LCR 2020/3EC - Compendium

Australian Government
Australian Taxation Office

Public advice and guidance compendium – LCR 2020/3

Relying on this Compendium

This Compendium of comments provides responses to comments received on draft Law Companion Ruling LCR 2019/D4 *The superannuation fund for foreign residents withholding tax exemption and sovereign immunity*. It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

Issue number	Issue raised	ATO response
1	It would be helpful if the Ruling provided further guidance in relation to the meaning of 'determine' in respect of the influence test.	Paragraph 11 has been amended in the final Ruling to provide further clarification on this issue.
2	We submit that where an entity has a right to appoint a member of a unitholder/shareholder advisory committee at specific intervals (where the recommendations are not binding on the fund manager) but does not exercise that right, this should not amount to the requisite level of influence notwithstanding the entity has not irrevocably waived its right to appoint a committee member in the future. We acknowledge this circumstance could change in the future where the right is exercised at a future interval at which time the outcomes under the influence test would need to be reconsidered.	As set out in paragraph 11 of the final Ruling, the phrase 'able to' focuses on the relevant entity's capacity or power. An entity which has the right, at a particular point in time, to appoint a relevant decision maker is 'able to determine the identity of' that decision maker even if they do not exercise their right. The test is not limited to situations where the entity has already determined, or intends to determine, the identity of one of the relevant decision makers.
3	The guidance in the draft Ruling starts with the implicit assumption that all advisory committees/boards are required, or have the ability, to approve decisions or make recommendations, and that such actions result in the advisory committees/boards having control and direction of the relevant entity.	We consider that there is sufficient guidance and examples provided for the purposes of the final Ruling. The specific decisions that an advisory committee/board makes, and whether they comprise the control and direction of the test entity's operation, will depend on the specific facts and circumstances of each case. It is not practical or useful to provide a detailed example in relation to only one or a few such cases. We invite taxpayers to engage with us to discuss their specific situations.

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	In our view, the threshold matter of which practical rights, mechanisms and arrangements indicate the existence (or not) of control and influence over the direction of a fund, including consideration of rights imparted on an advisory committee/board should be addressed in the final Ruling.	
4	We submit that not all investment advisory committees approve decisions or make recommendations that are in relation to the control and direction of an entity, and if this is the case, the influence test should not be satisfied by the investor or the investment manager who is appointed to the investment advisory committee of that entity.	We agree that it is important, in each case, to consider the role of the relevant investment advisory committee and the decisions or recommendations it makes. See also our response to Issue 3 of this Compendium.
5	In Example 2 of the draft Ruling, two investors are taken to have the requisite level of influence over an entity based on their aggregate investment and their use of a common investment manager. We submit that the interests of two independent and separate investors should not be aggregated in this way, especially where the investors have different investment mandates with the investment manager.	Paragraph 19 of the final Ruling states that whether an entity 'acting in concert with others' is able to determine the identity of a decision maker depends on the relevant facts and circumstances. Example 2 of the Ruling is an example of one such case. Example 4.7 in the Revised Explanatory Memorandum to the Treasury Amendments (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and other Measures) Bill 2018 is another example of when two unrelated investors using a common investment manager have influence in relation to a test entity of the kind described in subsection 880-105(6) of the *Income Tax Assessment Act 1997* (ITAA 1997).
6	Example 2 of the draft Ruling provides that where a superannuation fund for foreign residents (SFFR) and a sovereign entity (SE) utilise a common investment manager (IM) to invest in an Australian managed investment trust (MIT) and each of the following conditions are satisfied, both entities have the requisite level of influence for the purposes of the influence test: • the IM has a right to appoint a member to the Advisory Board '*based on the aggregate investment of the SFFR and SE',* and	The co-existence of the three factors listed are highly likely to lead to a conclusion that the entities have the requisite level of influence for the purposes of the influence test as concluded in Example 2 of the Ruling. However, we do not agree that all three need to be satisfied. Whether one, all, or a combination of the three points is enough for the relevant entities to have the requisite level of influence would depend on the facts of each case. Note: the influence test is not limited to these three factors as there may be other relevant factors to consider. See also our response to Issue 5 of this Compendium.

