8 November 2019

Renae Ali
Tax Counsel Network
AUSTRALIAN TAXATION OFFICE
By email: Renae.Ali@ato.gov.au

Submission: Draft Taxation TD 2019/D10

The Financial Services Council (FSC) welcomes the opportunity to provide comments on draft tax determination TD 2019/D10.

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

Submission

The FSC submits the view in Draft Taxation Determination (TD) poses significant issues for the Funds Management industry, particularly in the light of the recent decision in *Burton v Commissioner of Taxation [2019] FCAFC 141* (***Burton***).

Pursuant to the *Burton* decision, it may be case that if the capital gain on foreign assets for Australian tax purposes is *less* than the foreign capital gain that is subject to foreign tax, only the taxes paid on the smaller amount of capital gain can be a Foreign Income Tax Offset (**FITO**). As such, if there is a Capital Gains Tax (**CGT**) discount, or the Australian capital gain is reduced because of movements in the exchange rate, it may be the case that the FITO is reduced.

The FSC submits Draft TD 2019/D10 is unclear as to the extent to which the ***offset limit*** (or cap) then operates in the reverse situation where the foreign capital gain is smaller than the Australian capital gain (again because of FX rates, or any other reason, e.g. the capital gain for foreign purposes is simply calculated on a different basis to the Australian CGT rules).

The FSC recommends that the TD should make it clear that if a capital gain as calculated under Australia's CGT rules has been subjected to foreign tax (however the capital gain is calculated in the foreign jurisdiction) the capital gain that is assessable income under the Australian CGT calculation is included in the FITO limit calculation.

That is, we submit that the Australian Taxation Office (ATO) should make it clear that the words "in respect of" in sub-paragraph 770-75(4)(a)(i) of the Income Tax Assessment Act 1997 (**ITAA97**) be read generally as referring to all the assessable income arising from a capital gain upon which foreign tax is paid.

It is also submitted that the words "on which" in the Example in section 770-75 of the ITAA97 be read as referring to all the assessable income arising from a capital gain upon which foreign tax was paid.

We also request that the ATO consider the impact of Australia's Double Tax Treaties. It is submitted that in most if not all Double Tax Treaties the ATO would be obliged to provide a foreign tax credit for any foreign taxes paid in relation to a transaction against the Australian tax payable on the income or gains.

If this were not the case, an Australian taxpayer could be subject to double taxation on a foreign capital gain. For example, if an Australian complying superannuation fund in the accumulation phase sells a foreign asset and has a discounted capital gain of $10 the Australian tax would normally be $1.5, but say that if FX movements were removed the foreign capital gain (converted to Australian dollars) is only, say, $5, it is not clear from the TD whether the ATO considers that the cap should be calculated on $10 or on $5. If the cap were calculated on only $5 and the capital gain was taxed at, say, the US rates of 21% (or $1.05) then cap would be $0.75 cents and as such the Australian super fund would have suffered worldwide tax of $1.8 (being $0.75 Australian tax and $1.05 US tax, as $0.3 of the foreign tax would not be creditable).

It is noted that the ATO does not provide support for the proposition in paragraph 11 of the draft TD that a net capital gain does not have a source. In particular, the draft TD is silent on the situation if a taxpayer only has foreign sourced capital gains, but some of them are not taxed offshore. It is submitted that at the very least the ATO's view should be that the net capital gain in such a situation must be from a source that is other than an Australian source.

Sub-paragraph 770-75(4)(a)(ii) of the ITAA97 refers to "amounts", which as the *Burton* decision states is as a result of a computation. Source is generally defined to be the place of origin. It is submitted that amounts that are put into a computation always have a place of origination. Indeed, the ATO in paragraph 11 states that a net capital gain is a product of certain numbers. In the case of foreign sourced capital gains, these inputs to the calculation are not from Australian sources (as defined) and thus it must follow that the relevant net capital gain (or statutory income) that is a subset of foreign sourced gains is not from Australian sources (as defined) and thus the "amounts" should count toward the FITO *offset limit*.

