# Paradigm

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FALL 2014

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# Investment via Limited Partnership Falls out of Double Tax Treaty

The 2014 G-20 Heads of Government Summit in Australia follows other 2014 G-20 meetings in Australia, including meetings of finance ministers, trade ministers and central bank governors. On the agenda is the contribution of trade agreements towards economic growth. Australia is a party to free trade agreements with the United States, New Zealand and Korea, and it recently concluded an economic partnership agreement with Japan.

These treaties, along with applicable double tax treaties, form an important part of the framework for cross border dealings. They also increase uniformity of treatment, but some differences remain.

This article focuses on the 2014 Australian full Federal Court decision in Commissioner of Taxation v Resources Capital Fund III LP, which involved consideration of the Australian/United States double taxation treaty, as well as principles for valuation of business components.

## Background

The Resources Capital Fund III Limited Partnership (RCF) was a Cayman Islands limited partnership with a Cayman Islands general partner. Almost all of the limited partners were U.S. residents. The partnership invested in an Australian company, St. Barbara Mines Limited (SBML). RCF sold the shares in SBML for a gain of over $58 million. The Australian tax authorities wished to tax that gain on the basis that the sale resulted in a capital gain liable for tax in Australia.

At this point it is important to note that with some exceptions (including for certain venture capital limited and management partnerships), corporate limited partnerships are treated as taxable entities under Australian law even though for United States tax purposes they may be regarded as tax transparent (i.e. the partners rather than the partnership being assessed to tax).

The Australian Taxation Office (ATO) assessed RCF under Division 855 of the Australian Income Tax Assessment Act 1997, which applied Australian tax to a foreign resident on a capital gain on the sale of shares in an Australian company only if the shares were an "indirect Australian real estate property interest," which in turn required that the shares constitute a greater than 10 percent interest in the company and that the sum of the market value of the company's assets that are taxable Australian real property (TARP) must exceed the market value of the company's non-TARP assets. TARP assets include real property and mining rights in Australia.

Note that a different regime would apply where the foreign resident has used an Australian permanent establishment.

## The Valuation Issue

The assets of SBML included mining rights (which constituted TARP), and mining information together with the plant and equipment (which was not TARP).

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The trial judge suggested that the correct valuation approach was to value separately each category of assets as if it was the only asset offered for sale in a transaction. However on appeal the full Federal Court preferred to measure the market value of the individual assets on the basis that they "are to be ascertained as if they were offered for sale as a bundle, not as if they were offered for sale on a stand alone basis." This meant that a hypothetical purchaser of the TARP assets might expect to acquire the mining information and the plant and equipment for less than their production or acquisition costs and without material delay. This reflects the reality that information and plant will generally be sold to the purchaser of the relevant mine. The result was that the TARP assets exceeded the non-TARP for a least one relevant date, and the transaction was taxable, subject to the application of the U.S./Australia double tax treaty.

## Double Tax Treaty Issue

The general Australian tax laws are subject to inconsistent provisions of relevant double tax treaties. The U.S. limited partners may have had the benefit of protection under the U.S./Australia double tax treaty if the relevant tax payer was a U.S. resident. As noted, for U.S. purposes the limited partnership was regarded as fiscally transparent (i.e. a pass through situation). However, with some exceptions, Australian tax law treats a corporate limited partnership as a separate taxpayer, generally taxed as if it was a company, so that apart from the treaty Australian tax law would treat the taxpayer as a Cayman Islands limited partnership rather than looking through to the U.S. limited partners.

The trial judge paid heavy regard to the OECD commentary on the model tax treaty on which the Australia/U.S. double tax treaty was based, to find that the U.S. limited partners were the relevant taxpayers, and accordingly protected by the double tax treaty.

On appeal the full Federal Court said that the Australia/U.S. double tax treaty did not apply because RCF (i.e. the taxpayer assessed, being the Cayman Islands limited partnership rather than the partners), was neither a resident of the United States nor a resident of Australia.

Subject to any further appeal or change in the law, one consequence is that where there are TARP assets (e.g. mining rights or real estate), a non-Australian investor should consider investing directly from an entity in a treaty jurisdiction, to reduce the risk of double tax. In addition, other structures and specific advice should be considered. While the context here is Australia/U.S., similar issues may occur under other double tax treaties where there is an interposed entity or structure, even a fiscally transparent one, with a domicile different to the parties of the treaty. P