TD 2020/7EC - Compendium

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Public advice and guidance compendium – TD 2020/7

Relying on this Compendium

This Compendium of comments provides responses to comments received on draft Taxation Determination TD 2019/D10 *Income tax: can capital gains be included under subparagraph 770-75(4)(a)(ii) of the Income Tax Assessment Act 1997 when calculating the foreign income tax offset limit?* 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	The issue is of significant importance to taxpayers in the superannuation industry.	We acknowledge the importance of this issue to taxpayers in the superannuation industry.
2	Net capital gains can have a source: • Refer Taxation Ruling IT 2562 *Income tax: foreign tax credit system: interaction of foreign tax credit provisions with capital gains and capital losses provisions of Part IIIA*. All amounts of statutory income must have a source (subsection 6-10(4) and paragraph 6-10(5)(b) of the *Income Tax Assessment Act 1997*).[1] • Clarify that the view that net capital gains do not have a source is in the context of Division 770.	For the purposes of the foreign tax credit regime, IT 2562 clarified that only foreign capital gains on which foreign income tax was paid were deemed to be treated as foreign income for foreign tax credit purposes. That Ruling does not concern the issue of whether a net capital gain has a source. IT 2562 discusses the source of individual capital gains. Subsection 6-10(4) and paragraph 6-10(5)(b) do not require that all statutory income must have an Australian or non-Australian source. We hold the view that a net capital gain calculated under section 102-5 does not have a source. The purpose of this Determination is to provide clarity that a net capital gain, or a capital gain, cannot be disregarded under subparagraph 770-75(4)(a)(ii).

[1] All legislative references in this Compendium are to the *Income Tax Assessment Act 1997.*

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3	If net capital gains do not have a source, this has other outcomes contrary to policy intent and legislative design, for example section 320-327 regarding foreign branch exemption for life insurance companies.	We assume the reference is intended to be a reference to section 320-37, which provides for certain statutory income of life insurance companies to be treated as non-assessable non-exempt income. However, section 118-315 provides that capital gains or losses made by life insurance companies are disregarded for capital gains tax (CGT) purposes. Therefore section 320-37 does not refer to net capital gains calculated under section 102-5. More generally, the view in the final Determination provides that a net capital gain is a singular statutory income amount and that subparagraph 770-75(4)(a)(ii) does not provide a mechanism to disaggregate the net capital gain.
4	There is a basis for disaggregating net capital gains into individual capital gains for the purposes of identifying their source: (a) It is possible under subparagraph 770-75(4)(a)(i), so it follows that it is possible under subparagraph 770-75(4)(a)(ii). (b) It was necessary in *Burton v Commissioner of Taxation* [2019] FCAFC 141 (*Burton*) to disaggregate. (c) Emphasis should be on the word 'amount' and not assessable income or statutory income. Amount means an aggregate or sum.	(a) The language in each subparagraph is different. In particular the phrase 'so much of' appears in subparagraph 770-75(4)(a)(i) but not subparagraph 770-75(4)(a)(ii); subparagraph (ii) is concerned with amounts of statutory income whereas subparagraph (i) refers to '… any amount included in your assessable income'. (b) Similarly, in the response to Issue 4(a) of this Compendium, the language in subparagraph 770-75(4)(a)(ii) is different to that in section 770-10, being the relevant provision considered in the *Burton* decision. (c) Section 770-75 needs to be read as a whole and the word 'amount' must be taken in context of the composite phrase 'amount of statutory income'. 'Amount' has a different meaning in different contexts and can be referring to one figure, such as the derivation of one amount of statutory income.

