



Taxpayer Alert

TA 2007/3

FOI status: may be released

Taxpayer Alerts are intended to be an "early warning" of significant new and emerging higher risk tax planning issues or arrangements that the Tax Office has under risk assessment.

Taxpayer Alerts will provide information that is in the interests of an open tax administration to taxpayers. Taxpayer Alerts are written principally for taxpayers and their advisers and they also serve to inform tax officers of new and emerging higher risk tax planning issues. Not all potential tax planning issues that the Tax Office has under risk assessment will be subject of a Taxpayer Alert, and some arrangements that are the subject of a Taxpayer Alert may on further examination be found not to be of concern to the Tax Office.

Taxpayer Alerts will give the title of the issue (which may be a scheme, arrangement or particular transaction), briefly describe the issue and will highlight the features which the Tax Office considers give rise to taxation issues. These issues will generally require more detailed analysis to provide the Tax Office view to taxpayers.

Taxpayers who have entered into or are contemplating entering into an arrangement similar to that described in this Taxpayer Alert can seek a formal determination of the ATO's position through a Private Ruling. (It should be noted that the Taxation Administration Act 1953 sets out circumstances where the Commissioner may decline to issue such a ruling). Such taxpayers might also contact the tax officer named in the Alert and/or obtain their own advice.

This Taxpayer Alert is issued under the authority of the Commissioner.

TITLE: Income Tax: Foreign tax credit enhanced return bond investment.

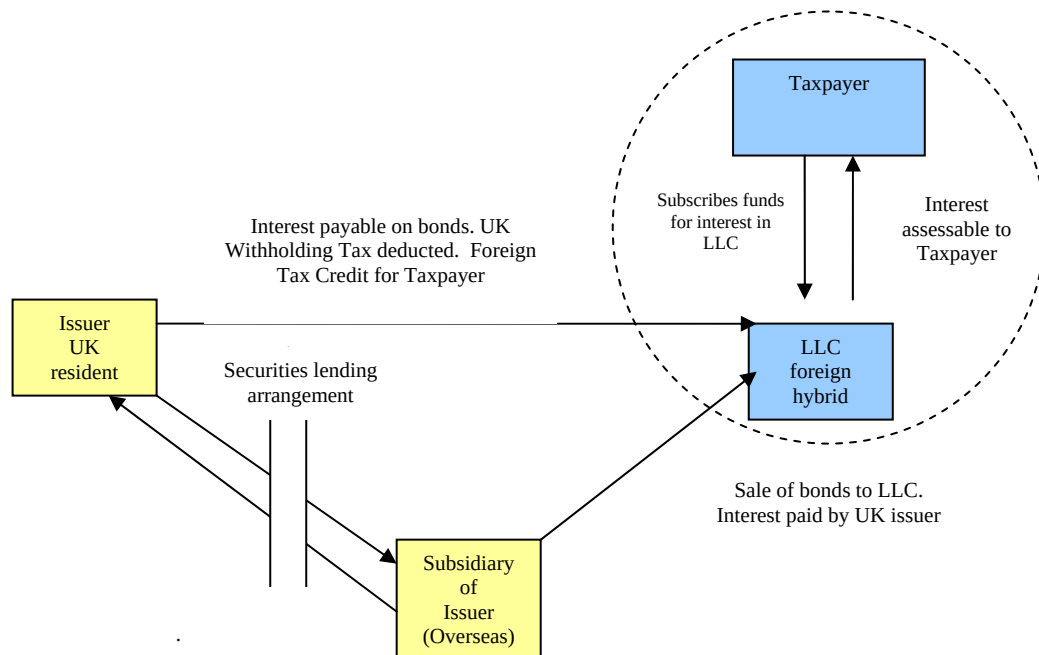
This Taxpayer Alert describes an arrangement where an Australian resident taxpayer seeks to enhance its return on a bond investment, through access to foreign tax credits for withholding tax claimed to be payable under the arrangement. The desired net effect of the arrangement is that neither the bond issuer group, nor the Australian resident taxpayer, bears the economic cost of the tax withheld.

DESCRIPTION

This alert applies to arrangements generally marketed to financial institutions that exhibit some or all of the following elements:

1. An Australian resident taxpayer (the taxpayer) establishes a wholly owned limited liability company (LLC) in an offshore jurisdiction.
2. The LLC is treated on a flow-through basis for the purposes of tax in the foreign jurisdiction and is treated as a foreign hybrid for Australian tax purposes.
3. The LLC acquires bonds (or similar instruments) issued in the United Kingdom (UK) by a UK financial institution ('the Issuer').
4. The bonds offer an enhanced return over those of a similar grade of issuer.
5. The payment of interest on the bonds is claimed by the issuer to attract UK withholding tax at the rate applicable.
6. A securities lending arrangement is put in place within the Issuer's group that is claimed by that group to create a credit known as a 'reverse charge' tax credit. That credit is equal to the amount of the UK withholding tax liable to be paid under UK tax law.
7. A foreign tax credit is claimed by the taxpayer for the amount of UK withholding tax paid.
8. The foreign tax credit exceeds the Australian income tax payable on the net interest income from the arrangement.
9. This excess is claimed to be available for use to reduce Australian tax payable on other foreign sourced income of the taxpayer.
10. The effect of this arrangement is that the taxpayer is provided with an enhanced return funded not by the issuer but through the availability of the foreign tax credits.

DIAGRAM



FEATURES WHICH THE TAX OFFICE CONSIDERS GIVE RISE TO TAXATION ISSUES

The Tax Office considers that an arrangement of this type gives rise to taxation issues that include whether:

- (a) the withholding tax paid in the UK on the interest received by the LLC was paid 'in accordance with this convention' for the purposes of Article 22(1) of the 2003 UK Convention and Notes in Schedule 1 of the *International Tax Agreements Act 1953* (UK Convention);
- (b) under Article 22(1) of the UK Convention and Division 18 of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936) a credit against Australian tax is to be allowed to the taxpayer in respect of the withholding tax paid in the UK; and
- (c) the general anti-avoidance provisions in Part IVA of the *ITAA 1936* apply.

The Australian Taxation Office is examining these arrangements.

subject references: foreign tax credits
 foreign hybrid
 international tax
 withholding tax

legislative references:

Article 22 of the 2003 UK Convention and Notes in
Schedule 1 of the *International Tax Agreements Act*
1953

International Tax Agreements Act 1953

Division 18 of Part III of the *Income Tax Assessment*
Act 1936

Part IVA of the *Income Tax Assessment Act 1936*

related taxpayer alerts:

related media releases:

file references:

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