income of the trust estate and therefore be included in the assessable income of the resident entity. However, it will not be included in the assessable income of the resident entity if the non-resident company is a CFC, and a resident entity has already had an amount included in its assessable income in respect of the attributable income of the CFC under the CFC provisions (subparagraph 102AAU(1)(c)(vii)).

[23] Refer to subsubparagraphs 102AAT(1)(a)(i)(D) and 102AAT(1)(a)(i)(E).

Other transferors

52. A resident entity that has transferred property or services to a non-resident company which is wholly or partly owned, directly or indirectly by a non-resident trust estate is attributed the full amount of the trust estate's attributable income, notwithstanding that there may be other attributable taxpayers in relation to the trust estate. However, the Commissioner may reduce the amount included in the taxpayer's assessable income to reflect the attributable income referrable to the property transferred by the transferor, provided the resident entity provides the necessary information to the Commissioner (subsection 102AAZD(3)).

53. This is consistent with the intention of the provisions to assess the whole of the attributable income of the trust to each transferor of value in relation to that trust. To ensure that the measure does not operate harshly, provision was made for the Commissioner to apportion the tax payable to the transferors on the basis of the income attributable to the property transferred by each transferor if sufficient information is provided to permit apportionment.[24]

54. Where other entities have transferred property or services to the non-resident trust estate concerned, and the resident entity provides the necessary information, the Commissioner will reduce the amount to be included in the resident entity's assessable income having regard to the extent to which the attributable income is attributable to the property or services transferred by the entity.

Information requirements

55. For guidance, it can be assumed that the necessary information required by the Commissioner will include the information outlined in paragraph 63 of this draft Ruling.

Subsection 344(3)

56. The effect of a transfer of property or services being caught under subsection 344(3) is that it triggers the CFC provisions to potentially attribute income to the Australian resident transferor in respect of the non-resident company, or any other entities held by the non-resident trust estate.

[24] 'Taxation of foreign source income' an Information Paper, April 1989, paragraphs 10.43 and 10.44, page 127.

57. Subsection 344(3) treats the transfer of property and services to the non-resident company to be a transfer to the non-resident trust estate for the purposes of determining whether a resident entity is an eligible transferor under sections 347 or 348, and thus whether the non-resident trust is a CFT under section 342. However, the resident entity will only be an attributable taxpayer if the transfer satisfies the specific conditions contained in sections 346, 347 and 348. For example, a resident entity will not constitute an eligible transferor where the transfer is to a non-discretionary trust estate for arm's length consideration. Nor will a resident entity constitute an eligible transferor where the transfer is to a discretionary trust estate in the course of carrying on a business and satisfies arm's length transaction requirements, or is not made in the course of carrying on a business but is an arm's length transaction and the transferor is not in a position to control the trust estate.

58. The existence of a CFT establishes the potential control link between the resident entity and the non-resident company by virtue of section 352. The resident entity will have an associate inclusive control interest in the non-resident company calculated by multiplying the control tracing interest the entity has in the CFT by the control tracing interest (which equals the direct control interest) the CFT has in the non-resident company. In the absence of any other control interests, the associate inclusive control interest (section 349) operates for the purpose of determining whether the company is a CFC under section 340. For example, a 40% associate inclusive control interest would result in the non-resident company being a CFC of the resident entity if the company is not controlled by another non-resident entity.

59. As an eligible transferor, the resident entity is deemed to have a 100% control tracing interest in the CFT (subsection 355(1)). Further, the CFT is deemed to have a control tracing interest in the non-resident company of 100% if it satisfies any of the direct control tests in subsection 353(2), which are similar to the section 340 tests. This is particularly relevant where there is a chain of entities.

