Victorian Government
Department of Innovation, Industry and Regional Development

Policy Contribution to the Review of International Taxation Arrangements – Consultation Paper

28 October 2002

1. Executive Summary

The Victorian Government welcomes the opportunity to make this submission to the Board of Taxation on the Review of International Taxation Arrangements – Consultation Paper ("the Consultation Paper").

The Victorian Government supports initiatives that both remove the regulatory impediments for international investors and initiatives that assist us to globalise our local economy.

The Consultation Paper identifies both problems and potential solutions in the following four major areas of international taxation reform:

- Promoting Australia as a location for internationally focused companies.
- Promoting Australia as a global financial service centre.
- Attracting equity capital for offshore expansion.
- Improving Australia's tax treatment of foreign expatriates.

The Victorian Government supports those options for reform of the federal taxation system that would encourage direct foreign investment in the State. It also supports those recommendations for reforms designed to encourage and retain in Victoria existing Australian companies with an international focus. The Victorian Government considers that these issues are critically important to the future economic development of the State, and to the creation of employment opportunities for all Victorians.

Unlike many other submissions likely to be received by the Board of Taxation, this submission does not focus on a highly technical review of detailed aspects of Australia's international tax rules, and those options for consultation. Rather, this submission represents the Victorian Government's endorsement of the importance of the review into Australia's international tax system, and seeks to highlight some of the issues Victoria faces in trying to attract and retain internationally focused businesses in this State.

The need for a comprehensive review of the international tax system was first raised, but not addressed, in the report *"A Tax System Redesigned"* by the Review of Business Taxation ("RBT") released in September 1999. The Business Council of Australia's White Paper rejuvenated the momentum for reform of the international tax system last year, "*Removing Barriers to International Growth*". Many of the options for reform canvassed in the Consultation Paper are drawn directly from the concerns voiced by Australian and international businesses during the preparation of the White Paper.

The review of Australia's international tax system must also be seen in the context of developments in other OECD countries in the three years since the RBT's report. Globally, many other countries are reviewing their own international tax arrangements, and the Victorian Government believes Australia must seize this opportunity to do the same.

For the purposes of simplicity, this submission follows the order of issues raised in the Consultation Paper. In addition to the areas for review outlined in the Consultation Paper, the Victorian Government seeks to put on the reform agenda the issues relating to the taxation treatment arising from the research and development of intellectual property. The importance of venture capital reform and the role it plays in funding innovation is also outlined in our submission.

2. Introduction

Within the Victorian Government, the Department of Innovation, Industry and Regional Development is the primary agency charged with delivering the Government's commitment to the economic growth of the whole State. The Department has wide ranging responsibilities for coordinating the whole-of-government policy and service delivery to the business community. It is also the primary vehicle for achieving the Government's commitment to the economic, industrial and regional development of the State.

Through this Department, the Victorian Government facilitates investment and provides business development support to promote growth and excellence in Victoria's agricultural, manufacturing and services sectors. Its major objectives include building the capacity of the State to create wealth and jobs, and encouraging increased private sector investment in Victoria.

The Victorian Government actively seeks new investors and reinvestment opportunities from existing investors. Victoria is promoted as a competitive location for business both domestically and abroad. It assists Victorian businesses to grow and export, and enhances the business community's capabilities for success in the global market. Its objectives also include the promotion of Victoria as a global investment location by attracting and facilitating international investment, and encouraging the retention and re-investment by Australian resident global companies in the State.

The programs and activities of the Department show the commitment and importance the Victorian Government places on the business issues considered in the Consultation Paper.

In its recent report entitled, "*Offshore Investment by Australian Firms: Survey Evidence*", the Productivity Commission found that the Australian taxation system was the third most important factor amongst considerations for Australian companies to relocate or retain corporate headquarters in Australia. Importantly, for companies considering relocating their headquarters offshore the Australian taxation regime was rated the highest of all commercial and government related factors by this group[1]. For all participants in the survey, the Australian federal taxation system was rated as the most significant factor within the control of government policy in influencing firms to invest directly offshore.

