The Senate

Economics
Legislation Committee

Tax and Superannuation Laws Amendment (2015 Measures No. 1) Bill 2015 [Provisions]

June 2015

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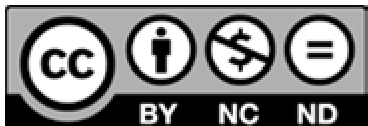

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Inquiry into the provisions of the Tax and Superannuation Laws Amendment (2015 Measures No. 1) Bill 2015

Referral and conduct of the inquiry

1.1 On 13 May 2015, the Senate passed the following resolution:

> To ensure appropriate consideration of time critical bills by Senate committees, the provisions of all bills introduced into the House of Representatives after 14 May 2015 and up to and including 4 June 2015 that contain substantive provisions commencing on or before 1 July 2015 (together with the provisions of any related bill), are referred to committees for inquiry and report by 15 June 2015…[1]

1.2 Accordingly, following its introduction into the House of Representatives on 27 May 2015, the provisions of the Tax and Superannuation Laws Amendment (2015 Measures No. 1) Bill 2015 were referred to the Senate Economics Legislation Committee for inquiry and report.

1.3 The committee advertised the inquiry on its website and wrote to relevant stakeholders and interested parties inviting submissions by 10 June 2015. The committee received seven submissions, which are listed in Appendix 1. Given the short timeframe for this inquiry, the committee resolved that it would rely on the submissions to prepare its report and not hold a public hearing.

1.4 The committee would like to acknowledge and convey its appreciation to those organisations and individuals who, within a very short timeframe, provided a submission to this inquiry.

Overview of the bill

1.5 This omnibus bill proposes to amend various taxation and superannuation laws to:

- end the first home saver accounts scheme (schedule 1 to the bill);
- abolish the dependent spouse tax offset and expand the dependant (invalid and carer) tax offset by removing the exclusion in relation to spouses previously covered by the dependent spouse tax offset (schedule 2);
- make several changes to the offshore banking unit regime (schedule 3);

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1 *Journals of the Senate*, 2013–15, no. 93 (13 May 2015), p. 2585.

- exempt the Global Infrastructure Hub Ltd[2] from liability to pay income tax on ordinary income and statutory income (schedule 4);
- update the list of specifically listed deductible gift recipients (schedule 5);
- make a number of miscellaneous amendments, including style and formatting changes, the repeal of redundant provisions, the correction of anomalous outcomes and corrections to previous amending Acts (schedule 6); and
- implement changes to the investment manager regime (schedule 7).

Scope and structure of this report

1.6 Submissions received by the committee commented on schedules 1–3 and 7 to the bill. As the committee does not have any findings or recommendations to make that specifically apply to schedules 4–6, the committee's report describes and considers only the schedules commented on by submitters. The explanatory memorandum that accompanied the bill sets out all of the proposed amendments in detail.

1.7 This report examines schedules 1–3 and 7 in turn. The committee's comments on individual schedules are at the end of each section. The committee's overall conclusion can be found at the end of the report.

Schedule 1—First home saver accounts scheme

1.8 The first home saver accounts scheme was introduced in 2008 to assist individuals to save for their first home. Under the scheme, individuals aged between 18 and 65 who had not previously owned a home in Australia are entitled to open a first home saver account (FHSA), and could make contributions up to a cap (now $90,000).[3]

1.9 Concessions provided by the government to assist saving included direct contributions (17 per cent of the first $6,000 contributed in a year) and tax concessions that are similar to those provided to superannuation accounts.[4] Withdrawals from an FHSA could only occur if the account holder:

- met a minimum qualifying period (the four-year rule);[5]

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2 The Global Infrastructure Hub was an outcome of the November 2014 G20 meeting. The Australian government will contribute $30 million for the Hub until 2018. In his second reading speech, the Assistant Treasurer stated that it 'would be inappropriate for the Australian government to tax assistance provided to the Hub under an arrangement agreed to as part of Australia's G20 presidency'. The Hon Josh Frydenberg MP, Assistant Treasurer, *Proof House of Representatives Hansard*, 27 May 2015, p. 19.

