HENRY DAVIS YORK
LAWYERS

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By email: taxboard@treasury.gov.au

The Board of Taxation
c/-The Treasury
Langton Crescent
CANBERRA ACT 2600

Dear Sir/Madam

Henry Davis York - Submission
Review of the Tax Arrangements Applying to Collective Investment Vehicles

We welcome the Board of Taxation's discussion paper titled *Review of the Tax Arrangements Applying to Collective Investment Vehicles*, issued on 17 December 2010 (**Discussion Paper**) and appreciate the opportunity to make our submissions on certain issues raised in the Discussion Paper.

In preparing our submissions, we have consulted with our clients in the funds management industry to ascertain the major impediments that they encounter in developing Australia as a leading regional financial centre. In light of our review and consultation process, we recommend that the following principles be adopted when developing a collective investment vehicle (**CIV**) and investment manager regime (**IMR**):

1. Develop a tax system that is simple, equitable and efficient. In so doing, the IMR regimes of other countries should be reviewed in order to extract their best features and develop a system that is globally competitive and understood.

2. Provide tax certainty for foreign investors investing into Australia. The lack of certainty has been consistently identified as a major barrier to doing business in Australia. Whilst some of these changes may require the introduction of concessions/exemptions, our experience, at least anecdotally is that this is unlikely to result in a net loss to revenue on the basis that currently offshore CIVs are simply avoiding Australia as a jurisdiction on account of the complexity involved.

3. Develop a range of appropriate CIV options which each benefit from flow-through tax treatment. Those CIV structures which have been successfully adopted overseas should be identified with a view to replicating the structures which are already well understood and accepted by international investors.

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In order to maximise the volume of funds managed by Australian fund managers and to ensure that Australia achieves a competitive advantage over its competitor countries, we strongly submit that the implementation of the IMR regime be a priority for the Government and that the implementation timetable be accelerated. Failure to address these issues will result in Australia being at a significant competitive disadvantage. We are currently seeing a growth of the financial services industry across the region and if we fail to create a competitive and easily understood regime at this time, Australia will miss out on the opportunity to build the commercial infrastructure needed to make us a viable long term financial services hub.

Our detailed submission is attached as Appendix A.

Should you have any questions, please do not hesitate to contact us.

Yours faithfully
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Appendix A

1 Investment Manager Regime

We welcome the changes announced by the Assistant Treasurer and Minister for Financial Services and Superannuation in the Media Release of 19 January 2011.

In addition to the changes announced in the Media Release, we recommend that the Government consider the following tax issues in designing the Investment Manager Regime (**IMR**):

1.1 The need for certainty

There must be tax certainty for foreign investors investing into Australia. In our discussions with clients, one of the key factors raised as being an impediment to investment in Australia by foreign clients is the lack of certainty around taxation outcomes. Our existing tax law, with its reliance on source, residency, the capital revenue distinction and complex trust taxation provisions mean that it is very difficult, if not impossible, to definitively determine taxation outcomes for foreign funds and investors. The resulting uncertainty, particularly in light of the US accounting standards (i.e. the former FIN 48) and the potential impact on returns to investors have meant that many foreign funds look to invest in or through neighbouring jurisdictions (often Singapore) whose tax regimes provide for a clearer exemption from tax for foreign funds.

As set out in the discussion paper it would seem that adopting a similar exemption based model would be appropriate and, in our view, supported by industry.

In order to make such a model work, in practice it would be necessary to ensure that eligibility requirements in order to enter the exemption system are clear and easily understood with reference to similar systems employed by competitor jurisdictions.

The feedback we have received is that unless a simple, broad based exemption model, similar to that available in Singapore, is introduced, Australia would increasingly find itself at a competitive disadvantage to neighbouring jurisdictions that have either introduced or are looking to introduce similar regimes.

1.2 Eligible investments

It is hoped that any proposed IMR will incorporate an exemption from Australian taxation for portfolio style investments of foreign investors made either directly or through foreign collective investment vehicles (**CIVs**). Further, it is hoped the exemption will be available regardless of whether the investment is on capital account (which would be exempt under the current law) or on revenue account.

We note that a similar exemption regime has recently been introduced with regards to managed investment trust (**MIT**) investments and can see no reason why a similar concession cannot be extended to cover foreign investors.

With regard to the types of assets that will be covered by the IMR, it is hoped that the range of eligible investments will be as broad as possible and or cover both direct investments and investments in Australian collective investment vehicles (local funds).

Financial markets are continually evolving and we are seeing an increased range of financial products and investment offerings. Trying to restrict the IMR regime to a closely defined group of assets (e.g. marketable securities only) may hinder innovation in this industry and leave Australia at a competitive disadvantage, particularly where such investment types are covered under competitor jurisdictions.

