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Review of the Tax Arrangements applying to Collective Investment Vehicles
The Board of Taxation
c/- The Treasury
Langton Crescent
CANBERRA ACT 2600

BY POST & EMAIL: taxboard@tresury.gov.au

BOARD OF TAXATION REVIEW INTO COLLECTIVE INVESTMENT VEHICLES

The Financial Services Council (FSC) welcomes the opportunity to comment on the Board of Taxation's discussion paper on the review of the tax arrangements applying to collective investment vehicles (CIVs).

The Financial Services Council is the peak body representing Australia's retail and wholesale funds management businesses, superannuation funds, life insures and financial advisory networks. Collectively the FSC has 128 members who are responsible for investing over $1.7 trillion on behalf of more than ten million Australians – this is set to rise to $3 trillion by 2020 and $5 trillion by 2030.

Part 1 of our attached submission outlines the broader context for these reforms, the jurisdictions considered to be the primary competitor markets for Australia and the vehicles currently used by Australian based fund managers for their offshore operations. The submission also lists a number of characteristics that a CIV regime must contain to develop Australia into an attractive financial services centre.

Part 1 identifies potential changes to corporations law should the Board recommend that boarder vehicles be incorporated. The submission also considers the introduction of a CIV regime in the context of other announcements by the Government. To assist the Board a summary table of key tax considerations for CIVs in foreign jurisdictions is extracted from the FSC's Asia Region Funds Passport Report in Appendix A

Part 2 of our submission addresses the design of an Investment Manager Regime (IMR) and outlines characteristics that such a regime would require.

If you have any questions regarding the FSC's submission please do not hesitate to contact Pravin Madhanagopal or myself on (02) 9299 3022.

Yours sincerely

MARTIN CODINA
Director of Policy

PART 1

COLLECTIVE INVESTMENT VEHICLES

1. INTRODUCTION

For Australia to develop into an international financial services centre, it will be necessary to be cognisant of the preferences of international investors.

Many foreign investors (even though they may reside in a Double Tax Treaty country) do not come from a common law jurisdiction. Consequently, these investors are not familiar with trusts and often prefer to invest in a Collective Investment Vehicle (CIV) which has either a contractual basis (e.g. an Irish common contractual fund) or is a corporate entity (e.g. a Luxembourg SICAV).

In order to allow Australian based fund managers to service these clients from Australia, as opposed to them establishing an off shore CIV for these clients in a competing jurisdiction, serious consideration needs to be given to the establishment of alternative flow through vehicles, particularly for non-resident investors.

It is suggested that the new elective provisions that apply to Managed Investment Trusts ("MITs") should not be limited to unit trusts. Instead any legal entity that meets the prescribed prerequisite conditions would be eligible to elect, irrevocably, into the new regime. Once such an entity has elected into the regime the features normally associated with MITs such as transparency, flow through, deemed capital status would apply, regardless of how that type of entity might normally be treated for tax purposes.

By allowing such flexibility, Australian managers would be able to develop products that suited particular overseas jurisdictions. In Appendix E the Board has correctly identified that the preferred style of CIV may differ from country to country and, indeed, may even vary within a country depending upon the type of investment.[1] Such flexibility provides a degree of protection against future developments that may result in unit trusts falling out of favour with investors.

Additionally, by allowing other types of entity within the MIT regime it may be possible to overcome the deficiency that many Double Tax Agreements do not accord protection to trusts and other tax transparent entities that are not the beneficial owner of the investments. In this regard, many investors ultimately reside in countries with which Australia has a Double Tax Agreement, but prefer to invest via a CIV for commercial reasons. For example, they may not themselves have sufficient capital to directly invest in assets outside their home jurisdiction.

