Economics Legislation Committee
Senate Standing Committees on Economics
Parliament House
Canberra ACT 2600

19 October 2018

Dear Committee Members

Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018

We appreciate the opportunity to bring to the Committee's attention some concerns related to the future application of the legislation currently under review.

Based on an in-depth analysis of the bill, we consider it important to bring to the attention of the Committee some observations related to the application of the eligibility criteria for the sovereign immunity transitional provisions for existing investments.

Indeed, we think there might be a discrepancy between the stated intent of the transitional provisions "to ensure that there is no immediate adverse impact on sovereign entities for investments held at the time the changes were announced" and how, in practice, access to these provisions by sovereign investors will be determined.

The attached note will provide you with more details on the issue and puts forward potential solutions that could be implemented in the Bill.

We thank you sincerely for your time and for your assistance on this important matter for investors interested in contributing to Australia's economic growth.

Best regards,

[Name withheld]

Observations on eligibility for sovereign immunity tax exemption transitional provisions

According to articles 4.64 and 4.65 of the Explanatory Memorandum "transitional rules apply to protect income and gains for which the Commissioner provides a tax exemption under the doctrine of sovereign immunity. These transitional rules ensure that there is no immediate adverse impact on sovereign entity for investments held at the time the changes were announced."

Based on these principles, it would be our expectation that a sovereign investor who has made an investment prior to 27 March 2018 and had been viewed as benefiting from sovereign immunity should normally qualify for the transitional rules.

Unfortunately, as the proposed legislation is currently drafted, we think there may be cases – admittedly, a very small number – of funds that would be unable to qualify for the transitional rules for sovereign immunity because of the technical requirement that transitional relief only applies to a "sovereign entity" that holds a positive ruling from the Commissioner during the transitional period, and the sovereign entity applied for that ruling on or before 27 March 2018.

This can be a problem for some investors that invest on behalf of multiple government bodies – i.e. who might be investing on behalf of more than one fund (which would still be all wholly owned by the same sovereign). We have observed in the past that for practical reasons, and to ensure that ATO resources are not unnecessarily overburdened, an investor might apply for a ruling on behalf of only one of its sovereign fund when completing an investment – yet proceed in such a way that the existence of the other sovereign funds involved in the transaction are known to all parties involved, including the ATO. As a practical example, a complete list of other funds involved can be appended to the ruling application, implying that the all funds listed have the same profile and would therefore also be entitled to sovereign immunity.

It must be noted that quite often, ruling applications are made for investments that are the subject of a competitive bid process, and so it is not possible, from a time perspective, to fill applications on behalf of each fund involved and yet expect a timely response from the ATO, given the truncated bid timeframe.

It appears that in some cases, an investor has historically applied the outcome of the private ruling (i.e. the administrative sovereign immunity exemption) to the other funds for which a ruling had not been specifically requested, on the basis that these other sovereign funds were transparently and openly listed alongside the ruling request. This

kind of practice, because it was based on transparency and openness with all players involved, has been understood to be generally acceptable to the ATO and was consistent with advice obtained from local advisors on the accepted practice in Australia.

In the context of the new legislation, based on a literal application of the proposed transitional rule in new section 880-5 of the Income Tax (Transitional Provisions) act 1997, sovereign funds from the same entity that did not get a ruling prior to March 2018 would not be eligible for the transitional provisions – even if they had been presented as sovereign in a ruling application for a fund belonging to the same "Sovereign Entity".

Needless to say, if the investments made by such an investor (representing multiple sovereign funds) before 27 March 2018 did not qualify for the transitional rules, this would represent an "immediate adverse impact" on the investment – one that would clearly be contrary with the stated intent of the new legislation (see paragraph 4.65 of the Explanatory Memorandum to the *Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018)*.

We appreciate that requiring there to be a valid private binding ruling in place constitutes a bright-line test that would apply as intended in most cases; namely, it would limit the concession to those sovereigns that have had their eligibility tested and validated by the ATO by the applicable date. However, a bright line test is not always appropriate where there are investors that have a unique status or structure.

We therefore request the Committee to consider applying a more flexible test for applying the transitional rule, albeit one that is drafted in such a way that is still consistent with the intention of the Government that the transitional provisions should protect income and gains from existing investments of a sovereign entity "for which the Commissioner provides a tax exemption under the doctrine of sovereign immunity". (See paragraph 4.64 of the Explanatory Memorandum).

To prevent a literal application by the ATO of section 880-5, there must be a clear statement of policy from Parliament that a more flexible approach is warranted.
In this context, **we respectfully believe that a legislative amendment is required to provide this clear statement of policy** and thereby enable sovereigns in this unique situation to qualify for the transitional rules even though for the commercial and pragmatic reasons discussed earlier not all the funds have a ruling.

There may be a number of ways this clear statement of policy could be demonstrated:

1) The transitional provisions are amended to require that *an* entity within the same Sovereign Entity Group has applied for and received a favourable ruling from the Commissioner with respect to the investment.

2) The Commissioner is provided with a discretion to apply the transitional rules to an entity that does not have a ruling but is a member of a Sovereign Entity Group and at least one member of that Group has a ruling or had applied for a ruling before 28 March 2018 for that investment.

3) The Commissioner is provided with a discretion to apply the transitional rules to an entity where neither 1. or 2. applies but he considers it reasonable to do so having regard to certain criteria. These criteria could include his previous administrative practice, whether any other entities in the same Sovereign Entity Group had obtained a sovereign immunity ruling, etc.

Typically, when investing in Australia, sovereign investors have to maintain ongoing engagement with the ATO, supported by multiple written submission and abundant details on their funds and structure. In this context, any one of these additions to the requirements for the transitional rules to apply should enable the ATO to come to an agreement on the applicability of the transition provisions to sovereign investors that is consistent with the intention of the rules.

We consider a legislative clarification of the type suggested above is appropriate as it acknowledges that:

- Not all sovereign funds are structured the same, and therefore may not readily conform to an “entity” based characterisation that relies on Australian common law concepts; and

- Foreign direct investment is of national interest to Australia and that investors that have contributed to the economic development of Australia in good faith should be treated in accordance with the understanding of applicable tax policy settings at the time of the investment.

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