



## Tax Insights

# AAT rejects associate connection based on sufficient influence

### Snapshot

A recent decision of the Administrative Appeals Tribunal (AAT) considered the meaning of **sufficiently influenced**, in the context of the Australian Controlled Foreign Company (CFC) provisions, where the underlying fact pattern involved a Singapore marketing hub.

The decision considered the impact of a dual listed company (DLC) arrangement, under which the taxpayer group had an Australian listed company and a UK listed company. The question was whether companies in the DLC group were “associates” for Australian tax purposes under section 318 of the Income Tax Assessment Act, 1936. In particular, the issue was whether members of the DLC group were sufficiently influenced by other members of the group?

The AAT held in favour of the taxpayer and concluded that neither the terms of the DLC Arrangement nor any other circumstance indicated that

relevant companies were sufficiently influenced by other members of the DLC group, and so were not associates.

## Implications

Taxpayers will need to continue to monitor developments to see whether the ATO appeals this decision.

The application of the test of associate can be challenging in many fact patterns. This case addresses the potential breadth of the concept via sufficient influence, but also places limits on the operation of that aspect of the definition.

Whilst the case was in the context of the CFC rules, the concept of "associate" is used widely throughout the tax legislation, so the decision is of wider impact.

Whilst the facts of this matter are very specific to the particular DLC arrangement, consideration should be given to the documentation and implementation of other similar arrangements involving entities acting in concert or in parallel, such as consortia agreements and joint venture arrangements. As always, even if the formal terms of the arrangement support an absence of sufficient influence, the practical implementation will need to align in order for a taxpayer to support its position.

## Facts

The matter was heard by the AAT, rather than the Federal Court, however, in this matter the AAT consisted of Justice Logan, who is also a judge in the Federal Court. As can be done in matters before the AAT, the matter was run on an anonymous basis with pseudonyms being adopted for the relevant entities.

As the AAT noted, there are features of the facts which must necessarily be disclosed which limit the extent to which it is practical to afford privacy. Relevantly, the facts involved:

- an Australian resident and Australian listed company (Limited).
- a UK resident and listed UK company (PLC).
- a DLC Arrangement between Limited and PLC. Limited and PLC and their respective subsidiaries carried on a global resource business under the terms of the DLC.
- QMAG was incorporated in Switzerland and via a branch in Singapore, undertook the marketing and trading of commodities.
- QMAG was ultimately held as to 58% by Limited and as to 42% by PLC
- QMAG made profits on the sale of commodities which it purchased from:
  - Limited's indirectly wholly-owned Australian subsidiaries (Limited Aus SellCo), resulting in profits to QMAG referred to as the **Limited purchase profits**; and
  - PLC's indirectly wholly-owned Australian subsidiaries (PLC Aus SellCo), resulting in profits to QMAG referred to as the **PLC purchase profits**

Limited ultimately controlled a majority voting interest in each of QMAG and Limited Aus SellCo. It was common ground that, for the purposes of the CFC rules, the Limited purchase profits were tainted sales income: representing profits made by QMAG relating to goods purchased from an Australian resident associate (Limited Aus SellCo). Limited presumably included 58% of such tainted sales income (relating to the Limited purchase profits) in its assessable income pursuant to the CFC provisions.

The ATO sought to also include the PLC purchase profits in tainted sales income.

### **DLC Arrangement**

Some of the relevant features of the DLC Arrangement were that Limited and PLC:

- had boards of directors comprised of the same individuals;
- had a unified senior executive management
- required their directors, in addition to their duties to the specific company, to have regard to the interests of shareholders in each of Limited and PLC, as if Limited and PLC were a "single unified economic entity"

Further, the Constitution or equivalent of each of Limited, PLC and QMAG vested the management and control of each company in the board of each company. As an example, the practice of the Risk and Audit Committee of Limited was that it resolved to declare a dividend because of an instruction given to it by the board of Limited. Whilst the Committee noted the dividend declared by the board of PLC, the actions of PLC had no "causative effect" on the decisions of the Committee, or of Limited.

It was held by the AAT that the parties acted consistently with the terms of the Constitution, etc, and there was no abrogation of control by the shareholders or boards of the respective companies.

