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29 October 2009

Mr Ivan Rakoczi
Australian Taxation Office
GPO Box 9977
Melbourne VIC 3001

Dear Sir

Draft Taxation Determination TD 2009/D7

Attached please find comments from the Association of Superannuation Funds of Australia (ASFA) to the release by the Australian Taxation Office of Draft Taxation Determination TD 2009/D7 (“the TD”).

ASFA is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. Our members, which include corporate, public sector, industry and retail superannuation funds, account for more than 5.7 million member accounts and over 80% of superannuation savings.

ASFA appreciates the opportunity to respond to the issues outlined in the TD, as these issues are of direct relevance to a number of Australia's largest superannuation funds.

As outlined in the attachment, ASFA questions the approach adopted in the draft determination and proposes that there is another approach that should be considered which is more closely aligned to the operation of partnership law.

Should you have any questions, please contact Robert Hodge, Principal Policy Adviser on 02 8079 0806.

Melinda Howes
Director Policy and Industry Practice

DRAFT TAXATION DETERMINATION TD2009/D7

Background

Broadly, the TD expresses the view that if:

- An Australian complying superannuation fund (“ACSF”) holds an interest in a foreign hybrid entity (“Hybrid”) (as that term is understood in Division 830 of the *Income Tax Assessment Act 1997*, as amended (“ITAA97”); and
- the Hybrid is a Controlled Foreign Corporation, or the superannuation fund makes the election pursuant to section 485AA of the *Income Tax Assessment Act 1936*, as amended (“ITAA36”) in respect of its interest in the Hybrid, such that the Hybrid is treated as a partnership for Australian taxation purposes; and
- the Hybrid itself is the holder of interests in various underlying entities, each of which would be exempt interests in Foreign Investment Funds (“FIFs”) pursuant to section 519B of ITAA36 if they were instead held direct by the superannuation fund;

then the ACSF loses the benefit of the section 519B exemption.

This is because the TD expresses the view that, in calculating the partnership income, the Hybrid is required to calculate the attributable income pursuant to section 529 of ITAA36 in respect of any non-exempt FIFs that it might hold, and that the Hybrid is not entitled to the section 519B deduction as it:

- (a) is not an ACSF; and
- (b) is not a fixed trust wholly owned by ACSFs.

The outcome of the above is that:

- The Hybrid is required to incur the significant compliance costs associated with the determination as to whether any of the other various exemptions in sections 492 to 527 of ITAA36 apply to each of the underlying FIF interests within the Hybrid;
- The Hybrid is required to calculate attributable FIF income as part of its calculation of net partnership income where none of these other exemptions apply; and
- The ACSF is required to include its share of any such attributable income as part of its assessable income, notwithstanding that all of the other holders of interests in the Hybrid may be other ACSFs, each of which would have been exempt from these attribution rules had they directly held the underlying interests in FIFs rather than indirectly held by them through the Hybrid.

Comments

ASFA considers that, whilst the position as stated in the TD is arguable, it both is open to, and would be appropriate for, the ATO to take the contrary position.

Why it is open for the ATO to take the contrary position

ASFA submits that it is open for the ATO to take the contrary position. Our reasons are as follows:

- 1 A partnership is not the owner of an asset for many relevant purposes – rather, each partner owns a fractional interest in each of the underlying assets of the partnership.
- 2 This position is specifically the case in Australia’s capital gains tax provisions, pursuant to section 106-5 of ITAA97 and former section 160C(3) of ITAA36. It should be noted however, many specialists in partnership and taxation law consider that both of these provisions merely serve to clarify the position. That is the capital gains tax provisions would apply in the same way with or without these sections.
- 3 On this basis of ‘application of similar principles’, it would be possible to argue that a partnership is ultimately not the holder of an interest in a FIF but rather that the partners are the holders of the interest (i.e. each partner is the holder of a fractional interest).

- 4 Although this would seem contrary to section 485A of ITAA36, it may be argued that this section merely provides the mechanism for calculation of the relevant attributable income pursuant to the FIF provisions. Whether the income is actually to be included in assessable income would depend on what type of tax entity the partner is. That is, the income would only be included by a partner if that partner was not an ACSF or other entity exempt pursuant to section 519B of ITAA36.
- 5 Whilst such an interpretation would appear to still require the calculation of the relevant attributable income to be undertaken, and the compliance costs thereby incurred by the Hybrid, this would not be the case if all of the partners in the partnership, or the only Australian partners in the partnership, were ACSFs or fixed trusts wholly owned by ACSFs.

Why it would be appropriate for the ATO to take this contrary position

ASFA submits that, even if the ATO were to determine that the position in the TD is stronger than that outlined in points 1 to 5 above, it would be nonetheless appropriate for the ATO to take this contrary position for the following reasons:

- 1 The position taken in the TD places an unnecessary burden on ACSFs which own FIFs indirectly through hybrid entities. In particular, such funds will incur many of the compliance costs associated with these provisions, even if other exempting provisions within sections 492 to 527 of ITAA36 apply to the Hybrid in respect of its underlying investments.
- 2 The position taken in the TD is impractical, in that it results in a compliance burden, and indeed in FIF attribution income, even where all partners are ACSFs or fixed trusts wholly owned by such funds, or where the only Australian partners are ACSFs or fixed trusts wholly owned by such funds.
- 3 The position taken in the TD is contrary to the intention of the Government when it introduced section 519B, and significantly diminishes the effectiveness of that exemption for ACSFs. In particular, an ACSF may then face a difficult choice:
 - Make the Hybrid election and assume the significant burden associated with compliance with the FIF rules; or
 - Not make the Hybrid election and thereby lose any possibility of obtaining Foreign Income Tax Offsets in respect of withholding tax by foreign jurisdictions from distributions made by the underlying investments to the Hybrid.
- 4 The position taken in the TD would also seem to take an unnecessarily hard line, given the proposed broader removal of the FIF rules, and the specific removal of the CFC rules for ACSFs.

An unfortunate consequence of the application of the TD, should it issue as a final determination in its present form, is that a number of ACSFs may have attributable FIF income for only a small number of years, as they may be more broadly exempt when FIF and the CFC rules are removed for ACSFs.

Notwithstanding the exemption that would then apply, the ACSFs would continue to have to maintain FIF attribution accounts, and continue to obtain information from the Hybrid in respect of the underlying investments, in order to reduce assessable income on eventual distributions or capital gains to the extent of such attribution accounts.

Application date

ASFA submits that, should the ATO not accept the above arguments, the TD not be issued with a retrospective application date (as stated in present paragraph 8).

There may be many ACSFs that invested in good faith on the basis of the contrary position, or indeed on the basis of ATO ID 2006/40 which, whilst not articulating the specific arguments above, nonetheless concluded that the exemption was available.

Given the burdens imposed on ACSFs that invest in foreign hybrid entities by the interpretation in the TD, ASFA submits that the TD should only have prospective application.