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Manager
Tax Treaties Unit
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: taxtreatiesunit_consultation@treasury.gov.au

Dear Sir / Madam,

RE: Consultation on Australia's tax treaty negotiation program

The Association of Superannuation Funds of Australia (ASFA) would like to lodge this submission with respect to the above consultation.

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

ASFA welcomes the consultation process as the superannuation industry represents some of the largest Australian investors in foreign jurisdictions and the removal of, or reduction in, taxation barriers caused by double taxation of income or capital gains assists the superannuation sector in its primary objective of advancing the retirement outcomes of Australians.

In this submission we raise three issues for consideration in future treaty negotiations:

1. Australian superannuation funds as "persons" or beneficial owners for the purposes of double tax treaties

2. Potential exemption clause in respect of income derived by superannuation or pension funds.
3. (Relevant to the US-Australia tax treaty specifically) Availability of credit for taxes paid within Australian superannuation funds on contributions and earnings against any US taxes imposed on individuals in respect of such contributions and earnings.

Specific Comments

1. *Australian superannuation funds as "persons" or beneficial owners for the purposes of double tax treaties*

For many of ASFA's large superannuation fund members, one of the more significant practical aspects of implementation of Australia's tax treaties is that a number of jurisdictions are not willing to accept that Australian superannuation funds are beneficial owners of income entitled to treaty benefits. As a result of this stance, they will not accept a Certificate of Residency from the Australian Taxation Office as sufficient documentation to enable a superannuation fund to claim the benefits of the treaty.

For example, Taiwan takes a "look through" approach to establishing the beneficial owners of the income and requires Australian superannuation funds to provide additional, detailed and extensive documentation in respect of funds' underlying members. In the case of our largest superannuation funds, this would require the provision of details for more than 1 million members which may not be practical or possible due to the operation of privacy laws. It may be appreciated that, unless the quantum of dividend income from these jurisdictions is very large, the compliance costs in obtaining this documentation may easily outweigh the potential benefits from the application of the lower withholding tax rate specified in the treaty.

We understand that this treatment by Taiwan is not restricted to Australia, but the nature of the issue can vary from country to country. For example, for UK pension funds, we understand that Taiwan has accepted a certificate of residency issued by the UK revenue authority (HMRC) that also states the % ownership of UK residents in the pension fund. It is not clear whether Taiwan would accept a similar certificate from the ATO or whether the ATO would be willing to issue such a certificate (or whether it would refuse to do so on the basis that it does not consider that it has the necessary information to cite the percentage of Australian residents in any particular Australian superannuation fund). Indeed, we understand that the UK HMRC has more recently started to refuse to issue certificates with the percentage included on similar grounds, resulting in UK pension funds having to provide similar documentation to Taiwan to that presently required of Australian funds.

By way of further example, Korea requires superannuation funds to certify that they are "pension funds set up under the laws of a treaty partner country that are similar to

Korean laws on pension funds". Due to the complexity of pension and superannuation fund laws in both jurisdictions, this may not be possible to establish to the satisfaction of the Korean authorities in the absence of a lengthy and complex confirmation process with the Korean authorities.

Again, we understand that, in the UK, some pension funds have satisfied themselves that they meet the equivalent criteria for Korea, and are declaring this on the form, whereas others have taken a more conservative view and where that is the case either provide details of underlying beneficial owners (where they are able to do so) or do not apply for the relief at all. Thus, it is clear that Korea presents problems that extend well beyond Australian superannuation funds.

ASFA is also concerned that as superannuation funds expand their direct offshore investment portfolios, many more examples will arise of these practical difficulties which act as barriers to Australian superannuation funds obtaining benefits under Australia's treaties.

In addition, Australian income tax legislation operates such that, strictly, the maximum foreign income tax offset ("FITO") is limited to the treaty rate (even if in practice, this treaty rate is difficult or very costly to obtain). This means that no FITO is available for any withholding tax that exceeds the treaty rate. In these circumstances, the Australian superannuation fund <u>actually incurs higher total taxes on dividend income from these jurisdictions than on the equivalent dividend income from a jurisdiction with which Australia has no treaty</u>. This is because, in the case of dividends from a non-treaty country, it is likely that the FITO would be available for the full withholding tax imposed, provided that the Australian superannuation fund had not exceeded its FITO cap in respect of its total foreign income.

