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- Accommodation suppliers, where fees are charged for forfeiting accommodation bookings.
- Property and business sale transactions, where deposits are paid and occasionally forfeited.

Refunds and ITCs

All taxpayers who have remitted GST on forfeited deposits should request a refund of the amount of overpaid GST. While the Commissioner may not process such refunds until the outcome of the Reliance litigation is finalised, taxpayers will only be able to preserve their refund entitlements over the past 4-year period by lodging such a request. Taxpayers seeking to obtain a refund without passing it on to the end consumer will need to consider s 105-65 of Sch 1 of the *Taxation Administration Act 1953* and ATO Practice Statement PS LA 2002/12.

On the other hand, taxpayers who have claimed input tax credits arising from the forfeiture of a deposit may not be required to repay those credits where they can demonstrate reliance on GST Ruling GSTR 2006/2.

In future, consider GST treatment

Finally, those taxpayers likely to receive forfeited deposits, cancellation fees, late fees or similar amounts in the future should consider the appropriate GST treatment of those amounts in light of the Full Court's decision.

[1352] UK limited liability partnerships now eligible for foreign hybrid treatment. But what about other entities?

by Nicole Sammel, Senior Associate, Mallesons Stephen Jaques

A UK limited liability partnership formed under the *Limited Liability Partnership Act* 2000 (UK) ("UK LLP") is now eligible to be treated as a foreign hybrid under Div 830 of the ITAA 1997. This is the effect of Reg 830-15.01 which came into force on 26 June 2007 under the *Income Tax Amendment Regulations 2007 (No 4)*, reported at 2007 WTB 28 [1277].

However, whether some other common foreign investment vehicles (eg a Delaware limited partnership) are eligible for foreign hybrid treatment remains unclear. It will depend on whether the vehicle is a "company" as defined in s 995-1, which is not always straightforward to determine.

The foreign hybrid rules - some background

Purpose of the foreign hybrid rules

Certain overseas investment activities including "real estate" and "private equity" are commonly conducted through entities that are treated for foreign tax purposes as partnerships (with flow-through consequences).

Such entities, although treated as partnerships for foreign tax purposes, are often classified under the ITAA 1936 and ITAA 1997 as companies or limited partnerships. As a result, a taxpayer who holds an interest in the entity would ordinarily be taxed under the CFC or FIF regimes rather than under Div 5. Treasury acknowledges that the application of the CFC or FIF regimes in these circumstances can give rise to unintended and inappropriate consequences for taxpayers including potential double taxation and significant compliance costs. (See the Explanatory Memorandum to the *Taxation Laws Amendment Bill (No 7) 2003* which introduced Div 830 and Press Release C026/03, issued by the Assistant Treasurer on 8 April 2003.)

Division 830 ("Foreign Hybrids") was introduced in 2004 to address this problem. It is intended to apply to entities that are treated as partnerships for foreign tax purposes but as companies or limited partnerships under Australian tax law. An entity that qualifies as a "foreign hybrid" under Div 830 will be treated for Australian tax purposes as a partnership (subject to certain qualifications) rather than as a company or corporate limited partnership. Relevantly, this means that a taxpayer who holds an interest in the entity will be taxed under the partnership provisions in Div 5 rather than under the CFC or FIF regimes.

Tests to qualify as a foreign hybrid

There are 2 alternate tests to qualify as a "foreign hybrid" under Div 830. One test applies to entities that are "companies" under s 995-1 (s 830-10). The other test applies to entities that are "limited partnerships" under s 995-1 (s 830-15).

The requirements under the 2 tests are, in most respects, very similar. Broadly, both tests require ("Common Requirements") that the entity:

- be formed in a foreign country;
- not be resident for tax purposes in Australia or any other country;
- be treated for foreign tax purposes as a partnership (except where the entity is a US LLC in which case an alternative condition can be satisfied) (The circumstances in which this requirement will be satisfied is controversial and beyond the scope of this article.); and
- either be a CFC in respect of which the taxpayer is an attributable taxpayer, or be an entity in respect of which the taxpayer has elected for Div 830 to apply.

