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The Treasury  
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Dear Mr Potts

**Exposure Draft Legislation – Offshore Banking Unit Reforms**

The Australian Custodial Services Association (ACSA) welcomes the opportunity to provide our views on the exposure draft legislation released by Treasury dealing with reforms to offshore banking units. ACSA has previously provided our views on the list of eligible activities and specifically the nature of custodial services in our letter dated 10 September 2014. That letter expressed support for the submission lodged by the Australian Financial Markets Association (AFMA).

*About ACSA*

ACSA is the peak industry body representing members of Australia's investment custodial and administration sector. Collectively, the members of ACSA hold securities and investments valued at more than AUD \$2 trillion in custody and under administration. Members of ACSA include NAB Asset Servicing, BNP Paribas, JP Morgan, HSBC, State Street, RBC Investor Services, Northern Trust and Citigroup.

*ACSA's views on the OBU exposure draft*

The OBU provisions currently include references to custodians which reflect a policy that custodial activities are within the scope of the OBU provisions. Indeed the Explanatory Memorandum introducing OBU amendments in 1999 made specific reference to a broad range of services provided by custodians which would be brought within the OBU provisions (refer in particular to paragraphs 1.61 to 1.63 of the Explanatory Memorandum to Taxation Laws Amendment Act (No. 2) 1999).

For ease of reference, these comments are extracted below:

“Extension of eligible OBU activities

Custodial services

1.61 The Government *has decided to extend the range of OBU activities to allow OBUs to provide custodial services to non-residents.*

What are custodial services?

1.62 Custodial service providers (custodians) offer a broad range of services directed at investment related activities. In contrast to fund managers, *custodians perform these functions at the direction of their clients.* Some common entities providing custodial services as part of their broader activities are global banking groups, funds management groups and insurance companies.

1.63 Custodial services include the following:

- safe-keeping of assets (the physical security and storage of assets);
- settlement of transactions (the finalisation of financial matters to the point of settlement);
- foreign exchange dealings;
- collection of income (the collection and distribution of interest and dividend income);
- corporate actions (the notification of and follow-up regarding upcoming corporate events in which clients have an interest);
- securities management;
- reporting and advisory services; and
- tax reclamation (obtaining tax refunds where appropriate).”

The ACSA submission of 10 September 2014 supported the view that the OBU provisions adopt a definition of custodial activities which aligned with the definition in the *Corporations Act* to ensure that custodial activities were clearly within the OBU provisions. This remains ACSA’s preferred approach. Although the Exposure Draft legislation did not adopt this proposal, no commentary was provided in relation to this matter so it is not clear whether there were any specific concerns with the proposal. ACSA would be grateful for any comments on why this approach was not adopted so that any concerns could be considered and addressed where necessary. In the absence of such commentary, however, ACSA would propose an alternative means to remove the uncertainty regarding custodial activities.

The uncertainty in the current provisions arises from the structure of the legislation relating to custodians which raises some doubt whether the practical operation of custodial activities are covered.

The current provisions which refer to the role of a custodian within the OBU regime are in the context of investment activity in subsection 121D(1) ITAA1936. The scope of the term "investment activity" is then described in subsections 121D(6), (6A) and (6B) as follows (our emphasis):

*(6) ... an investment activity is **making** (but not managing), as broker or agent for, or trustee for the benefit of, an offshore person ...an investment with an offshore person ..."*

*"(6A) ... an investment activity is also the **managing** by an OBU of a portfolio investment (see subsection 121DA(1)) for the whole or part (the investment management period) of a year of income, where:  
(a) the portfolio investment is **managed** as broker, agent or **custodian** for, or trustee for the benefit of, a non-resident..."*

*"(6B) ... an investment activity is also the **managing** by an OBU of a portfolio investment (see subsection 121DA(1)) for the whole or part (the investment management period) of a year of income, where: (a) the portfolio investment is **managed** as broker, agent or **custodian** for, or trustee for the benefit of, an overseas charitable institution..."*

The key aspect of concern from the structure of the above provisions is that they do not refer to the provision of custodial services but refer to "making" or "managing" investments.