3 Explanatory Memorandum, p. 9 [paragraph 1.3].

4 Explanatory Memorandum, pp. 9–10 [paragraphs 1.2–1.9].

5 To meet this condition, the account holder must have made the minimum contribution or owned their home in at least four financial years; or reached the account balance cap and the account has been open in at least four financial years. Australian Taxation Office (ATO), 'First home saver account', www.ato.gov.au/Individuals/First-home-saver-account/In-detail/Accessing-your-funds/Accessing-your-funds (accessed 5 June 2015).

- acquired a home with another first home saver account holder who is eligible to access their funds;
- chose to transfer the balance into their superannuation fund;
- turned 60 years of age; or
- met other specified circumstances.[6]

1.10 The planned cessation of the FHSA scheme was announced in the 2014–15 Budget.[7] It is proposed that new accounts opened after the 2014–15 Budget night will not be eligible for any concessions. For existing account holders, the accounts will cease to be FHSAs from 1 July 2015, meaning they will no longer be subject to regulatory restrictions on withdrawals, however, they will also no longer receive government co-contributions and the tax and social security concessions will be removed.[8] The bill would make a number of amendments to various Acts to remove references to FHSAs.

1.11 Although the FHSA scheme would cease from the 2015–16 financial year, the bill proposes that entitlement to government contributions will cease to arise from the 2014–15 financial year onwards.[9]

1.12 In his second reading speech, the Assistant Treasurer made the following observations about the low take-up rate for FHSAs and the limited success of the scheme:

> When first home saver accounts were introduced by the previous government, they were expected to hold around $6.5 billion in total combined savings after four years. At the beginning of last year, more than five years after the scheme was introduced, fewer than 50,000 accounts were open, and containing total combined savings of only $540 million. This is less than 10 per cent of the previous government's prediction.

1.13 The Assistant Treasurer concluded:

> …it is clear that the first home saver accounts have not helped address rising housing costs in Australia. If we are to help young Australian families realise the dream of owning their own home, then we need to address the real issues faced by families looking to enter the property market.
>
> The supply of housing is not keeping pace with recent growth in demand. To improve housing supply, regulatory barriers relating to state and local governments' planning, land use and housing infrastructure policies must be removed.[10]

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6 ATO, 'First home saver account'.

7 Australian Government, *Budget Measures 2014-15: Budget Paper No. 2*, May 2014, p. 216.

8 The Hon Josh Frydenberg MP, *Proof House of Representatives Hansard*, 27 May 2015, p. 17.

9 Schedule 1, item 2014(1).

10 The Hon Josh Frydenberg MP, *Proof House of Representatives Hansard*, 27 May 2015, p. 17.

1.14 Over the 2014–15 forward estimates, the cessation of the scheme is projected to save $113.3 million.[11]

Stakeholder views on schedule 1

1.15 The committee received two submissions on the FHSA scheme. The Australian Bankers' Association (ABA) noted that the banking sector initially welcomed the creation of the FHSA scheme, however, the ABA explained that:

> …there were some significant issues that impacted the banks' ability to deliver these new products in a straightforward, low cost and timely manner. Despite changes being made to FHSAs, consumer interest remained low. The complex product rules, especially the four year qualifying rule, and the availability of better savings products within the market limited consumer interest in FHSAs.[12]

1.16 The ABA submitted that as the FHSAs will be treated as ordinary deposit accounts following the end of the FHSA scheme, customers will not be disadvantaged.[13]

1.17 A submission from an individual with an FHSA expressed support for the cessation of the scheme. The submitter noted that his ability to save for a house was impeded by the low interest rates the accounts currently offer and the inability to invest his savings in 'a more appropriate risk–reward asset class'.[14] Similar evidence was received by the Economics References Committee during its recently completed inquiry into affordable housing.[15]

Committee comment on schedule 1

1.18 The low take-up rate for FHSAs indicates that the scheme has not been a success. The abolition of the scheme is a sensible savings measure that the committee supports.

Schedule 2—Dependent spouse tax offset

1.19 Schedule 2 to the bill would amend the *Income Tax Assessment Act 1936* (ITAA 1936) and the *Income Tax Assessment Act 1997* (ITAA 1997) to:

- abolish the dependent spouse tax offset (DSTO);

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11 Explanatory Memorandum, p. 3.