The Victorian Government welcomes this opportunity to influence the development of federal international tax policy.

Internationally focused companies are extremely important to the economy of Victoria. These are companies with Australian origins, who expand into overseas markets and raise capital from sources outside of Australia. These are also foreign companies who choose Victoria as the place from which to do business in this region of the world.

The presence of these internationally focused companies in major capital and regional centres is vital to the economic growth of local communities. These companies deliver employment opportunities, and their businesses add value in the supply chain delivering goods and services to both local and export markets.

[1] Productivity Commission, Commission Research Paper, "*Offshore Investment by Australian Firms: Survey Evidence*", Commonwealth of Australia, 2002, Page 28-29.

Internationally focused companies also provide opportunities for Australians to be actively involved in the management of international businesses. They provide direct employment and funding for our valuable research and scientific communities. They also generate opportunities and work for those lawyers, accountants, bankers and other professionals who provide services to them. Perhaps critically these companies increase the tax base for Australia at rates not possible with local organic growth. The flow on effect from their presence in Australia is enormous in terms of employment, economic growth and our State's relevance in the global economy.

3. Attracting Equity Capital for Offshore Expansion

The Victorian Government supports initiatives that reduce the disincentive for Australian companies to expand their global operations and that reduce the incentive for globally focussed Australian companies to relocate offshore because of taxation reasons only.

Chapter 2 of the Consultation Paper addresses the concerns raised by Australian business that the Australian tax system, and in particular dividend imputation, contains inherent biases that encourage Australian companies to invest domestically, rather than expand their activities into overseas markets.

Option 2.1 for consultation in the Consultation Paper canvasses three options to redress the possible effect of bias against foreign source income at the shareholder level resulting from the operation of the dividend imputation system.

They are the following alternative options:

- A: providing domestic shareholder tax relief for unfranked dividends paid out of foreign source income;
- B: allowing dividend streaming of foreign source income; and
- C: providing franking credits for foreign dividend withholding taxes.

3.1. Dividend Imputation

Australia introduced a system of dividend imputation in 1987 to replace a system of classical taxation whereby dividends were taxed once at the company level and again at the shareholder level. The Consultation paper opposes the return to a classical taxation system.

The dividend imputation bias identified in this Chapter arises from the apparent preference of Australian individual and institutional investors to receive franked dividend distributions rather than unfranked dividends. This is due to the ability of individuals and superannuation funds to offset franking credits against the personal or fund income tax liability. When a tax exempt body receives a franked dividend, the underlying corporate tax will be refunded.

3.2. Bias Against Foreign Expansion

Australian resident investors consider their after-tax returns in making investment choices and would factor in the franking percentage of the dividend in calculating the return on investments. When after-tax returns to Australian investors are considered, imputation creates a bias against investing in Australian-based companies with significant profits derived from foreign sources. These companies will need to offer significantly higher rates of return to compensate for the lack of franking credits.

Where an Australian company operates an active business in a foreign country, the dividends repatriated to Australia will generally be exempt from Australian corporate income tax. When a distribution is made to shareholders from this pool of exempt foreign source income, it will be an unfranked dividend (unless other franking credits from Australian tax payments are available to the company).

Australian companies should make investment decisions on the basis of projects, which bring the best economic returns, regardless of where those projects might be located. With Australian markets representing approximately 2% of all capital markets, by definition, many opportunities for growth must exist outside of Australia. Australian companies pursuing those opportunities should not be discouraged by the Australian taxation system.

3.3. The Cost of Capital Debate

There is a concern expressed by business that Australia's current dividend imputation system imposes an increased the cost of capital for multinational Australian - based companies investing directly offshore, particularly where those companies wish to access international capital markets to source equity funds. This submission does not attempt to address the issues associated with the cost of capital debate. Australian companies with foreign investors and significant foreign source income will be better placed to outline the difficulties they face in raising equity capital in overseas locations.