However, there is at least one important difference between the 2 tests. The test which applies to companies contains an additional requirement that regulations be in force in relation to the company and that the company satisfy any requirements under those regulations: s 830-15(3)(c). (The additional requirement does not apply to companies that are US LLCs.) The additional requirement and its associated problems is the focus of this article.

Why was Reg 830-15.01 made?

I suspect that a UK LLP was intended to be eligible for foreign hybrid treatment immediately upon commencement of Div 830 in 2004. (See para 9.2 of EM and the Press Release.) In other words, it seems that Div 830 was drafted on the assumption that a UK LLP is a "limited partnership" as defined in s 995-1 (rather than a "company") and would therefore be eligible for foreign hybrid treatment without the need for any regulations to be made. (Given that the UK LLP has the words, "limited" and "partnership" in its title, it is understandable why it may have been assumed that a UK LLP is a "limited partnership" as defined in s 995-1.)

Is a UK LLP a "limited partnership" or a "company"?

In contrast, in ATO IDs 2006/331 and 2006/332, the ATO expresses a view that a UK LLP is a "company" and not a "limited partnership" as defined in s 995-1. The ATO forms this view by comparing the characteristics of the UK LLP as prescribed in the Limited Liability Partnerships Act ("UK LLP Act") against the definition of "company" and "limited partnership" in s 995-1 of the ITAA 1997.

For present purposes, the relevant parts of the respective s 995-1 definitions are as follows:

"***Limited partnership***" is defined in s 995-1 as:

*"an association of persons (other than a company) carrying on business as partners or in receipt of *ordinary income or *statutory income jointly, where the liability of at least one of those partners is limited …* ."

The expression, "carry on business as partners" is defined in case law and now also in the various state and territory Partnership Acts to mean, "carry on business in common with a view of profit".

"***Company***" is defined in s 995-1 as:

"(a) a body corporate; or

(b) any other unincorporated association or body of persons

but does not include a partnership [which includes a limited partnership] …"

The expression, "body corporate" emanates from case law where it refers to vehicles to which the legal system, by the process of incorporation, has given the capacity to have legal rights and duties as a fictional legal person. (See [1.051] in Ford's *Principles of Corporation Law*.)

The UK LLP Act describes a UK LLP as a body corporate with a legal personality separate from that of its members, which is formed by being incorporated under that Act (refer to s 1(2) of the UK LLP Act).

The ATO concludes that the UK LLP is a "company" as defined in s 995-1 on the basis that:

- it is a body corporate; and
- it is ***not*** an association of persons … carrying on business as partners or in receipt of ordinary or statutory income jointly. Instead, a UK LLP is a legal person which carries on business and derives income itself.

I agree with the ATO's view.

Consequences of UK LLP being a "company"

Being a "company" rather than a "limited partnership", a UK LLP is a foreign hybrid only if it satisfies the requirements in s 830-15, including the requirement that regulations are in force in relation to the UK LLP and the UK LLP satisfies any requirements of those regulations: s 830-15(3)(c). At the time when ATO IDs 2006/331 and 2006/332 were issued, no such regulations were in existence. Consequently, the ATO IDs concluded that a UK LLP was not a foreign hybrid under Div 830.

This is the context in which Reg 830-15.01 (which came into force on 26 June 2007) was made. Regulation 830-15.01 requires that for a company (other than a US LLC) to be a foreign hybrid under Div 830, the company must be a limited liability partnership for the purposes of the UK LLP Act. Accordingly, as of 26 June 2007, regulations are in force which set out a requirement for a company to be a foreign hybrid and the UK LLP satisfies that requirement. Thus, it is now possible for a UK LLP to be treated as a foreign hybrid under Div 830. (Regulation 830-15.01 will apply to UK LLPs for the 2006-07 income year but not on a retrospective basis to earlier years: s 830-15(4).)

