TD 2019/D12 - Income tax: is section 951A of the US Internal Revenue Code a provision of a law of a foreign country that corresponds to section 456 or 457 of the Income Tax Assessment Act 1936 for the purpose of subsection 832-130(5) of the Income Tax Assessment Act 1997 ?

This cover sheet is provided for information only. It does not form part of *TD 2019/D12 - Income tax: is section 951A of the US Internal Revenue Code a provision of a law of a foreign country that corresponds to section 456 or 457 of the Income Tax Assessment Act 1936 for the purpose of subsection 832-130(5) of the Income Tax Assessment Act 1997 ?*

This document has been finalised by TD 2022/9.

There is a Compendium for this document: **TD 2022/9EC** .

Draft Taxation Determination

Income tax: is section 951A of the US *Internal Revenue Code* a provision of a law of a foreign country that corresponds to section 456 or 457 of the *Income Tax Assessment Act 1936* for the purpose of subsection 832-130(5) of the *Income Tax Assessment Act 1997*?

Relying on this draft Ruling

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

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

Ruling

1. No. Section 951A of the United States (US) *Internal Revenue Code of 1986* (Internal Revenue Code) is not a provision of a law of a foreign country that corresponds to section 456 or 457 of the *Income Tax Assessment Act 1936* for the purpose of subsection 832-130(5) of the *Income Tax Assessment Act 1997*.

Examples

Example 1 – identification and calculation of the deduction / non-inclusion outcome

2. *US Co, a US resident company, has numerous wholly owned foreign subsidiaries including Aus Co, an Australian resident company, and Foreign LP, a limited partnership which is a reverse hybrid entity.*

3. *Aus Co makes a deductible payment of $100 to Foreign LP which is not taxed in Foreign LP's formation country because the formation country treats US Co as the liable entity in respect of Foreign LP's income and profits. The payment of $100 is also not taxed in the hands of US Co because the US treats Foreign LP as a foreign corporation and the liable entity in respect of Foreign LP's income and profits.*

4. *Section 951A applies to US Co with respect to its interests in its foreign subsidiaries, including Foreign LP. The payment of $100 from Aus Co to Foreign LP is taken into account in calculating whether Foreign LP has tested income or a tested loss amount which in turn is taken into account in determining the section 951A inclusion amount for US Co.*

5. *Because section 951A does not correspond to section 456 or 457, any section 951A inclusion amount for US Co (including any part of the $100 payment from Aus Co to Foreign LP included in any section 951A inclusion amount for US Co) will not be taken to be subject to foreign income tax under subsection 832-130(5). This is irrespective of whether Foreign LP has tested income or a tested loss under section 951A or whether the section 951A amount included in US Co's gross income for US tax purposes is positive or nil.*

Example 2 – identification and calculation of dual inclusion income

6. *Aus Co 1 and Aus Co 2, Australian resident companies, are both wholly owned subsidiaries of US Parent, a US tax resident corporation.*

7. *US Parent is the 100% shareholder of Aus Co 1. In turn, Aus Co 1 is the 100% shareholder of Aus Co 2. Aus Co 1 (head company) and Aus Co 2 (subsidiary member) are members of a tax consolidated group for Australian tax purposes.*

8. *An election was made for Aus Co 1 to be 'disregarded' for US tax purposes. As a result, the income derived by, and all of the deductible payments made by, Aus Co 1 are treated as income and expenses of US Parent for US tax purposes, with the exception of any transactions directly between Aus Co 1 and US Parent which are disregarded. The election is limited to Aus Co 1. Aus Co 2 is treated as a foreign corporation of US Parent.*

9. *Aus Co 1 makes a $100 deductible payment to US Parent which gives rise to a hybrid payer mismatch amount under Subdivision 832-D.*

10. *Aus Co 2 (ignoring tax consolidation) has income from sales to third parties that is included in the assessable income of the tax consolidated group and regarded as subject to Australian income tax under section 832-125.*

11. *Section 951A applies to US Parent with respect to its interest in Aus Co 2 (and any other foreign subsidiaries). As part of the calculation of the section 951A inclusion amount for US Parent, the income and expenses of Aus Co 2 are included in net CFC tested income.*

12. *Because section 951A does not correspond to section 456 or 457, any section 951A inclusion amount for US Parent (including any part of Aus Co 2's income from sales to third parties included in any section 951A inclusion amount for US Parent) will not be taken to be subject to foreign income tax under subsection 832-130(5). This is irrespective of whether Aus Co 2 has tested income or a tested loss under section 951A or whether the section 951A amount included in US Parent's gross income for US tax purposes is positive or nil.*

Date of effect

13. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Determination (see paragraphs 75 to 76 of Taxation Ruling TR 2006/10 *Public Rulings*).

