AustralianSuper

19/04/2024

Corporate and International Taxation Division
The Treasury
Langton Crescent
PARKES ACT 2600

Via email to **taxtreatiesbranch@treasury.gov.au**

Dear Treasury,

AustralianSuper submission to Expansion of Australia’s Tax Treaty Network consultation

AustralianSuper welcomes the opportunity to provide a submission in response to Treasury’s Expansion of Australia’s Tax Treaty Network consultation. We strongly support Treasury’s commitment to expanding Australia’s tax treaty network.

AustralianSuper is Australia’s largest superannuation fund and is run only to benefit members. AustralianSuper has over 3.3 million members and manages over $315 billion of members’ assets. Our purpose is to help members achieve their best financial position in retirement and this drives everything that we do.

As the size of Australia’s superannuation industry continues to increase, so does its range of cross-border investments. Australia’s tax treaty network is therefore of increasing importance to funds across the sector as they seek out the best investments globally to generate returns for members in Australia.

Because of the unique features of Australian superannuation funds compared to overseas pension funds, Australian superannuation funds either cannot obtain certain benefits under tax treaties or there are significant administrative and compliance processes to establish entitlement to benefits. The following key proposals are important for future treaty negotiation:

- Australia’s tax treaties should contain a specific reference to Australian superannuation funds to ensure they are able to access the benefits of the treaties, with minimal administrative difficulty. We recognise and welcome that this has been included in some recent treaties.
- Australia’s tax treaties should provide an interest and dividend withholding tax exemption in relation to portfolio-like interests for Australian superannuation funds investing overseas. This would reciprocate the exemption already provided under Australian domestic law to foreign pension funds investing in Australia. We recognise and welcome that this has been given effect in some recent treaties.
- We recommend that, where relevant, changes to the existing tax treaties being re-negotiated include a withholding tax exemption for interest derived by unrelated financial institutions, in line with Australia’s approach to its more recent tax treaties.
- Australia’s tax treaties should provide a consistent definition of ‘pensions’ and ‘lump sums’. This should include providing clarity on the withholding tax treatment of lump sum payments at source in Australia that are paid from Australian superannuation funds.

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Addressing these issues would help to boost trade and investment, simplify administrative complexities and ensure the Australian superannuation industry can effectively compete in the global market to gain the best investment opportunities for Australian members.

Inclusion of specific reference to Australian superannuation funds

Australian superannuation funds have unique features compared to foreign pension funds, in that Australian super funds are:

- taxed on their returns and are not tax-exempt entities, and
- generally defined contribution funds rather than defined benefit funds.

In contrast to the experience of a corporate entity, or a foreign pension fund, this can lead to significant administrative and compliance processes for Australian superannuation funds in establishing their entitlement to benefits under tax treaties with overseas revenue authorities, notwithstanding the intent of the treaties.

Australia's double tax treaties should contain a specific reference to Australian superannuation funds. This would make clear that, like a corporate entity or foreign pension fund, Australian superannuation funds are entitled to the benefits of tax treaties, including relief from double taxation, and would streamline administration.

Such a reference already exists in some of our treaties. By way of example, the Iceland treaty provides, at paragraph 1(l) of Article 3:

> *[T]he term "recognised pension fund" of a Contracting State means an entity or arrangement established in that State that is treated as a separate person under the taxation laws of that State <u>or, in the case of Australia, an Australian superannuation fund for the purposes of Australian tax</u> or, in the case of Iceland, an Icelandic pension fund according to the income tax law of Iceland, and:*
>
> *(i) that is established and operated exclusively or almost exclusively to administer or provide retirement benefits and ancillary or incidental benefits to individuals and that is regulated as such by that State or one of its political subdivisions or local authorities; or*
>
> *(ii) that is established and operated exclusively or almost exclusively to invest funds for the benefit of entities or arrangements referred to in subparagraph (i) or, in the case of Australia, to invest such funds, or the complying superannuation assets or segregated exempt assets of a life insurance company that is a resident of Australia, or any combination thereof;*