What about other entities?

Now that regulations are in force in relation to UK LLPs, it is clear that UK LLPs (and US LLCs) are eligible for foreign hybrid treatment. However, there is no such clarity for other entities. This is illustrated through the example of a "Delaware limited partnership".

A so-called limited partnership formed under the Delaware Revised Uniform Limited Partnership Act (ie chapter 17 of the Delaware Code) ("DRULP Act") ("DLP") is commonly used for "private equity" investments. Australian investors in DLPs need to know whether they will be taxed under the CFC or FIF regimes, or, instead, under Div 5, on the basis that the DLP is a foreign hybrid.

I suspect that the DLP is another example (like the UK LLP) of an entity which was assumed to be a "limited partnership" at the time Div 830 was drafted and thus was intended to be eligible for foreign hybrid treatment without the need for regulations. (Again, see para 9.2 of the EM.) However, it is by no means clear that the DLP is a "limited partnership" as defined in s 995-1.

Whether a particular DLP is a "limited partnership" or a "company" as defined in s 995-1 must be determined by comparing the characteristics of the entity as prescribed in the DRULP Act and as set out in any partnership agreement (the partners of a DLP may "contract out" of the provisions of the DRULP Act: s 17-1101) against the definitions of "company" and "limited partnership" in s 995-1.

Due to the way the s 995-1 definitions of "company" and "limited partnership" overlap and cross-reference one another, determining whether an "association of persons" is a "limited partnership" or is instead a "company", is not always straightforward.

In the case of the UK LLP, it is easy to conclude that the entity is a "company" as defined under s 995-1 because (having regard to the foreign law under which it is formed), it is a body corporate. Where an association is a body corporate, the accepted position appears to be that the association is a company and not a limited partnership. The rationale, presumably, is that because a body corporate has separate legal existence from the persons who comprise the association, any business is carried on, and any income is received, ***by the sep-***

arate legal entity and not by the persons who comprise the association. In other words, where the association of persons is a body corporate, the association is a "company" (within the s 995-1 definition) because:

- the association is a "body corporate" (ie para (a) of the definition of "company" is satisfied); and
- the association is not a limited partnership (ie, the "exclusionary limb" of the definition of "company" is not invoked). The association is not a limited partnership because the business is not carried on, and income is not received, by ***persons*** in common. Instead, the business is carried on, and income is received, by the separate legal entity.

The DLP, however, is not stated to be a body corporate nor does it appear to be "incorporated" under the DRULP Act. Where an association is ***not*** a body corporate, determining whether the association is a company or a limited partnership is more difficult. Prima facie, the association satisfies the definition of both "limited partnership" and "company". However, due to the "exclusionary limbs" of the definitions, the association cannot be a limited partnership if it is a company and cannot be a company if it is a limited partnership. In *Case 86* (1957) 7 CTBR (NS), the Commonwealth Taxation Board of Review was asked to determine whether an unincorporated mining syndicate, which did not have separate legal existence, was a company or a limited partnership. The Board weighed the features of the syndicate which were characteristic of a company against those which were characteristic of a limited partnership. It concluded that the syndicate was a limited partnership. No single factor was cited as being decisive.

The features of the DLP as set out in the DRULP Act are characteristic, in some respects, of a limited partnership, and in others, of a company. Specifically:

- the "limited partnership-like" characteristics of the DLP include that:
  - the DLP is not stated to be a body corporate and the DLP does not appear to be "incorporated" under the DRULP Act (cf the UK LLP); and
  - a general partner of a DLP is subject to the same obligations to which a partner in an ordinary partnership would be subject: s 17-402 (cf the UK LLP - see ATO ID 2006/331, 3rd paragraph under the heading "Facts"); and
- the "company-like" characteristics of the DLP include that:
  - the DLP is a separate legal entity from the partners: s 17-201(b);
  - the DLP can be sued: s 17-403(d);
  - the DLP may carry on a business or activity whether or not for profit: s 17-106;
  - partners of the DLP can transact with the DLP: s 17-107;
  - a partner has no interest in specific limited partnership property: s 17-701.