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	• the SFFR and SE have entered into agreements which govern how the IM will appoint the Advisory Board member, and • the Advisory Board is required to approve decisions in relation to the control and direction of the Australian MIT. We submit that clarification be provided that all of the above points need to be satisfied for the requisite level of influence to be achieved.	
7	Observers are not able to participate in any decision making nor can they impose their views on the board of directors or management. Therefore, we are of the view that the appointment of observers by itself should not amount to influence for the purposes of the influence test.	The final Ruling does not conclude that the right to appoint an observer would, of itself, lead to a conclusion that the relevant entity holds the requisite level of influence. However, the right to appoint an observer, and what the observer does, is relevant in considering the influence test (including whether the board of directors or management are accustomed, obliged, or might reasonably be expected to act in accordance with the relevant entity's wishes).
8	We note that the language used in paragraph 36 of the draft Ruling '*rather than those uniform across all investors'* suggests that taxpayers are able to and should be required to make comparisons across side letters agreed by a fund. In practice, this would be difficult to achieve as in many cases each investor would not have access to any other side letters. For this reason, we submit that the uniformity or otherwise of a side letter should not be relevant to a determination of influence, but rather the specific terms of the side letter and the degree of influence to which those terms provide.	Paragraph 36 of the final Ruling has been amended in response to this issue.
9	The Ruling should address the interaction of the terms 'influence' and 'sufficient influence' especially given the concepts 'accustomed', 'obliged to act' or 'might be reasonably be expected to act', in accordance with the directions, instructions or wishes' of any entity are used in both definitions in the ITAA 1997 and ITAA 1936 respectively.	We have updated paragraphs 28 to 30 of the final Ruling to reflect the decision in *BHP Billiton Limited v Commissioner of Taxation* [2020] HCA 5.

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	The draft Ruling does not reference *Commissioner of Taxation v BHP Billiton Limited* [2019] FCAFC 4 which considers the definition of sufficient influence nor does it consider that the case has been appealed. Once the final appeal decision has been handed down, we suggest it should be updated to reflect the final court decision.	
10	Is a foreign government superannuation fund constituted as a trust with a sovereign entity acting as its trustee of itself a sovereign entity?	This issue has been clarified in the final Ruling at paragraphs 46 to 50. The issue will depend on whether the trust is a sovereign entity and not on the identity of the trustee.
11	It would be helpful if the final Ruling provided further guidance in relation to whether certain typical components of income distributed by a MIT are considered a 'return on' an interest held by a sovereign entity.	Paragraph 52 of the final Ruling now clarifies that is a non-exhaustive list of the types of return that would meet paragraph 880-105(1)(b) of the ITAA 1997. The phrase 'return on' includes all income distributed by a MIT to a unitholder in relation to their unitholding.
12	It would be beneficial to have further guidance to understand the ATO view expressed in paragraph 64 of the draft Ruling that the 'public monies' requirement will not be satisfied where a sovereign entity obtains third-party debt funding, particularly in the context of the statement in paragraph 49 of the draft Ruling that the proceeds from the issue of government bonds (that is, a form of third-party debt) would comprise public monies.	We consider that there is sufficient guidance on this issue provided in paragraphs 54 and 70 of the final Ruling. The proceeds of government-issued bonds would ordinarily form part of general government revenue held for a public purpose. This differs to Example 11 of the final Ruling where a sovereign entity obtains third-party debt to fund its investment activity. In such a circumstance, the returns of that sovereign entity will, in part, be used to repay the relevant third-party lender.
13	The Ruling effectively requires sovereign entities to consider the scope of monies covered by their sovereign state's equivalent to Australia's Consolidated Revenue Fund (CRF). Relevantly, not all governments have a definition in their Constitution, nor are their investment structures similar to that of Australia. A practical concern is that by allowing the term to be given meaning by a foreign government's equivalent of the CRF, the application of the term 'public monies' could be given a range of meanings depending on the foreign government's laws, which potentially leads to an inconsistent outcome between taxpayers. We submit that the codification of these rules should seek to simplify the application of the codified rules for taxpayers and	The final Ruling has been amended (see paragraph 54) to provide further clarity on this issue.