12 Australian Bankers' Association (ABA), *Submission 6*, p. 1.

13 ABA, *Submission 6*, p. 2.

14 Mr Ewen McNee, *Submission 1*, p. 1. Interest rates offered on savings products have fallen significantly since the FHSA scheme was introduced. Changes to the Reserve Bank of Australia's official cash rate target over time provide some insight into this. When the legislation that introduced the FHSA scheme received the Royal Assent in June 2008, the official cash rate target was 7.25 per cent. As at 1 June 2015, the cash rate target was 2 per cent.

15 See Senate Economics References Committee, *Out of reach? The Australian housing affordability challenge*, May 2015, pp. 173–74.

- expand the dependant (invalid and carer) tax offset (DICTO) by removing the exclusion in relation to spouses previously covered by the DSTO;
- remove an entitlement to the DSTO where it is made available as a component of the zone tax offset (ZTO), overseas civilians tax offset (OCTO) or overseas forces tax offset (OFTO), and replace that component with a component made up of the DICTO;[16] and
- rewrite the notional tax offsets covering children, students and sole parents that are available as components of other tax offsets.[17]

1.20 The DSTO is a dependency tax offset that can be claimed by taxpayers who:

- have a dependent spouse born before 1 July 1952;[18] or
- are eligible for the ZTO, OFTO or OCTO—taxpayers eligible for these offsets can access the DSTO regardless of the age of their spouse and can receive a further entitlement of 50 per cent or 20 per cent of their DSTO entitlement as a component of ZTO, OFTO or OCTO depending on where they reside.[19]

1.21 The DSTO is an income tested offset that is based on the taxpayer's and the spouse's adjusted taxable income. In 2013–14, the DSTO was worth up to $2,471.[20]

1.22 Following the proposed abolition of the DSTO, a taxpayer may be entitled to the DICTO for an income year if they contributed to the maintenance of an eligible dependant during that year.[21] The DICTO is available to taxpayers who maintain a dependant who is unable to work due to disability or carer obligations.[22]

1.23 The abolition of the DSTO was announced in the 2014–15 Budget,[23] and is projected to save $320 million over the 2014–15 forward estimates.[24]

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16 That is, a person who is eligible for the zone, overseas civilian or overseas forces tax offset would only be entitled to claim DICTO for a dependent (including a spouse) who is an invalid or cares for an invalid.

17 Explanatory Memorandum, pp. 21, 24–25 [paragraphs 2.1 and 2.21].

18 Schedule 4 to the *Tax Laws Amendment (2012 Measures No. 1) Act 2012* amended the ITAA 1936 to limit the DSTO to income taxpayers who have a dependent spouse born before 1 July 1952. This measure was intended to result in the gradual phase out of the offset as the population ages. Tax Laws Amendment (2012 Measures No. 1) Bill 2012, Explanatory Memorandum, paragraph 4.22

19 Explanatory Memorandum, p. 25.

20 The offset is indexed. Explanatory Memorandum, p. 22 [paragraphs 2.4 and 2.7].

21 Explanatory Memorandum, p. 22 [paragraph 2.8].

22 The Hon Josh Frydenberg MP, *Proof House of Representatives Hansard*, 27 May 2015, p. 18; Tax and Superannuation Laws Amendment (2013 Measures No. 2) Bill 2013, Explanatory Memorandum, paragraph 7.2.

23 Australian Government, *Budget Measures 2014-15: Budget Paper No. 2*, May 2014, pp. 13–14.

24 Explanatory Memorandum, p. 4.

1.24 In his second reading speech on the bill, the Assistant Treasurer made the following observation in support of the proposed changes:

> When the Dependent Spouse Tax Offset was introduced many decades ago, its purpose was to provide a concession to taxpayers who 'maintained' a dependent spouse. It was introduced at a time when the welfare system was in its infancy. With changes in our society and our economy, this offset is obviously outdated.
>
> Maintaining concessions that have outlived their purpose is simply not sustainable—particularly in view of other assistance available through the welfare system that is more targeted and appropriate and the need to promote workforce participation as our population ages.[25]

