

Received

24 FEB 2011

Board of Taxation

20 Netherlee Street,  
Glen Iris,  
VIC 3146

21 February 2011

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

Received

24 FEB 2011

Board of Taxation

Dear Sir/Madam

**Review of Tax Arrangements Applying to Collective Investment Vehicles – Discussion Paper**

I am writing in a personal capacity in response to the above Discussion Paper, and in particular in response to a question as to whether or not the LIC structure may be useful for off-shore investors.

The current LIC regime is one that works well for LICs that invest for the long-term predominantly in Australian companies for Australian shareholders. They provide reliable income for many retirees and are a cheap entry point for many retail investors into the Australian share market.

The legislation should not be amended in its current form with the exception of giving deemed capital treatment to LICs to minimise the risk that they are seen as 'less desirable' as investment vehicles to the above target audience.

There is, however, an opportunity for an LIC-type regime to be introduced which may meet some of the concerns noted in the Discussion Paper. This separate LIC regime would be suitable for both non-resident and possibly resident retail investors in non-Australian assets who nonetheless would prefer to have their investment primarily in a company that is Australian resident and subject to Australian corporate law and listing regulations.

For an offshore retail investor, investing in a structure that is similar to an Australian LIC would provide:

- a) visibility of their investment on a recognised and well-regarded Securities Exchange
- b) liquidity of their investment
- c) the entity being subject to Australian corporate governance requirements including auditing, accounting standards and continuous disclosure requirements

It would also be important that such a vehicle is NOT 'flow-through' or fully attributable – this would distinguish the LICs from current CIVs and enable the Board of the LIC to determine distributions in the same manner as other corporate entities, thus enabling gains to be either re-invested or distributed, depending on the objectives of the company, and which would also enable distributions to be maintained through the utilisation of reserves, as is currently the case with LICs.

Having regard to Australia's current tax framework there are a number of areas of law which have recently been introduced to make Australia a more competitive place for both international inbound and outbound investment. For example the current framework provides concessions with respect to the taxation of:

- a) Dividends (for example, Section 23AJ and conduit foreign income rules);
- b) Capital Gains for both inbound foreign investors into Australian and outbound foreign investment; and
- c) Branches (for example, Section 23AH).

These regimes have reduced the taxation burdens of investing into and out of Australia. An effective LIC regime for foreign residents should seek to draw on these frameworks, which have largely been put

into place for non-portfolio investments (i.e. over 10% ownership), and extend the principle that non-Australian sourced revenue should not be subject to tax at the corporate vehicle level which happens to be resident in Australia but in the hands of the investor, to portfolio interests as well.

An LIC environment could be considered where the current concessions available are extended to achieve the objective of the non-resident LIC regime. For example, a non-resident LIC regime (i.e. an LIC that invests predominantly in non-resident companies/investments) that meets certain prescribed conditions should be entitled to an exemption from taxation on dividends received from a foreign company, notwithstanding that it would probably not hold a non-portfolio interest. (In the event such a dividend was paid onto an Australian investor in the non-resident LIC then the amount would be unfranked and taxable at the Australian resident's marginal tax rate. Where it was paid to a non-resident shareholder consideration needs to be given to whether withholding tax should be applied.)

In order for such an alternative regime to work, the characteristics of these new LICs could include:

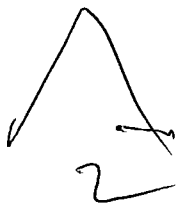
- a) Investments only in non-Australian assets with any Australian sourced income received from those assets being subject to taxation at the corporate level
- b) Non-Australian sourced income and capital gains not to be subject to any Australian tax
- c) Requirement for the non-resident LIC to be widely held (e.g. no shareholding of more than 10%) to prevent off-shore investors using the LIC as controlled entity to accumulate income free of tax.
- d) Availability of capital election
- e) Dividends paid by the company to be notified to investors as between those sourced from income and those sourced from capital gains
- f) Any withholding tax suffered by the company to be allocated/notified to shareholders with any final dividend, in proportion to their shareholding. It should be up to the Company to determine whether income being distributed is from sources which have been subject to WHT.
- g) Resident investors would therefore be taxed on the income that they receive as potentially income and capital. The Company will need to note on the distribution statement what % of the gain paid out was from securities that have been held for greater than 1 year.
- h) The LIC may need to charge either a fee (similar to the arm's length fee discussed in Chapter 5 on the Investment Manager Regime) or for all expenses incurred in the running of the company to be charged to profit. It is likely that this will be set off against the income that the company derives rather than the capital gain.

The question remains as to whether these vehicles would be attractive to larger institutional overseas investors but they may be popular with those who service the retail market and lack the size or expertise to manage off-shore investments themselves.

Similar vehicles might also be considered for off-shore investors to invest into Australia but the risk would be run that current resident investors may set themselves up with non-resident vehicles to access a 'gross' investment leading to delays or reduction in revenue for the ATO.

I would be happy to discuss these views with you in more detail should you have any questions.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Andrew J. B. Porter'. The signature is stylized, with a large 'A' and 'P' and a cursive 'B'. There are some additional scribbles below the main signature.

Andrew J. B. Porter