



## Connected Entities Exemption – Interest in a Hybrid Company

This Commissioner's practice clarifies when an interest in a hybrid company is analogous to an issued share of a corporation for the purposes of a connected entity exemption.

### Background

Under chapter 6 of the *Duties Act 2008* (Duties Act), duty is exempt for *relevant transactions*<sup>1</sup> between corporations and unit trust schemes that qualify as members of a *family*.<sup>2</sup>

A *family* consists of a parent entity and its subsidiary entities. To be a subsidiary, the parent must hold at least 90 per cent of the *securities* of that entity and control at least 90 per cent of the votes at a general meeting of that entity.<sup>3</sup>

A *security* is an issued share of a corporation or a unit issued under a unit trust scheme. If a corporation is a hybrid company, a security includes an interest that the Commissioner considers is analogous to an issued share of the corporation.<sup>4</sup>

A *corporation*<sup>5</sup> includes a company registered under the *Corporations Act 2001* (Cth) (Corporations Act), and a body corporate.

A *share* includes any interest in a share or stock of a corporation.<sup>6</sup>

When a share is allotted or issued, intangible personal property known as a chose in action is created and invested in the shareholder.<sup>7,8,9</sup> The process of becoming a shareholder in an Australian company by the issue of shares ends with entry in the register of members.<sup>10</sup>

Hybrid companies are corporations<sup>11</sup> that include foreign limited liability companies and cooperatives. These entities do not issue shares in the same way as most companies. For example, limited liability companies pass the entity's profits and losses through members, and Dutch cooperatives are set up with members that are entitled to the entity's profits.

The Corporations Act refers to certain foreign companies that have *share capital*, which is the money subscribed for shares of a company. When an entity does not have share capital,

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<sup>1</sup> Duties Act s 257.

<sup>2</sup> Duties Act s 258.

<sup>3</sup> Duties Act s 257(2).

<sup>4</sup> Duties Act s 257(1).

<sup>5</sup> Duties Act s 3: *Corporation* has the meaning given in s 57A of the *Corporations Act 2001* (Cth).

<sup>6</sup> Duties Act s 3.

<sup>7</sup> Corporations Act s 601CM.

<sup>8</sup> Archibald Howie Pty Ltd v Commissioner of Stamp Duties (NSW) (1948) 77 CLR 143 at 157 per Williams J.

<sup>9</sup> Precision Data Holdings Ltd v Titan Hills Australia Ltd (1990) 2 ACSR 707 at 164.

<sup>10</sup> *Bodikian v Sproule* (2009) 72 ACSR 298 at [22] per Austin J.

<sup>11</sup> within the meaning of the Corporations Act.

contributions of capital may still be recognised as entitling the contributor to certain rights in the entity.<sup>12</sup>

This Practice should be read with [Revenue Ruling DA 19 'Duties – Applying for a Connected Entities Exemption'](#) which provides the Commissioner's interpretation of certain terms relevant to applying for a connected entities exemption, and [Commissioner's Practice TAA / DA 48 'Revocation of Connected Entities Exemption'](#) which outlines when a connected entities exemption will be revoked, when penalty tax may apply and how that penalty tax will be remitted.

### Commissioner's Practice

1. To apply the connected entities exemption, an interest in a hybrid company must be considered analogous to an issued share of a corporation.
2. The Commissioner must be satisfied the hybrid company
  - 2.1 possesses a separate legal personality that is distinct from that of its members
  - 2.2 is able to carry on business and
  - 2.3 owns assets in its own rightbefore considering whether the hybrid company has shares<sup>13</sup> that have been issued rather than simply created.
3. The Commissioner will consider all relevant factors when considering the nature of a member's interest in the hybrid company, including
  - 3.1 whether the interest is comparable to a share (that is, a portion of the fixed capital of the corporate body), or comparable to a debt (that is, money owed by the body corporate to its members)
  - 3.2 what proprietary rights and responsibilities attach to the interest, such as rights to participate in control by voting, receive a dividend of the company's profits, and share in a distribution of the company's assets in the event of winding up
  - 3.3 whether any subscription is payable for the interest and if so, whether it remains the member's property, becomes the property of the corporation, or is allocated in some other way
  - 3.4 whether the law relevant to the hybrid company requires amounts subscribed to be allocated to the fixed capital of the company
  - 3.5 whether the interest
    - 3.5.1 can be legally evidenced in accordance with the local laws, for example, whether the interest is registered in a company-held document, with a public authority, or by a certificate or similar document
    - 3.5.2 is denominated in a stated fixed value
    - 3.5.3 forms a fixed and certain amount of capital, or part of that, to which creditors can look as security
    - 3.5.4 is capable of transfer, and if so, whether a transfer would be similar to a transfer of a portion of the capital of the hybrid company and