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1 http://www.taxboard.gov.au/content/reviews_and_consultations/managed_investment_trusts/discussion_paper/managed_investment_trusts_discussion_paper.pdf

2. COMPETITOR JURISDICTIONS

The following jurisdictions are considered to be the primary competitor markets for Australia. Appendix A contains a summary of tax considerations for CIVs in the Asia region. Many funds that accept global investors and intend on holding global assets tend to favour Ireland, Luxembourg or Cayman Islands for the following reasons:

- The flexibility in each regulatory regime;
- Tax flow through nature without the concern of extensive integrity rules (on the basis those jurisdictions are just conduit countries and rarely does the fund have assets in those countries or ultimate resident investors in those countries, if so, they would be in the minority); and
- The accepted familiarity that those jurisdictions have built up with investors. For example Malta can generally offer what Ireland, Luxembourg or Caymans can offer, but they have not established themselves with enough history.

Luxembourg

- The funds market consists of three main types of legal entities:

  - Investment company with variable capital;
  - Investment company with fixed capital; and
  - Common funds.

Ireland

- Funds can be established as either an investment company, unit trust, investment limited partnership or common contractual fund:

  - An investment company incorporated with fixed or variable capital;
  - A unit trust created by a trust deed between the manager and trustee;
  - An ILP created by partnership agreement; and
  - A CCF, which is an unincorporated contractual arrangement.

Hong Kong

- Funds are commonly structured as unit trusts or mutual fund corporations.
- A unit trust is typically constituted contractually by a trust deed made between the trustee and manager. A unit trust does not have a separate legal personality.
- A mutual fund corporation is a corporate entity, and can be domiciled off-shore as an exempted company with limited liability, engaged primarily in the business of trading in securities. An interest in the mutual fund company is represented by a share in the company.

Singapore

- Funds are structured as unit trusts and considered to be Collective Investment Schemes under the Securities and Futures Act.

Cayman

- Funds usually take one of three legal forms:
  - Unit trusts;
  - Limited Partnerships; and
  - Segregated Portfolio Companies.

3. VEHICLES UTILISED BY AUSTRALIAN BASED FUND MANAGERS OFFSHORE

The following vehicles are currently used by Australian based fund managers who operate in offshore jurisdictions:

- Australian Managed Investment Trusts;
- Luxembourg Société d'investissement à Capital Variable (SICAVs) in the corporate forms of Société Anonyme (SA)and Société à Responsabilité Limitée (SARL);
- Singapore Unit Trusts[2];
- Singapore REITs;
- Hong Kong Unit Trust;
- US Delaware Trusts;
- US REITS;
- English Limited Partnerships;
- Indonesia Unit Trusts[3];
- Cayman Limited Partnerships;
- Cayman Segregated Portfolio Companies;
- Cayman Unit Trusts;
- Cayman Islands Exempted Limited Partnerships;
- Bermudan companies; and
- Vehicles used under the UCITs Regime include:
  - Irish unit trusts;
  - UK OEIC (Open-ended Investment Co) for offer in Europe; and
  - Irish VCC (Variable Capital Co) for offer in Asia.

The experience of our members is that Asian investors are very comfortable with UCITs funds. With more than 80% of funds registered for sale in Hong Kong, Singapore and Taiwan being UCITs funds established in Luxembourg or Ireland.

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[2] These were originally established to satisfy the historical requirement for domestic architecture to operate in Singapore. This requirement was relaxed in 2002.
[3] There are significant limitations on how international funds operate in Indonesia (e.g. no more than 50 foreign investors per fund).

4. CIV REGIME CHARACTERISTICS

If Australia is to develop into a genuinely attractive Financial Services Centre our CIV regime must contain the following features:

