TD 2017/25 - Income tax: can a foreign resident elect to treat their interest in a limited partnership as an interest in a foreign hybrid limited partnership under paragraph 830-10(2)(b) of the Income Tax Assessment Act 1997 ?

There is a Compendium for this document: **TD 2017/25EC** .

Taxation Determination

Income tax: can a foreign resident elect to treat their interest in a limited partnership as an interest in a foreign hybrid limited partnership under paragraph 830-10(2)(b) of the *Income Tax Assessment Act 1997*?

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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.

Ruling

1. No. A foreign resident cannot make an election under paragraph 830-10(2)(b) of the *Income Tax Assessment Act 1997* (ITAA 1997).[1] However this ruling does not apply:

(a) if the foreign resident is a controlled foreign company (CFC) or was taken to be a Part XI Australian resident under former Part XI of the *Income Tax Assessment Act 1936* (ITAA 1936), or

(b) for the purposes of calculating the net income of a partnership or trust estate.

Date of effect

2. This Determination applies to years of income commencing both before and after its date of issue. However, this Determination will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

[1] All legislative references are to the ITAA 1997 unless otherwise indicated.

Commissioner of Taxation
18 December 2017

Appendix 1 – Explanation

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.

3. Generally, limited partnerships are taxed like companies for Australian income tax purposes.[2] However Division 830 provides an exception. It was introduced to change the way investments in certain foreign limited partnerships (and other 'foreign hybrids') are taxed in Australia.[3]

4. Prior to the enactment of Division 830, Australian resident taxpayers with interests in foreign hybrids were potentially taxed on their share of the income derived by the foreign hybrid entity under Australia's controlled foreign company (CFC) or former foreign investment fund (FIF) rules. The application of these rules led to inappropriate outcomes:

(a) sometimes comparably taxed income was attributed

(b) the active income test could not be satisfied

(c) there was a risk of double taxation, and

(d) there were significant compliance costs.[4]

5. Under Division 830, an entity that qualifies as a 'foreign hybrid' is treated as a partnership, rather than a company, for Australian tax purposes. As a consequence, an attributable taxpayer[5] in relation to a foreign hybrid limited partnership is taxed on their share of the foreign hybrid's net income under Division 5 of the ITAA 1936 (dealing with partnerships) instead of on their share of the foreign hybrid's attributable income calculated under the CFC rules.

6. However a limited partnership is still treated like a company in relation to partners who are not attributable taxpayers (that is, where a partner's interest would have been dealt with under the FIF rules rather than the CFC rules) unless they have made an election under former subsection 485AA(1) of the ITAA 1936 or under paragraph 830-10(2)(b).[6]

Election under paragraph 830-10(2)(b)

7. Subsection 830-10(4) provides that an election can only be made under paragraph 830-10(2)(b) if:

(a) disregarding subsection 94D(6) of the *Income Tax Assessment Act 1936*:

(i) at the end of the income year in which the election is made, the partner has an interest in a FIF (within the meaning of former Part XI of that Act) that is a *corporate limited partnership; and

(ii) the interest consists of a *share in the FIF; and

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[2] Division 5A of the ITAA 1936.
[3] Foreign hybrids are entities that are treated as partnerships for foreign income tax purposes, but as companies for Australian income tax purposes (putting aside the application of Division 830).
[4] Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 7) 2003 at paragraphs 9.2 to 9.7.
[5] As defined in the CFC provisions and disregarding subsection 94D(5) of the ITAA 1936.
[6] The FIF rules were repealed by *Tax Laws Amendment (Foreign Source Income Deferral) Act (No. 1) 2010* and the election under former subsection 485AA(1) of the ITAA 1936 is now provided for by paragraph 830-10(2)(b).

(b) the limited partnership satisfies paragraphs (1)(a) to (d) in relation to the income year in which the election is made.