Commissioner of Taxation
21 November 2019

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.

14. All legislative references are to provisions of the *Income Tax Assessment Act 1936*, the *Income Tax Assessment Act 1997* or to the Internal Revenue Code (as detailed in the table in Appendix 3 of this draft Determination[1]).

Subsection 832-130(5)

15. Subsection 832-130(5) extends the meaning of subject to foreign income tax in subsection 832-130(1) having regard to the effect of foreign CFC regimes.

16. Subsection 832-130(5) states:

> An amount of income or profits of an entity is ***subject to foreign income tax*** if the amount is included in working out the tax base of another entity under a provision of a law of a foreign country that corresponds to section 456 or 457 of the *Income Tax Assessment Act 1936* (including a tax base that is nil, or a negative amount).

Meaning of 'corresponds to'

17. The phrase 'corresponds to' in subsection 832-130(5) is not defined and regard should be had to the ordinary meaning of correspond. Dictionary definitions of correspond share common indicators. In the ordinary sense, for two things to correspond to each other they should agree, be similar or analogous, or be equivalent in function.[2]

18. The Revised Explanatory Memorandum to Treasury Laws Amendment (Tax Integrity and Other Measures No. 2) Bill 2018 (the EM) does not elaborate on when a provision of a foreign law will correspond to section 456 or 457 for the purpose of subsection 832-130(5). The EM does comment on the phrase in the context of the meaning of 'foreign hybrid mismatch rules' which is defined in subsection 995-1(1) as a foreign law corresponding to Division 832.

19. The EM in discussing the meaning of foreign hybrid mismatch rules explains[3]:

> … a foreign law will correspond to Australia's hybrid mismatch rules in Division 832 only if that law is consistent with the effect of the recommendations of the OECD Action 2 Report.

20. In *Chevron Australia Holdings Pty Ltd v Commissioner of Taxation (No 4)* [2015] FCA 1092 (*Chevron*), one of the issues considered was whether Article 9 of the United

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[1] All further references to 'this Determination' refer to the Determination as it will read when finalised. Note that this Determination will not take effect until finalised.

[2] Oxford Dictionaries, 2004, *Australian Oxford Dictionary*, 2nd edn, Oxford University Press; Oxford Dictionaries, 2010, *Oxford Dictionary of English*, 3rd edn, Oxford University Press; Macmillan Publishers Australia, *The Macquarie Dictionary* online*, www.macquariedictionary.com.au,* viewed 2 September 2019.

[3] At paragraph 1.90.

States Convention[4] corresponded to Article 9 of the United Kingdom Convention[5] for the purpose of subsection 815-15(5). Robertson J said, at [565]:

> … In my opinion, "corresponding provision" does not focus on the detail but refers to another provision the gist of which is the same … acknowledging that the meaning of "corresponding provision" depends on the context …

Sections 456 and 457

21. Sections 456 and 457 are the assessing provisions in Australia's CFC regime contained in Part X. The policy intent of sections 456 and 457 is to assess certain Australian shareholders of controlled foreign companies (CFCs) on an accruals basis in respect of particular income that is readily movable to a foreign tax jurisdiction and prone to Australian tax deferral or avoidance (that is, 'tainted income'). Generally, 'active income' (income from genuine business activity) is not subject to taxation on an accruals basis under section 456 or 457.

22. Section 456 operates to include an amount in the assessable income of an attributable taxpayer (that is, a significant Australian resident shareholder) based on their attribution percentage of the attributable income of a CFC for a statutory accounting period.

23. Section 456 applies to 'attributable income', which is the amount that would be the CFC's taxable income for the statutory accounting period if certain assumptions were made. These assumptions are set out in sections 383 to 385 and largely have the effect of attributing income that is (or is a subset of) adjusted tainted income.

24. Section 457 also operates to include an amount in the assessable income of an attributable taxpayer and applies where there is a change of residence of a CFC from an unlisted country to a listed country or Australia. The amount to which section 457 applies is the attributable taxpayer's attribution percentage of the 'adjusted distributable profits' of the CFC, which is broadly the CFC's adjusted tainted income for the period until the change of residence.

25. Sections 456 and 457 apply on a CFC by CFC basis. CFCs are not aggregated in calculating the assessable inclusion amount under section 456 or 457.

Section 951A

26. Section 951A was added to subpart F of the *Internal Revenue Code* (subpart F) as part of the tax reforms contained in the Act known as the *Tax Cuts and Jobs Act of 2017*.

27. A US shareholder of any CFC for a taxable year is required to include in their gross income their global intangible low-taxed income (GILTI) for that year.[6]

28. A US shareholder's GILTI for a taxable year is determined on an aggregate basis. The GILTI inclusion takes into account certain CFC-level items in respect of all of the US

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[4] Convention between the Government of Australia and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income [1983] ATS 16.