- Character flow through;
- Complete transparency, including flow through of losses, so that there are equivalent tax results for direct investment and indirect investment through the CIV;
- The regime should allow legal entities of different types to elect, irrevocably, to be CIVs. Similar to the UCITs regime;
- Stamp Duty free applications, redemptions and transfers between investors (subject to a land rich exclusion);
- Domestic investors should be able to access domestic tax incentives such as franking credits and CGT discounts;
- Simple withholding tax rules for non resident investors (i.e. one or two withholding tax rates instead of the six or more that apply to distributions from trusts);
- Single platform allowing multiple independent funds (i.e. like a Cayman SPC or Cayman Unit Trust series) and funds must be 100% segregated (i.e. bankruptcy remote from each other);
- The new regime should have a specific designation that can be easily incorporated into future Double Tax Agreement negotiations;
- Allow accumulation and reinvestment for offshore investors only, as both have neutral revenue impact (i.e. effectively remove the requirement to annually distribute taxable income to non-residents);
- Multiple unit classes should be possible as should multi currency classes i.e. one set of accounts but separate tax returns per class;
- Domestic investment by CIVs should be passive but offshore investment can be more active;
- True character and source matching of income (i.e. hedging gains and losses should only be 'Australian sourced' when the hedge covers Australian assets);
- FX on capital account i.e. matching of gains/loss to be matched to the asset it is hedging e.g. shares;
- No application of the CFC rules; and
- The ability to offer classes in a company. This will provide an advantage from a reduction in administration costs.

The FSC would be pleased to discuss any of the above in further detail.

5. REGULATORY ISSUES REGARDING THE CORPORATIONS LAW

Assumptions

The stock take of different legal CIV structures used globally today will inform this draft insert.
The new CIV structure will be an Australia domiciled onshore vehicle, primarily intended for investment by non-resident investors.

Different CIV Legal Structures

The definition of a CIV for this purpose should encompass corporate vehicles, limited partnership vehicles and any future vehicle which meets the criteria. It is important that we future-proof this regime so as to be flexible enough to pick up any legal form.

The existing definition of "managed investment scheme" in section 9 of the Corporations Act already applies to cover all forms of CIV legal structures except that for a corporate CIV vehicle the definition will need to be amended so that the corporate CIV vehicle is not exempted from being a managed investment scheme simply because it is a body corporate, or an alternative regulatory regime would need to be enacted.

The Corporations Act rules that apply to ordinary companies will need to be modified for corporate CIV vehicles as they are not appropriate for an investment company. In particular, amendments would be required to lift the restrictions on redemptions of shares and share buy-backs to facilitate open-ended corporate funds.

Existing Managed Investment Scheme Regime in Chapter 5C

This regime would need to be amended in order to apply to different structures. For example:

1. For a corporate CIV vehicle the manager of the vehicle most closely approximates to the responsible entity under Chapter 5C, however a number of changes to the legislation would be required to reflect this; and

2. For a limited partnership the general partner most closely approximates to the responsible entity.

It may be desirable to expand and clarify ASIC's modification powers in respect of Chapter 5C to enable it at an administrative level to modify the application of the Chapter 5C regime to a retail CIV structure in order to ensure that it applies appropriately.

Limited Liability of Partners under a LP CIV Structure

It may need to be clarified that limited partners have limited liability.

6. TIMING

The Discussion Paper requires the Board to report to Government by 31 December 2011 with its recommendations, the exception being that the recommendations regarding the Venture Capital Limited Partnership component are to be brought forward to 30 June 2011.

The FSC believes the timing of announcements regarding any proposed changes arising out of the Board's recommendations are a critical aspect of the success of the measures. Specifically:

- *FIN 48*

  The Government's announcement regarding an exemption for foreign funds for the year ending 30 June 2010 and prior years (the "FIN 48 announcement") on 17 December 2010 largely removed the issue for foreign funds caused by the US accounting standards covering investments into Australia.

  However the position going forward post 2010 was not decided upon and the Assistant Treasurer's announcement suggests that the period post that date is meant to be encapsulated into the proposed IMR regime - presumably by backdating the IMR to 1 July 2010.

  The issue that arises is that if the Board is to report in December 2011 this will mean that foreign funds will again be left with the same uncertainty for the 31 December 2011 year as existed prior to the FIN 48 announcement and risk again disenfranchising foreign funds from investment in Australia.

  The FSC believes the better approach would be to extend the FIN 48 announcement until such time as the Government announces its position regarding the Board's recommendations which based on the current schedule would not be until 2012. The FSC would look for the Board's support in seeking that position.