On balance, the characteristics of a DLP as prescribed in the DRULP Act tend to suggest that a DLP is a company, rather than a limited partnership. The DLP would arguably be a "company" on the basis that it is an "unincorporated association or body of person" (para (b) of the definition of "company") that is not a "limited partnership". (It would not be a "limited partnership" because, owing to the separate legal existence, it is the entity itself which carries on any business and receives any income, rather than the members/partners.) However, as noted above, the provisions of the DRULP Act are not the end of the matter because it is open to the partners to "contract out" of the provisions in the partnership agreement: s 17-1101. In short, there is no certainty that a DLP is a "limited partnership", and thus no certainty that a DLP is eligible for foreign hybrid treatment under the current law.

(The above approach to determining whether an entity is a "limited partnership" as defined in s 995-1 differs from that taken by the ATO in ATO ID 2006/91 ("Bermudan Exempted Limited Partnership") and ATO ID 2006/149 ("Korean Hapja Hosea"). In these ATO IDs, the ATO concludes that the entity in question is a "limited partnership" without addressing why the entity is not a company.)

Why s 830-15(3)(c) should be repealed

The legislature's intention (in relation to taxation of entities treated for foreign tax purposes as partnerships) might be better effected if the additional requirement for companies in s 830-15(3)(c) were repealed. In short, s 830-15(3)(c):

- is unnecessary because the Common Requirements (see above under "Foreign hybrid rules - some background") already adequately limit the class of entities eligible for foreign hybrid treatment in accordance with the stated objectives of the legislation (as set out in the EM). Specifically, the Common Requirements already ensure that the only entities which will be eligible for foreign hybrid treatment are those that:
  - are treated for foreign tax purposes as partnerships;
  - are not resident in Australia; and
  - would otherwise be dealt with under the CFC regime (or the FIF regime, in the case where a taxpayer makes the relevant election);
- increases compliance costs and uncertainty because it requires taxpayers to establish whether an entity is a company or whether it is a limited partnership (as a pre-requisite to determining whether the entity is a foreign hybrid); and
- inadvertently denies foreign hybrid treatment for certain entities which were intended to be eligible for foreign hybrid treatment.

Conclusion - practical guidelines for determining whether an entity is a foreign hybrid

Unless and until further regulations are introduced or s 830-15(3)(c) is repealed, the following guidelines may assist practitioners to determine whether an entity that satisfies the Common Requirements is a foreign hybrid:

- a US LLC or a UK LLP which satisfies the Common Requirements will be a foreign hybrid;
- any other entity which satisfies the Common Requirements will be a foreign hybrid only if it satisfies the definition of "limited partnership" in s 995-1 and is not a "company". In this regard:
  - an entity which has the words "limited partnership" in its title is not necessarily a "limited partnership";
  - determining whether an entity is a limited partnership (rather than a company) will require analysis of the features of the entity which may be set out in foreign legislation, an agreement between the members of the entity or both;
  - if the entity is a body corporate, it is likely to be a company on the basis that it satisfies para (a) of the definition of "company" in s 995-1 and is not a "partnership" because the entity, rather than the members, will carry on any business and receive any income;
  - if the entity is not a body corporate but nevertheless has separate legal existence, then the entity will arguably be a company under para (b) of the definition of "company" in s 995-1 on the basis that it satisfies the para (b) of the definition of "company" in s 995-1 and is not a "partnership" because the entity, rather than the members will carry on any business and receive any income; and
  - if the entity is not a body corporate and does not have separate legal existence, reference can be had to *Case 86* for the purpose of determining whether the entity is a limited partnership.

[*This article represents my own views and not necessarily those of Mallesons Stephen Jaques. I would like to thank Steven Vrontis and David Williams for their comments, and also John King. All errors are my own*.]