[5] Convention between the Government of Australia and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and on Capital Gains [2003] ATS 22.

[6] Section 951A(a).

shareholder's CFCs for a taxable year. These CFC-level items are then aggregated at the US shareholder level.

29. The CFC-level items taken into account are:

- tested income
- tested loss, and
- qualifying business asset investment (QBAI).

Tested income

30. Tested income is the excess (if any) of the gross income of a CFC over the deductions (including taxes) properly allocable to such gross income.[7] Certain items of gross income are disregarded in determining tested income. These items include effectively connected income, subpart F income, and income excluded from subpart F income by reason of the high tax exception in section 954(b)(4).

Tested loss

31. Tested loss is the reverse of tested income.[8]

Qualifying business asset investment

32. QBAI is the average of a CFC's aggregate adjusted bases in tangible property used to produce tested income.[9] The tangible property must be used in a trade or business of the CFC and be of a type with respect to which a deduction is allowable under section 167 (that is, depreciable assets). A CFC with a tested loss for a taxable year cannot have QBAI for that taxable year.

33. Tested income, tested loss and QBAI are aggregated at the US shareholder level to determine the GILTI inclusion amount.

Net CFC tested income

34. A US shareholder aggregates its pro rata share of the tested income and tested loss of each CFC with respect to which it is a US shareholder. Net CFC tested income at the US shareholder level is the excess (if any) of aggregate tested income over aggregate tested loss.[10]

Net deemed tangible income return

35. A US shareholder aggregates its pro rata share of the QBAI of each CFC with respect to which it is a US shareholder. Aggregate QBAI is multiplied by 10% to produce a deemed tangible income return. The deemed tangible income return is intended to reflect a 'normal return' on the depreciable property that comprises QBAI. Net deemed tangible

[7] Section 951A(c)(2)(A).
[8] Section 951A(c)(2)(B).
[9] Section 951A(d).
[10] Section 951A(c)(1).

income return is the excess of the deemed tangible income return over certain interest expense.[11]

GILTI inclusion

36. A US shareholder's GILTI inclusion for a taxable year is the excess (if any) of their net CFC tested income over their net deemed tangible income return.[12]

37. It can be seen paragraphs 30 to 36 that in substance a GILTI inclusion represents a deemed above-normal return on certain depreciable property.

Section 951A – legislative history

38. The legislative history to section 951A supports that a GILTI inclusion reflects a deemed above-normal return on certain depreciable property.

39. Initially, section 4301 of the Tax Cuts and Jobs Bill (the Bill) proposed the insertion of section 951A into subpart F. Under section 4301 of the Bill, the section 951A inclusion was referred to as the 'foreign high return amount'. As a result of Senate amendments, section 951A was ultimately inserted into subpart F under section 14201 of the *Tax Cuts and Jobs Act of 2017* which renamed the section 951A inclusion as 'global intangible low-taxed income'. However, the fundamental mechanics for calculating the section 951A inclusion amount did not materially change. Under both proposals, the section 951A inclusion amount represents a deemed high or above-normal return on certain depreciable property.

40. Both the House of Representatives Committee on Ways and Means and the Senate Committee on Finance described the purpose of section 951A.[13] Both committees explained that the purpose of section 951A is to protect the US tax base against erosion following the US's transition from a worldwide system to a participation exemption system. The Ways and Means Committee focussed on the concentration of a multinational enterprise's high value functions, assets and risks in low taxed jurisdictions as one common form of US base erosion. The Committee on Finance saw intangible income as the type of income most readily allocated to low or no tax jurisdictions. Both focuses overlap. As noted in paragraph 39 of this Determination, the fundamental mechanics for calculating the section 951A inclusion amount under the original and ultimate proposal did not materially change. Accordingly, it can reasonably be said that in substance section 951A is a US base protection measure that includes deemed high or above-normal returns on certain depreciable property in a US shareholder's gross income.

The broader GILTI regime

41. Sections 250 and 960(d) complete the GILTI regime.

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[11] Section 951A(b)(2).
[12] Section 951A(b)(1).
[13] Committee on Ways and Means, 2017, *Tax Cuts and Jobs Act: Report of the Committee on Ways and Means House of Representatives on H.R. 1 together with dissenting and additional views*, U.S. Government Publishing Office, Washington, pp. 388-390; Committee on the Budget United States Senate, 2017, *Reconciliation Recommendations pursuant to H. Con. Res. 71: Committee Recommendations as submitted to the Committee on the Budget pursuant to H. Con. Res. 71*, U.S. Government Publishing Office, Washington, p. 370.