The Switzerland treaty provides, at paragraph 1(i) of Article 3:

> *The term "pension scheme' means any plan, scheme, fund, foundation, trust or other arrangement established in a Contracting State <u>or, in the case of Australia, that is an Australian superannuation fund for the purpose of Australian tax</u>, which is:*
>
> *(i) regulated by that State; or*
>
> *(ii) operated principally to administer or provide pension or retirement benefits or to earn income for the benefit of one or more such schemes.*

AustralianSuper would strongly support the inclusion of such definitions in Australia's broader double tax treaties network.

Recommendation:

Australia's double tax treaties should contain a specific reference to Australian superannuation funds. This would streamline the administration of treaties and make clear that, like corporate entities and foreign pension funds, Australian superannuation funds are entitled to benefits under the treaty.

Reciprocal withholding tax exemptions

Australian domestic law currently provides non-resident pension funds with a specific exemption from Australian withholding tax on interest and dividend income. This exemption is contained in paragraph 128B(3)(jb) of the *Income Tax Assessment Act 1936* and applies in relation to portfolio-like interests. We submit that reciprocal benefits should be provided to Australian superannuation funds investing overseas.

Such benefits are currently contained in some of Australia's double tax treaties. The Iceland treaty, for example, provides the following exemption from dividend withholding tax for portfolio-like voting interests, at paragraph 4 of Article 10:

> *Notwithstanding the provisions of subparagraph (b) of paragraph 2, dividends shall not be taxed in the Contracting State of which the company paying the dividends is a resident if the beneficial owner of the dividends directly holds less than 10 per cent of the voting power in the company paying the dividends, the beneficial owner is not able to directly or indirectly determine the identity of one or more persons who make the decisions that comprise the control and direction of the operations of the company paying the dividends, and the beneficial owner is:*
>
> *(a) a Contracting State, or political subdivision or a local authority thereof (including a government investment fund);*
>
> *(b) the Reserve Bank of Australia or the Central Bank of Iceland;*
>
> *(c) in the case of Australia, a recognised pension fund of Australia or a resident of Australia deriving such dividends from the carrying on of complying superannuation activities; or*
>
> *(d) in the case of Iceland, a recognised pension fund of Iceland whose income is exempt from Icelandic tax.*

There is also an exemption from interest withholding tax, at paragraph 3 of Article 11 of the Iceland treaty:

> *Notwithstanding paragraph 2, interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall not be taxed in the first-mentioned State if the interest is derived by:*
>
> *(a) a Contracting State or a political subdivision or a local authority thereof (including a government investment fund);*
>
> *(b) the Reserve Bank of Australia or the Central bank of Iceland;*
>
> *(c) in the case of Australia, a recognised pension fund of Australia or a resident of Australia deriving such interest from the carrying on of complying superannuation activities;*
>
> *(d) in the case of Iceland, a recognised pension fund of Iceland whose income is exempt from Icelandic tax; or*
>
> *(e) a financial institution which is unrelated to and dealing wholly independently with the payer. For the purposes of this Article, the term "financial institution" means a bank or other enterprise substantially deriving its profits by raising debt finance in the financial markets or by taking deposits at interest and using those funds in carrying on a business of providing finance.*

Recommendation:

Exemptions from interest and dividend withholding taxes should be included in Australia's broader double tax treaties network, to ensure Australian superannuation fund members are on a level playing field with non-resident pension funds. This would reciprocate existing exemptions available to foreign pension funds under Australian law.

Interest withholding tax exemption for payments to unrelated financial institutions

Australian superannuation funds enter into various derivative transactions with unrelated financial institutions globally as part of managing their portfolios and optimising returns for members. Some of the derivative arrangements are highly complex and involve payments to unrelated foreign financial institutions that may be classified as interest for Australian withholding tax purposes. Where this is the case, unless an exemption applies, it has the potential to create a significant operational burden for superannuation funds to ensure compliance with withholding tax obligations.