3.4. International Trends Away from Imputation

In a global economy, where companies and countries compete for investment capital, the Victorian Government believes that Australian taxation policy cannot be developed in isolation from the fiscal reforms in other parts of the world. In this context, the Consultation Paper acknowledges some of the inherent biases in the Australian imputation system; yet, a broader review of the imputation system has not been considered as one of the options for reform.

Acknowledging the greater mobility of capital, many European countries have modified their imputation models and moved towards a dual rate taxation system whereby the income from capital is taxed at a lower rate than income from labour. In countries like the United Kingdom, shareholders receive notional tax credits and pay tax on dividends at a much lower rate than other income. The attraction of this approach is that it provides very similar benefits to those provided by dividend imputation, but without the bias towards domestic source income. The notional credit applies without reference to the source of the profits or whether tax has been paid at the corporate level.

The Victorian Government recommends that further analysis might be undertaken of the impetus of countries such as Germany, the United Kingdom and Singapore to move away from a pure dividend imputation system. There appears to be some evidence from the BCA White Paper that Germany has recognised that dividend imputation encourages the domestic expansion of business - at the opportunity cost of international expansion.

The Consultation Paper notes that a shareholder relief mechanism along the lines adopted by the United Kingdom would be far more simple for Australian business than the imputation system, yet proposes other options for reform. This is on the basis that the other options would require less significant change than would the reform of the imputation system. The recent international trend to move away from dividend imputation as a form of providing relief against the double taxation of dividends must be recognised. Accordingly, the Victorian Government encourages a more detailed review of the recent international developments in this area.

3.5. Shareholder Partial Credit

Option A considers the option of a 1/9th non-refundable shareholder credit. This would go part of the way to improving the high effective tax rates which would otherwise be incurred by shareholders receiving unfranked distributions from foreign source income.

3.6. Dividend Streaming and Dual Listed Companies

Dividend streaming addresses the issue of providing foreign dividends to foreign shareholders. In the Consultation Paper, the view is expressed that Dual Listed Company ("DLC") structures allow a form of streaming which may adequately address the inherent biases of the Australian imputation system. DLC structures should be considered in their context as a response to the deficiencies of the imputation system. DLC's should not be considered as the preferred solution to the difficulties of matching investors tax profiles and the tax attributes of dividend streams.

The impact of the DLC arrangements on the activities of affected Australian companies needs to be considered more carefully. DLC arrangements may provide a solution to streaming issues only in very limited circumstances, and will work only in some jurisdictions. It is not clear that a DLC approach would assist smaller emerging companies to access overseas equity markets to fund their overseas expansion.

In particular, in endorsing a DLC approach rather than more general dividend streaming, care needs to be taken to ensure that there is no risk that the head office activity gravitates away from Australia to the overseas listing location. This potentially reduces the physical presence of management operations in Australia and the associated flow-on effect to the Australian industries and professionals, which provide services to them.

4. Promoting Australia as a location for internationally focused companies

The Victorian Government understands the enormous benefit that international investment provides to the economy. We understand that the continued globalising of our economy will protect our long-term global income and ensure that we can maintain our standard of living over time. What we fear most is being marginalised, being left out of the global value networks that are evolving. Given the perceived geographic distance, its is important that Australian governments ensure that our regulatory and taxation regimes are open and transparent and that, as part of the global economy, our international taxation laws fit into the global regime mix.

Under no circumstances does the Victorian Government seek encourage erosion of the Australian tax base, but we seek to support initiatives that position Australia well in the market for international investment flows.

Chapter 3 of the Consultation Paper considers the taxation issues around promoting Australia as a location for internationally focused companies. This Chapter deals principally with issues relating to the following taxation considerations:

- Australia's Controlled Foreign Company ("CFC") rules which attribute income from controlled foreign companies to Australian companies depending on the nature of the income and the location of the controlled foreign company.

- Dividend withholding taxes under Double tax Agreements with our major trading partners, which apply to dividends, paid by companies to residents of other countries. Dividend withholding tax rates are generally reduced to 15% under various Double Tax Agreements but will not apply to a dividend paid by an Australian company to the extent that it is franked.

