



**Australian  
Skandia**

*Where To Invest*

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The International Taxation Project  
Board of Taxation Secretariat  
C/- The Treasury  
Langton Crescent  
PARKES ACT 2600

Dear Sirs

### **Submission in Relation to the Review of International Taxation Arrangements**

Australian Skandia Limited welcomes the Government's decision to review certain aspects of Australia's international taxation arrangements with a view to promoting Australia as a global financial services centre. Australian Skandia is a member of the Investment & Financial Services Association and supports the IFSA submission to the Board in relation to this review. However, there are a number of issues in relation to which Australian Skandia would like to raise in its own submission.

### **Background on Australian Skandia**

Australian Skandia is the Australian subsidiary of Skandia, the Swedish multi-national insurance and funds management group which globally has approximately \$A200 billion in funds under management. Australian Skandia started operations in 2001 and acts as responsible entity for 52 Australian resident unit trusts and acts as trustee of a public offer superannuation fund.

Skandia adopts a manager of managers approach to funds management. It does not directly manage any funds itself, but rather invests funds with independent third party fund managers selected under rigorous selection criteria. Part of what Skandia brings to Australian investors is the capability to access global research capabilities, global structures and global buying power with the aim of providing investors with ready access to quality, secure, world-class managed investments on an international, regional and local basis. Skandia operates in more than 20 international markets.

22/04/03

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ABN 54 093 415 251

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## Specific Issues for Consideration by the Board of Taxation

### 1. Fair Treatment of Investment into US Mutual Funds.

A number of the Australian Skandia unit trusts currently invest in US mutual funds which qualify for exemption from Australia's Foreign Investment Fund ("FIF") tax regime. However, Australian Skandia believes there is an unintended technical anomaly relating to the Australian tax treatment of capital gains distributed to Australian resident investors by US mutual funds which are constituted as trusts which adversely impacts on the attractiveness of these vehicles as a means of accessing US and other foreign markets.

In certain circumstances, the benefit of the CGT discount concession in respect of gains on assets held for twelve months or more will not be available. Australian Skandia does not believe that this reflects a policy decision on the part of the Government, but is rather an unintended consequence of the interaction of the trust provisions in the Income Tax Assessment Act 1936 (the 1936 Act) and the CGT provisions in the Income Tax Assessment Act 1977 ("the 1997 Act").

#### 1.1 Background

In June 1999 the Australian Parliament passed legislation amending the Foreign Investment Fund (FIF) provisions within the 1936 Act to provide exemptions for certain US based FIFs. These exemptions include in paragraph 513(1)(b) "a company or trust that is treated as a regulated investment company, or real estate investment trust, for the purposes of the Internal Revenue Code of 1986 of the United States of America".

A stated policy driver behind this exemption was a desire on the part of the Government to promote competition within the Australian managed investments industry by removing an artificial barrier to the marketing of US mutual funds in Australia.

Some US mutual funds are constituted as companies and others are constituted as trusts. Where the US mutual fund is constituted as a company, a distribution from the fund will be treated for Australian tax purposes as a dividend irrespective of the components of the distribution. However, where the US mutual fund is constituted as a trust, the components of the distribution will, prima facie, retain their character in the hands of an Australian resident investor.

Under US tax law, long term capital gains (ie. gains on assets held for more than twelve months) are subject to concessional rates of tax. US mutual funds distributing such gains to their investors are required to separately identify the long term capital gain component so that their investors can enjoy the concessional rate of capital gains tax.

Consequently, an Australian resident individual, trust or superannuation entity which is an investor in a US mutual fund will be formally advised of the quantum of gains which co-incidentally are prima facie eligible for discount CGT treatment. The calculation and reporting of that information is subject to strict controls sufficient to satisfy the US Internal Revenue Service. Accordingly, the Australian Taxation Office should be able to rely on the veracity of the information.

## **1.2 Technical Analysis of Australian Tax Treatment of Australian Resident Investor in US Mutual Fund Constituted as a Trust**

It can be assumed that the US mutual fund would not lodge an Australian tax return and would not calculate a tax net income pursuant to Section 95 of the 1936 Act. However, an Australian resident beneficiary of the US mutual fund should include in its assessable income:

- (i) pursuant to Section 97, its proportionate share of the net income of the US trust  
calculated according to Australian tax rules, or alternatively,
- (ii) pursuant to s99B, amounts paid to it (or applied for its benefit) by the US trust during the year of income.

Under s96A(1) an amount is not to be included in the assessable income of a beneficiary under s97 if the beneficiary is a resident, the trust is a non-resident and s529 applies (i.e., FIF income is included in assessable income) or but for Division 8 of Part XI (the US FIF exemption) would have applied. Australian Skandia understand that the proviso was inserted after lobbying by Australian-based fund managers with US Real Estate Investment Trust (REIT) products who were keen to ensure that their Australian resident investors were only assessed on what they received from the REIT (under s99B) rather than on a present entitlement basis under s97 on their share of the REIT net income calculated according to Australian rules.