1.25 The bill also proposes to rewrite into the ITAA 1997 parts of the dependency tax offsets in the ITAA 1936 that are still required. The explanatory memorandum advised that this is because the 'provisions are now extremely complex and difficult to understand and apply' due to the numerous amendments made over the last 50 years.[26]

Stakeholder views on schedule 2

1.26 The committee received one submission on the proposed abolition of the DSTO. The submitter focused on the proposed removal of the entitlement to claim for the DSTO as part of the ZTO. The submitter argued that the proposed amendments conflict with other government policies that relate to northern Australia as the proposed amendments 'would not encourage workers to remain or move to remote zones'. The submitter concluded that this is 'a minor budgetary revenue measure that will have a detrimental impact on many low paid workers in regional Australia'.[27]

Committee comment on schedule 2

1.27 The committee understands that some individuals will be affected by the abolition of the DSTO. However, the committee considers that it is important to update Australia's taxation laws to ensure that concessions are well-targeted and appropriate. Importantly, other offsets in the taxation system such as the DICTO will ensure that support continues to be provided to those who most need it.

Schedule 3—Offshore banking unit regime

1.28 Schedule 3 to the bill contains proposed amendments to the offshore banking (OB) regime that seek to:

- implement recommendations of the 2009 report by the Australian Financial Centre Forum, *Australia as a Financial Centre: Building on our Strengths* (known as the Johnson Report after the chair of the forum, Mr Mark Johnson AO); and

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25 The Hon Josh Frydenberg MP, *Proof House of Representatives Hansard*, 27 May 2015, p. 18.

26 Explanatory Memorandum, p. 27 [paragraph 2.29].

27 Mr Wayne McEvoy, *Submission 2*, p. 1.

- address integrity concerns with the existing regime.[28]

1.29 An offshore banking unit (OBU) is a notional division or business unit of an Australian entity that conducts offshore banking activities. Concessional tax treatment is provided in respect of eligible OB activities, provided additional criteria are met.[29] The tax incentives are provided to 'attract and maintain highly mobile financial sector activities within Australia'. Such activities include financial intermediation between offshore lenders and offshore borrowers and the provision of other financial services to offshore investors who are investing outside Australia.[30]

1.30 Under these taxation arrangements, assessable income from eligible activities is effectively subject to a tax rate of 10 per cent. In addition, interest payments made by OBUs when borrowing from offshore are not subject to interest withholding tax when the borrowed funds are used to carry on eligible activities under the regime.[31]

1.31 The proposed amendments contained in schedule 3 to the bill would:

- limit the availability of the OBU concession in certain circumstances where it could otherwise be used to convert an ineligible activity into an eligible OB activity;
- codify the 'choice principle' to remove uncertainty for taxpayers;[32]
- introduce a new method of allocating certain expenses between the operations of a taxpayer's domestic banking unit and OBU;
- modernise the list of eligible OB activities; and
- treat internal financial dealings (for example, between an entity's domestic banking unit and OBU) as if they were on an arm's length basis.[33]

Stakeholder views on schedule 3

1.32 In their joint submission, the Australian Financial Markets Association (AFMA) and the ABA, commented on the changes to the list of eligible OB activities.

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28 Explanatory Memorandum, p. 35 [paragraph 3.1].

29 Explanatory Memorandum, p. 36 [paragraphs 3.6–3.7].

30 Explanatory Memorandum, p. 35 [paragraph 3.3].

31 Explanatory Memorandum, p. 35 [paragraph 3.4].

32 The explanatory memorandum noted that the Commissioner of Taxation has issued a tax determination that expressed the view that a taxpayer is entitled to make the choice, at the time of entering into an eligible OB activity transaction, to treat the activity as if it were ineligible. As the transaction is treated as not being an OB activity, the associated income does not risk the taxpayer failing the 'purity test' in section 121EH of the ITAA 1936 if the activity was financed through non-OB money (the purity test provides that if more than 10 per cent of an OBU's assessable income for an income year is attributed to lending, investing or other use of non-OB money, than the concessional tax rate will not apply to any of the OBU's income in the relevant year). By choosing to treat an activity as ineligible, the taxpayer can also avoid a recoupment of exempted withholding tax. Explanatory Memorandum, pp. 36–37 [paragraphs 3.10–3.13].

