


PR 2017/14 - Income tax: tax consequences of investing in the LPP I Asset Pooling Authorised Contractual Scheme

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Product Ruling

Income tax: tax consequences of investing in the LPP I Asset Pooling Authorised Contractual Scheme

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📌 This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

No guarantee of commercial success

The Commissioner **does not** sanction or guarantee this product. Further, the Commissioner gives no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. The Commissioner recommends a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out in the **Ruling** part of this document are available, **provided that** the scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document. If the scheme is not carried out as described, participants lose the protection of this Product Ruling.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the entity(s) who applied for the Product Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Product Ruling.

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified in the Ruling section apply to the defined class of entities who take part in the scheme to which this Ruling relates.
2. All legislative references in this Product Ruling are to the *Income Tax Assessment Act 1936* (ITAA 1936) unless otherwise indicated. In this Product Ruling, terms defined in the documents listed at paragraph 16 have been capitalised.
3. In this Product Ruling the scheme is an investment in Units of the LPP I Asset Pooling Authorised Contractual Scheme (the ACS) offered under a Prospectus issued by Local Pensions Partnership Investments Limited (the ACS Manager) on 31 October 2016.
4. This Product Ruling does not address:
 - (a) the taxation consequences of any financial accommodation the Unitholder obtains to fund the purchase of their Units
 - (b) the taxation consequences of any costs or fees paid by the Unitholder in relation to their Units
 - (c) the taxation consequences arising upon the acquisition, switch, conversion or redemption of the Unitholder's Units
 - (d) the assessability of income derived by the ACS (or a Sub-fund) from a source outside of Australia
 - (e) the taxation consequences of any foreign exchange currency gains or losses arising under the scheme
 - (f) the taxation consequences arising upon the termination of the ACS or a Sub-fund
 - (g) a Unitholder's entitlement to a foreign income tax offset under Division 770 of the *Income Tax Assessment Act 1997* (ITAA 1997), and
 - (h) whether this scheme constitutes a financial arrangement for the purposes of Division 230 of the ITAA 1997 (Taxation of financial arrangements).

Class of entities

5. This part of the Product Ruling specifies which entities can rely on the Ruling section of this Product Ruling and which entities cannot rely on the Ruling section. Those entities that can rely on the Ruling section are referred to in this Product Ruling as the Unitholder.

6. The class of entities that can rely on the Ruling section of this Product Ruling consists of those entities that:

- are a 'superannuation fund for foreign residents', as defined under section 118-520 of the ITAA 1997, and
- are accepted to participate in the scheme described in paragraphs 16 to 34 of this Product Ruling on or after 1 July 2017 and on or before 30 June 2020.

7. The class of entities who can rely on the Ruling section of this Product Ruling does **not** include entities that:

- are not a 'superannuation fund for foreign residents'
- are accepted to participate in the scheme described in paragraphs 16 to 34 of this Product Ruling before 1 July 2017 or after 30 June 2020, or
- participate in the scheme through offers made other than through the Prospectus, or who enter into an undisclosed arrangement with the promoter or a promoter associate, or an independent adviser that is interdependent with scheme obligations and/or scheme benefits (which may include tax benefits) in any way.

Qualifications

8. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 16 to 34 of this Ruling.

9. If the scheme actually carried out is materially different from the scheme that is described in this Product Ruling, then:

- this Product Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled, and
- this Product Ruling may be withdrawn or modified.

Date of effect

10. This Product Ruling applies prospectively from 1 July 2017. It therefore applies only to the specified class of entities that enter into the scheme from 1 July 2017 until 30 June 2020, being its period of application. This Product Ruling will continue to apply to those entities

even after its period of application has ended for the scheme entered into during the period of application.

11. However the Product Ruling only applies to the extent that there is no change in the scheme or in the entity's involvement in the scheme.

Changes in the law

12. Although this Product Ruling deals with the income tax laws enacted at the time it was issued, later amendments may impact on this Product Ruling. Any such changes will take precedence over the application of this Product Ruling and, to that extent, this Product Ruling will have no effect.

13. Entities who are considering participating in the scheme are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

14. Product Rulings were introduced for the purpose of providing certainty about tax consequences for entities in schemes such as this. In keeping with that intention the Commissioner suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling has issued.