In situations where the Australian beneficiary would not have had s529 FIF income even if the US FIF exemption was not available e.g. where the s525 balanced portfolio exemption or s515 exemption for FIF interests of less than \$50,000 would have been available, s96A will not apply and the beneficiary will be assessed under s97.

In situations where it is only the Division 8 US FIF exemption which saves the beneficiary from having assessable FIF income under s529, then s96A will apply and the beneficiary will be assessed under s99B. This will be the case where for example an Australian resident public unit trust holds interests in US mutual funds

as its only assets.

The significance of the assessing provision relates to the wording of s115-215 of the 1997 Act, the CGT provision which deals with beneficiaries who receive a distribution of a discount capital gain from a trust. As currently drafted s115-215 operates where the beneficiary is assessed under s97(1)(a), s98A(1) or s100(1) but not where s99B applies.

This means that an Australian investor in a US mutual fund who does not rely on the US FIF exemption is eligible for discount CGT treatment of long term gains distributed from the fund. However, an Australian investor in the same US mutual fund who does rely on the US FIF exemption is not eligible for discount treatment of distributed gains.

Assuming that this technical anomaly was rectified, the analysis would continue as follows.

In calculating the tax net income of the US trust it is reasonable for the Australian resident investor to stand in the shoes of the trustee in terms of choosing to apply the discount method in calculating the taxable gain on disposal of investments held for 12 months or more. Consequently it would be reasonable to take the long term gain component as advised by the US trust and treat half as being as assessable capital gain component and half as being a CGT Concession amount.

Under s115-215(3)(b) the Australian resident investor would calculate his own CGT position by calculating a capital gain equal to twice the amount of the taxable discount gain distributed from the US trust i.e. by grossing back up to the nominal amount of long term gain distributed by the US trust. Under s115-215(4)(a) the Australian taxpayer is treated as if that deemed capital gain were a discount capital gain such that the 50% discount could then be applied.

### **1.3 Suggested Amendment to the Tax Law**

Discount CGT treatment is not limited to Australian assets and there does not appear to be a policy reason precluding discount treatment for long term gains distributed by foreign trusts. The above analysis that in some circumstances discount treatment will be available and in others it will not, would appear to be an unintended result.

Australian Skandia believe that the technical amendment required to rectify the current anomalous treatment would be quite simple. A possible form of the amendment is as follows:

## **Part 1 – Income Tax Assessment Act 1997**

### **1 Sub-paragraph 115-215(2)(b)(iii)**

Repeal the sub-paragraph, substitute:

- (iii) under subsection 99B(1) of that Act; or*
- (iv) under subsection 100(1) of that Act.*

## **Part 2 – Application of Amendments**

### **2 Application**

- (1) The amendment in Item 1 is effective from 21 September 1999 and applicable to assessments for the income year including 21 September 1999 and for later income years.

#### **2. Accessing Non-US Foreign Investment Vehicles**

With a view to expanding the range of investment options open to Australian investors and allowing them to benefit from global economies of scale, Australian Skandia is keen for the Board to consider an exemption for European collective investment vehicles along the lines of the section 513 exemption for US mutual funds. In particular, Australian Skandia would like to be able to access its range of Dublin based investment funds. These funds have been established under the well regulated investment and financial environment of Ireland.

The primary purpose by Skandia for the establishment of the global funds structure in Ireland is to provide quality third party fund management expertise to Skandia investors around the world. This provides greater and more diverse investment opportunities at a lower cost to Australian Investors. Our experience in Australia is that we do not have the scale to provide such depth and range of opportunities from the establishment of registered investment vehicles in Australia. These investment vehicles upon not achieving critical mass will be expensive for Australian investors compared to their European cousin. By removing the FIF attribution Australian investors are able to access global opportunities efficiently and be treated in exactly the same manner as Australian Investors investing in domestic investment vehicles. For example we offer a China Mainland Fund in our Dublin structure. This offers investors an opportunity to access a market that is developing and will offer good long term returns.

3.

Australian Skandia recognises and respects the overall policy objective of not allowing Australian resident investors to roll-up income and gains in foreign accumulation vehicles. However, it believes that it would be possible to provide an exemption for investment in particular vehicles or classes of shares or interests in particular vehicles which are subject to a requirement to distribute all or substantially all of their income and gains. The investments of the foreign vehicle would be limited to direct investments or interfunding into other vehicles which have the same requirement to distribute all or substantially all of their income and gains. The exclusion of roll-up vehicles from the class of potential investments should allay Treasury fears of a roll-up occurring at a lower level.

### **Further Consultation**

Australian Skandia would be happy to meet with representatives of the Board to further discuss the issues raised in this submission.

Please call me on 8226 8905 should you wish to discuss any aspect of this submission or to arrange a face to face meeting.

Yours faithfully

Ross Laidlaw  
Managing Director