33 Explanatory Memorandum, p. 39 [paragraph 3.27].

One of the additions to the list is leasing activities, which covers activities undertaken as either a lessor or a lessee (or a sublessor or a sublessee). The explanatory memorandum noted that this is intended to 'give greater flexibility to OBUs in recognition of the fact that many leasing arrangements have similar commercial features to existing OB activities such as lending'.[34]

1.33 AFMA and the ABA noted that they are supportive of the proposal to include leasing as an eligible activity; however, they questioned whether the sale of an OBU leased asset would be part of the leasing activity and, hence, an eligible OB activity. AFMA and the ABA provided the following explanation of their concern in this regard:

> While it is arguable that the broad definition of 'leasing activity' includes the sale of the OBU leased asset, as this is routinely what entities engaged in leasing businesses do, given the punitive consequences that arise should an OBU conduct an ineligible activity, and particularly receive non-OB money, our view is that clarity is appropriate.[35]

1.34 AFMA and the ABA submitted that the bill should be amended to clarify whether the sale of an OBU leased asset is part of the leasing activity. AFMA and the ABA provided the following reasoning in support of their recommendation:

> Our primary concern arising from the lack of clarity is that it either effectively compels an OBU to hold the asset at completion of the lease to perpetuity or risk falling foul of the 'purity test' in section 121EH of the 1936 Act. Section 121EH provides, broadly, that where an OBU derives more than 10% of its income for the year from the use of 'non-OB money' then the entire income of the OBU for the particular income year is not eligible for the concession. 'Non-OB money' is defined in section 121C as including money received by an OBU from conducting an activity that is not an eligible-OB activity.
>
> Hence, it follows that if the disposition of the OBU leased asset is not an eligible OB activity then any sale proceeds will constitute non-OB money and hence threaten the OBU's status for that income year.
>
> In practice, this would mean that no leasing activity would be undertaken in an OBU, thereby rendering the reforms in the current Bill as futile.[36]

1.35 AFMA and the ABA also raised a drafting concern regarding proposed new section 121EDA. The following statement on this matter was provided in their submission:

> The current definition of 'assessable OB income' in section 121EE includes amounts either derived from OB activities or 'included in the assessable income because of such activities' (section 121EE(2)(b)). The proposed definition in section 121EDA, as it applies to ordinary income, only relates

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34 Explanatory Memorandum, p. 52 [paragraph 3.92].

35 Australian Financial Markets Association (AFMA) and the ABA, *Submission 4*, p. 2.

36 AFMA and the ABA, *Submission 4*, p. 2.

> to income derived from OB activities of the OBU and hence [the] 'because of such activities' limb has been removed, except as it relates to 'statutory income'.
>
> AFMA and the ABA do not believe this change was intentional, as it was not raised during consultation nor is the basis for the change reflected in the Explanatory Memorandum. We recommend that proposed section 121EDA be amended to refer to 'assessable' income as opposed to 'statutory' income.[37]

1.36 Assessable OB income is currently defined at length in section 121EE(2) of the ITAA 1936. However, in proposed new section 121EDA, the bill seeks to provide a definition of OB income to accommodate the proposed introduction of a new definition of a general OB deduction.[38] As a result, the bill would change the definition of assessable OB income so that the definition refers to the concept of OB income that is defined in proposed new section 121EDA.

1.37 As the proposed new definition of assessable OB income encompasses 'so much of the OBU's OB income…as is assessable income',[39] it may not be appropriate to include a reference to assessable income in the definition of OB income itself.

Committee comment

1.38 The committee draws the government's attention to the issues raised by AFMA and the ABA regarding leasing activities.

Schedule 7—Investment manager regime

1.39 The investment manager regime (IMR), contained in Subdivision 842-I of the ITAA 1997, exempts from Australian income tax certain income derived by foreign entities.

1.40 The introduction of an IMR was a recommendation of the Johnson Report. The Johnson Report considered that the introduction of an IMR would remove impediments created by Australia's tax system to certain cross-border activities.[40]

1.41 The proposed amendments contained in schedule 7 to the bill would implement the third and final element of the IMR reforms and make some other changes to the existing regime.[41] The IMR reforms are 'aimed at encouraging greater foreign investment into Australia, and promoting Australia as a financial services

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37 AFMA and the ABA, *Submission 4*, p. 3.