Ruling

15. Subject to paragraph 4 of this Product Ruling and the assumptions in paragraph 34 of this Ruling:

- (a) The relationship between the ACS Manager (and/or the Depository) and the Unitholders constitutes a trust relationship for Australian income tax purposes, including Division 6.
- (b) Subparagraph 97(1)(a)(ii) includes an amount in the assessable income of the Unitholders, equal to so much of that share of the net income of the trust estate as is attributable to sources in Australia to which the Unitholders (as beneficiaries) are presently entitled.
- (c) Interest derived by the ACS and to which subsection 128B(2) applies, and unfranked dividends derived by the ACS and to which subsection 128B(1) applies, will be exempt from Australian withholding tax pursuant to paragraph 128B(3)(jb).
- (d) Amounts referred to in paragraph 15(c) above will constitute income that is not assessable income and is

not exempt income of the Unitholders pursuant to section 128D.

- (e) Provided the scheme ruled on is entered into and carried out as described in this Product Ruling, the anti-avoidance provisions in Part IVA will not apply to the Unitholders.

Scheme

16. The scheme that is the subject of this Product Ruling is identified and described in the following documents:

- application for a Product Ruling as constituted by documents and information received on 25 May 2017
- LPP I Asset Pooling Authorised Contractual Scheme Prospectus dated 31 October 2016 (Prospectus)
- Co-Ownership Deed in respect of the LPP I Asset Pooling Authorised Contractual Scheme dated 8 September 2016 (Deed)
- LPP I Asset Pooling Authorised Contractual Scheme Depositary Agreement dated 31 October 2016 (Depositary Agreement)
- Investment Management Agreement relating to the global equities sub-fund of the Local Pensions Partnership Investments Ltd Authorised Contractual Scheme, and
- Services Agreement dated 31 October 2016 (Services Agreement).

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

17. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements.

18. For the purposes of describing the scheme to which this Product Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which a Unitholder, or any associate of a Unitholder, will be a party to, which are a part of the scheme.

Overview of the ACS

19. The ACS is an umbrella authorised contractual scheme governed by the laws of England and Wales, authorised by the Financial Conduct Authority under section 261D of the *Financial*

Services and Markets Act 2000, and constituted by the Deed entered into by the ACS Manager and the Depositary.

20. The ACS is not established as an incorporated entity, but is a contractual arrangement for the unincorporated co-ownership of assets referred to in paragraph 21 below, as permitted by the laws of England and Wales. As such, the ACS does not have a separate legal personality and is represented by the ACS Manager.

21. The object of the ACS is the collective investment in transferable securities and/or other liquid financial assets, near cash and units or shares in other collective investment schemes and any rights or interests in any of these investments, immovables, precious metals and commodity contracts globally, using capital raised from registered holders of Units in the ACS (the Unitholders), each being an investor which meets the eligibility criteria set out in the Prospectus (an Eligible Investor).

22. The Unitholders are co-investors in a co-ownership scheme and are not carrying on business in common.

23. The ACS comprises of separately identifiable pools of funds by reference to which Units are issued (the Sub-funds). Each Sub-fund represents a portfolio of assets which is invested in accordance with the investment objective and policies of the governing agreements on behalf, and for the exclusive benefit, of the Unitholders as co-owners of the relevant Sub-fund's assets.

24. The ACS Manager has primary responsibility for the management and administration of the ACS in compliance with the Collective Investment Schemes Sourcebook issued by the Financial Conduct Authority. Under the Deed, the Unitholders authorise the ACS Manager to acquire, manage and dispose of the assets which are subject to the ACS and enter into contracts which are binding on Unitholders. Such functions (but not responsibility) may be delegated by the ACS Manager to third parties.

25. The Depositary, appointed on the terms of the Depositary Agreement, is responsible for the safe keeping of the assets (other than tangible moveable assets) of the ACS. The assets of each Sub-fund (except for sums standing to the credit of its distribution account) are held by the Depositary for, on behalf and in the interests of its Unitholders in accordance with the regulations governing the ACS and the number of Units held by the Unitholders. Accordingly, legal title to the assets of the ACS is held by the Depositary.

26. The Deed declares that the assets of each Sub-fund:

- except for sums standing to the credit of its distribution account, are beneficially owned by the Unitholders in that Sub-fund as tenants in common
- belong exclusively to that Sub-fund
- shall be segregated from the assets of other Sub-funds, and

- must not be used to discharge any liabilities of, or meet any claims against, any person other than the Unitholders in that Sub-fund.

27. Each Sub-fund will be charged with the liabilities, expenses, costs and charges of the ACS attributable to that Sub-fund. Any liabilities, expenses, costs and charges not attributable to a particular Sub-fund may be allocated by the ACS Manager in a manner which it believes is fair to the Unitholders. Generally, this will be pro rata to the Net Asset Value of the relevant Sub-funds.

28. The debts of each Sub-fund are to be paid by the ACS Manager out of the assets of that Sub-fund. Unitholders are not liable for the debts of the Sub-fund in which they are invested.