8. An 'interest in a FIF' was defined in former Part XI of the ITAA 1936, relevantly, as a share in a foreign company.[7] Because the definition did not have a residency requirement for the holder, a foreign resident could technically have an interest in a FIF even though it was not an interest to which Part XI of the ITAA 1936 applied. Construed in isolation and read literally, it might be argued that section 830-10 does not preclude a foreign resident from electing to treat their interest in a limited partnership as an interest in a 'foreign hybrid limited partnership'.[8]

9. However, statutory interpretation principles require that legislation be considered in its context including the existing state of the law and the mischief the statute was intended to remedy.[9]

Position under former FIF rules

10. The precursor to the election in paragraph 830-10(2)(b) was contained in the FIF rules in former Part XI of the ITAA 1936. As stated in its heading[10], section 485AA of the ITAA 1936 permitted a taxpayer to elect to **exclude** their interest in a foreign hybrid 'from the **operation** of this Part' (emphasis added). The effect of the election was that section 529 of the ITAA 1936 (the 'operative provision') did not apply to the taxpayer's interest in the limited partnership[11], and as a result, no income would be attributed from the FIF to the taxpayer.[12] The circumstances in which the operative provision applied to a taxpayer were set out in section 485 of the ITAA 1936 which was limited to taxpayers who were 'Part XI Australian residents'.[13]

11. Therefore the election available under section 485AA of the ITAA 1936 was limited to Part XI Australian residents who would otherwise be subject to the operation of the FIF rules. Generally, a foreign resident was not subject to the FIF rules and could not make that election.[14]

[7] Former sections 481 and 483 of the ITAA 1936.
[8] Assuming for present purposes that the limited partnership satisfies paragraphs 830-10(1)(a) to (d).
[9] See *CIC Insurance Ltd v. Bankstown Football Club Ltd* (1997) 187 CLR 384; [1997] HCA 2 at CLR 408; *Project Blue Sky Inc v. Australian Broadcasting Authority* (1998) 194 CLR 355; [1998] HCA 28 at [69] to [71]; *Alcan (NT) Alumina Pty Ltd v. Commissioner of Territory Revenue (NT)* (2009) 239 CLR 27; [2009] HCA 41 at [47] and *Commissioner of Taxation v. Consolidated Media Holdings Ltd* (2012) 250 CLR 503; [2012] HCA 55 at [39].
[10] Subsection 13(1) of the *Acts Interpretation Act 1901 (Cth)* provides that headings form part of an Act.
[11] Subsection 485AA(5) of the ITAA 1936.
[12] The election generally needed to be made on or before the taxpayer lodged their tax return for the year of income (subsection 485AA(3) of the ITAA 1936).
[13] Paragraph 485(3)(c) of the ITAA 1936.
[14] However certain taxpayers were taken to be Part XI Australian residents (see subsection 485(6) of the ITAA 1936). Also, the former FIF rules applied in the calculation of the notional income of a CFC (based on the assumption in section 383 of the ITAA 1936 that the CFC is a taxpayer and a resident), and in the calculation of the net income of a partnership or trust estate (see section 485A of the ITAA 1936).

Division 830 amended in 2010

12. The *Tax Laws Amendment (Foreign Source Income Deferral) Act (No. 1) 2010* repealed the FIF rules (including section 485AA of the ITAA 1936). However subsection 830-10(2) was amended to preserve the effect of an election that had been made previously and to ensure that taxpayers could continue to make an election for foreign hybrid treatment notwithstanding the repeal of section 485AA of the ITAA 1936.

13. Importantly, the amendments did not broaden the scope of the election; the conditions required to make an election under paragraph 830-10(2)(b) are the same as those under former section 485AA of the ITAA 1936.[15] This was to ensure that the election 'would continue to operate as intended'.[16] That is, where a particular partner is not an attributable taxpayer in relation to a limited partnership, they can choose whether or not their interest is treated as an interest in a foreign hybrid limited partnership (regardless of whether there is another taxpayer that is an attributable taxpayer).[17]

14. Accordingly, an election for foreign hybrid treatment is only available to partners who have an interest in a FIF to which Part XI of the ITAA 1936 applied, being partners who are Australian residents.[18] Foreign residents who were not subject to the former FIF rules cannot make an election under subsection 830-10(2). This is supported by the context and purpose of section 830-10.

