SUBMISSION

Submission to Australian Taxation Office — Decision Impact Statement for *Burton v Commissioner of Taxation*

12 June 2020

The Association of Superannuation Funds of Australia Limited
Level 11, 77 Castlereagh Street
Sydney NSW 2000

PO Box 1485
Sydney NSW 2001

T +61 2 9264 9300
1800 812 798 (outside Sydney)
F 1300 926 484
W www.superannuation.asn.au

ABN 29 002 786 290 CAN 002 786 290

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Mr Michael McCormack

Australian Taxation Office

Via email: Michael.McCormack@ato.gov.au

12 June 2020

Dear Mr McCormack

Submission to Australian Taxation Office – Decision Impact Statement for *Burton v Commissioner of Taxation*

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the release on 22 April 2020 by the Australian Taxation Office (ATO) and the invitation for comments in respect of the Decision Impact Statement (the DIS) for *Burton v Commissioner of Taxation* (the Burton case).

About ASFA

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing almost 90 per cent of the 16 million Australians with superannuation.

ASFA's submission has been prepared with the assistance of our Tax Specialist Advisory Committee. The Committee has identified a number of practical concerns for superannuation fund and pooled superannuation trust investors (collectively referred to herein as superannuation funds except where otherwise noted), which arise from the DIS and the Burton case more broadly, as outlined overleaf.

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If you have any queries or comments in relation to the content of our submission, please contact me on (03) 9225 4027 or by email jstannard@superannuation.asn.au.

Yours sincerely

Julia Stannard

Senior Policy Advisor

General comments

In our submission dated 8 November 2019 responding to *Draft Taxation Determination* TD 2019/D10, we highlighted a number of long-standing issues relating to the determination of entitlements to Foreign Income Tax Offsets (FITOs) in relation to which superannuation funds seek certainty. We note that, at the date of this submission, TD 2019/D10 has not been finalised.[1]

The issues we highlighted are directly relevant to the work funds will shortly need to attend to as part of preparing their income tax returns for the year ending 30 June 2020, and in calculating their Australian tax payable position.

The current COVID-19 pandemic will highlight the uncertainties associated with determining FITO entitlements, given the recent and ongoing volatility of global investment markets and the Australian dollar, along with the propensity of foreign governments to implement changes to how their tax regimes apply to non-resident investors (such as Australian superannuation funds).

Furthermore, as shown by APRA's recently released Quarterly Superannuation Performance Statistics as at 31 March 2020[2], APRA regulated funds hold over $600 billion in foreign assets — reflecting more than one-third of their total investments.

It is therefore imperative that superannuation funds have certainty with respect to applying the FITO rules in Division 770 of the *Income Tax Assessment Act 1997* (the ITAA 1997), and other provisions of the taxation law which affect their tax position, to such a significant part of their investment portfolios.

In the specific context of the Burton case and the DIS, while ASFA accepts in principle the decision of the Full Federal Court in limiting the amount of foreign tax paid able to be counted towards the taxpayer's FITO entitlement by reference to the Capital Gains Tax (CGT) discount, it raises a number of technical and practical questions which should in our view be confirmed by the ATO by way of further — and, we would submit, more specific — guidance.

These are outlined below. For completeness, we have also included brief comments regarding other matters which, while relevant to the Burton case and the DIS, are submitted to be settled in terms of the application of the law.

Specific comments in relation to the Decision Impact Statement

Impact of foreign exchange fluctuations

In the DIS, under the heading 'ATO view of decision', it is stated that:

> "*The Court's interpretation of subsection 770–10(1) confirms the correctness of the Commissioner's view expressed in ATO ID 2010/175 – that is, that where a resident of Australia pays foreign income tax on the whole of a foreign capital gain which is only partly assessable in Australia, only a proportionate share of the foreign income tax counts towards the foreign income tax offset under subsection 770-10(1).*"

[1] Refer to income tax issue [3974] from: https://www.ato.gov.au/general/ato-advice-and-guidance/advice-under-development-program/advice-under-development---income-tax-issues/

[2] Refer to Table 1d "Superannuation industry asset allocation" which can be accessed from: https://www.apra.gov.au/quarterly-superannuation-statistics

The impact of fluctuations in foreign currency exchange rates between the acquisition date and disposal date does not seem to have been significant in the Burton case, noting that the total amount of the gains taxed in the United States was USD$23,570,360 whereas in Australia the total 'long' gains (that is, prior to application of the 50 per cent CGT discount under Division 115 of the ITAA 1997) was $22,754,321. Nevertheless, this will be relevant in many cases, resulting in scenarios including (but not limited to) where the amount of the gain taxed in the foreign country is:

a) much lower than the Australian capital gain amount; or

b) much higher than the Australian capital gain amount.