- The company residence test which deems a foreign company to be a resident of Australia if central management and control of the company is exercised in Australia.

4.1. The Victoria Government as an Investment Agency

The Victorian Government supports those areas of international tax reform discussed in this Chapter that would encourage inbound investment by foreign companies in Victoria. The Consultation Paper acknowledges that tax arrangements can affect the level and country location of foreign direct investment. This is especially the case where an international business is considering the location of a regional management company.

The Victorian Government actively tries to attract investment by foreign companies in projects located in Victoria by marketing, facilitation and in some cases by providing various forms of government assistance. While noting that many factors influence the decision to locate a company's regional or global headquarters the Victorian experience is that tax arrangements will be significant in determining the location of a direct investment decision by a foreign investor.

4.2. Australia as a Regional Headquarter Location

It would be difficult to quantify the instances of foreign companies, which, for tax purposes, by-pass Australia as a regional headquarters location. Internationally based companies simply do not discuss their broader corporate strategies with State Government agencies unless specific project-based assistance is sought, so it is data that we do not collect. Government investment attraction agencies are unlikely to see regional headquarter projects at all, as no incentives can really compensate for structural issues such as conduit income and the various taxes on sale of business assets. What we can say anecdotally is that corporations and site selection advisors consistently refer to our CFC and Conduit Holding Rules as potential disincentives to Australian investment.

Anecdotally, we understand that when a foreign owner acquires an Australian company group, the ownership of the foreign subsidiaries will often be restructured so that they are no longer owned through an Australian resident company. The reasons for restructuring in this manner are a direct result of the operation of Australia's residency, capital gains tax and CFC rules. Once the regional companies are removed from the chain of ownership which flows through Australia, there is potentially a real diminution in Australian involvement in those regional companies.

4.3. Residency Tests for Companies

Australia's residency rules for companies operate to tax an overseas company as a resident of Australia if its "central management and control" is in Australia. As a result of this rule, Australian involvement at the board and management levels of overseas subsidiaries may to be minimised because of the risk of bringing the overseas company into the Australian tax net. The operation of this residency rule potentially reduces the scope for regional headquarter involvement by Australians and provides management issues for locally owned international groups. These rules could be simply amended by changing the definition of residence by providing that a company shall not be deemed to carry on business in Australia solely because central management and control is exercised here.

4.4. Controlled Foreign Company Rules

The CFC rules are a complex set of tax attribution rules which need to be reviewed to ensure that the appropriate balance is struck between integrity of the system, and reducing the complexity and associated compliance costs of the rules. A substantial reduction in compliance costs would result if CFC's resident in broad exemption list countries (countries with comparative tax systems) were entirely excluded from the attribution rules.

The Victorian Government also supports the proposal to increase the number of broad-exemption listed countries. Prior to 1997, this list included some sixty or so countries which had a tax rate and a system of income tax broadly equivalent to Australia's. The majority of these countries have been removed from the list, leaving only the United States, the United Kingdom, France, Germany, Canada, Japan and New Zealand. This list needs to be reviewed to include many countries especially in the Asia-Pacific area with comparative tax systems. Priority should be given to those countries which attract the largest share of direct outbound Australian investment.

4.5. Conduit Holding Company Concessions

Countries such as Singapore have sought to build large portions of their economy based on the presence of regional management companies. Clearly this has been done with the expectation that the flow on benefits to the community in terms of employment and growth are immense. The opportunities which parent holding companies, regional holding companies and other inbound investments offer individual Australians are enormous. These opportunities are greater not only in the number of jobs that they generate but also in the quality of the opportunities provided for individuals.

The Victorian Government would support concessional treatment for the flow through taxation of foreign gains and foreign income and the careful targeting of this concession to encourage holding companies located in Australia.

If a foreign investor owns regional subsidiaries through an Australian holding company, Australia's capital gains tax (CGT) rules will tax any gains made on subsequent sales of the shares in those subsidiaries. This outcome results even though these gains are not generated in Australia, and are not attributable to Australian shareholders.