Context and purpose

15. The object of Division 830 was to address unintended consequences of CFC and FIF attribution. There are two distinct elements under subsection 830-10(4) that must be satisfied for the election to be made. The first element focuses upon the partner's relationship with the FIF – the partner must have an 'interest in a FIF (within the meaning of Part XI of that Act)' that 'consists of a share in the FIF'. The second element focusses on the features of the limited partnership – the partnership must satisfy paragraphs 830-10(1)(a) to (d).

16. Under a literal view, the first element is superfluous because it would be sufficient to merely apply the second element. A partner in a corporate limited partnership that satisfies the requirements in paragraphs 830-10(1)(a) to (d) will always have an interest that is a share in a FIF. An interpretation that promotes a role and function for paragraph 830-10(4)(a) is to be preferred to one that does not.

17. As McHugh, Gummow, Kirby and Hayne JJ observed in *Project Blue Sky Inc v. Australian Broadcasting Authority* (1998) 194 CLR 355; [1998] HCA 28 at [71]:

> … a court construing a statutory provision must strive to give meaning to every word of the provision. In The *Commonwealth v. Baume* Griffith CJ cited *R v. Berchet* to support the proposition that it was 'a known rule in the interpretation of Statutes that such a sense is to be made upon the whole as that no clause, sentence, or word shall prove superfluous, void, or insignificant, if by any other construction they may all be made useful and pertinent' (footnotes omitted).

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[15] Subsection 830-10(4) adopted the language previously used in subsection 485AA(1) of the ITAA 1936, and as a result the wording of the provisions is the same in all relevant respects.

[16] Explanatory Memorandum to the Tax Laws Amendment (Foreign Source Income Deferral) Bill (No. 1) 2010 at paragraphs 1.34 to 1.36.

[17] Explanatory Memorandum to the Tax Laws Amendment (Foreign Source Income Deferral) Bill (No. 1) 2010 at paragraphs 1.39 to 1.41.

[18] A taxpayer must be an Australian resident in order to be a 'Part XI Australian resident' under former section 470 of the ITAA 1936.

18. The requirement in subsection 830-10(4) that the partner have an 'interest in a FIF' should be read down to limit the election to partners who have an interest in a FIF to which Part XI of the ITAA 1936 applied. It is improbable that Parliament would use specific language from the repealed FIF rules if the intention was simply to require the partner have an interest in a 'foreign company'[19] – a requirement which, as noted above, is superfluous for corporate limited partnerships that satisfy paragraphs 830-10(1)(a) to (d).

[19] Relevant to corporate limited partnerships, FIF means a 'foreign company' (former section 481 of the ITAA 1936).

Appendix 2 – Alternative views

This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the binding public ruling.

19. An alternative view is that the plain and ordinary meaning of the text in subsections 830-10(2) and (4) does not contain any limitation that would preclude a foreign resident from electing to treat their interest in a limited partnership as an interest in a foreign hybrid. The requirement that the partner has an 'interest in a FIF' as defined in former Part XI of the ITAA 1936 is clear and unambiguous – it does not require that the holder is an Australian resident – and so a foreign resident can have an interest in a FIF (even though it may not have been an interest to which Part XI of the ITAA 1936 applied). It is impermissible to look at legislative history and extrinsic materials to displace the clear meaning of the words used in the provision where there is no ambiguity.[20]

20. The Commissioner does not accept this alternative view which construes section 830-10 literally and in isolation.

21. The amended section 830-10 is to be interpreted in accordance with the modern approach to statutory interpretation. In *Alcan (NT) Alumina Pty Ltd v. Commissioner of Territory Revenue (NT)* (2009) 239 CLR 27; [2009] HCA 41 the High Court said:

> 47. ... the task of statutory construction must begin with a consideration of the text itself. Historical considerations and extrinsic materials cannot be relied on to displace the clear meaning of the text. The language which has actually been employed in the text of legislation is the surest guide to legislative intention. The meaning of the text may require consideration of the context, which includes the general purpose and policy of a provision, in particular the mischief it is seeking to remedy.