38 Explanatory Memorandum, p. 47 [paragraph 3.56].

39 Schedule 3, item 14 [proposed new subsection 121EE(2) of the ITAA 1936].

40 Explanatory Memorandum, p. 78 [paragraph 7.4].

41 Explanatory Memorandum, p. 78 [paragraph 7.1]. Information on the first and second elements of the reforms can be found in paragraph 7.7 of the explanatory memorandum.

centre…by removing the uncertainties in the application of Australia's tax laws as they apply to widely held foreign funds and foreign investors'.[42]

Overview of the proposed amendments

1.42 The proposed amendments would replace the existing IMR with a new regime:

- that extends the IMR concession to cover direct investments in Australian assets that are of a portfolio nature;
- that removes the portfolio restriction in respect of investments in foreign assets that are made through Australia; and
- with changed criteria that determines when a foreign fund is 'widely held'[43] and a simplified legislative mechanism for providing the IMR concession.[44]

1.43 The stated object of the new IMR would be 'to encourage particular kinds of investment made into or through Australia by some foreign residents that have wide membership, or that use Australian fund managers'.[45]

1.44 Under the proposed changes, income derived by an 'IMR entity', which cannot be an 'Australian resident' or a 'resident trust for CGT purposes' as defined by the income tax law, can qualify for the IMR concession. The IMR concession:

- treats certain amounts of income that would otherwise be assessable income as non-assessable non-exempt income;
- denies certain deductions; and
- disregards certain capital gains and capital losses.[46]

1.45 Foreign entities would qualify for the IMR concession by investing:

- directly in Australia (direct investment concession); or
- via an Australian fund manager (indirect investment concession).[47]

1.46 The direct investment concession would be available to foreign entities that pool their investments in a widely held fund. Such entities would 'disregard Australian income tax consequences that arise in respect of disposal gains and losses from

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42 The Hon Josh Frydenberg MP, *Proof House of Representatives Hansard*, 27 May 2015, p. 19.

43 The 'widely held' requirement is an integrity measure that requires foreign managed funds to have 25 or more members. This is intended to limit the opportunity for Australian investors to access the benefits of the regime by structuring through an off-shore entity and reducing the likelihood that a small number of people could 'control the investments of a foreign managed fund and hence benefit inappropriately from the IMR'. Explanatory Memorandum, p. 116 [paragraph 7.134].

44 Explanatory Memorandum, pp. 79, 80 [paragraphs 7.7 and 7.10].

45 Schedule 7, part 1, item 1 [proposed new section 842-205].

46 Explanatory Memorandum, pp. 82–83 [paragraphs 7.18–7.19 and 7.22].

47 Explanatory Memorandum, p. 80 [paragraph 7.10].

portfolio and passive investments into Australia to the extent that the returns or gains are not attributable to Australian real property'.[48]

1.47 The indirect investment concession would be available to foreign entities that engage an independent Australian fund manager to invest into, or through, Australia. Such entities would 'disregard Australian income tax consequences arising as a result of engaging the Australian fund manager in respect of gains and losses from those investments (including portfolio and non-portfolio foreign investments and portfolio Australian investments) to the extent that the returns or gains are not attributable to Australian real property'.[49]

1.48 There are two limbs to the IMR concession. The first limb is outlined in proposed new subsection 842-215(1), and would apply in relation to IMR financial arrangements.[50] This subsection is relevant for both the direct investment concession and the indirect investment concession.