42. Subject to a taxable income limitation, a domestic corporation is allowed a deduction under section 250 for 50%[14] of the GILTI amount included in its gross income. This reduces the US federal tax rate on GILTI to 10.5%[15] for domestic corporations.

43. Under section 960(d), a domestic corporation is deemed to have paid a portion of certain foreign income taxes paid or accrued by its tested income CFCs. Subject to a foreign tax credit limitation, this 'deemed paid credit' reduces the US federal income tax payable in respect of the GILTI amount included in a domestic corporation's gross income under section 951A.

Does section 951A correspond to section 456 or 457?

44. There are notable differences between section 951A and sections 456 and 457.

45. Notwithstanding that section 951A is contained within subpart F, section 951A functions as the inclusion provision for the broader GILTI regime comprising sections 951A, 250 and 960(d) which is widely referred to as a global minimum tax regime for which there is no equivalent in Australia. In contrast, sections 456 and 457 do not function as inclusion provisions for a global minimum tax regime. Sections 456 and 457 are inclusion provisions for a general CFC anti-deferral regime. Reflective of section 951A functioning as the inclusion provision for a global minimum tax regime, a GILTI inclusion under section 951A is determined on an aggregate CFC basis. In contrast, sections 456 and 457 (not being inclusion provisions for a global minimum tax regime) operate on a CFC by CFC basis.

46. GILTI is a different category of income to subpart F income and is determined in a way that is fundamentally different to determining subpart F income. In substance, a GILTI inclusion under section 951A represents a deemed high or above-normal return on certain depreciable property whether or not the deemed return in fact comprises passive or tainted income and whether or not the deemed return in fact comprises intangible income. In contrast, an inclusion under section 456 or 457 does not represent a deemed high or above-normal return on depreciable property. Sections 456 and 457 require that there be an amount of attributable income or adjusted distributable profits, both of which fundamentally comprise actual passive or tainted income and irrespective of whether that income represents a below-normal, normal or above-normal return.

47. Having regard to these differences, we consider that section 951A does not correspond to section 456 or 457 either in the ordinary sense or within the meaning referred to in *Chevron*. Accordingly, section 951A does not correspond to section 456 or 457 for the purpose of subsection 832-130(5).

[14] 37.5% for taxable years beginning after 31 December 2025.
[15] 13.125% for taxable years beginning after 31 December 2025.

Appendix 2 – Your comments

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

49. A compendium of comments is prepared for the consideration of the relevant Public Advice and Guidance Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments
- be published on ato.gov.au

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

Due date: **17 January 2020**

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

Appendix 3 – Legislative provisions

50. This paragraph sets out the details of the provisions ruled upon or referenced in this Determination.

United Kingdom Convention	Article 9
United States Convention	Article 9
Income Tax Assessment Act 1936	Part X
Income Tax Assessment Act 1936	section 383
Income Tax Assessment Act 1936	section 384
Income Tax Assessment Act 1936	section 385
Income Tax Assessment Act 1936	section 456
Income Tax Assessment Act 1936	section 457
Income Tax Assessment Act 1997	subsection 815-15(5)
Income Tax Assessment Act 1997	Division 832
Income Tax Assessment Act 1997	Subdivision 832-D
Income Tax Assessment Act 1997	section 832-125
Income Tax Assessment Act 1997	section 832-130
Income Tax Assessment Act 1997	subsection 995-1(1)
Internal Revenue Code of 1986	section 167
Internal Revenue Code of 1986	section 250
Internal Revenue Code of 1986	subpart F
Internal Revenue Code of 1986	section 951A
Internal Revenue Code of 1986	section 954(b)(4)
Internal Revenue Code of 1986	section 960(d)
Tax Cuts and Jobs Act of 2017	section 14201

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Cases relied on:

- Chevron Australia Holdings Pty Ltd v Commissioner of Taxation (No 4) [2015] FCA 1092; 2015 ATC 20-535; 102 ATR 13

Other references:

- Committee on the Budget United States Senate, 2017, Reconciliation Recommendations pursuant to H. Con. Res. 71: Committee Recommendations as submitted to the Committee on the Budget pursuant to H. Con. Res. 71, U.S. Government Publishing Office, Washington
- Committee on Ways and Means, 2017, Tax Cuts and Jobs Act: Report of the Committee on Ways and Means House of Representatives on H.R. 1 together with dissenting and additional views, U.S. Government Publishing Office, Washington
- Revised Explanatory Memorandum to Treasury Laws Amendment (Tax Integrity and Other Measures No.2) Bill 2018
- Macmillan Publishers Australia, *The Macquarie Dictionary* online, www.macquariedictionary.com.au
- Oxford Dictionaries, 2004, *Australian Oxford Dictionary*, 2nd edn, Oxford University Press
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