- *Interim Reports*

  The announcements to date together with the broader regulatory changes being undertaken in the Financial Services Sector (such as "passporting") are strong indicators to foreign investors that the Government is serious about seeking to position Australia as a competitive financial centre. The prospect of a broader CIV regime together with an IMR and effective VCLP provisions are being regarded by foreign investors and local managers as a significant leap forward in bringing Australia up to speed with the rest of the world.

  The present strong Australian economic conditions have provided a window of opportunity to attract foreign investment and the prospect of a broader CIV regime and an IMR particularly will likely open up opportunities that to date have been lost to other financial centres.

  In this regard the period before which the Board will report and then the Government make its final announcement regarding the changes could push any concluded position out until at the earliest - the first quarter of 2012.
  The FSC understands that due process is required – however:

  - The length of time before the Government firms up its position may cause foreign funds to look to other jurisdictions;

- It may dissuade local managers from investing in capital and infrastructure until the position is known;
- As economic conditions improve overseas - Australia's comparative advantage will become less; and
- Foreign jurisdictions may themselves take action to improve their attractiveness.

As was demonstrated with the Assistant Treasurer's announcement on 19 January 2011 it is possible to move on those aspects where there is a degree of likelihood as to how an aspect may operate. However we expect the Government will be reluctant to make many more announcements until the Board reports.

The FSC therefore believes there is significant merit in the Board releasing to the Government aspects of its report before the 31 December deadline. For instance the CIV and IMR regimes to some extent will not be dependent on each other and so the Board could consider releasing aspects regarding the IMR prior to finalising its views on the breadth of the CIV regime.

7. LINKAGE TO OTHER REFORMS

While the Board of Taxation review is concerned with the taxation treatment of collective investment vehicles and investors in these vehicles, there are a number of other regulatory reforms which are also relevant to the future of collective investment vehicles in Australia.

In this regard, we strongly concur with the views expressed in the final Johnson Report which highlight the need to see the various reforms as a package.

> *"The key recommendations need to be seen as a package, designed to remove obstacles to Australian based companies engaging in more cross-border business and also to offshore companies and investors conducting more business in and through Australia" (p109)*

In relation to funds management, the Report states:

> *"The Investment Manager Regime (IMR), funds management vehicles and Asian Passport package of proposals is designed to make it easier for Australian fund managers to attract overseas investors into funds run and administered out of Australia" (p109)*

Naturally, seeing the reforms as a package raises the question as to which of these measures should be introduced first.

We are strongly of the view that the benefits of existing and further Mutual Recognition Agreements and the creation of an Asian Region Fund Passport will not be realised until Australia's tax settings have been reformed (specifically, but not limited to, the introduction of an IMR and CIV flexibility).

We therefore believe that the introduction of an IMR and CIV flexibility should be prioritised and implemented prior to the creation of an Asian Region Fund Passport.

If the reforms are done in reverse, Australian based managers will be at a competitive disadvantage compared to managers based in other jurisdictions in the region, where these tax issues have already been addressed.

The major relevant regulatory reform in this area is the proposed development of an Asian Region Funds Passport. Broadly speaking, the Passport would require a set of regulations to allow the creation, domiciling, management, offer, custody and administration of funds across the region.

Rules with respect to eligible investment asset classes; custody arrangements; offer document conditions; registration and licensing arrangements; liquidity requirements; capital requirements; leveraging; and consumer protection and dispute resolution procedures would also likely be required.

The development of an Asian Region Funds Passport is expected to take a number of years as a number of countries work together to develop this common framework. As a result, waiting for this reform to be completed prior to introducing an IMR and CIV flexibility would only serve to disadvantage Australian based fund managers who will continue to be at a competitive disadvantage to their regional and international peers.

PART 2

INVESTMENT MANAGER REGIME

The FSC welcomes the recent announcement by the Assistant Treasurer and Minister for Financial Services & Superannuation that income from relevant investments of a foreign fund, that is taken to have a 'permanent establishment' in Australia, will be exempt from income tax.