1.49 The second limb is outlined in proposed new subsection 842-215(2). This subsection would provide further concessions that apply in relation to specific tax consequences that arise or relate to an IMR financial arrangement as a result of an independent Australian fund manager constituting a permanent establishment of the IMR entity. The second limb is only relevant for the indirect investment concession.[51]

Stakeholder views on schedule 7

1.50 In its submission, Platinum Investment Management stated that it 'welcomes the IMR reforms' that the bill seeks to implement. Platinum Investment Management explained that:

> As a well-established Australian investment manager with more than $29 billion under management, Platinum has seen first-hand the demand from overseas investors for the services of world-class Australian managers. The uncertainties in Australian tax law, however, have jeopardised and, if left unaddressed, will continue to jeopardise, our ability to export our services globally.[52]

1.51 Notwithstanding its overall support for the IMR reforms, Platinum Investment Management suggested that ambiguities in the proposed amendments could 'give rise to interpretations that have the effect of undermining the policy objective of the IMR reform'. The two matters that Platinum Investment Management discussed related to

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48 Explanatory Memorandum, p. 80.

49 Explanatory Memorandum, p. 81.

50 A financial arrangement is an IMR financial arrangement unless it is or relates to a capital gains tax asset that is taxable Australian real property or an indirect Australian real property interest. Schedule 7, part 1, item 1 [proposed new section 842-225 of the ITAA 1997].

51 Explanatory Memorandum, p. 84 [paragraph 7.23].

52 Platinum Investment Management, *Submission 3*, p. 1.

the further concessions relating to permanent establishments under proposed new subsection 842-215(2).[53]

1.52 Under this proposed new subsection, income that 'relates to or arises under' an IMR financial arrangement, and that would otherwise be the entity's assessable income for the year, is treated as non-assessable non-exempt income of the entity, to the extent that:

- the income is treated as having a source in Australia because it is attributable to a permanent establishment of the entity in Australia (if the entity is resident in a country that has entered into an international tax agreement with Australia containing a business profits article);[54] or if this is not applicable
- the income is treated as having a source in Australia because arm's length profits for a permanent establishment in Australia are taken to be attributable to sources in Australia in accordance with subsection 815-230(1).[55]

1.53 The first concern raised by Platinum Investment Management was whether a fund resident in a treaty country, but to which the treaty does not apply, will be eligible for the further concessions relating to permanent establishments if it is managed by an independent Australian manager.

1.54 As shown above, proposed new subparagraphs 842-215(2)(a)(i) and (ii) refer to international tax agreements and the ITAA 1997. Platinum Investment Management argued that 'it is not always clear from subparagraphs (i) and (ii) whether the applicable test is the relevant treaty or the Act'. Platinum Investment Management considered it would be useful for clarification as to whether:

- the reference to 'resident' in the opening sentence of subparagraph (i) refers to residence under the relevant treaty definition;
- the reference to 'permanent establishment' in subparagraph (i) is intended to refer to the definition under the relevant treaty or that contained in the income tax law;[56]
- a fund resident in a treaty country but to which the treaty does not apply, and which is managed by an independent Australian manager, will have the benefit of the concessions relating to permanent establishment under

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53 Proposed new section 842-215 of the ITAA 1997 sets out the IMR concession. Proposed new subsection 842-215(1) would provide concessions relating to IMR financial arrangements, whereas proposed new subsection 842-215(2) would provide further concessions relating to permanent establishments that undertake indirect investment through an independent Australian fund manager.

54 Schedule 7, item 1 [proposed new subparagraph 842-215(2)(a)(i) of the ITAA 1997].

55 Schedule 7, item 1 [proposed new subparagraph 842-215(2)(a)(ii) of the ITAA 1997].

56 'Permanent establishment' in subparagraph 842-215(2)(a)(i) is an asterisked term; that is, it is a term defined in section 995-1 of the ITAA 1997 (which provides that the term has the meaning given by subsection 6(1) of the ITAA 1936).

paragraph 842-215(2)(a) (that is, whether the IMR entity can rely on subparagraph (ii)).

1.55 To illustrate its concerns, Platinum Investment Management devised the following example:

> Ireland is a country with which Australia has entered into an international tax treaty. Assuming that under the domestic laws of Ireland XYZ Fund plc is considered 'resident in Ireland' but has tax exempt status, XYZ Fund plc would not be considered a 'resident' of Ireland under the treaty. Moreover, the treaty would not operate to treat XYZ Fund plc's income to have an Australian source as the treaty does not apply to it. In such a case, it is not clear from paragraph 842-215(2)(a) whether subparagraph (i) or (ii) or neither would apply to XYZ Fund plc.[57]