ASFA submits that, in negotiating tax treaties with other countries, and/or renegotiating or liaising with jurisdictions in respect of existing tax treaties, key outcomes should include:

1. That any agreed withholding tax rates pursuant to the treaty apply to all dividends paid by that country to an Australian person, and that an Australian superannuation fund be specifically included to be treated as an "Australian person" for that purpose;
2. That the agreed withholding tax rates should apply at the point of payment of the dividends by companies resident in the other jurisdiction, and not require the Australian person to apply for refund or reclaim of an initially over-withheld amount from the revenue authorities in the other jurisdiction; and
3. That if the other jurisdiction requires documentation to evidence that an Australian superannuation fund shareholder is an Australian person, such documentation be limited to a Certificate of Residency obtained by the Australian superannuation fund from the Australian Taxation Office (without any additional specification on this

Certificate of Residency in respect of the percentage of the fund's Australian-resident members).

2. *Potential exemption clause in respect of income derived by superannuation or pension funds*

ASFA notes that paragraph 69 of Article 18 of the OECD Model Treaty contemplates the inclusion of a specific exemption for a pension fund in one country from tax on its income in the other country. The OECD commentary seems to limit this to circumstances where both countries do not tax pension fund income (unlike Australia, which taxes most superannuation fund income at 15%).

However, the relatively low rate of taxation of superannuation fund income in Australia means that many of the same issues that gave rise to the need for an exemption for pension funds (i.e., taxation in one country, without the capacity to provide adequate credit for such tax in the other country) are also relevant to Australia.

Accordingly, there would seem to no compelling reason why Australia should not seek to include an exemption in its treaty negotiations. Indeed, ASFA notes that Australia already provides exemption from withholding tax in section 128B(3)(jb) of the Income Tax Assessment Act 1936, as amended, in all circumstances where the relevant income is exempt in the foreign jurisdiction.

ASFA submits that an exemption for Australian superannuation funds could be modeled on that included in a number of the UK's double tax treaties, which are typically included in the Article of the treaty dealing with dividend income. ASFA notes that, typically, withholding tax on dividends accounts for the largest single part of the foreign tax paid by pension funds, including by Australian superannuation funds.

By way of examples, extracts from the UK-Switzerland and UK-Japan treaties follow:

> UK-Switzerland treaty
>
> However, such dividends:
>
> (a) shall be exempt from tax in the Contracting State of which the company paying the dividends is a resident if the beneficial owner of the dividends is:
>
> (i) a company which is a resident of the other Contracting State and controls, directly or indirectly, at least 10 per cent of the capital in the company paying the dividends; or
> (ii) a pension scheme;
>
> UK – Japan treaty
>
> Notwithstanding the provisions of paragraph 2 of this Article, dividends shall not be taxed in the Contracting State of which the company paying the dividends is a

resident if the beneficial owner of the dividends is a resident of the other Contracting State and either:

(a) is a company that has owned, directly or indirectly, shares representing at least 50 per cent of the voting power of the company paying the dividends for the period of six months ending on the date on which entitlement to the dividends is determined; or

(b) is a pension fund or pension scheme, provided that such dividends are not derived from the carrying on of a business, directly or indirectly, by such pension fund or pension scheme.

ASFA submits that Australia should consider the inclusion of equivalent clauses in future treaties or renegotiation of existing treaties, to exempt dividend income derived by Australian superannuation funds from tax in the foreign jurisdiction.

3. US tax treatment of interests in Australian superannuation funds

The OECD Model Tax Convention includes Article 18 which allocates taxing rights to the country in which a taxpayer is resident:

> Article 18
>
> PENSIONS
>
> Subject to the provisions of paragraph 2 of Article 19, pensions and other similar remuneration paid to a resident of a Contracting State in consideration of past employment shall be taxable only in that State.

However, the Article would appear to not adequately address how to provide credit in foreign jurisdictions for Australian taxes imposed in respect of superannuation contributions, earnings and benefits.

This issue would presently appear to be restricted to the US-Australia tax treaty, as the US seeks to tax individuals in the US on the contributions and earnings from Australian superannuation funds in a variety of circumstances. Given that the relevant taxes in Australia are not imposed on the individuals but on the funds, issues arise in respect of the availability of credits in the US for these Australian taxes against the US taxes that may be imposed on individuals relating to these same amounts.

ASFA understands that similar issues in respect of the US taxes on individuals in respect of superannuation or pension fund entitlements have been raised in the context of the US tax agreements with both Canada and the UK. However, the issues for Australia are somewhat unique due to the manner in which superannuation contributions and earnings are taxed in Australia.

ASFA recommends that the particular issues associated with Australia's taxes on superannuation contributions and earnings, and the availability of credits for these taxes

in the foreign jurisdiction be considered in all future tax treaties, and specifically in any review of the US/Australia tax treaty.

Should you have any questions on any of the matters raised in this submission please contact Robert Hodge by email (rhodge@superannuation.asn.au) or phone (02 8079 0806).

Yours sincerely

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