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The Australian Taxation Office releases two final Tax Determinations in relation to the treatment of gains made by non-resident private equity investors

On November 11, 2009 the Australian Commissioner of Taxation sought to prevent the distribution of proceeds from an initial public offering of Myer Holdings Limited to its non-resident private equity ("PE") investor based on an assertion that Australian tax was payable on the profits.

Following the debate over the appropriate tax treatment of such profits, the Australian Tax Office ("ATO") released four Tax Determinations on December 1, 2010 (two of which were final and two of which were in draft form).

On October 26, 2011, the ATO finalized and issued the remaining two Tax Determinations:

- **TD 2011/24** - Source of income derived from the sale of shares in an Australian company by a non-resident PE fund; and

- **TD 2011/25** - ability to 'look through' certain non-resident fiscally transparent entities (such as foreign resident partnerships in tax havens) to the ultimate investors, for the purposes of considering whether treaty benefits apply to that investor.

TD 2011/24 - Determining the source of income

TD 2011/24 confirms the Commissioner's view that the source of profit derived by a non-resident from the sale of shares in an Australian corporate group, which is acquired in a leveraged buy-out ("LBO") by a private equity fund, is not dependent **solely** on where the purchase and sale contracts are executed.

Rather, it is the ATO's view that 'Australian source' in these circumstances is to be determined having regard to all the facts and circumstances of the particular case.

In this Determination, the Commissioner outlines the following factors which will need to be addressed in order to conclude the source of income:

- the location of activities undertaken by the fund, or on the fund's behalf by an Australian "advising entity owned or controlled by the private equity firm", in making any improvements to the Australian investee group,
- the nature of any agreements between the entities (with a focus on local advisory companies that may source and negotiate domestic bank funding, provide management support activities, etc.),
- the extent and nature of any control or involvement in the management of the Australian investee group,
- where the purchase contracts and sale contracts are executed, and
- the form and substance of the purchase payments.

The Commissioner states that many of the elements of a leveraged buy-out listed in the Determination are undertaken in conjunction with the related/associated/controlled local advisory company in Australia.

Accordingly, the significance of the activities undertaken in Australia, relative to the profit, will be examined and the source of income will then be determined. This suggests a weighting of relative factors, but without an indication of which factors are considered to be of greater or lesser importance.

In addition to the source question, the Commissioner indicates that the arrangements with a local advisory entity may create an Australian permanent establishment for the general partner or the limited partner, depending on the facts and circumstances. However, the Determination provides no further guidance on this aspect.

TD 2011/25 - "Look-through" approach

Taxation Determination TD 2011/25 confirms the Commissioner's view that the business profits article can apply to Australian-sourced business profits of a foreign

limited partnership ("LP") where the LP is treated as fiscally transparent in a country with which Australia has entered into a double tax agreement ("DTA") and the LP's partners are residents of that DTA country.

In the Determination, the Commissioner has now finalised his view that the principles of the OECD partnership report (which provide for a "look through" approach to the ultimate investor in partnerships for the purposes of treaty benefits) are recognised as inherent in Australia's broader treaty network.

Many fund managers, including international PE firms, investing abroad utilize fiscally transparent entities (such as foreign partnerships resident in tax havens). These structures are generally designed to address legal, regulatory and administrative issues, including reduced US compliance costs.

For certain foreign taxpayers looking to invest in Australia, such as PE funds, this Determination means that the practical requirement of using a vehicle in a jurisdiction that does not have a treaty with Australia (such as the Cayman Islands), can still enable protection from double taxation under a relevant treaty. This will be the case so long as the entity is a partnership and the ultimate investor's country of residence has a treaty with Australia and treats the partnership as transparent under its tax law.

TD 2011/25 is considered a positive development for certain non-residents looking to invest in Australia.

Date of effect

TD 2011/24 and TD 2011/25 will apply to tax years commencing both before and after their date of issue.

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