60. If a non-resident company is a CFC of the resident entity, the resident entity will be an attributable taxpayer of the CFC if it holds an associate inclusive control interest of at least 10%. Similar tracing rules to those used for control purposes will apply to determine the attribution interest. The resident entity will have an attribution interest in the CFC calculated by multiplying the attribution tracing interest the entity has in the CFT by the attribution tracing interest (which equals the direct attribution interest) the CFT has in the company. In the absence of any attribution interests held by other resident entities, this attribution interest would constitute the attribution percentage of the resident entity in relation to the CFC.

61. An important consideration is that as an eligible transferor, the resident entity is deemed to have a 100% attribution tracing interest in the CFT (subsection 360(1)). Thus, the resident entity will have an attribution percentage in the CFC based on the whole of the shareholding by the CFT in the CFC.

62. This could result in a resident entity that has transferred property or services to a CFC being assessed on the full amount of the relevant attributable income of the CFC, notwithstanding that there are other eligible transferors in relation to the CFT which holds shares in the CFC. However, in these circumstances the Commissioner may reduce the attribution percentage to such amount as he considers reasonable, provided the resident entity provides the necessary information to the Commissioner (subsection 362(3)). Provided the necessary conditions are satisfied, the Commissioner will reduce the attribution percentage (and thus the attributable income) of the resident entity to reflect only its share of the attributable income from the CFC.

Information requirements

63. The information that the Commissioner requires under subsection 362(3) will include documents and records relating to all the relevant transfers (including deemed transfers) showing:

(i) the identities of each of the other entities that has transferred property or services to the trust;

(ii) the dates of those transfers and particulars of the property or services transferred; and

(iii) the percentage of the attributable income of the trust that is attributable to the property or services transferred by the eligible transferors.[25]

Conclusion

64. While subsection 344(3) operates on a broad basis to trigger the CFC provisions, this still produces a reasonable outcome for the relevant resident entity as:

(i) the CFC provisions will not apply if relevant arm's length transaction requirements are met for the transfer;

(ii) paragraph 340(b) of the CFC provisions will not apply where the relevant resident entities (and their associates) hold less than 40% of control interests in the non-resident company; and

[25] Page 503 of the Explanatory Memorandum to the Taxation Laws Amendment (Foreign Income) Bill 1990 (House of Representatives).

(iii) any attributable amount would be limited to the relevant resident entity's appropriate share, provided it meets the information requirements which are necessitated by the use of a non-resident entity as part of the avoidance arrangement.

Examples of implications of transfer

Example 3(a)

65. This example has the same facts as Example 1 at paragraphs 16 to 18 of this draft Ruling, where it was concluded that the transfer of $10 million by Blue to GCo will be treated as a transfer by Blue to SwissCo for the purposes of the transferor trust and CFC provisions respectively.

66. For the purposes of the transferor trust provisions, as the transfer is neither in the ordinary course of Blue's business, nor an arm's length transaction,[26] Blue will be an attributable taxpayer in respect of SwissTrust. Blue will have 100% of the attributable income of SwissTrust included in his assessable income.[27]

67. Blue provides details of the trust accounts and the trust deed, including details of the transfer of funds, which show that there are no other transferors in respect to SwissTrust and that SwissTrust has no assets other than the shares in ACo and has derived no income over the relevant period. As Blue has satisfied the information requirements of the transferor trust provisions the Commissioner would not include any amount in his assessable income as attributable income of SwissTrust.[28]

68. For the purposes of the CFC provisions, as the transfer is neither in the ordinary course of Blue's business, nor an arm's length transaction[29] Blue will be an eligible transferor in respect of SwissTrust with a 100% attribution tracing interest in SwissTrust. In addition, as SwissTrust owns 100% of ACo, which in turn owns 100% of GCo, GCo will be a CFC. Blue will accordingly have a 100% attribution interest in GCo (100% $\times$ 100% $\times$ 100%). Thus, Blue will have 100% of the attributable income of GCo ($1 million, assuming that the attributable income of GCo is equal to its gross passive income) included in his assessable income under section 456.

