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Dear Chris,

RE: ATO Consultation on Limited Partnerships

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the request for comments in respect to the 12 September 2014 consultation paper: *Summary of industry concerns and issues, raised in the consultation process, in relation to the operation of sections 94L and 94M of the Income Tax Assessment Act 1936* ("the Consultation Summary"). We would also like to place on the record our appreciation of the ATO's willingness to continue to consult with industry on this matter in pursuit of a resolution that is acceptable, as far as is possible, to all parties.

About ASFA

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. We focus on the issues that affect the entire superannuation system. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90% of the 12 million Australians with superannuation.

General comments

There is uncertainty in the industry relating to the application of Division 5A of the *Income Tax Assessment Act 1936 (ITAA 1936)* when calculating the taxable income arising from investments in limited partnerships. As discussed in the consultation sessions there seem to be a range of practices adopted in the industry in this regard.

ASFA is supportive of the Australian Taxation Office's (ATO) review of the application of these provisions with a view to providing greater certainty to taxpayers. However, given the widespread holdings of these investments we submit that any guidance needs to be practical and efficient to ensure that superannuation funds can appropriately discharge their taxation obligations without undue administration burdens or risks. For example, the ATO guidance needs to recognise the widespread use of by superannuation funds of custodians for tax reporting purposes and the constraints this imposes on what information is available. In this respect the guidance should contemplate the use of a systems based compliance solution.

Furthermore, we would request that any ATO guidance have prospective application to new acquisitions as many of these investments have been held by Funds for years. A change in taxation treatment in respect of existing limited partnership investments may give rise to permanent tax differences due to the 4 year limitation period for amendment of investor's assessments. Further requiring retrospective application of the final ATO views where they are divergent with previous Fund practice may result in significant ATO and Fund compliance costs where Fund returns would need to be amended for such differences.

We outline below our responses to the items raised in the Consultation Summary.

Item 1: Practical Issues with Limited Partnerships as identified by industry

Information access

ASFA agrees with the ATO summary of issues regarding a limited partner's access to information. This issue generally stems from the lack of control that a limited partner has over the operations and management of the limited partnership. Effectively, the limited partners are only investors with rights to income, capital and limited voting rights based on the constituting documents of the partnership. As an investor in the limited partnership (and often a minority investor), it may not be possible for limited partners to obtain detailed information that would allow the preparation of separate calculations for Australian tax purposes.

Timing of information and different reporting periods

ASFA agrees with the observations made in the Consultation Summary that difficulties arise as a result of the Australian 30 June tax year-end (i.e. the typical year-end for the superannuation sector) not aligning with the 31 December year end of the majority of limited partnerships. In this regard, many Australian tax returns are prepared using final distribution statements provided by the general partner for the period to 31 December. However subsequent distributions paid during the period to 30 June are based on a "best estimate" approach as the components of these distributions may not yet be known. Consequently, it may be necessary for an Australian tax return to be amended once finalised limited partnership reporting is provided.

ASFA suggests that the ATO consider an administrative arrangement to permit Funds to include these limited partnership "true-ups" in the following year 30 June tax return (at their election), rather than require an amendment to the prior year tax return.

Content of information received

ASFA agrees with the ATO summary that the content of the information provided by the General Partner of a foreign limited partnership will not be prepared with reference to Australian tax law or Australian accounting standards and that considerable work is often required to characterise income and capital components of the unpaid 'credited' amount when preparing Australian tax returns. Such methods include using United States K1 schedules, audited financial statements or statements provided by the General Partner summarising movements in the limited partner's investment.

Maintaining own records

ASFA acknowledges that as a result of the issues outlined above some Funds maintain separate accounts to track retained profits and returns of capital. This approach is deemed necessary where, due to uncertainty as to the operation of the provisions, the Fund adopts a broad definition of the

term “credits” for the purposes of section 94M. In these circumstances, the Fund may consider that additional information is required with respect to the distributions of the limited partnership in order to prepare their tax calculations beyond what is disclosed in the statements provided by the General Partner.

