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Tax Alert

Commissioner Releases Final Rulings on Cross-Border Private Equity

On 1 December 2010, the Commissioner of Taxation ("*Commissioner*") released his final ruling on the income tax treatment of cross-border private equity transactions.

Summary of Ruling

In summary, the Commissioner has left the door slightly ajar for foreign private equity investors involved in leveraged buy-outs of Australian companies.

Despite ruling complex structures involving multiple entities across numbers of jurisdictions including tax havens may not be eligible for treaty relief, the Commissioner has accepted treaty benefits can be claimed by Limited Liability Partnerships (LLP) in tax haven jurisdictions where the partners in the LLP are residents of a country with which Australia has a Double Tax Agreement.

Limited Liability Partnerships are commonly used by private equity investors and are typically treated as fiscally transparent for the domestic tax purposes of our treaty partners (i.e. the partners are taxed on the income of the LLP in their own hands).

The Commissioner is however insisting such entities prove that partners are resident in treaty countries, consistent with the trend for greater information disclosure in international tax.

Not only does this potentially add significant compliance costs and time delays but it also presumes foreign taxpayers are satisfied that the disclosure of information to the Australian Revenue will not in turn open them up to issues with their own Revenue authorities.

Key Points

- More generally, the implications of the rulings on inbound structuring include: The Commissioner appears to have shifted the onus of proof regarding structuring, indicating taxpayers will need to clearly explain and justify every entity and country in an investment structure, or it will be assumed Part IVA applies to the structure.

- The Commissioner applying Part IVA to private equity transactions now, whereas it has previously not pursued the opportunity in similar circumstances (i.e. in the Lamesa Holdings litigation in 1997) indicates a more aggressive approach to protecting its revenue base post the Global Financial Crisis.

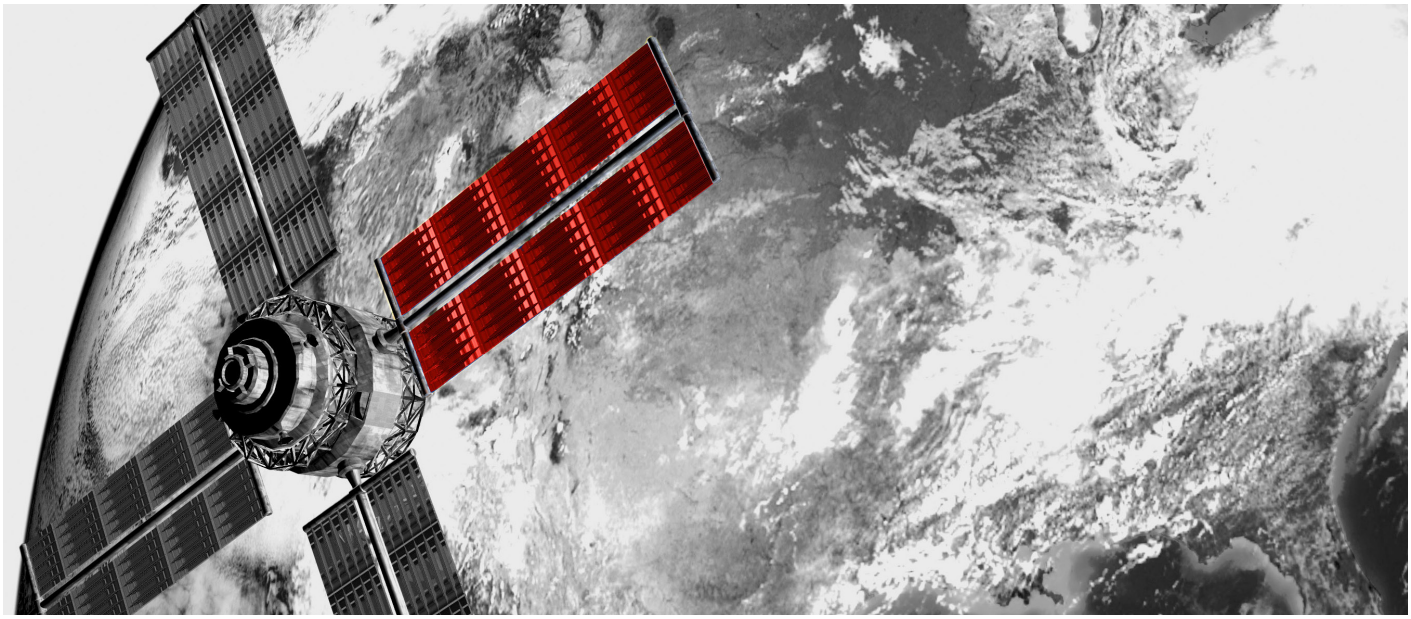
- The Commissioner has provided further commentary on when:

  >> Income will be sourced in Australia. However, the analysis provided is cursory and does not seem to distinguish activities done by non-residents and their resident subsidiaries, which would appear to be an ambitious ambit claim; and

  >> Gains will be of a revenue nature, being gains from investments with a short to medium timeframe for realisation. However, the Commissioner has not provided any indication of the limits of such timeframes, leaving the revenue versus capital question as uncertain as ever.

Action Points

Inbound investors, including private equity, should review their structuring on existing and proposed investments to assess the tax implications which may now apply.



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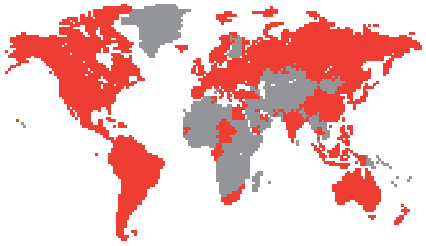

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