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<sup>12</sup> St George Bank Ltd v Commissioner of Taxation (2009) 176 FLR 424.

<sup>13</sup> as that term is understood under general Australian law.

3.5.5 based on any other indicators, is being issued, and has the character of ordinary share capital.

4. Numerous strong indicators must point to an entity having issued share capital, however, it is not necessary for every factor to be present. Different weight may be placed on different factors.
5. The Commissioner will have regard to information about the background and state of the affairs of the hybrid company, including
  - 5.1 establishing documents such as its constitution, or articles of association, incorporation, organisation or equivalent
  - 5.2 documents regulating the hybrid company's activities, especially those which deal with subscription for capital or govern the use of profits and assets, such as its constitution, an operating agreement or a membership agreement
  - 5.3 copies of the share register and issued share certificates, or records evidencing how the interests are held
  - 5.4 the corporate law of the governing foreign country
  - 5.5 general commentaries on the company's legal and commercial status and
  - 5.6 financial statements (including the balance sheet) showing the company's state of affairs and how the money subscribed or otherwise provided by the members is allocated.

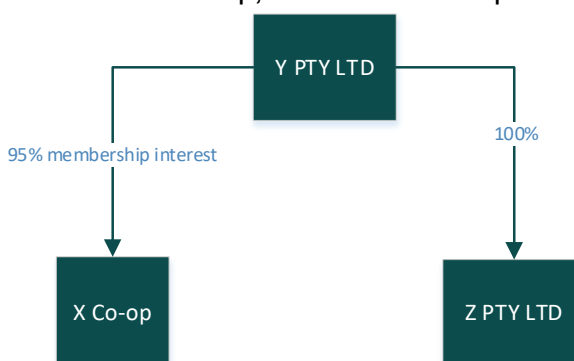
*Example 1*

X Co-op is a foreign hybrid company governed by articles of incorporation which define it as a separate legal entity that is distinct from its members. It is capable of continuing to exist upon changes to its members. It has the power to own and dispose of assets, enter into contracts, and to sue and be sued in its own right.

Under the articles of incorporation, for a potential member to join X Co-op, it must subscribe for a membership interest and pay a determined amount. Each member is entitled to a number of votes equal to its ownership in X Co-op. X Co-op must maintain an account for each member with their name and address, and benefits and dividends are provided to the members in proportion to their membership interests. The membership interest is transferable subject to prior approval at a general meeting of the members.

Y Pty Ltd has a 95 per cent membership interest in X Co-op, and controls 95 per cent of the votes at a general meeting of X Co-op. Y Pty Ltd also holds 100 per cent of the securities of Z Pty Ltd, and controls 100 per cent of the votes at a general meeting of Z Pty Ltd.

For the purposes of connected entities exemption, the entities are family members and Y Pty Ltd's interest in X Co-op are analogous to issued shares of a corporation.



### Example 2

D LLC is a foreign limited liability company incorporated in the United States. It is governed by its articles of organisation and operating agreement.

The articles of organisation state the purpose of D LLC's business and that its life span, or duration of operation, is 30 years. They also state that D LLC can own and dispose of assets, enter into contracts, and sue and be sued in its own right.

