



AIMA AUSTRALIA

SUBMISSION TO THE BOARD OF TAXATION

**REVIEW OF TAX ARRANGEMENTS APPLYING TO
COLLECTIVE INVESTMENT VEHICLES
DISCUSSION PAPER**

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**A submission prepared by the Regulatory Committee
of the Alternative Investment Management Association
Australia Chapter**

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Background on AIMA Australia

The Alternative Investment Management Association (**AIMA**) was established in 1990 as a direct result of the growing importance of alternative investments in global investment management. It is a not-for-profit educational and research body that specifically represents practitioners in hedge funds, futures funds and currency fund management - whether managing money or providing a service such as prime brokerage, administration, legal or accounting advice. AIMA's global membership is in excess of 1200 corporate members, comprising 5000+ individuals in 46 countries.

The Australia network of AIMA Australia (**AIMA Australia**) represents participants in alternative investments in Australia. AIMA Australia has over 60 members, including fund of funds managers, institutional investors, hedge fund managers, prime brokers, lawyers, auditors and other service providers.

1. Summary:

Globally, AIMA is strongly supportive of the Government's goal to develop Australia into a financial services hub. Our submission covers the high level principles we consider are important to achieving this objective.

AIMA considers the immediate opportunity for growth of the industry is managing more non-resident assets in predominately offshore fund vehicles. There are a large number of international investors who are experienced in investing in alternative investment strategies and have a demonstrated preference for investing via well established and familiar global fund structures (e.g. Cayman Islands mutual funds). Current barriers regarding tax uncertainty and lack of familiarity with Australian fund structures (e.g. Australian Unit Trusts) is a significant impediment to raising assets from these investors. Removing the current tax uncertainty and the implementation of an effective IMR that accommodates funds structures that already work well for offshore investors is critical to achieving this growth.

In addition, AIMA believes it is important to put in place a framework to encourage fund managers to domicile and administer funds within Australia. Such fund structures will take longer to become known and accepted with offshore investors. However, over time they can play an important role for select investors (e.g. those marketing such funds to retail end investors) who will prefer to invest via an onshore structure.

Whether offshore investors ultimately choose to invest in offshore funds or locally domiciled funds, provided the funds are managed by locally established fund managers there will be significant benefits to the Australian economy. These benefits will include attracting fund managers to establish businesses in Australia resulting in revenue gains from the taxation of those businesses and making it more attractive for foreign capital to invest in Australia. This will create new jobs for Australian residents not only in the funds industry but also in the support services sectors including administration services, legal, tax, accounting and technology sectors.

2. Investment Manager regime

AIMA welcomes the recent announcements by the Assistant Treasurer and Minister for Financial Services and 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 positive development which provides certainty in respect of the income tax treatment of investment income of foreign funds for prior tax years. It is important that this certainty is provided for the existing tax year (and future years) as soon as possible.

To be effective, we consider that the design of an IMR should address the following issues:

- It must be competitive with other jurisdictions and provide certainty without complexity. For example, the definition of a "widely held trust" for MIT purposes is cumbersome and onerous in its application. Further, the on-going testing required in order to ensure that the definition is satisfied provides too much uncertainty.
- If the intention is to encourage the use of Australian investment managers, then the regime should apply widely and consistently to include hedge funds and other foreign collective investment vehicles and the definition should not be a significant hurdle to overcome. Any limitation of what is a foreign managed fund will benefit offshore managers as it will make the use of Australian managers less attractive.
- AIMA is particularly concerned about the requirement that the foreign fund meet a widely held test. Many AIMA members are boutique start up fund managers marketing to smaller investors. If a foreign fund does not meet a widely held test, then it will put Australian managers at a disadvantage to offshore managers because of the resultant tax treatment of using an Australian manager. We consider the test should be more qualitative around ensuring the foreign fund is publicly offered rather than imposing a quantitative test which provides more uncertainty around whether a fund qualifies and the consequences of no longer qualifying.
- The IMR must accommodate what is familiar and already working for non-resident investors. Australian managers should be able to be appointed as managers of offshore funds on the same terms as offshore based managers. Many Australian hedge fund managers are engaged to manage funds under a Cayman or British Virgin Island jurisdiction. A lot of expense and time is used in structuring to avoid central management and control and permanent establishment issues for the foreign funds.
- Consideration needs to be given to an exemption for Australian assets that form part of an offshore portfolio. Many managers manage an Asian focused strategy and Australian assets can comprise up to 50% of a portfolio. We note that if the investment focus is Asia-Pacific excluding Japan then Australia is often 30-50% of the portfolio (although this is likely to fall over time as emerging Asian investment markets grow in size).

3. **Collective Investment Vehicles**

The unique structural requirements of Australia's regulatory regime effectively only allowing the use of unit trusts put Australian fund managers at a disadvantage. The disadvantage is due to foreign investors' lack of familiarity with this structure as it is not used globally. Many Australian hedge fund managers establish offshore funds, structured as corporate vehicles, to service non-resident investors because these investors are not familiar with our trust structure. Accordingly, there should be flexibility to establish other Australian domiciled vehicles that accommodate these non-resident investors. These should include body corporate and limited partnerships and have the flexibility to include other future structures that are developed, such as UCITs.

To be effective, we consider that a CIV regime should contain the following features:

- Ability of different legal entities to elect to be CIVs.
- The different CIVs structures should be tax neutral.
- Managers should not be required to establish mirror vehicles for Australian resident and non-resident investors.
- The new regime should have a specific designation that can be easily incorporated into future Double Tax Agreement negotiations.

Timing

As mentioned above, Australian managers manage a very small proportion of non resident monies. This will not change until the current tax uncertainty is addressed. In many instances, Australian investors do not progress past the due diligence stage because of the tax uncertainty. The recent government announcements have assisted. However, immediate action is required to address the future position to assist Australian fund managers to attract offshore capital to manage.

In addition, there are many offshore managers interested in setting up operations in Australia. However, the longer it takes to implement the IMR regime in Australia, the more likely offshore managers will choose to set up in other jurisdictions.

We consider a longer term goal is to put in place a framework to encourage the establishment of Australian domiciled funds. This goal is one that will bring significant benefits to the Australian economy including attracting fund managers to establish businesses in Australia resulting in revenue gains from the taxation of those businesses.

Contact points

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