An example might be where a US asset was acquired in March 2020 for USD$100,000 when the exchange rate was AUD$1=USD$0.60, but then disposed of in June 2020 for USD$120,000 when the exchange rate is now AUD$1=USD$0.70. In this case the USD gain is $20,000 but the AUD gain is only $4,763 (based on proceeds of $171,429 less cost of $166,666). The reduced amount of the AUD gain arises here because the Australian CGT rules do not separately determine a foreign exchange component —if they did, the AUD gain would be $28,571 and the foreign currency exchange loss component would be $23,808. Effectively, these amounts are each recognised albeit netted off as part of calculating the overall capital gain of $4,763.

ASFA seeks confirmation from the ATO that in this scenario, it would not consider the foreign capital gain to be only partly assessable in Australia, and therefore no proportionate reduction is required. Accordingly, any US tax paid on the USD$20,000 capital gain would count in full towards the FITO (again subject to the gain not being reduced by capital losses along with the other normal FITO entitlement rules).

ASFA does, however, acknowledge that if the Australian outcome from the above was a capital loss then no part of the foreign tax paid should count towards the FITO.

Impact of capital loss offsetting in foreign tax jurisdiction

Like the Australian CGT rules, certain foreign tax regimes may allow capital losses to be offset against gains to determine a net gain amount subject to foreign tax. Where this is the case, the amount of foreign tax paid referable to specific capital gains might not be readily ascertainable, however the identification of specific gain and related foreign tax amounts remains important given the CGT loss application ordering rules from section 102-5 as noted above. This is particularly the case where, for Australian CGT purposes, the foreign gains are a mixture of 'short' and 'long' gains.

ASFA seeks confirmation from the ATO that:

(i) where the foreign tax jurisdiction has rules pursuant to which losses are offset against specific gains, then the identity of the remaining net gain amount subject to foreign tax is to be determined applying that approach; and

(ii) otherwise, a proportionate approach is accepted — for example, if total gains are 100 and total losses are 50 in the foreign jurisdiction, then treat half of each capital gain as being reflected in the remaining net gain of 50 (and apply the relevant foreign tax rate to then determine the amount of foreign tax paid on each gain).

Foreign tax paid on capital gains included in trust distributions or AMIT attributions – third party data reliance

Superannuation funds commonly invest via managed investment schemes, which for tax purposes are either Managed Investment Trusts (MITs) or 'Attribution' MITs (AMITs).

In a MIT and CGT event E4 context, the ATO had previously suggested that recipients of tax distribution statements might be able to rely on information contained thereon[3]. However, as was made clear during the recent Streamlined Tax Assurance Review (STAR) program for large superannuation funds, such tax statements (along with AMIT Member Annual Statements (AMMAs) received from AMITs) form part of third party data to which a superannuation fund should apply appropriate tax risk management controls.

ASFA notes that the ATO STAR Reports provided to superannuation funds stated that the ATO intends to develop and publish further guidance in 2020 on what it considers to be appropriate controls and processes to reduce the risk of reliance on third party data.

ASFA seeks guidance from the ATO as to the type of controls which would be considered appropriate in considering FITO amounts from trusts which are identified as relating to capital gains, noting that the ATO-endorsed standard 2020 year form of AMMA and tax distribution statements[4] (along with Annual Investment Income Report specifications) do not contain detailed information in this regard.

As such guidance may not be provided in the short-term, ASFA requests that the ATO confirm that it will not apply compliance resources with respect to the year ending 30 June 2020 where superannuation fund investors apply the following 'best efforts' approach to determine their FITO entitlements arising from foreign tax amounts reported by MITs and AMITs:

> Where it is not clear from the AMMA or tax distribution statement, and where relevant amounts are not immaterial[5], superannuation fund investors should confirm whether any FITO amounts relate to foreign taxes paid on capital gains, and if so:
>
> - that the capital gains were not offset by capital losses within the trust;
> - the extent to which the foreign taxes related to 'short' and 'long' capital gains; and
> - for long capital gains subject to foreign tax, whether the foreign tax amount is 50 per cent or 100 per cent of the foreign tax paid.