### **Summary**

Whilst Logan J commented that "as a matter of first impression", the DLC Arrangement appears to fall within the concept of the "in accordance with" relationships, so as to indicate sufficient influence of members of the DLC Arrangement over other members of the DLC Arrangement, he held that

- Limited and PLC were **not** associates, and
- that QMAG did not act "in accordance with" the directions, etc of Limited and PLC, such that QMAG was **not** an associate of PLC Aus SellCo.

The tainted income of QMAG related only to the commodities purchased from Limited Aus SellCo. Accordingly, the AAT held that the amended assessments were excessive and should be set aside.

There were two critical aspects to the decision. Firstly, it was held that the shareholders and boards of the respective companies conducted the respective roles required of them with no abrogation of their responsibilities. Second, it was concluded (as an example of the first point) that each of Limited and PLC made their own separate and independent

decision to enter into the DLC Arrangement. Having done so, the effect of the DLC Arrangement was to ensure that all companies within the DLC group acted in furtherance of the DLC arrangement. Whilst the companies within the group were seen to be acting in concert, and undertaking parallel implementation behaviours, such behaviours were in accordance with and as a result of the respective decisions of each particular company.

### Associate & sufficient influence

The definition of associate section 318 is extremely broad, and includes a range of different fact patterns that result in an associate relationship between a primary entity and another entity. Amongst other tests, an associate relationship can be found via the following connections:

- Where entities are partners in a partnership;
- A "majority voting interest" that one entity holds in another entity, or
- Where one entity is sufficiently influenced by another entity

For these purposes, sufficient influence is defined broadly and in the following terms: "a company is **sufficiently influenced** by an entity or entities 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 (when in those directions, instructions or wishes are, or might reasonably be expected to be, communicated directly or through interposed companies, partnerships or trusts)".

### Submissions

The ATO asserted that the PLC purchase profits represented tainted sales income on the basis that PLC Aus SellCo was an associate of QMAG, via the "sufficient influence" test in the definition of associate. On that basis, the ATO issued amended assessments to Limited for the 2006 to 2010 years to include in the assessable income of Limited 58% of the PLC purchase profits. The ATO also imposed penalties.

Essentially the ATO asserted that:

- Limited and PLC acted other than in accordance with the directions of their Board, as each company was under an obligation to act in accordance with the directions the other company. That is, each of Limited and PLC sufficiently influenced the other so as to create an associate relationship between the two companies
- A majority voting interest in PLC Aus SellCo was controlled by PLC
- QMAG was sufficiently influenced by PLC and Limited
- As a result, PLC Aus SellCo was an associate of QMAG.

The taxpayer asserted that the respective boards of Limited, PLC and QMAG each exercised an independent value judgement and determined that it is in the individual interests of each company to act in parallel.

### Decision

A key aspect of the decision is that the separate boards of Limited and PLC made a separate deliberate judgement that was in the best interests of

The word "associate" occurs more than 600 times in Australian tax legislation, including in the FBT & GST law. The concept is used in the Income Tax Assessment Act in a range of areas including the CFC rules, Part IVA, thin capitalisation, and Section 128F.

each company to enter into and to implement the DLC Arrangement. Having made that separate and independent decision, actions in furtherance of the DLC Arrangement and subsequent parallel implementation behaviours were “unremarkable”. Once Limited and PLC made the separate decisions to implement the DLC Arrangement in accordance with their respective wishes, whilst Limited, PLC and QMAG could be seen to be acting in concert, no company was subservient to any other company. Each company, for its own reasons, wished that its actions coincide other companies to achieve “a single unified economic entity end”.

If (contrary to the findings in this matter) a Board abrogated its responsibilities to another and instead acted only by “rubber-stamping decisions actually made elsewhere by others”, that behaviour would be consistent with the entity being sufficiently influenced by another. Logan J also made it clear that a person can be sufficiently influenced notwithstanding the absence of formal directions or instructions.

It was held that there was no evidence to suggest that the board of QMAG neglected their duties or failed to act, first and foremost in the interest of QMAG. It is the case that QMAG’s interests regularly coincided with those of Limited and PLC, and that QMAG’s actions furthered not just its own interests but the interests of others. However, QMAG was not accustomed to, nor could reasonably be expected to, treat the wishes or directions of Limited and PLC as sufficient reason to act without more. QMAG’s board only followed the wishes or directions of Limited or PLC if the board of QMAG considered that to do so was in QMAG’s best interests. It was held that the QMAG board, which was obliged to act in the best interests of the company and its shareholders, did so act. In that regard, Logan J commented more than once on the “meticulous” adherence to corporate governance and respect for separate legal personalities. On that basis, there was no entity that sufficiently influenced QMAG.