However, any concession should be carefully targeted so that it would apply only to new acquisitions. There should also be prescriptive requirements for eligibility such as a significant presence in the country (for example in terms of turnover or number of employees being located in the Australia).

4.6. Attracting Foreign Investment and Competitive Tax Rates

In addition to the location of regional management companies, for Victoria there remains the broader issue of attracting direct foreign investment in projects located in this State. The issues around attracting portfolio investment in projects are considered in more detail in Chapter 4 of the Consultation Paper and are especially important to our submission.

In Appendix A of this submission is a summary of Victoria's recent experience in competing with other global locations to attract investment in the Victoria. The case study relates to three investment proposals by foreign companies operating in the pharmaceutical industry. One of these case studies illustrates that a project located in Victoria may be more profitable on a pre-tax basis compared with locating the project in an alternative overseas location. However, in this case once taxation considerations were factored into the project, the decision was made to locate the facility not in Melbourne but in Singapore.

Australia's corporate headline tax rate at 30% is more internationally competitive than it has been in recent years. This reduction in Australia's tax rate follows the international trend to reduce corporate tax rates (as illustrated in Chart 1.1 of the Consultation Paper). Chart 1.3 illustrates how many countries in the region such as Singapore, Malaysia, Chinese Taipei and Korea do offer a lower headline corporate tax rate.

The Consultation Paper does not consider the issue of further lowering corporate income tax rates as one of the options for reform.

Australia offers many benefits to compensate for the difference in headline corporate tax rates. These include benefits such as lower business costs, political stability, good infrastructure and social amenities offered by cities such as Melbourne. However, consideration needs to be given to other aspects of the Australia's tax system which, despite these other benefits, lead overseas companies to bypass Australia for investment projects.

4.7. Dividend Withholding Taxes

Dividend withholding tax is one particular area in need of further reform. The rates of withholding tax on dividends paid between residents of other countries are generally much lower than the rates that apply to dividends paid to, or from, Australia.

In order to address this anomaly, Australia should continue to progress the re-negotiation of Double Tax Agreements (DTAs) with major trading partners to obtain more competitive rates of dividend withholding tax. The recent changes to the Protocol to the DTA with the United States of America reducing dividend withholding tax are welcomed, and provide the model for future treaty renegotiations.

5. Promoting Australia as a Global Financial Services Centre

Chapter 4 of the Consultation Paper deals with options to enhance Australia as a global financial service centre.

The importance of the managed funds industry to the Victorian economy is significant. Many boutique funds managers, as well as offshore institutions, have established funds management operations in Melbourne. As at 30 June 2002, the Australian Bureau of Statistics reports that the total consolidated assets of managed funds institutions was $645.0 billion. Interestingly, it is estimated that Australian investment managers receive approximately 95% of their funds from domestic sources.

The Victorian Government supports those reforms to the Foreign Investment Fund rules that simplify the compliance tasks for Australian funds managers.

The anomaly that the direct investment by a non-resident in an Australian portfolio investment is treated more favourably than identical investments via an Australian fund also needs to be addressed. The provisions in Australia's DTA's which attribute a permanent establishment to certain portfolio investors need to be removed. Currently investors who hold portfolio investment through units trusts are taxed as residents on their investment returns, unlike foreign direct investors who are subject only to dividend withholding tax on distributions paid. This does very little to encourage international involvement in our managed funds industry.

6. Taxation Treatment of Foreign Expatriates

Removing disincentives to the temporary employment of skilled overseas workers will be of particular benefit for skill intensive industries. It will assist in attracting and retaining regional headquarters and offices. Equally as important, the exemptions will make it easier to attract workers in areas where Australia is experiencing skill shortages.

There is a case for the targeting of these exemptions to individuals with skills in demand by Australian businesses (as outlined in the Consultation Paper considering the expatriate taxation concession offered by the Netherlands).