However, the process of maintaining separate records for each limited partnership is a costly and time consuming process due the difficulty in obtaining the necessary information.

Furthermore, there may be potential issues as:

- The Fund may not be able to obtain the required information, or in sufficient detail, to allow it to prepare its income tax calculations (particularly where it is a minority investor).
- The Fund is not involved in the preparation of the documents obtained (e.g. financial statements or US K1 schedules) and must make certain assumptions when utilising this information in the preparation of their income tax calculations.
- The Fund may not be aware of subsequent amendments to the audited financial statements and other schedules which could impact the income tax calculations.
- The information provided to the Fund may not be consistent with other distribution statements, accounting and financial records.

ASFA is concerned that the above matters are likely to result in a greater level of uncertainty for Australian limited partners in preparing their income tax calculations.

Conversion of LP into foreign hybrids

ASFA acknowledges the risk that movements in limited partnership interests may lead to inadvertent exposure to the foreign hybrid rules. As noted above, it is likely to be difficult to obtain records in relation to the limited partnership (particularly where this information relates to details of other investors which may be considered as confidential) and, as a result, a limited partner may not be aware that their interest is subject to the foreign hybrid rules.

Classification as a ‘foreign hybrid limited partnership’ requires an examination of the complex Controlled Foreign Company (“CFC”) rules. We note that, where the CFC rules are not satisfied a superannuation fund may, in certain circumstances, make an election for its interest in the entity to be treated as a ‘foreign hybrid limited partnership’. ASFA suggests that this issue could potentially be resolved by treating a limited partnership as a “foreign hybrid” only at the election of the Fund (whether a CFC or otherwise).

Item 2: Application of Division 5A – issues identified by industry with the interaction between sections 94L and 94M of the Income Tax Assessment Act 1936

General tendency to apply section 94L rather than subsection 94M(1)

ASFA acknowledges that Funds may be more likely to apply section 94L than subsection 94M(1) when calculating their assessable income in respect of limited partnership interests. However, this is not due to subsection 94M(1) being ignored but rather is due to the fact that section 94L is more likely to be applicable in most instances. In this regard, the circumstances in which subsection

94M(1) may apply are likely to be limited based on the general interpretation of "credited" as used in this section.

ASFA agrees with the Consultation Summary which notes that Brookton Co-operative Society Limited v FCT (1981) 11 ATR 880 (*Brookton's case*) and Commissioner of Taxes (Vic) v Nicholas (1938) 59 CLR 230 (*Nicholas' case*) support the view that "credited" should be interpreted narrowly. It is ASFA's view that a similar interpretation should apply to the term 'paid or credited' for section 94M purposes.

This interpretation should permit funds to follow the cash and determine their Australian tax liability under section 94L at the point in time when distributions are actually paid.

Support for a narrow reading of subsection 94M(1) – 'credited; equating to 'paid'

ASFA is also of the view that taxpayers should be permitted to adopt a narrow reading of "credited" for the purposes of section 94M.

The Explanatory Memorandum (the EM) to the *Taxation Laws Amendment Act (No.6) 1992* which introduced the provisions in Division 5A states at page 30 that:

> *"The object of this new Division is to ensure that limited partnerships will be treated as companies for taxation purposes. This is not confined to the payment of income tax by limited partnerships, but includes all other purposes under income tax law, including the payment of tax by partners in limited partnerships, for instance, imputation and the taxation of dividends for shareholders".*

Based on the objective of Division 5A (as outlined in section 94A) and the EM, ASFA submits that Division 5A should be read as modifying the existing tax law in respect of companies so that the law applies equally to corporate limited partnerships. Importantly, ASFA notes that at no point do the objectives of the provisions in section 94A or the EM contemplate that Division 5A should be seen as extending the operation of the tax law for limited partnerships beyond that of the tax law for companies. ASFA submits that Division 5A is not meant to be a punitive regime or introduce an accruals regime.