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[26] Note that this draft Ruling does not deal with any transfer pricing aspects of the transfer of property or services.
[27] Refer to paragraph 102AAZD(1)(d).
[28] Refer to subsection 102AAZD(3).
[29] Refer to subsections 361(2) and 351(3).

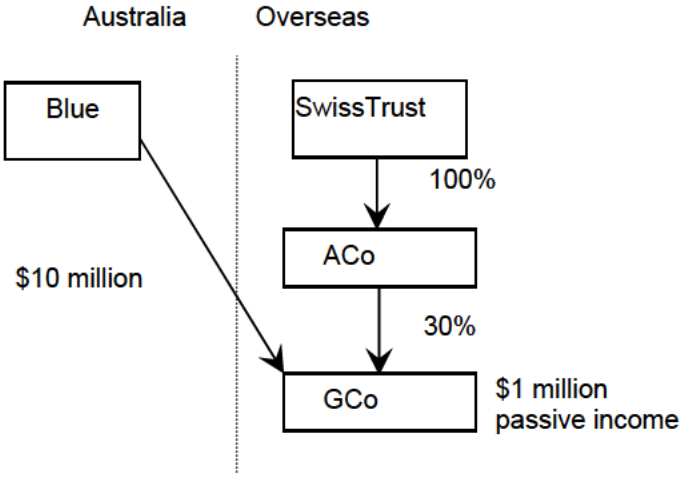
Example 3(b)

69. The facts are the same as for Example 1 at paragraphs 16 to 18 of this draft Ruling, except that rather than transfer funds, Blue provides its standard consultancy services that it provides to other clients to GCo for $1 million, which are provided in the ordinary course of Blue's consultancy business and reflect the full arm's length value of the services.

70. Because the transfer is to a discretionary trust estate in the course of carrying on a business, and there were similar transactions by Blue in the ordinary course of business to ordinary clients under arm's length transactions,[30] neither the transferor trust nor the CFC provisions will apply.[31]

Example 3(c)

71. The facts are the same as for Example 1 at paragraphs 16 to 18 of this draft Ruling, except that ACo only owns 30% of GCo's shares and does not hold any indirect interest, nor are there associates or any other Australian resident entities with direct or indirect interests in GCo.



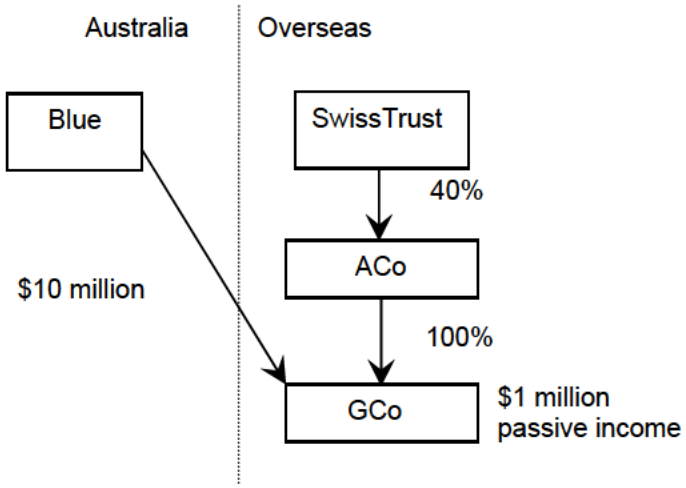
72. Subsection 102AAJ(3) still applies to treat the $10 million as having been transferred by Blue to SwissTrust for the purposes of the transferor trust provisions. However, as Blue has provided information which shows that SwissTrust has no attributable income there will be no amount included in Blue's assessable income under section 102AAZD.

[30] Note that this draft Ruling does not deal with any transfer pricing aspects of the transfer of property or services.
[31] Refer to subparagraph 102AAT(1)(a)(i)(D), section 346 and subparagraph 347(1)(a)(ii).

