



THE TAX INSTITUTE

THE MARK OF EXPERTISE

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The Manager
Public Groups and International
Australian Taxation Office

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Dear Sir/Madam

Draft Privatisation and Infrastructure Framework: Control under Division 6C

The Tax Institute refers to the draft Privatisation and Infrastructure Australian Federal Tax Framework (**the Framework**) released by the ATO on 31 January 2017. This submission sets out our comments in relation to Part 3.6 of the Framework which is in relation to control for the purposes of Division 6C of the *Income Tax Assessment Act 1936* (**Division 6C**).

Negative Control – veto powers

The application of the control test in Division 6C must be applied having regard to the words of the section and the purpose for which the section was enacted. The ATO's position that the ability of a shareholder to veto certain decisions gives that shareholder control of the company's business has no support in either the text of the legislation, the purpose for which Division 6C was enacted or the cases cited by the ATO.

Mendes v Commissioner of Probate Duties (Vic) [1967] 122 CLR 152 is cited in the Framework as authority for the proposition that control, for the purposes of revenue law, generally arises as a result of members holding enough shares in a company to carry an ordinary resolution of the company. We support this.

Re The News Corporation Ltd (1987) 15 FCR 227 (**News Corporation**), is cited in the Framework in an attempt to build on the proposition that control of a company's business is different to control of the company. Whilst Beaumont J. in *News Corporation* acknowledges that this may be the case in certain factual circumstances, the passage cited does not assist the ATO's view that if control of a business is different, this is achieved through a shareholder's ability to veto certain decisions. In *News Corporation*, the facts of the case resulted in the relevant 'controller' being able to veto **all decisions** of the board through the appointment of a majority of directors. This is a very different scenario to that of an investor that holds a minority stake in an entity and has the ability to veto certain decisions of the board.

Based on the Explanatory Memorandum to the *Taxation Laws Amendment Act (No 4) 1985 (Cth)* (which introduced Division 6C), it is clear that the purpose for which Division 6C was enacted was to prevent a business that would otherwise be operated as a public company from structuring its affairs as a unit trust. Section 102N of the *Income Tax Assessment Act 1936 (ITAA 36)* is an integrity provision that prevents that structure from being one step removed from the public unit trust. Having regard to the purposes, 'control' should be read as being limited to the circumstance where the unit trust could otherwise have carried on the business but structured its affairs in such a way as to avoid the operation of Division 6C. This is clearly not the case for a minority investor that holds veto rights over certain decisions in relation to its underlying investment.

Control of operations

Having regard to the purpose of Division 6C, it should be understood that the 'control' for the purposes of Division 6C must extend to the operations of the business rather than those high level decisions which it is perfectly reasonable for investors to have a say in. The words of the division are directed at 'affairs or operations' in respect of the carrying on of a trading business. This should not be read as extending to the high level decisions of a company, such as investments and the capital structure which investors have a legitimate interest to veto, but rather the operations of the business.

Negative Control – application to other areas

We seek clarification that the ATO's negative control views do not extend to other analogous areas of tax law such as the associate test.

We note that the ATO's views on negative control in a Division 6C context create uncertainty in other areas of the tax law. For example, under section 340 of the ITAA 36 a foreign company will be a controlled foreign corporation where it is "controlled" by a group of five or fewer Australian entities. In section 318 of the ITAA 36, an entity will be an associate of another entity if there is "sufficient influence", that is, if "the company, or its directors, are accustomed or under an obligation (whether formal or informal), or might reasonably be expected, to act in accordance with the directions, instructions or wishes of the entity or entities (whether those directions, instructions or wishes are, or might reasonably be expected to be, communicated directly or through interposed companies, partnerships or trusts)" (refer s318(6)(b) of the ITAA 36). There will undoubtedly be other areas that reference similar concepts.

The ATO's views on negative control suggest that a negative inference would also be drawn by the ATO in these other areas of tax law. In our view, this would cause a wide range of unintended consequences.

We believe it is imperative that the ATO clarify definitively whether its views on negative control extend to other areas of tax law. If those views do not extend to other areas of tax law, the ATO should distinguish these other areas and explain the technical basis for such a distinction, so that taxpayers and advisers can draw sensible conclusions in relation to these other areas.

Negative Control - Impact on lenders

It is usual for lenders to an entity or project to have veto rights over a range of matters that include those matters identified by the ATO as giving rise to negative control. The views adopted by the ATO would have the effect that any debt funds that participate in the lending market could not obtain Managed Investment Trust (i.e. MIT) status. The ATO should clarify that its views only apply where the veto rights are held by entities that hold membership interests in the relevant entity carrying on the trading business.

If you would like to discuss, please contact either me or Tax Counsel, Angie Ananda, on 02 8223 0011.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Matthew Pawson', with a stylized, flowing script.

Matthew Pawson
President