29. Units in the ACS may be made available as either income or reinvestment Units. Holders of income Units are entitled to be paid the distributable income attributed to those Units. Holders of reinvestment Units are also entitled to a distribution of income but that will automatically be re-invested to purchase more reinvestment Units of the relevant Sub-fund.

30. The Deed states that income should be allocated to holders of income Units at intervals stated in the Prospectus (that is, at least annually), and Unitholders are absolutely entitled to the income of the ACS as it arises irrespective of whether or not a distribution is made.

31. Any sums standing to the credit of each distribution account are held by the Depositary to distribute or apply them in accordance with the Collective Investment Schemes Sourcebook issued by the Financial Conduct Authority.

32. The transfer of Units in a Sub-fund is not permitted.

33. The ACS has been established for an indefinite period and will continue in existence until otherwise wound up upon direction to do so by the Financial Conduct Authority.

Assumptions

34. This Product Ruling is made on the basis of the following necessary assumptions:

- (a) the Unitholders are 'superannuation funds for foreign residents' as defined in section 118-520 of the ITAA 1997, whose income is exempt from income tax in the United Kingdom where the Unitholders reside for tax purposes
- (b) Unitholders are invested in Unit Class I income Units which allow them to elect to have their distributable income re-invested
- (c) where Unitholders invested in Unit Class I income Units elect to have their distributable income re-invested, no amount will be physically paid out of the

relevant Sub-fund, and instead the ACS Manager will, on the Unitholders' behalf, re-invest the distributions to which they are absolutely entitled into additional income Units of the ACS

- (d) subject to the assumption at paragraph 34(c) above, the ACS Manager shall declare and pay income (reduced for expenses and disbursements) on an income allocation date to the relevant Unitholders, as declared at or before the end of the corresponding accounting period
- (e) the scheme will be executed in the manner described in the Scheme section of this Product Ruling and the scheme documentation referred to in paragraph 16 of this Ruling, and
- (f) all dealings by the Unitholders, the ACS Manager, the Depositary and the Investment Manager under the scheme will be at arm's length.

Appendix 1 – Explanation

❶ ***This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.***

The ACS constitutes a trust

35. The term 'trust' is not defined in the ITAA 1936 or ITAA 1997. Whether or not a trust exists depends on the circumstances of each case: see *Tito & Ors v. Waddell & Ors (No 2)* [1977] Ch 106 at 211 per Megarry V/C. Broadly speaking, a trust will exist where a person holds property or rights on behalf of another for a particular purpose. However, whether this creates a trust relationship depends on the intention of the parties, the factual setting and the wording of the particular documents.

36. French J in *Harmer & Ors v. Federal Commissioner of Taxation* 89 ATC 5180; (1989) 20 ATR 1461 stated at 89 ATC 5187 that there were four essential elements of a trust being:

- the trustee who holds a legal or equitable interest in the trust property
- the trust property which must be property capable of being held on trust and which includes a chose in action
- one or more beneficiaries other than the trustee, and
- a personal obligation on the trustee to deal with the trust property for the benefit of the beneficiaries, which obligation is also annexed to personal property.

37. Having regard to the documents listed in paragraph 16 of this Product Ruling, it is considered that all elements of a trust are present so as to give rise to a trust relationship between the Depository (and/or the ACS Manager) and the Unitholders in the ACS. This is because:

- the Depository acting in the capacity of trustee (as defined in subsection 6(1)), holds legal title to the assets of each Sub-fund (directly or through a Delegate)
- the assets of the ACS (and each Sub-fund), being the trust property, are capable of being held on trust
- the Depository holds these assets and, together with the ACS Manager, has a legal obligation to deal with these assets on behalf of, in the best interest and for the benefit of, the Unitholders of each Sub-fund, and
- the Unitholders of the ACS (as beneficiaries of a trust estate) are absolutely entitled to the income from the assets (less any expenses) of the relevant Sub-fund.

However no Unit confers a specific interest or share in any particular part of the assets of the relevant Sub-fund. Put another way, Unitholders of a particular Sub-fund could not get together and cause the Sub-fund to end and have the assets of that Sub-fund transferred to them as per the rule in *Saunders v. Vautier* (1841) 4 Beav 115 [49 ER 282].

38. Therefore, the Unitholders of the ACS, as non-resident beneficiaries of a trust estate, are taxable on their share of the net income of the trust as is attributable to sources in Australia where the requirements of subsection 97(1) are met.

Are the Unitholders presently entitled to the income of a Sub-fund as it arises?