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	ensure a consistent approach be adopted by all sovereign entities. This could be achieved by giving a specific meaning to the term 'public monies'.	
14	The ATO could clarify whether returns on monies invested by a sovereign entity that is wholly owned by a foreign government are 'public monies' where they are reinvested by that sovereign entity to further its purpose. We have concerns that certain sovereign states do not require the proceeds from an investment to be accounted for as part of the CRF and permit the reinvestment of such proceeds until pre-determined milestones or requests are made by the Government to access such monies.	The final Ruling has been amended (see paragraph 54) to provide clarity on this issue.
15	Previous rulings issued by the ATO considered the definition of 'government monies' and in particular, whether an entity's monies were considered 'government monies'. In prior rulings, this determination was made by reference to the relevant legislation establishing the funding and ownership of an entity. We understand that the purpose of Division 880 of the ITAA 1997 sought to codify the existing practice of sovereign immunity while limiting the scope of the exemption (for example, clarifying the exclusion of non-portfolio investments) and consider that where an entity is previously considered to have been funded by government monies, they should still be considered to be funded by public monies.	Division 880 of the ITAA 1997 was introduced to both codify **and restrict** the administrative practice adopted by the ATO with respect to the sovereign immunity tax exemption. As such, although there are many similarities, there are also differences between the administrative practice and the new law. Paragraphs 53 to 72 of the final Ruling provide our view of the term 'public monies.' We invite taxpayers to engage with us to discuss their specific situations if they are uncertain whether they are funded by public monies.
16	Greater commentary is needed on the difference of what is a sovereign wealth fund and what is a superannuation fund for foreign residents. We submit that any distinction made with reference to the CRF is inappropriate and a distinction should instead be drawn based on the objective criteria of how the monies in the fund are dealt with. The final Ruling should in our view also include examples that cover the facts and circumstances contemplated in	We consider that this issue is sufficiently dealt with in the final Ruling. We note that while the examples from the 2011 consultation paper cited may be relevant, the examples in the final Ruling are sufficient on this issue.

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	the 2011 Proposal Paper[1] (in particular Example 3 and 4 of that Paper).	
17	Example 8 of the draft Ruling makes an important distinction where an employee also contributes to the foreign government superannuation fund. However, better guidance is required to draw a distinction between what are in fact 'employee contributions' and what may be a compulsory tax. A clearer distinction would be that if membership to the Foreign Government Superannuation Fund is voluntary, and the employee as a condition of that membership agrees to make personal contributions, then in such a case the fund is not a sovereign wealth fund, but instead is a foreign superannuation fund. However, where 'contributions' are in fact a tax (on the individual, the employer or both) and there is no provision in the government pension for a person to make additional voluntary contributions (to enhance the benefit they may ultimately be entitled to), the fund should in our view qualify as a sovereign wealth fund. In such a case, the fact that the pension benefit provided on retirement to a particular individual may be calculated by reference to the amount of 'contributions' (that are in fact taxes) does not cause the monies to be other than public monies and the fund should be considered a sovereign wealth fund. Where the monies of a fund are invested and later used to fund government pensions payable to anyone who has ever been liable to the levy, the monies remain government monies in the sense that the obligation to make pension payments under the government pension is always a government obligation undertaken in the conduct of government functions (of that country). Where the right to receive a pension from a government is a statutory right	As outlined and clarified in paragraph 47, and later in paragraphs 59 to 62 of the final Ruling, government-administered superannuation funds will not generally satisfy the definition of a sovereign entity. In addition, superannuation/pension funds are listed as common examples of public financial entities. However, for completeness, the suggested distinction between voluntary and involuntary membership/contributions is not something which can be adopted. For example, there are non-discretionary contributions in Australia's superannuation system for both defined-benefit and defined-contribution superannuation funds. As a general concept, the monies held and invested by a superannuation fund represents deferred remuneration in respect of an individual's employment. A government pension/social security benefit, on the other hand, commonly is paid with no reference to employment or contributions.