Support for treating allocations out of profits or anticipated profits as 'credited' for subsection 94M(1) purposes

The possible application of section 45B of the ITAA 1936 to limited partnership distributions of capital is an ongoing risk that has resulted in some Funds adopting this alternative subsection 94M(1) approach.

ASFA requests that the ATO consider issuing a ruling to the effect that section 45B should not apply to distributions from limited partnerships. Such a ruling would assist industry adopt a more consistent approach to the taxation of limited partnerships.

Double taxation and subsection 94M(2)

ASFA acknowledges the uncertainty regarding how subsection 94M(2) may apply in the event Funds want to take a broad interpretation of credits. Attribution rules have historically been complex and expensive to administer with the risk of double taxation still possible.

ASFA requests that any ATO guidelines on this section be broad and practical so as to permit superannuation funds to deal with double taxation in a manner that is efficient and simple to administer.

Item 3: Options proposed by industry for addressing their areas of concern

Generally

ASFA recommends that the ATO provide guidance on the operation and interaction of sections 94L and 94M and in particular to what is meant by the term "credited". In this regard, ASFA acknowledges a private binding ruling (Authorisation Number: 1012582983519) which was published by the ATO in early 2014 provides some limited guidance in relation to these issues. However, we understand, through the consultative process, that this private binding ruling may not represent the ATO's final view on this matter.

We request that any administrative approach provided by the ATO for dealing with the issues surrounding section 94L and subsection 94M(1) take into account the matters considered above in ASFA's response to the Consultation Summary.

Importantly, the uncertainty surrounding limited partnership should be resolved by the ATO as a matter of priority as limited partnership investments are a common form of collective investment vehicle used in foreign jurisdictions and the quantum of the investments is significant.

Narrow interpretation of 'credits'

ASFA suggests that taxpayers should be permitted to rely on the partnership distribution statements provided to them in relation to distributions received from their limited partnership investments. This is similar to the treatment permitted for other investment options, where investors rely on trust distribution and dividend statements.

Furthermore, there should not be any perceived mischief or avoidance of paying tax in respect of a limited partnership investment where a limited partner relies on a distribution statement provided by the general partner. As noted in the Consultation Summary, it would generally not be possible for the limited partner to influence the amount of the distribution paid as limited partners usually lack control over the operations of the limited partnership. ASFA would argue that in circumstances where the limited partner does have an element of control over the limited partnership the Controlled Foreign Company provisions in Part X of the ITAA 1936 should apply and that it is not the intention of the legislation that Division 5A should apply an additional attribution regime.

Broad interpretation of 'credits' and 'credited'

ASFA acknowledges that this approach may currently be adopted by superannuation funds as a result of the uncertainty surrounding the interaction of section 94L and subsection 94M(1). Furthermore, uncertainty surrounding the potential application of section 45B also results in some Funds adopting this approach.

However, there are a range of potential issues with implementing this approach:

- Taxpayers may have difficultly accessing the required information from the limited partnership, or obtaining the information in a timely manner. In addition, taxpayers need to contend with differing accounting methods and presentation standards between countries.

- There would be significant additional compliance costs for taxpayers.
- Without further guidance in relation to the application of subsection 94M(2), there is the potential risk of double taxation arising in circumstances where amounts paid to limited partners were previously subject to tax when credited to the partner's account (but not paid), or where an amount credited to a partner's account is offset by previous or subsequent losses of the partnership.

ASFA requests that should a narrow interpretation of "credits" be adopted by the ATO then an administrative concession should be provided to superannuation funds that have previously adopted the broader interpretation of credits in calculating their assessable income of the limited partnerships in the form of the ATO also accepting this position as reasonable.

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If you have any queries or comments regarding the contents of our submission, please contact me on (02) 8079 0806 or by email rhodge@superannuation.asn.au.

Yours sincerely

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Principal policy Adviser