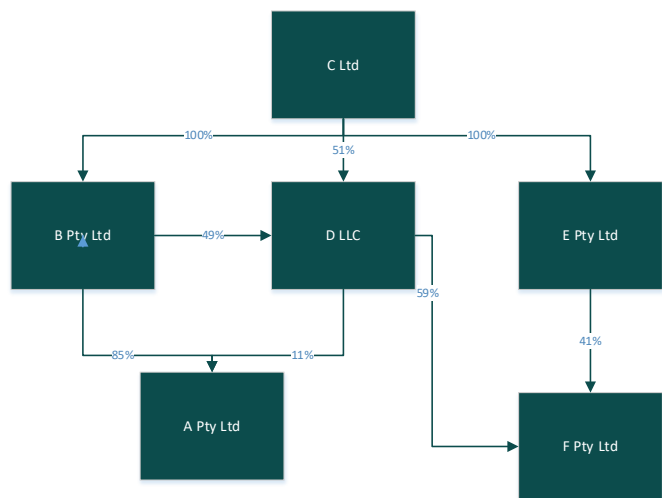
D LLC's operating agreement sets out the management structure and responsibilities of each member including member ownership percentages, profit allocations, member voting rights, member exiting procedures and company dissolution procedures.

D LLC has a 59 per cent interest in F Pty Ltd, and controls 59 per cent of the votes at a general meeting of F Pty Ltd. E Pty Ltd has a 41 per cent interest in F Pty Ltd, and controls 41 per cent of the votes at a general meeting of F Pty Ltd.

A Pty Ltd is 100 per cent held and controlled by B Pty Ltd, which has a 49 per cent membership interest and controls 49% of the voting rights at a general meeting of D LLC.

B Pty Ltd and E Pty Ltd are wholly owned subsidiaries of C Ltd, which has a 51 per cent membership interest and controls 51 per cent of the voting rights at a general meeting of D LLC.

For the purposes of a connected entities exemption, the entities are family members and the membership interests in D LLC are analogous to issued shares of a corporation.



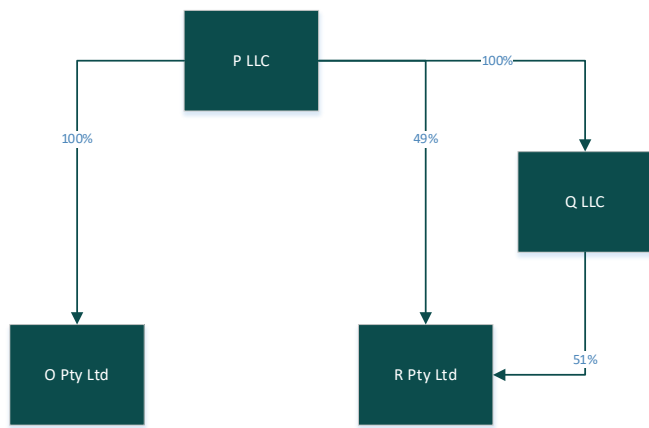
### Example 3

Q LLC is a foreign limited liability company incorporated in the United States. While it has articles of organisation, it does not have an operating agreement. It is governed by the default rules contained in relevant state statutes. Q LLC has a 51 per cent interest with equivalent votes in R Pty Ltd.

P LLC is a foreign limited liability company incorporated in the United States which directly holds a 100% interest in Q LLC, a 49 per cent interest and equivalent voting rights in R Pty Ltd, and indirectly holds a 51 per cent interest and equivalent voting rights in R Pty Ltd. P LLC directly holds a 100 per cent interest and controls 100 per cent of the votes in O Pty Ltd.

The articles of organisation for Q LLC and the relevant governing jurisdiction's statutes do not confirm that the member's rights and interests are equivalent to those of a shareholder of a corporation. There is no evidence that Q LLC has elected to be treated as a corporation by the relevant governing jurisdiction.

Based on this evidence, P LLC's interest in Q LLC is not considered analogous to issued shares in a corporation, and P LLC's indirect 51 per cent interest in R Pty Ltd will not be treated as shares in a corporation. O Pty Ltd and R Pty Ltd are not family members for the purposes of connected entities exemption.



### Date of Effect

This Commissioner's practice takes effect from 22 March 2021.

Nicki Godecke  
 COMMISSIONER OF STATE REVENUE  
 22 March 2021

### Document History

Commissioner's Practice	Issued	Dates of Effect	
		From	To
DA 49.0	22 March 2021	22 March 2021	Current