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	(d) The ATO accepts disaggregation in a trust context and the view in this draft Determination is inconsistent with other ATO views. For example ATO ID 2010/54 C*apital gains tax: foreign source capital gains made by a resident trust for CGT purposes*, ATO ID 2010/55 *Capital gains tax: Australian source capital gains made by a resident trust for CGT purposes* and Draft Taxation Determination TD 2019/D7 *Income tax: is the source concept in Division 6 of Part III of the Income Tax Assessment Act 1936 relevant in determining whether a non-resident beneficiary of a resident trust (or trustee for them) is assessed on an amount of trust capital gain arising under Subdivision 115-C of the Income Tax Assessment Act 1997?*	(d) ATO Interpretative Decisions ATO ID 2010/54 and ATO ID 2010/55 and also TD 2019/D7 provide clarity on the taxation of capital gains and trusts. ATO ID 2010/54 and ATO ID 2010/55 express the view that a capital gain, as distinct from a net capital gain, can have a source while draft TD 2019/D7 provides that the source concept is not relevant in determining whether a non-resident beneficiary of a resident trust is assessed on an amount of trust capital gain arising under Subdivision 115-C. These public guidance products do not express a view that a net capital gain can have a source. In a taxation of trusts context, the source of the underlying capital gains and losses might have been historically relevant to determining a beneficiary's share of the net income that was attributable to foreign capital gains. The foreign income tax offset (FITO) limit is a different statutory context and has different statutory language.
	(e) It is nonsensical/inconsistent to accept that a capital gain can have a source but an amount comprising capital gains cannot.	(e) Net capital gains are calculated based on a statutory formula. There is no statutory or common law interpretation which assigns a source to income derived under such a formula. While components of a formula may have a source, this would not result in the end product of the formula taking on any sources of components of that formula.
	(f) There is no support given in the draft Determination for the proposition that disaggregation is not possible. Why can't it be disaggregated?	(f) There is no language of disaggregation in subparagraph 770-75(4)(a)(ii). Issue 4(a) of this Compendium addresses the clear difference in wording between subparagraphs 770-75(4)(a)(i) and (ii). This Determination has been updated to clarify this point.
	(g) The ATO's *Guide to foreign income tax offset rules* provides for disaggregation.	(g) The *Guide to foreign income tax offset rules* is concerned with the source of individual capital gains, not net capital gains, and the examples in that Guide are relevant to section 770-10.
5	It is not clear whether the ATO is saying that no capital gains can be disregarded under paragraph 770-75(4)(a).	Capital gains in respect of which foreign tax has been paid may be disregarded under subparagraph 770-75(4)(a)(i) subject to other legislative requirements. The final Determination has been updated to clarify this point.
6	The final Determination should provide that 'in respect of' in subparagraph 770-75(4)(a)(i) means all assessable income	This is outside the scope of the final Determination.

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	arising from a capital gain upon which foreign tax is paid.	
7	If the net capital gain is comprised of a single foreign capital gain, then the net capital gain is foreign.	Regardless of the composition of the capital gains (or capital gains and capital losses) that are included in the calculation of a net capital gain, we hold the view that a net capital gain calculated under section 102-5 does not have a source.
8	Clarify the operation of subparagraph 770-75(4)(a)(i) when applied in conjunction with paragraph 12 of the draft Determination that you do not disaggregate a net capital gain. That is, where a foreign capital gain could be said to have a gain (or loss) element as well as a foreign exchange gain (or loss) element, if those elements were to be disaggregated.	We assume reference to a net capital gain is to an individual capital gain. This is outside the scope of the final Determination, the subject of which is whether untaxed foreign capital gains can be included under subparagraph 770-75(4)(a)(ii). For completeness, individual foreign capital gains may be included in subparagraph 770-75(4)(a)(i) where other legislative requirements have been met. Individual capital gains are calculated according to CGT provisions and have interactions with Division 960 translation rules where appropriate. The resulting amount of the foreign capital gain after the interaction of these provisions is then included under subparagraph 770-75(4)(a)(i) where other legislative requirements are met.
9	The final Determination should consider the impact of Australia's double-tax treaties.	The double-tax treaties have their usual application and commenting on the treaties is outside the scope of this final Determination.
10	The draft Determination is inconsistent with the Annual investment income report for managed investment trusts.	We will work with the industry to assist with practical compliance issues arising from this final Determination and other reporting requirements.
11	The view in the draft Determination is a U-turn and should not be applied retrospectively.	We have not previously held a different view on this issue and have been applying our previously unpublished view. We have observed that the majority of taxpayers were already calculating their FITO limit consistently with the now-published view in this final Determination.
12	The draft Determination does not provide any references to supporting statements from the Explanatory Memorandum to the Tax Laws Amendment (2007) Measures No.4) Bill 2007 (EM), Second Reading Speech and reports. The proposition in paragraph 11 of the draft Determination is not explained/supported.	The Determination has been updated to clarify this point. However, the reasoning in the Determination is based on the plain wording of the provision. While there are supporting statements in the EM, we do not consider it necessary to set these out in the final Determination. For example, paragraph 1.42 of the EM states: In general, the new law maintains the current treatment with respect to net capital gains. Only foreign income tax paid on the whole or part of a capital gain