### **Alternative argument**

Logan J also upheld a further alternative submission of the applicant, regarding the statutory interpretation of the definition of associate. Limited argued that if QMAG did act in accordance with the directions, instructions, etc of another (which was denied), that other was Limited (the majority owner of QMAG), and it would be concluded that QMAG was sufficiently influenced by Limited pursuant to Section 318(2)(d)(i)(A).

The ATO asserted that QMAG was sufficiently influenced by Limited and PLC so as to attract Section 318(2)(d)(i)(B), which referred to an entity being sufficiently influenced by “the controlling entity and another entity or entities”. In this alternative submission, Limited argued that Section 318(2)(d)(i)(B) could not be engaged where there was a single controller exerting sufficient influence (hypothetically Limited). Section 318(2)(d)(i)(B) is mutually exclusive to the operation of Section 318(2)(d)(i)(A). Section 318(2)(d)(i)(B) can only be activated where two or more entities together sufficiently influence another entity, but neither of the two entities sufficiently influence the other entity on their own. Logan J agreed with the taxpayer’s submission: even if QMAG was held to be sufficiently influenced, such influence would reside with Limited, and not with Limited and PLC.

## Contacts

**Mark Hadassin**  
**Partner**

+ 61 2 9322 5807  
[mhadassin@deloitte.com.au](mailto:mhadassin@deloitte.com.au)

**Vik Khanna**  
**Partner**

+ 61 3 9671 6666  
[vkhanna@deloitte.com.au](mailto:vkhanna@deloitte.com.au)

**Claudio Cimetta**  
**Partner**

+ 61 3 9671 7601  
[ccimetta@deloitte.com.au](mailto:ccimetta@deloitte.com.au)

**Peter Radlovacki**  
**Partner**

+ 61 2 8260 4243  
[pradlovacki@deloitte.com.au](mailto:pradlovacki@deloitte.com.au)

**Megan Field**  
**Partner**

+61 8 8407 7109  
[mfield@deloitte.com.au](mailto:mfield@deloitte.com.au)

**Jonathan Hill**  
**Australian desk, NY**

+1 718 508 6805  
[jonhill@deloitte.com](mailto:jonhill@deloitte.com)

**Gordon Thring**  
**Partner**

+ 61 3 9671 7666  
[gtring@deloitte.com.au](mailto:gtring@deloitte.com.au)

**Kamlee Coorey**  
**Partner**

+61 2 9840 7030  
[mfield@deloitte.com.au](mailto:mfield@deloitte.com.au)

**Jacques Van Rhyn**  
**Partner**

+ 61 7 3308 7226  
[jvanrhyn@deloitte.com.au](mailto:jvanrhyn@deloitte.com.au)

**Jonathan Schneider**  
**Partner**

+ 61 8 9365 7315  
[joschneider@deloitte.com.au](mailto:joschneider@deloitte.com.au)

**David Watkins**  
**Partner**

+ 61 2 9322 7251  
[dwatkins@deloitte.com.au](mailto:dwatkins@deloitte.com.au)

This publication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively the "Deloitte Network") is, by means of this publication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

### About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see [www.deloitte.com/au/about](http://www.deloitte.com/au/about) for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte's approximately 200,000 professionals are committed to becoming the standard of excellence.

### About Deloitte Australia

In Australia, the member firm is the Australian partnership of Deloitte Touche Tohmatsu. As one of Australia's leading professional services firms, Deloitte Touche Tohmatsu and its affiliates provide audit, tax, consulting, and financial advisory services through approximately 6,000 people across the country. Focused on the creation of value and growth, and known as an employer of choice for innovative human resources programs, we are dedicated to helping our clients and our people excel. For more information, please visit our web site at [www.deloitte.com.au](http://www.deloitte.com.au).

Liability limited by a scheme approved under Professional Standards Legislation.

Member of Deloitte Touche Tohmatsu Limited

© 2018 Deloitte Tax Services Pty Ltd.