22. The Court has also said that apparently plain words may wear a different meaning when considered in their context. In *CIC Insurance Ltd v. Bankstown Football Club Ltd* (1997) 187 CLR 384; [1997] HCA 2 the majority said at CLR 408:

> …[T]he modern approach to statutory interpretation (a) insists that the context be considered in the first instance, not merely at some later stage when ambiguity might be thought to arise, and (b) uses 'context' in its widest sense to include such things as the existing state of the law and the mischief which, by legitimate means such as [permitted extrinsic materials], one may discern the statute was intended to remedy… if the apparently plain words of a provision are read in the light of the mischief which the statute was designed to overcome and of the objects of the legislation, they may wear a very different appearance. Further, inconvenience or improbability of result may assist the court in preferring to the literal meaning an alternative construction which, by the steps identified above, is reasonably open and more closely conforms to the legislative intent (footnotes omitted).[21]

23. The context here includes the text of the FIF provisions and section 830-10 before the *Tax Laws Amendment (Foreign Source Income Deferral) Act (No 1) 2010* was passed, as well as the object of Division 830 which was to address unintended consequences of CFC and FIF attribution. As noted above, the FIF rules only applied to a 'Part XI Australian resident' and section 485AA of the ITAA 1936 permitted such taxpayers to elect to exclude their interests from the operation of the FIF rules.

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[20] *Commissioner of Taxation v. Consolidated Media Holdings Ltd* (2012) 250 CLR 503; [2012] HCA 55 at [39].
[21] See also *Project Blue Sky Inc v. Australian Broadcasting Authority* [1998] HCA 28; (1998) 194 CLR 355 at [69] to [71].

24. Subsection 830-10(4) adopted the language previously used in subsection 485AA(1) of the ITAA 1936 such that the wording of the provisions is the same in all relevant respects. Therefore, the election under paragraph 830-10(2)(b) is limited in the same way that section 485AA of the ITAA 1936 was.

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TD 2016/D2

Related Rulings/Determinations:

TR 2006/10

Legislative references:

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- ITAA 1936 Div 5
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- ITAA 1936 94D(5)
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- ITAA 1936 470
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- ITAA 1997 830-10(1)(a)
- ITAA 1997 830-10(1)(b)
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- ITAA 1997 830-10(4)(a)
- Acts Interpretation Act 1901 13(1)
- Tax Laws Amendment (Foreign Source Income Deferral) Act (No. 1) 2010
- Tax Administration Act 1953

Cases relied on:

- Alcan (NT) Alumina Pty Ltd v. Commissioner of Territory Revenue - (2009) 73 ATR 256; [2009] HCA 41; (2009) 83 ALJR 1152; 2009 ATC 20-134; (2009) 260 ALR 1; (2009) 239 CLR 27; [2010] ALMD 481; [2010] ALMD 482; [2010] ALMD 511
- CIC Insurance Ltd v. Bankstown Football Club Ltd - (1997) 187 CLR 384; (1997) 71 ALJR 312; (1997) 141 ALR 618; (1997) 9 ANZ Insurance Cases 61-348; [1997] HCA 2
- Federal Commissioner of Taxation (FCT) v. Consolidated Media Holdings Ltd - [2012] HCA 55; (2012) 87 ALJR 98; [2013] ALMD 739; (2012) 293 ALR 257; [2013] ALMD 1126; [2013] ALMD 1128; (2012) 91 ACSR 359; (2012) 84 ATR 1; 2012 ATC 20-361; (2012) 250 CLR 503
- Project Blue Sky Inc v. Australian Broadcasting Authority - (1998) 194 CLR 355; (1998) 72 ALJR 841; (1998) 153 ALR 490; [1998] HCA 28

Other references:

- Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 7) 2003
- Explanatory Memorandum to the Tax Laws Amendment (Foreign Source Income Deferral) Bill (No. 1) 2010

ATO references

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