# *TD 2011/25EC - Compendium*

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# Ruling Compendium – TD 2011/25

This is a compendium of responses to the issues raised by external parties to draft Taxation Determination TD 2010/D8 – Income tax: does the business profits article (Article 7) of Australia's tax treaties apply to Australian sourced business profits of a foreign limited liability partnership (LLP) where the partners in the LLP are residents of a country with which Australia has entered into a tax treaty and the LLP is treated as fiscally transparent in the country of residence of the partners?

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

## Summary of issues raised and responses

| Issue No. | Issue raised | ATO response/action taken |
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| 1 | **Wider application**<br>The exemption should go beyond granting the treaty benefits through fiscally transparent entities in the form of a limited liability partnership. It should also apply to other entities which are treated as fiscally transparent for tax purposes in the country of residence of the investor where Australia has entered into a double tax treaty with that country.<br>If D8 focused on FTEs rather than LLPs, it could apply to a partnership, limited partnership, company, Limited Liability Company (LLC) or any other entity provided that the members/investors in that entity, rather than the entity itself, is subject to tax in the country of residence of the members/investors on the income and gains derived by or through the entity.[1] | The *Application of the OECD Model Tax Convention on Partnerships* (OECD Partnership Report) refers to partnerships, not tax law partnerships nor fiscally transparent entities. This TD applies those principles consistent with the scope of the Partnership Report.<br>This TD does not apply to unlimited partnerships as they are not corporate limited partnerships for Australian tax purposes and therefore the 'flow through' issue does not arise. |
| 2 | **'Liable to Tax' as a precondition**<br>The criterion of '*...liable to tax*' is not clearly defined and may be too restrictive as a condition to allow flow through treatment through tax transparent entities.<br>There are additional entities which may not be 'liable to tax' in another treaty country but which should be able to rely on treaty benefits, for example, tax exempt pension funds . Such entities should not be | Example 3 in the TD has been included to deal with tax exempt organisations that qualify as residents for the purposes of the relevant tax treaty. |

[1] To this end, one submission suggests using the definition of 'fiscally transparent foreign entity' from Taxation Ruling TR 2009/6.

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| | excluded from the application of the principle stated in TD 2010/D8. | |
| 3 | **Meaning of 'liable to tax'**<br>Does 'liable to tax' include those persons who are subject to tax in their country of residence, notwithstanding that due to the availability of a credit, rebate, deduction or exemption they did not actually pay tax?<br>As a general principle of treaty interpretation, in determining Australia's taxing rights under a treaty, it is not relevant for the source country to enquire whether tax is actually imposed on the relevant income in the country of residence. | See response above to issue 2. |
| 4 | **Application to sovereign investors**<br>Consideration should be given to sovereign investors who would not be taxed if their relevant investment would have been made directly based on the concept of sovereign immunity.<br>Where a limited partner is a sovereign entity and thus holds its investment into Australia indirectly through a limited partnership, the question is whether such investor will still be exempt from Australian taxation under the international law doctrine of sovereign immunity where the conditions set out under the current sovereign immunity administrative practice (ATO ID 2002/45) are satisfied?<br>Would the approach described in the draft TD to fiscally transparent entities, apply to this class of investor?<br>It is submitted that the sovereign immunity principle should apply whether the SWFs make their investments either directly or indirectly through private equity limited partnerships or other FTEs. | Leaving aside the existence of a permanent establishment, if a business profit within Article 7 is made by a sovereign wealth fund entity resident in a country with whom we have a tax treaty, that country has the taxing right. If there is no treaty we have the taxing right. |

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| 5 | **Application to exempt entities**<br>To the extent a foreign entity that would otherwise meet the requirements of Div 50 is an investor in a private equity limited partnership, it should be afforded the same tax treatment as if it had invested directly without the need for qualifying under a double-tax treaty.<br>The Draft Determination should provide guidance on how Division 50 (ITAA 1997) entities are treated. | The applicability of the relevant tax treaty to a limited partnership and, further, the availability of tax treaty benefits to the partners or ultimate investors in that limited partnership, is contingent upon the relevant conditions in the double tax agreement being met.<br>Further guidance regarding foreign entities otherwise meeting Division 50 requirements that are investors in such a partnership is beyond the scope of this TD. |
| 6 | **Investors in multiple countries**<br>The ATO should state its position in situations where a proportion of the investing members are residents of a country with which Australia has entered into a tax treaty and the remainder are residents of a non-treaty country.<br>Paragraph 19 of the Draft Determination creates ambiguity, in that it is unclear whether D8 applies only if *all* of the partners of the LLP are residents of treaty countries. | Paragraph 1 of the TD suggests that the provision of tax treaty benefits is available only to partners that are residents of a tax treaty country and that meet any other relevant tax treaty requirements. The whole tenor of the TD is that the LP will be taxed on the remaining profits payable to non-treaty country residents. |
| 7 | **Apportionment between countries**<br>Practical guidance should be given in the Draft Determination (or a practice statement) on the issue of apportionment in respect of the business profits where partners comprise residents of several countries, some being countries with which Australia has entered into a tax treaty, others being countries where Australia has no tax treaty. | Further information concerning the practical guidance requested is contained at paragraphs 34 – 41 of the TD.<br>Also, see 6 above. |
| 8 | **More examples needed**<br>The Draft Determination should provide further examples to reinforce the fact that the principle contained in the Draft Determination may apply in a variety of situations. Suggestions:<br>(a) Include an example where multiple FTEs are interposed between the income and the members (showing that the principle in the Draft Determination would apply regardless of the number of investment tiers involved); and<br>(b) Include an example where a proportion of the members of the FTE(s) are resident in a tax treaty country and remainder are | The TD now provides examples involving the instances specified. |

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| | resident in a non-treaty country. | |
| 9 | **Application to USA Tax Treaty**<br>It would be helpful if additional guidance could be provided by the ATO on the interpretation of Article 4(1)(b)(iii) of the Australia-United States Convention as it includes a specific provision for transparent entities which, unlike other Conventions, seeks to provide residency status to the transparent entity. | The TD provides the ATO's views in respect of all of Australia's tax treaty network. |
| 10 | **Administrative Requirements**<br>What is the means by which the residency status of the investing partners/members should be established?<br>When will the Commissioner be satisfied as to the residency of the investors in a fiscally transparent entity, both where the investment is made directly or indirectly through interposed FTEs?<br>The following issues need to be addressed. Where the FTE is located in a Tax Information Exchange Agreement (TIEA) country as well as where it is located in a non TIEA country:<br>• Which entity is responsible for establishing the residency status of the partners/members? Is it the FTE's responsibility?<br>• What form of evidence is required to establish the residency status of the partners/members? Will a certificate of residency be required from each of the investors? If so, how will this be administered? Will the investors have the obligation to provide to the FTE these certificates? What would be the FTE's continuing liability if a certificate of residency proves to be untrue?<br>• Will there be a self-assessment procedure whereby the FTE is responsible for identifying whether partners/members are from treaty or non-treaty countries? Will there be any specific notification requirements?<br>• Where multiple FTEs are interposed between the income and the partners/members, who has the obligation to determine the residency of the ultimate partners/members in such a case? | The practical consequences have been noted and, as far as is possible at a level spanning all treaty countries, addressed in the TD at paragraphs 34 to 41. |