To address the term "managing" first, it is generally made very clear in custodial contracts that custodians do not provide investment management services. Investment management is generally provided independently of the custodial relationship. The separation of management and custody provides extra confidence to the asset owner that the safe-keeping of assets will not be affected by any liabilities which could potentially arise from investment management activities. On this basis, custodial activities would not appear to be within the scope of subsection 121D(6A) and 121D(6B) as the custodian does not carry out any management activity.

In relation to the investment activity referred to in subsection 121D(6) of making investments, it is possible that custodial activities may come within this provision on the basis that the custodian (or its nominee) will acquire legal ownership of the relevant assets under custody. However, the following counter-arguments arise due to the structure of the legislation:

- There is an absence of specific reference to the term "custodian" in subsection 121D(6). On its own, the absence of the term "custodian" may not prevent the provision being interpreted to include a custodian as a custodian may be regarded as an "agent" or "trustee" for the client as required by the provision. However, as the term "custodian" is specifically mentioned in subsection 121D(6A) and subsection 121D(6B) a question arises whether the omission of a reference to custodian subsection 121D(6) reflects a legislative intent to exclude custodians from the scope of subsection 121D(6).
- One of the main ways in which a custodian acquires legal ownership of an asset is through the client instructing the custodian to make a new investment. Another way is where the custodian takes over the custodial relationship from a previous custodian. The former way would appear to clearly come within the scope of the provision. However, it is not clear if the transfer of legal ownership from a former custodian to a new custodian would be regarded as the making of an investment as the client already

holds beneficial ownership of the portfolio of investments from previous decisions to make those investments.

Due to the above uncertainties we respectfully submit that subsection 121D(6), in referring to investment activity of an OBU, should be modified to specifically refer to "custodian" and to use the more neutral term "the acquisition of an asset" instead of the reference to "making investments".

Based on this submission, subsection 121D(6) would read as follows (with markups):

*(6) For the purposes of paragraph (1)(e), an investment activity is making (but not managing), as broker or agent for, or trustee for the benefit of, an offshore person to whom paragraph 121E(a) applies, or acquiring, as custodian or nominee, for the benefit of such an offshore person an investment with an offshore person to whom that paragraph applies, where:*

*(a) the currency in which the investment is made is not Australian currency; and*

*(b) if the investment involves the purchase of any thing:*

*(i) if the thing is a share in a company--the company is a non-resident company; or*

*(ii) if the thing is a unit in a unit trust--the unit trust is a non-resident trust; or*

*(iii) if the thing is land or a building--the land or building is not in Australia; or*

*(iv) in any other case--the thing is located outside Australia.*

Advantages should flow to the Australian economy from ensuring that OBUs are able to provide custodial services. The advantages to the development of the Australian financial services industry are intrinsically related to those which arise from the encouragement of investment management activities in Australia. While the safe-keeping role of a custodian is the core activity of the custodial role, services that are more broadly provided by a custodian include investment reporting and analysis, income collection and tax reclaims. These were noted in the EM to the OBU provisions as referred to above.

Securing the custodial role in an Australian financial services provider will mean that there is greater likelihood of other financial services also being provided from Australia such as foreign exchange services to convert investment income and sales proceeds to a base currency and securities lending activities as a service to enhance portfolio values. Where a custodial relationship is held outside Australia, the potential to attract these other financial services to Australia would be diminished. Accordingly we submit that the OBU provisions should be modified as described above to clarify that custodial operations are within the scope of eligible OBU activities.

Please contact Mick Giddings, Chair of the ACSA Tax Working Group if you want to discuss any of the issues raised above.

Yours sincerely



**Director, ACSA**



**Chair, ACSA Tax Working Group**