73. Subsection 344(3) still applies to treat the $10 million as having been transferred by Blue to SwissTrust for the purposes of the CFC provisions. However, whilst ACo is still a CFC, GCo will not be a CFC as SwissTrust's 100% holding in ACo and ACo's 30% holding in GCo will only result in an indirect control interest in GCo of 30%. This (of itself) will not be sufficient to meet the CFC control tests in section 340. No amount of attributable income of GCo will be included in Blue's assessable income.[32]

Example 3(d)

74. The facts are the same as for Example 1 at paragraphs 16 to 18 of this draft Ruling, except that SwissTrust owns 40% of ACo's shares and does not hold any indirect interest, nor are there associates or any other Australian resident entities with direct or indirect interests in ACo. ACo is not controlled by any other group of entities.



75. The implications in respect of subsection 102AAJ(3) are the same as for Example 3(a).

76. Subsection 344(3) still applies to treat the $10 million as having been transferred by Blue to SwissTrust for the purposes of establishing whether SwissTrust is a CFT under the CFC provisions. As the transfer is not an arm's length transaction Blue will be an eligible transferor in respect to SwissTrust. GCo will be a CFC, as SwissTrust's 40% holding will result in Blue having an associate inclusive control interest of (100%[33] × 100%) in GCo, which meets the CFC control test under subsection 340(b).

[32] However, this does not mean that the Foreign Investment Fund provisions do not apply.
[33] Refer subsection 353(2).

77. Blue will be an attributable taxpayer in respect of GCo because his associate inclusive control interest exceeds 10% and he will have an attribution interest of 40% (40% × 100%) in the attributable income of GCo. Hence $400,000 will be included in his assessable income under section 456.

Example 4(a)

78. Example 4(a) has the same facts as Example 2 at paragraphs 19 to 21 of this draft Ruling, where it was concluded that the transfer by Red of $1 million and the transfer by Yellow of $2 million will be treated as having been transferred by Red and Yellow respectively to CaymanTrust for the purposes of the transferor trust and CFC provisions.

79. For the purposes of the transferor trust provisions, as the transfers were not arm's length transactions,[34] Red and Yellow will each be an attributable taxpayer in respect of CaymanTrust and will potentially have 100% of the attributable income of CaymanTrust included in their respective assessable incomes.

80. Both Red and Yellow provide copies of the trust accounts, the trust deed, and details of their respective transfers of funds, including the dates and particulars of the transfers. The documentation indicates that there is no attributable income for the non-resident trust estate for the relevant year. On these facts, the Commissioner would not include any amount in Red and Yellow's assessable incomes as attributable income.

81. For the purposes of the CFC provisions, as the transfer is not an arm's length transaction Red and Yellow will each be an eligible transferor in respect to CaymanTrust and each will potentially have an associate inclusive control interest in CaymanCo of 100% (100% × 100%).[35]

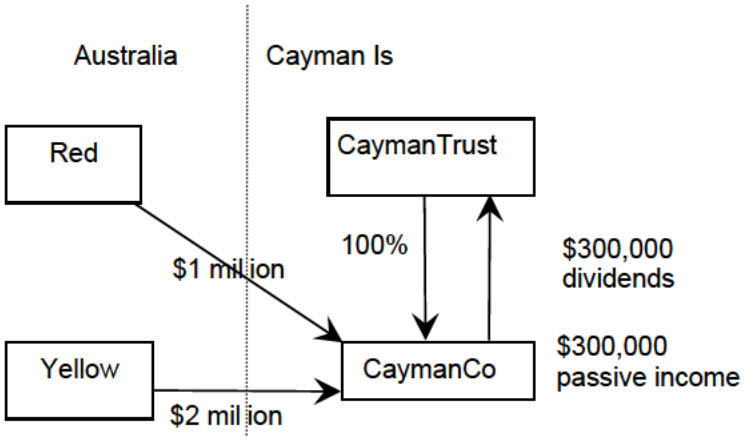
82. However, as noted at paragraph 81 of this draft Ruling, both Red and Yellow provide copies of the trust account and trust deed and details of their respective transfers of funds to CaymanCo, including the dates and particulars of the transfers.