The taxation treatment of expatriate employees sends a personal message to the individuals of foreign companies as to how welcome they are in Australia. The importance of this factor in the location decisions of inbound investors cannot be easily dismissed.

The present income tax treatment of foreign expatriates discourages individuals from relocating in Australia for significant periods of time. Foreign expatriates can face Australian tax on income from non-Australian assets acquired prior to their arrival in Australia. This is a serious impediment to attracting the best talent in the world to contribute to the success of Australian companies in the international marketplace.

In the Reading Speech to Taxation Laws Amendment Bill (No. 7) it was noted that exemptions from Australian tax are proposed for temporary residents to assist Australian businesses in attracting key personnel to Australia. The changes in this Bill recognise the vital importance to Australia of an internationally competitive tax regime. These changes to the taxation of foreign expatriates also allow Australian businesses to reduce the additional extra costs they typically incur in employing temporary residents. Many Australian companies operate taxation equalisation programs to reduce the personal tax costs to expatriate employees. These additional costs of employing expatriate employees are generally assumed by the Australian businesses.

7. Innovation, Intellectual Property and other Intangibles

The Consultation Paper does not address the tax impediments associated with the development and location of intellectual property in Australia. Australia is recognised internationally for the high quality of its education system and research facilities.

The Victorian Government plays an important leadership role in developing an understanding of the benefits that innovation brings to the local community. Victoria strongly believes that the development of world class infrastructure in the areas of science, technology and innovation will in turn encourage leading researchers and innovators to the State.

The Victorian Government considers that there is a particular need to reform Australia's taxation system so as to make Australia a more attractive location for the raising of capital and the development of intellectual property and other intangibles in Australia.

7.1. Australian Withholding Taxes on Royalty Payments

The withholding tax applied to royalties and other charges for the use of intellectual property is an important aspect of this debate. In the past, Australia has been a net importer of intellectual property and other forms of technology. As a result, the Australian tax regime has been focused on exercising its sourcing rights over payments for the use of intellectual property in order to protect its revenue.

Income characterised as a royalty will typically be taxed in the country of payment, and subject to royalty withholding tax - which can be as high as 30% of the royalty payment. However, in general this rate will be reduced to a withholding tax rate of 10% where payments are made to residents in countries with which Australia has a DTA.

In recent years many countries have reduced their royalty withholding tax rates to low rates or even to nil. Australia has been slow to follow this trend and has resulted in higher royalty withholding taxes than apply in cross border intellectual property transfers between many other countries. Increasingly, Australia is becoming an exporter of technology and this approach to the taxation of intellectual property transfers is in need of reappraisal. Royalty flows from residents of Sweden, the United Kingdom, Germany or the United States of America will be free from withholding tax when made to a resident of another of these countries.

High royalty withholding taxes increase the costs to Australian business making royalty payments to foreign owners, and negatively affect Australian companies receiving royalty streams attributable to Australian owned intellectual property. In many cases, when intellectual property is licensed to Australian companies, the owner of the intellectual property will require the royalty withholding tax to be met by the Australian licensee. In effect this requires the Australian licensee to make a royalty payment grossed-up for effect of the royalty withholding tax.

The Victorian Government supports the efforts of the Federal Government to renegotiate DTA's to reduce withholding tax on royalty payments to internationally competitive rates. The recent changes to the Protocol to the DTA with the United States of America may provide the basis for future treaty negotiations to reduce withholding tax rates to 5% or even nil.

7.2. Amortisation of Intangibles

The other important factor in developing Australia as a location for the development of innovative activities is the provision of tax recognition, or write-off for the costs of developing intangible property. Intangible assets are increasingly important and may account for more than 80% of the value of a business. A large proportion of this value will be attributable to a company's intellectual property such as its trademarks, copyright, patents, registered designs, information and know how.

Australian taxation law allows the amortisation of the costs of development of only certain types of intellectual property interests. These interests are the ownership and licensing rights associated with a patent, a registered design or copyright. Amortisation is generally available over the periods of statutory protection of those rights under the relevant Commonwealth laws.