39. The meaning of 'presently entitled' has been considered by the High Court in *Federal Commissioner of Taxation v. Whiting* (1943) 68 CLR 199 where Latham CJ and Williams J stated at 215-6:

The words 'presently entitled to a share of the income' refer to a right to income 'presently' existing-i.e., a right of such a kind that a beneficiary may demand payment of the income from the trustee, or that, within the meaning of s.19 of the Act, the trustee may properly reinvest, accumulate, capitalize, carry to any reserve, sinking fund or insurance fund however designated or otherwise deal with it as he directs or on his behalf.

40. The Unitholders have no right under the Deed to demand immediate payment of amounts of income to which they are entitled. Their interests may be defeated by the Depositary or ACS Manager in respect of fees or expenses incurred as per the method outlined in Part Three of the Schedule to the Deed. It is only after the ACS Manager has determined a Unitholder's proportionate interest in the assets and income of the Sub-fund that the Unitholder is presently entitled to the income of the trust (whether or not it has been paid). This is because it is only after the ACS Manager has done this calculation in respect of Units in a Sub-fund that it is clear what a Unitholder's entitlement to the income of the trust is. It is at that time that they have an absolutely vested and indefeasible interest in the income of the trust estate.

No liability to Australian withholding tax

41. Generally, an unfranked dividend, interest or royalty paid from Australia is subject to Australian withholding tax if it is derived by a non-resident (subsections 128B(1), (2) and (2B)).

42. For the purposes of Division 11A (of which subsections 128B(1), (2) and (2B) form part), a beneficiary who is presently entitled to a dividend, interest or royalty included in the income of a trust estate is deemed to have derived that dividend,

interest or royalty at the time of present entitlement (subsection 128A(3)).

43. However, paragraph 128B(3)(jb) provides an exemption from withholding tax on dividends and interest income paid by a resident company and derived by a non-resident that is a superannuation fund for foreign residents and exempt from income tax in the country in which the non-resident resides.

44. As the relationship between the Depositary (and the ACS Manager) and the Unitholders of the ACS constitutes a trust for Australian tax purposes (per paragraph 37 of this Product Ruling), any dividend or interest income received by the Depositary (or ACS Manager) as trustee is income of a trust estate for the purposes of subsection 128A(3) and, for the purposes of Division 11A, the Unitholders are deemed to have derived that income if they are presently entitled to it.

45. Any dividend and interest income paid by a company residing in Australia for tax purposes and received by the Depositary (or ACS Manager) under the ACS will, for the purposes of paragraph 128B(3)(jb), therefore be deemed to have been derived by the Unitholders, each being a non-resident that is a superannuation fund for foreign residents and exempt from income tax in the country in which the non-resident resides, as assumed for the purposes of this Product Ruling at paragraph 34(a) of this Ruling.

46. For the reasons stated in paragraph 45 above, interest and dividend income paid by a company residing in Australia for tax purposes to the ACS is income to which paragraph 128B(3)(jb) applies and excluded from being income that is otherwise subject to withholding tax under Division 11A.

47. Income upon which withholding tax would, but for paragraph 128B(3)(jb), be payable, is not assessable income and is not exempt income of a person pursuant to section 128D.

Part IVA – anti-avoidance

48. Provided that the scheme ruled on is entered into and carried out as described in this Product Ruling, it is accepted that the scheme is an ordinary commercial transaction and Part IVA will not apply.

Appendix 2 – Detailed contents list

49. The following is a detailed contents list for this Ruling:

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References

Previous draft:

Not previously issued as a draft

Legislative references:

- ITAA 1936
- ITAA 1936 6(1)
- ITAA 1936 Div 6
- ITAA 1936 97(1)
- ITAA 1936 97(1)(a)(ii)
- ITAA 1936 Div 11A
- ITAA 1936 128A(3)
- ITAA 1936 128B(1)
- ITAA 1936 128B(2)
- ITAA 1936 128B(2B)
- ITAA 1936 128B(3)(jb)
- ITAA 1936 128D
- ITAA 1936 Pt IVA
- ITAA 1997
- ITAA 1997 118-520

- ITAA 1997 Div 230
- ITAA 1997 Div 770
- TAA 1953
- Financial Services & Markets Act 2000 261D

Case references:

- *Federal Commissioner of Taxation v. Whiting* (1943) 68 CLR 199 at 210
- *Harmer v. Commissioner of Taxation* (Cth) (1989) 91 ALR 550; (1989) 20 ATR 1461; 89 ATC 5180
- *Saunders v. Vautier* (1841) 4 Beav 115; 49 ER 282
- *Tito & Ors v. Waddell & Ors* (No 2) [1977] Ch 106

ATO references

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