83. On these facts, the Commissioner decides to reduce the attributable percentage to reflect their respective shares of the CFCs attributable income based on their respective transfers to the CFC. Thus, $100,000 will be included in Red's assessable income and $200,000 will be included in Yellow's assessable income.

[34] Note that this draft Ruling does not deal with any transfer pricing aspects of the transfer of property or services.
[35] Refer to subsections 355(1) and 352(3).

Example 4(b)

84. The facts are the same as for Example 2 at paragraphs 19 to 21 of this draft Ruling, except that CaymanCo makes a dividend distribution of $300,000 to CaymanTrust in the following year.



85. For the purposes of the CFC provisions, the implications will be the same as indicated in paragraph 83 of this draft Ruling, that is, $100,000 will be included in Red's assessable income and $200,000 will be included in Yellow's assessable income during that year of income.

86. For the purposes of the transferor trust provisions, as with Example 4(a), Red and Yellow will each be an attributable taxpayer in respect of CaymanTrust and will potentially have 100% of the attributable income of CaymanTrust included in their respective assessable incomes – in this case being the year in which the trust derived the dividend of $300,000.

87. However, as an equivalent amount to the $300,000 dividend payment has been included in Red and Yellow's assessable incomes under the CFC provisions, the attributable income of CaymanTrust will be accordingly reduced by the amount of the attribution debit (subparagraph 102AAU(1)(c)(vii)). Therefore, the amounts to be included in Red and Yellow's assessable incomes under the transferor trust provisions will be reduced to nil.

Appendix 2 – Alternative views

This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.

88. An alternative view is that a transfer of property or services to a non-resident company owned by a non-resident trustee could not be applied for the benefit of the non-resident trustee where it is a transfer for full consideration. Under this view, a transfer can only provide a benefit for the trustee where it results in an improvement in the financial position of the trustee, and a transfer for full consideration is merely an exchange of one asset for another that does not improve the financial position of the trustee.

89. The Commissioner does not accept this view because the phrase 'applied for the benefit of' has a broader meaning than just providing a financial advantage and also includes providing control or influence over the transferred property or services. This is particularly the case in the context of anti-avoidance provisions which are addressed at complex structures that might otherwise avoid control identification and tracing mechanisms.

Appendix 3 – Your comments

90. We invite you to comment on this draft Taxation Ruling. 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.)

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Appendix 4 – Detailed contents list

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

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Subject references:

- applied for the benefit of
- attribution rules
- benefit
- controlled foreign companies
- controlled foreign trusts
- cross border dealings
- discretionary trusts
- distributions
- eligible transferor
- foreign attributable income
- foreign investments funds
- interest free loans
- international law
- modified accruals system of legislation
- non resident company
- non resident trust
- resident entity
- transfer of property
- transfer of services
- transferor trusts
- transfers
- trust estate

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- ITAA 1936 102AAB
- ITAA 1936 102AAJ
- ITAA 1936 102AAJ(1)
- ITAA 1936 102AAJ(3)
- ITAA 1936 102AAL
- ITAA 1936 102AAM(1B)
- ITAA 1936 102AAT
- ITAA 1936 102AAT(1)(a)(i)
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- ITAA 1936 102AAT(1)(a)(i)(B)
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- ITAA 1936 102AAT(1)(a)(i)(E)
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- ITAA 1936 353(2)
- ITAA 1936 355(1)
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- ITAA 1936 361(2)
- ITAA 1936 362(3)
- ITAA 1936 456

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- Davies v. Perpetual Trustees Executors and Agency Company of Tasmania (1935) 52 CLR 604
- Max Factor & Co Inc v. FC of T 71 ATC 4136; 124 CLR 353; 2 ATR 420
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