In the Review of Business Taxation Report ("RBT"), *"Review of Business Taxation: a Tax System Redesigned*", made various recommendations in relation to "blackhole expenses", this is expenditure which can be neither deducted outright, nor capitalised as an asset with a deduction available for the amortisation of the costs incurred. The capital allowance provisions introduced with effect from 1 July 2001 allow the amortisation of certain costs associated with a project in which intellectual property rights are sought to be obtained. Nevertheless, there remains a considerable amount of non-deductible expenditure on the creation of intangibles that fall outside the capital allowance rules.

Companies will have greater incentives to develop intellectual property in locations with more favourable taxation amortisation regimes. Both the United States of America, and more recently the United Kingdom, have introduced amortisation regimes covering a broad range of intangible property. As a result of amortisation allowances available in other jurisdictions, intangible property is increasingly foreign owned, and seldom licensed through Australian companies.

The movement of intellectual property outside of Australia because of taxation considerations also means that Australia misses out on the opportunities associated with the future development and commercialisation of the intellectual property. The loss of this development and licensing activity from Australia is accompanied by the loss of opportunity for our talented scientists and engineers who may also chose to relocate their careers, and families, outside of Australia.

The introduction of a tax amortisation allowance for the development of all forms of intangible property should be considered to remove a major obstacle to Australia becoming a centre for research and development and innovation.

The Victorian Government appreciates that this measure would require further analysis by the Board of Taxation and the Federal Government. While there may be some revenue costs associated with the introduction of an amortisation regime, any costs must be weighed against the opportunities that Australia forgoes by not hosting these activities.

7.3. Venture Capital Funding for Innovation

Australia needs a strong and active venture capital industry to raise the equity required to fund innovation, economic growth and employment creation. Venture capital investments provide significant sources of funding for early stage investments – particularly in areas such as biotechnology, computer technology, engineering and other innovative production processes. Later stage venture capital funding such as leveraged buy-outs, with the involvement of international venture capital funds, enable fledging Australian businesses to be grown to a global scale.

The Victorian Government welcomes the recent venture capital reforms which are proposed to encourage new investment into the Australian venture capital market, and to further develop the venture capital industry. The reforms are aimed at achieving an internationally competitive framework by allowing venture capital limited partnerships and venture capital funds of funds to be treated as flow through vehicles. Under these reforms, tax exempt residents of certain jurisdictions, or partners in limited partnerships will not be taxed on the profits, or on the disposal of investments in eligible investment companies.

These reforms are designed to encourage more investors to direct funds into Australia. However, some initial responses from participants in the private equity market show concern that the criteria to qualify for these venture capital concessions may be limited. The Pooled Developed Fund Registration Board will oversee registrations of the limited partnerships and funds of funds. The level of registrations should be carefully monitored to ensure that the reforms are appropriately targeted and achieve the desired outcomes.

Appendix A.

In recent years many pharmaceutical companies have been attracted to Victoria as a location for their manufacturing activities. The following are three examples of companies which considered locating significant pharmaceutical plants in Victoria. In negotiations with all three of these companies, it was agreed that Victoria met the benchmarks of each company's project requirements. In all three cases, Australia's taxation system resulted in the investment projects being located outside of Australia.

COMPANY A
Three years ago Company A concluded that Victoria was an ideal location for a new manufacturing plant. The company's review of investment locations concluded that, taxation issues aside, Victoria was a highly competitive location for their new plant. However, Company A chose Singapore in which to locate this investment because of its lower tax regime.

COMPANY B
Two years ago, Company B also concluded the suitability of Victoria as a location for a manufacturing plant. The Victorian Government discussed with the company an incentive package that would compensate the company for the effects of the Australian tax regime. However, no agreement was reached.

COMPANY C
Earlier this year Company C chose the Czech Republic rather than Victoria as a manufacturing location. Whilst there were other factors working for and against Victoria as a location, taxation was again considered a key reason for the decision to locate outside of Australia.

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