1.56 The second concern raised by Platinum Investment Management went to what income is covered under proposed new paragraph 842-215(2)(a). That paragraph refers to 'income that relates to or arises under the IMR financial arrangement, and that would otherwise be the entity's assessable income for the year'. Platinum Investment Management noted that the explanatory memorandum provides some examples of the types of income that would qualify for the IMR concession;[58] however, the business suggested that it would be helpful for additional examples to be provided. Platinum Investment Management submitted that it is seeking:

> …clarification on the status of the following types of income, all of which are common types of income that may arise from an IMR entity's ordinary eligible investment activities:
>
> - foreign exchange gains on normal expense accruals which are not directly related to a specific IMR financial arrangement (such as management fees, administration and custody fees, accounting fees);
> - incidental sub-underwriting fees which may not result in the IMR entity actually acquiring an IMR financial arrangement;
> - good value claims; and
> - compensation amounts.[59]

1.57 The other submitter that commented on schedule 7 was the Alternative Investment Management Association (AIMA). The AIMA expressed its support for the proposed amendments, however, it raised one issue regarding proposed new subsection 842-235(9).

1.58 Proposed section 842-235 outlines the rules for determining total participation interests for the purposes of the 'widely held' test. Subsection (9) would provide that,

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57 Platinum Investment Management, *Submission 3*, p. 2.

58 Paragraph 7.26 of the explanatory memorandum stated that 'gains arising from the disposal of portfolio equity interests in companies and in other entities (such as units in a unit trust), gains arising from the disposal of bonds and foreign exchange gains made under forward contracts qualify for the IMR concession'.

59 Platinum Investment Management, *Submission 3*, p. 2.

when excluding amounts equivalent to the fund manager's remuneration to determine whether the non-resident entity is widely-held, the fund manager must be an independent Australian fund manager in relation to the non-resident entity.[60] However, the AIMA advised that:

> When a non-resident entity wishes to rely upon the direct IMR concession (section 842-215(3)), it will very likely not have a separate independent Australian fund manager (since it would in that case likely be able to fall within the indirect IMR concession (section 842-215(5)). We request that further consideration be given to this point.[61]

Committee comment on schedule 7

1.59 The committee notes that some stakeholders are seeking clarification of certain terms and concepts in the proposed amendments. As the IMR seeks to remove uncertainties in the application of Australia's taxation laws as they apply to widely held foreign funds and certain foreign investors, it is particularly important that the guidance provided is clear.

1.60 To ensure that the intent underpinning the IMR is achieved as effectively as possible, the committee considers that there would be merit in a revised explanatory memorandum being issued that provides further clarification and examples to address the issues noted in this report.

Recommendation 1

1.61 The committee recommends that the government give consideration to issuing a revised explanatory memorandum that provides further clarification of concepts relevant to schedule 7.

Committee view

1.62 This omnibus bill contains a number of important measures relating to Australia's taxation laws. The measures that result in savings will assist the government to repair the budget and fund other policy priorities. The committee considers that the bill should be passed.

1.63 The committee has recommended that further guidance on some of the terms and concepts in schedule 7 may be of assistance to the funds management industry. The remaining issues outlined by submitters are technical in nature rather than substantive. In the committee's view, these issues can be effectively addressed by the government outside of the committee process. Accordingly, the committee draws to the government's attention the evidence received about the proposed changes to the offshore banking unit regime contained in schedule 3 and the IMR reforms in schedule 7.

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60 Paragraph 7.50 of the explanatory memorandum seemingly provides some guidance on this provision, however, the notation at the conclusion of the paragraph refers to subsections 842-260(1) and (9) in the bill (which do not exist).

61 Alternative Investment Management Association, *Submission 5*, p. 1.

Recommendation 2

1.64 The committee recommends that, after the government gives due consideration to recommendation 1, the bill be passed.

Senator Sean Edwards
Chair

APPENDIX 1
Submissions received

Submission Number	Submitter
1	Mr Ewen McNee
2	Mr Wayne McEvoy
3	Platinum Asset Management
4	Australian Financial Markets Association and Australian Bankers' Association
5	Alternative Investment Management Association (AIMA)
6	Australian Bankers' Association
7	Financial Services Council