This is a very positive development which provides certainty in respect of the income tax treatment of investment income of foreign funds

The Assistant Treasurer’s announcement, however, does not cover all of the relevant tax issues which an IMR should be designed to address. As outlined in previous submissions, the FSC supports the introduction of an IMR with the following characteristics:

- There should be taxation certainty for foreign investors investing into Australia whether that investment is on revenue or capital account based on a set of clear statutory rules as opposed to case law;

- Subject to integrity measures, the IMR should incorporate an exemption from Australian taxation for portfolio investments of foreign investors (including foreign collective investment vehicles) whether on capital account (as is currently the case) or on revenue account;

- The use of a local manager or agent should not cause the exemption from Australian taxation to be lost or compromised;

- The IMR should cover investments via local funds and ensure that gains on foreign (or local) assets should be able to flow through those funds to foreign investors without being subject to tax or attribution (by reason of the local management);

- The asset class of IMR qualified assets should be broad but generally confined to marketable securities (i.e. listed securities) and investments in Australian collective investment vehicles (i.e. local funds);

- There should be targeted integrity provisions built into the IMR. For example to ensure that fee and similar income derived by local managers and agents in managing funds are arm’s length and that Australian resident investors are restricted in their access to IMR concessions; and

- The IMR should be competitive with and draw on the best features of overseas regimes where IMRs are operating. The UK regime is one that may form an appropriate base to work with in Australia.

A more detailed response to the questions raised in the Board’s Discussion Paper will be provided in a subsequent submission.

Appendix A: Key tax considerations for CIVs in each jurisdiction

	Taxation of the fund			Withholding tax	Double tax agreements
	How would each of the fund vehicles in your jurisdiction be regarded for tax purposes?	What are the tax implications for a domestic fund domiciled in your jurisdiction, including annual reporting requirements?	What are the ongoing tax implications for a foreign fund being distributed into your jurisdiction?	What income withholding tax or capital gains withholding tax exposures arise on investments held in your jurisdiction?	To what extent can domestic funds benefit from double tax treaties?
Australia	Funds are not taxed at the fund level, but are instead regarded for tax as flow through entities (provided investors are entitled to all the income of the fund)	There is no tax at the fund level. Australian funds are required to lodge an annual tax return and also must report information to their investors annually so that they can complete their personal tax returns	Usually none	Australian funds are responsible for withholding tax on distributions to non-residents	Tax treaties exist but limitations may arise if the treaty requires beneficial ownership (due to the trust legal form)
China	Funds are free of capital income tax	Not applicable	Unclear	Minimal – as individual residents are free of capital gain tax, unclear for foreign investors	It is unclear whether funds would be able to access double tax agreements as funds do not pay domestic tax for their income arising from overseas investments
Hong Kong	All authorised funds are exempt for tax purposes	None	None if the foreign fund is an authorised fund in Hong Kong and there is no permanent establishment of the fund in Hong Kong	Generally none	Hong Kong has a growing number of Double Tax Treaties
India	A view can be taken that a Mutual fund registered with SEBI is exempt from tax.	Domestic entities are generally required to file an annual income tax return/wealth tax return. Other reporting requirements include withholding tax return, advance tax payments etc	Foreign funds cannot be directly distributed in India	No withholding tax on capital gains for resident and certain categories of foreign investors.	A domestic Mutual Fund could benefit from the treaty if it is regarded as resident under the relevant Double Taxation Avoidance Agreement