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		(or capital gains) that is (are) included in the taxpayer's net capital gain in accordance with section 102-5 will be eligible for a tax offset ***[Schedule 1, item 1, subsection 770-10(1)]***. The view in the final Determination is compatible with the legislative example in section 770-75. The example is disaggregating the net capital gain only to the extent that an entity has derived a foreign capital gain on which foreign income tax has been paid, and that foreign capital gain comprises part of its net capital gain. It states that '… only that capital gain on which foreign tax has been paid is disregarded.' We consider that, if capital gains on which no foreign tax had been paid but which were foreign sourced were intended to be disregarded, the example would either cover this scenario or make clear that other capital gains might be disregarded. Further, paragraph 1.140 of the EM states: In the event that a taxpayer has paid foreign income tax on a capital gain that comprises part of their net capital gain, only that capital gain on which foreign income tax has been paid will be disregarded ***[Schedule 1, item 1, subparagraph 770-75(4)(a)(i)]***. That is, the taxpayer in this situation does not disregard the entire net capital gain. This is consistent with the current treatment afforded to foreign tax paid on capital gains which form all or part of a taxpayer's net capital gain. If the disregarded amount in this example was the entire net capital gain, the proxy for the Australian tax payable would be inaccurate and in particular, the result would give rise to an increased cap. It follows that only those deductions that reasonably relate to the disregarded capital gain will be disregarded ***[Schedule 1, item 1, subparagraph 770-75(4)(b)(ii)]***. That is, the taxpayer does not disregard all deductions that reasonably relate to the entire net capital gain. If untaxed foreign capital gains were intended to be disregarded, it would be expected that the relevant EM would address that scenario rather than only referring to disaggregation in relation to the first disregarding rule. The EM would also not contain exhaustive language such as '… only those deductions that reasonably relate to [the first limb of disregarded income]'. Disregarding foreign capital gains in respect of which no foreign tax has been paid would be a change in approach from the treatment under the former foreign tax credit regime. Such a change is not noted in the EM but instead there are statements, such as the quotes above, which indicate the opposite.

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13	If a net capital gain does not have a source, the entire net capital gain should be disregarded as the net capital gain cannot be an amount of 'statutory income that is from a source other than an Australian source'.	This is contrary to the ordinary reading of the provision. It is also contrary to the intention of the provision. See, for example, the legislative example in section 770-75.
14	The description of the object of Division 770 in paragraph 2 of the draft Determination is not strictly correct or is incomplete.	This paragraph of the final Determination has been amended to accurately describe the object of Division 770.
15	The ATO should wait until after the finalisation of the *Burton* decision before publishing this Determination.	This comment is no longer applicable as the *Burton* decision is now final.
16	The ATO view is contrary to the policy intent in paragraphs 1.41, 1.141 and Example 1.20 in the EM which states that 'all foreign source income' is included.	Our view is premised on a view that net capital gains are not foreign sourced income. If that premise is correct, then the view is not contrary to the policy intent. We consider that the EM supports the view in this final Determination. It is also noted that paragraph 1.20 of the EM relates to the calculation of the FITO entitlement under section 770-10 and concerns a net capital gain comprised solely of a capital gain in respect of which foreign tax has been paid.
17	There is no reason to have different treatment of revenue and capital gains.	There is a clear policy intent to provide different treatment for revenue and capital gains for the calculation of the FITO limit. This is evidenced in the different construction of subparagraphs 770-75(4)(a)(i) and (ii). Further, both the *Income Tax Assessment Act 1936* and *the Income Tax Assessment Act 1997* generally provide different treatment for revenue and capital gains, including the availability of discounts, indexation and disregarding of capital gains and the statutory computation of net capital gains. We also note that historically there was a clear policy intent to provide different treatment for revenue and capital gains in the previous foreign tax credit regime which was subsequently reflected in paragraphs 1.42 and 1.140 of the EM.
18	The final Determination should include an example (given the significance and the need to differentiate between subparagraphs 770-75(4)(a)(i) and (ii)).	An example has been added to the final Determination.

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19	The words 'from a source' qualifies 'amounts' not 'statutory income'.	A natural reading of subparagraph 770-75(4)(a)(ii) is that the words 'from a source' refer to the relevant jurisdiction where the statutory income was derived.