It is submitted that this interpretation of sub-paragraph 770-75(4)(a)(ii) does not make sub-paragraph 770-75(4)(a)(i) of the ITAA97 ineffective. Sub-paragraph 770-75(4)(a)(i) of the ITAA97 caters for situations where foreign taxes are paid on Australian sourced amounts.

We also request that the ATO consider the impact of Australia's Double Tax Treaties in relation to the source of the net gains. For example, the Indian Double Tax Agreement makes it clear that gains taxable in India are sourced in India for the purpose of the law in Australia. Other treaties also refer to credits for foreign tax being allowable against income from sources outside of Australia (e.g. the US Double Tax Agreement). We also refer to the commentary in the *Burton* decision that make it clear that the gains in that case had a US source. The ATO had historically accepted the view that foreign capital gains have a foreign source. Specifically, we would refer you to Example 10 of the ATO's current

FITO Guide.[1] As such, it is submitted that the draft TD then arguing (especially in paragraph 12) that it is irrelevant that a capital gain has a foreign source (because a net capital gain cannot be disaggregated and have a foreign source capital gain component) is inconsistent with the implications of this particular ATO publication.

It should be noted that the ATO's view in this draft TD would impose significant administrative burden on the funds management industry as Managed Investment Trusts would be required to disclose capital gains on foreign assets and the tax paid on each CGT Event and disclose the relevant country(ies) to take into account the impact of Double Tax Agreements etc. Furthermore the approach in the draft TD is also at odds with the ATO's stated views in other ATO products, namely:

- the Annual Investment Income Report (**AIIR**) requirements; and
- ATO ID 2010/54 and ATO ID 2010/55.

The AIIR requirements and the explanation contained within the accompanying Companion Guide[2] requires reporting to include the component "Taxable foreign capital gains" (reference 9.89). Notably fund managers have previously and continue to rely upon this guidance when completing their AIIR. The position stated in the Draft TD regarding the source of net capital gains is in complete conflict with this accepted guidance.

In addition to being inconsistent with the guidance in the AIIR requirements, the view in the Draft TD is also inconsistent with ATO's currently stated position regarding source of net capital gains in ATO ID 2010/54 and ATO ID 2010/55. In those ATO IDs, the ATO position that net capital gains on income covered by section 855-10 of ITAA 1997 is taxable to a trust under s98(3) of the ITAAA 1936 is wholly reliant on a net capital gain being able to be disaggregated into Australian and foreign sourced components. On this point, the ATO explicitly states that in considering whether capital gains were sourced in Australia, *"reliance is appropriately placed on the common law source rules as they relate to income, notwithstanding that net capital gains are a form of statutory income".* Noting the above, we consider that consistent with its stated position in other ATO products, ATO guidance on sub-paragraph 775-75(4)(a)(ii) of the ITAA97 should support an interpretation which allows an aggregation of foreign sourced capital gains netted down by a reasonable allocation of deductions and capital losses to be "amounts" from a source other than an Australian source. That is, we consider it open to the ATO to consider that as capital gains can have a source, a subset of the aggregate of these numbers must also have a source. Such an interpretation would also be consistent with Australia's double tax agreement obligations. Furthermore, if the position in the final TD were to reflect the ATO's current position regarding "source" and net capital gains, then we submit that the ATO would need to acknowledge that non-resident beneficiaries in fixed trusts that are not withholding Managed Investment Trusts would not be taxed on Australian sourced net capital gains even if those gains were attributable to taxable Australian property.

Finally, we submit that to the extent the final TD is inconsistent with the current AIIR Companion Guide and the implications in the FITO Guide, the new view expressed within the TD would seemingly represent a U-turn on the part of the ATO and ought to only apply prospectively.

---

[1] Guide to foreign income tax offset rules 2019: https://www.ato.gov.au/misc/downloads/pdf/qc58647.pdf

[2] AIIR Companion Guide v3.0: https://softwaredevelopers.ato.gov.au/sites/default/files/resource-attachments/AIIR_companion_guide_v3.0.docx

The FSC requests a meeting with the relevant ATO offices to discuss this submission further. To discuss the submission and this request, I can be contacted on 02 9299 3022 or by email on [redacted]

SIGNED

Michael Potter
Senior Policy Manager, Economics, Tax & Strategy