	Taxation of the fund			Withholding tax	Double tax agreements
	How would each of the fund vehicles in your jurisdiction be regarded for tax purposes?	What are the tax implications for a domestic fund domiciled in your jurisdiction, including annual reporting requirements?	What are the ongoing tax implications for a foreign fund being distributed into your jurisdiction?	What income withholding tax or capital gains withholding tax exposures arise on investments held in your jurisdiction?	To what extent can domestic funds benefit from double tax treaties?
Indonesia	Collective investment fund regarded as a corporation for tax purposes. These funds are subject to tax	There are monthly and annual tax reporting requirements	No Indonesian tax implication if the fund is not Indonesian tax resident	For investment in a Mutual Fund irrespective of the residency, there should be no tax. Other types of investment may be subject to withholding tax, eg listed share, bonds and savings	Domestic mutual funds can benefit from double tax treaties
Japan	Investment trusts are not subject to Japanese corporate tax if certain criteria are met	No tax reporting requirement for the investment trust itself if certain criteria are met. There are information sharing requirements for the withholding tax agents which require reporting of certain information to tax authorities annually	Generally foreign investment trusts are not subject to Japanese corporate tax. Foreign corporate funds are generally not subject to Japanese corporate tax (except certain Japan source income) provided that there is no permanent establishment in Japan	Foreign funds may be subject to withholding tax on interest or dividend , earned in Japan	CIVs should be eligible (although some technical uncertainty remains)
	Investment trusts are treated as opaque under Japanese tax law. Income is recognized by the beneficiary at the time when a profit distribution form the trust is made		There are no tax reporting requirements for the foreign fund itself; however, there are information sharing requirements for the withholding tax agent in Japan		
Korea	A qualified trust type fund is not a taxable entity and not subject to income tax (it is however subject to annual "license tax" of KRW 45,000 (approx. USD 40))	A qualified trust type fund is not subject to tax filing obligations. A corporate type fund is in principle subject to the normal corporate income tax filing	Unless a foreign fund has a permanent establishment ("PE") in Korea, it is not subject to any tax filing/reporting requirement. However, a local distributor of the fund is liable to deduct withholding tax at the time of remitting the profits from the foreign fund to the Korean individual investors and subject to the withholding tax filing requirement	Withholding tax applies	A reduced treaty rate on dividends/interest and exemption on capital gains may be available
	A corporate type fund is subject to the normal corporate income tax. However, a qualified fund is entitled to a dividend declaration deduction				

	Taxation of the fund			Withholding tax	Double tax agreements
	How would each of the fund vehicles in your jurisdiction be regarded for tax purposes?	What are the tax implications for a domestic fund domiciled in your jurisdiction, including annual reporting requirements?	What are the ongoing tax implications for a foreign fund being distributed into your jurisdiction?	What income withholding tax or capital gains withholding tax exposures arise on investments held in your jurisdiction?	To what extent can domestic funds benefit from double tax treaties?
Malaysia	Generally taxed as a company however tax exemptions apply for most of the investments made by a unit trust REITs can achieve tax transparency provided 90% of its current year chargeable income is distributed	Filing of tax returns and paying tax (if any) as a normal company	Foreign funds cannot be distributed directly into Malaysia unless approval has been obtained from the Securities Commission and are made through domestic licensed fund managers	A withholding tax mechanism operates for payments to investors depending on the class (i.e. individuals or foreign investors)	Tax treaties should be applicable
Singapore	Fund vehicles are generally exempt from tax provided they apply for the various tax incentives offered for certain types of investment income	Annual tax filing is required despite the fund being exempt from tax	None	Withholding tax will only apply in certain cases for non-exempt dividend income	Potential benefits, but not clear as of yet
Taiwan	The fund itself is not a tax assessable entity	No tax or reporting requirements for the fund	None for the fund itself, except with regards to withholding tax.	Generally, interest income from domestic bond investments is subject to withholding tax. Withholding tax rate for interest income is higher for offshore investors, and dividend income derived by offshore investors would be subject to income tax	Taiwan adopts a look-through approach for funds that seek to access tax treaty benefits. If the underlying investors are tax resident and beneficial owners of the underlying income, tax treaty benefit may apply
			The Fund is liable to withholding tax when it distributes assessable income to underlying investors (domestic funds rarely distribute income to underlying investors)	If offshore investor has a permanent establishment in Taiwan, capital gains from securities trading would be subject to Alternative Minimum Tax	
Thailand	Thai mutual fund established under the Securities law is not subject to tax	Thai mutual fund is not required to file tax returns	Foreign funds are not subject to tax in Thailand. No annual tax reporting is required	The foreign investor is subject to 15% withholding tax on capital gain. However the rate may be reduced or exempt by the virtue of certain double tax treaty agreement	The domestic funds established under the Securities Law is not tax entity so they will not be entitled to benefit from double tax treaties