[1] Department of Treasury, 2011, *Greater Certainty for Sovereign Investments*, Department of Treasury, Canberra.

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	under the retirement incomes policy legislation of that country, and does not require the person to have been a government employee, we consider that the benefit is also a public purpose and is paid out of public monies.	
18	The draft Ruling provides examples of entities that should be considered public financial entities; however, it would be useful to provide some general guidance in the final Ruling in relation to how to interpret key concepts relevant to the definition.	Whether or not an entity is a public financial entity is a question of fact and is best illustrated by way of example – see paragraph 79 of the final Ruling.
19	Are government accident compensation schemes (including workers compensation schemes) public financial entities?	As noted in paragraph 79 of the final Ruling, insurance corporations are an example of a public financial entity as defined in subsection 880-130(2) of the ITAA 1997. Government accident compensation schemes are therefore likely to be public financial entities.
20	One example of a public financial entity provided in the Ruling is 'pension/superannuation funds'. We note the definition in paragraph 880-130(2)(c) of the ITAA 1997, and the comments in the Revised Explanatory Memorandum to the Treasury Amendments (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and other Measures) Bill 2018 at paragraphs 4.26 to 4.28 do not include a reference, example or description of such entities and we submit that the public financial entity definition should not include such pension/superannuation funds as an example. A consequential amendment should be made to footnote 30 of the draft Ruling.	The concept of a public financial entity is based on the *Government Finance Statistics Manual 2014*[2] and *Australian System of Government Finance Statistics: Concepts, Sources and Methods, 2015*.[3] Public financial entities are publicly-owned entities that engage in financial activity and include pension funds.
21	One key concept relevant to the definition of public financial entity is that of 'trading' in financial assets contained in paragraph 880-130(2)(a) of the ITAA 1997. The importance of whether an entity is 'trading' is further emphasised by the	Whether an entity is 'trading' for the purposes of these provisions requires an examination of the specific circumstances of the entity.

[2] International Monetary Fund, 2014, *Government Finance Statistics Manual 2014*, International Monetary Fund, Washington.
[3] Australian Bureau of Statistics, 2015, *Australian System of Government Finance Statistics: Concepts, Sources and Methods, 2015*, Australian Bureau of Statistics, Canberra.

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	examples provided in the draft Ruling, which relevantly include '*entities in the business of share trading'*. The final Ruling should provide further guidance on relevant examples of a type of entity that this definition is meant to capture.	
22	The ATO should consider including the following examples in the final Ruling in relation to the definition of public financial entity: • where a sovereign entity builds a portfolio of listed shares and trades these to track the movements in a listed index (for example, the National Association of Securities Dealers Automated Quotations System (NASDAQ)) • where a sovereign entity holds a portfolio of widely-held unlisted shares • where a sovereign entity buys and sells portfolio interests in listed shares with a view to outperform market indices • where a sovereign entity holds a portfolio of listed securities and trades them regularly with a view to profit from the trades • where a sovereign entity holds a portfolio of listed securities and trades them regularly with a view to profit from the trades as part of a short selling strategy • where a sovereign entity deploys various strategies, including the use of tactical and index replication-based allocations and quantitative analysis, in line with its mission to achieve good long-term returns above global inflation over a very long investment horizon (of more than 10 years).	It is not possible to cover every scenario in the Ruling. The final Ruling outlines common examples of public financial entities. Specific situations will need to be considered on a case-by-case basis.

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23	We submit that a declaration mechanism may be implemented for the purpose of the withholding tax exemption under paragraph 128(3)(jb) of the *Income Tax Assessment Act 1936* and for sovereign immunity in Division 880 of the ITAA 1997.	This is beyond the scope of this Ruling.