1.3 Supporting the local funds management industry

One of the key drivers for developing the IMR is to establish Australia as a financial services hub. This will include the establishment of a competitive domestic funds management industry. In order to ensure that this is the case it would be necessary for the IMR to allow foreign funds to engage the services of the local managers and agents without losing access to the exemption from Australian taxation that would otherwise be available for the foreign funds.

The IMR should also allow investments via local funds so as to ensure that gains on investments made by foreign funds into local funds are able to flow through the local funds to the foreign investors without being subject to tax or attribution.

By establishing an IMR that supports the local fund managers, we will grow the local funds management industry, with local managers being subject to ordinary Australian taxation. Australia's current transfer pricing rule should operate to ensure that fee income derived by local managers and agents are calculated on an arm's length basis and represent an appropriate return for the efforts and risks adopted.

It may be appropriate to consider whether minimum domestic spend, or safe harbour levels of returns are appropriate.

1.4 Clarification of eligibility

One of the main objectives of the IMR is to encourage the management of off-shore domiciled funds from Australia by Australian fund managers for non-residents. Consequently, the range of CIVs managed by the Australian fund managers is likely to be more diverse than those domiciled in Australia. In order to achieve this objective, the definition of CIVs used by non-resident investors should not be unduly restrictive or difficult to satisfy.

The definition of a foreign managed fund, as noted in the Media Release, will need to be reviewed. For example, the definition of a "widely held trust" for MIT purposes is cumbersome and onerous in its application. Further, the ongoing testing required in order to ensure that the definition is satisfied is likely to be difficult. Ideally such ongoing testing could be replaced by an initial hurdle test that, once satisfied, allows the fund to continue to be eligible.

2 Features of a Collective Investment Vehicle

2.1 The need for an internationally accepted range of CIV options

As recognised in the Discussion Paper, there are fundamental difficulties associated with the lack of familiarity among non-resident investors and fund managers with the trust structure. This lack of familiarity is in our experience a significant hurdle both for non-resident investors who are examining Australian investment opportunities as well as foreign fund-managers who are looking to

access Australian-domiciled investors. There is therefore a clear need to make available a wider range of CIVs to address this lack of familiarity with the unit trust.

The feedback we have received is that we need to take an industry-led approach to making available appropriate CIV options. In this regard, we see merit in looking at structures which are already accepted and understood internationally (eg. the Cayman Islands exempted companies and limited liability partnerships) and assessing the benefits of replicating those structures domestically. In implementing a broader range of CIV options, we need to be sensitive to the risk that 'best practice' structures may change over time and so the regime built around them would need to be flexible to accommodate different CIVs being developed in the future. The manner in which we define a CIV therefore becomes critical.

2.2 CIVs need to be clearly defined

We support the need for parameters by which CIVs are to be defined in order to distinguish between passive investment and trading style activities on the one hand and the operation of a trading business on the other. We note the 'widely held' and 'eligible investment' concepts identified in the Discussion Paper. However, we also note the inherent difficulties with applying these tests. For example, 'widely held' requirements are challenging in the case of start-up investment funds, which do not qualify until a sufficient number of investors are attracted. We also note the difficulties with industry-focussed exclusions from the CIV definition, such as hedge funds. We submit that such exclusions should not be adopted unless merited from the point of view of distinguishing a trading business which is accumulating income.

The feedback we have received on the current formulations of the 'widely held' and 'eligible investment' (i.e. passive investment) criteria (under, respectively, the ITAA 1997 and ITAA 1936) revolve around the ease by which the tests can be applied. We submit that the tests used to decide whether a vehicle is to be a CIV must be transparent and easily determined. In common with some of the broader themes in this submission, international investors require certainty around the investment vehicles that they establish. Definitions which involve complex or subjective assessments will potentially perpetuate existing uncertainty among international investors and fund managers.

2.3 Developing a common platform

We submit that it would not be an effective approach for CIVs to be developed exclusively for non-resident investors both from the perspective of the risk of 'round-tripping' by Australian residents and also in the interests of equity for domestic investors. We have the opportunity now to create a universal solution for both domestic and off-shore capital. We acknowledge that there will be inevitable legislative change in order to implement certain CIV options. For example, if we are to reframe the statutory regime applying to companies, it will be necessary to amend the aspects of the Corporations Act that deal with share redemption and cancellation in order to facilitate more seamless inward and outward flows of investment from and to shareholders. The timeline for these changes may necessarily be longer than those which will need to be considered for the IMR. However, in light of the industry and macro economic benefits, including employment and service provider opportunities, which could be generated by a broader based Australian-domiciled CIV industry, we submit it is worth tackling these technical challenges.