Australia's newer treaties generally contain a withholding tax exemption within the Interest Article for interest paid to unrelated financial institutions. This example is from paragraph 3 of Article 11 of the New Zealand treaty:

Notwithstanding paragraph 2, interest arising in a Contracting State and beneficially owned by a resident of the other Contracting State may not be taxed in the first-mentioned State if:

(a) the interest is derived by a Contracting State or by a political sub-division or a local authority thereof (including a government investment fund), or by a bank performing central banking functions in a Contracting State; or

(b) the interest is derived by a financial institution which is unrelated to and dealing wholly independently with the payer. For the purposes of this Article, the term "financial institution" means a bank or other enterprise substantially deriving its profits by raising debt finance in the financial markets or by taking deposits at interest and using those funds in carrying on a business of providing finance.

However, there are several older tax treaties within Australia's tax treaty network that are yet to be updated to insert the above exemption, including, relevantly, both the tax treaties with Sweden and the Republic of Korea.

Recommendation:

Re-negotiated tax treaties for Sweden and the Republic of Korea should include the above interest withholding tax exemption in respect of unrelated financial institutions. This would bring the Interest Article within these treaties into line with our more recent tax treaties. This exemption should also be included within the new tax treaties with Ukraine and Brazil. This exemption should also be kept in mind when re-negotiating, or entering into, other treaties in the future.

Clarity for tax treatment of pensions and lump sums

The Pensions Article in tax treaties tends to lack definitions of, or inconsistently define, 'pensions' and 'lump sums' paid from pension schemes or in consequence of retirement, invalidity, disability or death, or by way of compensation for injuries.

In particular, the lack of 'lump sum' payments being included in the relevant Pensions Article of tax treaties creates uncertainty for members of Australian superannuation funds that become residents in other countries. It also creates uncertainty for Australian superannuation funds who are subject to the withholding obligation in Australia on income streams and lump sum superannuation benefits paid to these members.

In our view, the correct tax treatment is that the lump sum payments are subject to withholding tax at source, which would be Australia. However, this is not clear in the OECD tax treaty model, nor in most of Australia's tax treaties.

The Iceland treaty is an example of the preferred approach to 'lump sums'. It provides at paragraph 3 of Article 17:

> *Notwithstanding the provisions of paragraph 1, lump sums arising in a Contracting State and paid to a resident of the other Contracting State from a recognised pension fund, under a retirement benefit scheme, or in consequence of retirement, invalidity, disability or death, or by way of compensation for injuries, may be taxed in the first-mentioned State.*

The definition of 'pensions' may vary across jurisdictions due the operation of each country's laws. However, it would be helpful if treaties defined 'pensions' in some way. The US treaty, for example, provides at paragraph 4 of Article 18:

> *The term "pensions and other similar remuneration", as used in this Article, means periodic payments made by reason of retirement or death, in consideration for services rendered, or by way of compensation paid after retirement for injuries received in connection with past employment.*

Recommendation:

New or renegotiated tax treaties should include:

- a consistent definition of 'pensions'. This definition would include the key characteristics of periodic payments, made by reason of retirement or death, and for life or an ascertainable period of time; and
- clarity in the relevant Pensions Article of each tax treaty on the definition and treatment of lump sum payments such that a lump sum arising in a Contracting State paid to a resident of the other Contracting State under an Australian superannuation fund or pension scheme, or in consequence of retirement, invalidity, disability or death, or by way of compensation for injury, may be taxed only in the first-mentioned State.

Conclusion

Thank you for the opportunity to engage with you on the expansion of Australia's tax treaty network. We would be pleased to discuss any matters raised in this submission at your convenience.

If you have any questions, or would like to arrange a discussion, please do not hesitate to contact me (**gmaio@australiansuper.com**) or Nick Coates, Head of Government Relations and Public Policy (**ncoates@australiansuper.com**).

Regards

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