ASFA submits that superannuation fund investors should not be required to interrogate the fund manager to understand the specific basis for foreign tax being imposed on capital gains, nor the extent to which expenses were allocated against capital gains. This is the responsibility of the MIT or AMIT itself as part of its own tax compliance and governance, and any expectation otherwise from the ATO would be an inappropriate and impractical burden to impose on superannuation fund investors and the managed fund industry in general.

[3] Refer to: https://www.ato.gov.au/Business/Bus/Interim-guidance-on-preparation-of-2016-and-2017-unit-trust-distribution-statements/

[4] Refer to: https://www.ato.gov.au/Forms/Attribution-managed-investment-trust-member-annual-statement-and-standard-distribution-statement--guidance-notes-for-trustees-2020/

[5] Based on an absolute dollar or relative amount to be determined.

Other comments on settled matters

Foreign tax paid on capital gains included in trust distributions or AMIT attributions – impact of CGT discount

The Burton case involved a capital gain distributed by a trust[6] to an individual. The 50 per cent CGT discount can apply to both entity types (pursuant to Division 115 of the ITAA 1997), the outcome being that only half of the foreign tax paid of AUD$3,414,207 could count towards the taxpayer's FITO.

As the DIS highlights, under the heading 'Issues decided by the Court':

> *"Per the whole Court - the reference in subsection 770-10(1) to foreign tax paid 'in respect of ... an amount included in your assessable income' was a reference only to the proportion of the foreign tax paid on the net capital gain that was included in assessable income, as determined by subsection 102-5(1)."*

For a trust beneficiary that is a superannuation fund (and not an individual like Mr Burton), then in the same facts as the Burton case, the net capital gain would be reduced by the one-third CGT discount under Division 115, and so would also the amount of the foreign tax paid which would count towards the FITO (that is, reduced by one-third from AUD$3,414,207 to AUD$2,276,138, again subject to other FITO entitlement rules).

This result is the clear outcome of the tax rules as they apply to unitholders of AMITs under section 276-80 of the ITAA 1997 where, for the purposes of working out a member's entitlement to a tax offset, the member is treated "…as having paid or received the amount reflected in the determined member component: (a) in the member's own right (rather than as a member of a trust); and (b) in the same circumstances as the AMIT paid or received that amount."

ASFA notes that the above matter may be affected by the proposal announced (and subsequently deferred) as part of the 2018-19 Federal Budget whereby MITs and AMITs would no longer apply the 50 per cent CGT discount at the trust level from 1 July 2020 (rather the applicable CGT discount would be applied at the beneficiary level). We await further details on that proposal.

Ordering of application of capital losses against capital gains

Section 102-5 of the ITAA 1997 (particularly Note 1 of Step 1 and Note 2 of Step 2 of the method statement contained in subsection (1)) clearly gives a taxpayer the choice as to which specific capital gains it applies both current year and then prior year capital losses against.

Accordingly, a taxpayer might choose to apply its capital losses against capital gains based on an ordering rule which first reduces gains (starting with short gains, then once exhausted, perhaps also long gains) which have not borne foreign taxes, before then reducing gains which were subject to foreign tax (again, short before long). Such an ordering approach is appropriate in allowing its remaining net capital gain to be comprised of gains which were subject to foreign tax to the maximum extent.

Where the taxpayer's net capital gain reflects only part of a capital gain which was subject to foreign tax (because its remaining losses are not sufficient to fully offset the gain), then consistent with the Burton case a proportional reduction must be made to the foreign tax referable to that gain to determine the amount which counts towards the FITO (but subject to normal FITO entitlement rules including adjustments for "exempt current pension income"[7] and also that the taxpayer's FITO cap was not exceeded).

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[6] Neither a MIT nor an AMIT although not considered important in this context.

[7] Determined under sections 295-385 and/or 295-390 for superannuation funds, and section 295-400 for pooled superannuation trusts.