02 December 2016

Division Head
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600
BY EMAIL: CIVwithholdingtax@treasury.gov.au

Dear Division Head

RE: Consultation Paper on Collective investment vehicle non-resident withholding taxes

The Financial Services Council (**FSC**) welcomes the opportunity to provide feedback to the Treasury Consultation Paper on collective investment vehicle non-resident withholding taxes.

The FSC has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than $2.7 trillion on behalf of 13 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world. The Financial Services Council promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

The consultation paper is an important step towards ensuring the competitiveness of Australian funds internationally. Along with the Government's commitment to introduce new internationally recognised collective investment vehicles and the incoming Asia Region Funds Passport, reform of our complex withholding tax regime is part of a package of measures which will send a clear message to the global market place that Australia is open for business. Collectively these measures have the power to provide significant economic benefits to Australia and will drive growth in exports of our funds management products and expertise.

Research by Deloitte Access Economics for the FSC found that if Australia could grow overseas-sourced funds under management equal to that of Hong Kong over the next decade, our GDP would grow by more than $4.2 billion, tax revenue would increase by $1.2 billion and nearly 10,000 jobs would be created.

Australia's complex and uncompetitive withholding tax regime was identified as a barrier to exporting our financial services expertise overseas by Mark Johnson AO seven years ago.

The FSC has long called for reform, so we welcome this latest step and urge the Government to keep going until the job is done.

Please find attached our submission, which highlights our recommendations as to how these reforms could make Australia a global leader in funds management for overseas investors.

Please contact me with any questions in relation to this submission on (02) 9299 3022.

Yours sincerely,

SPYRIDON PREMETIS
Senior Policy Manager
Tax and Economics

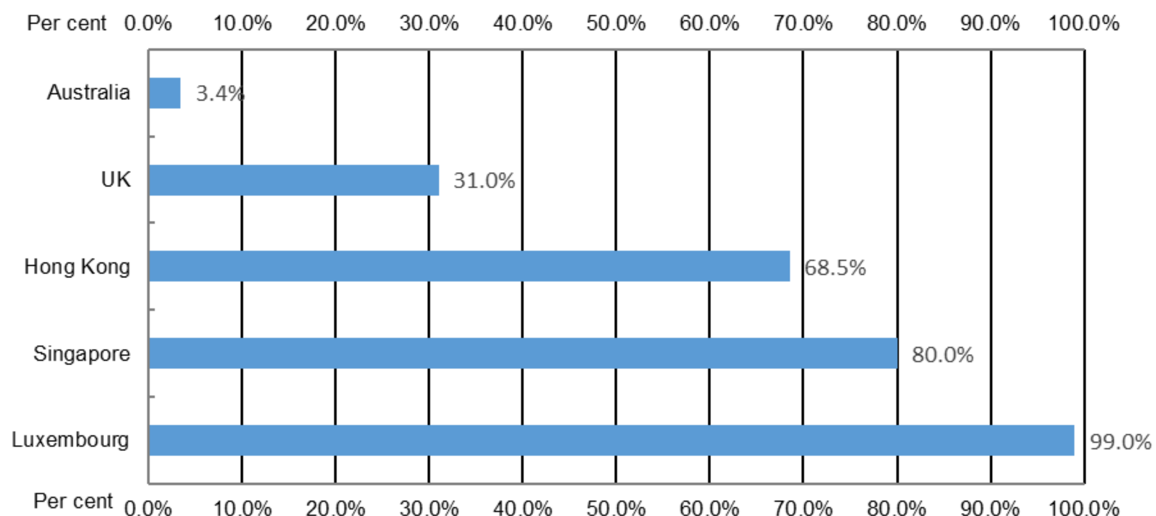
Executive Summary

The 2009 Johnson Review noted:

> *"Australia has arguably the most efficient and competitive full service financial sector in the Asia-Pacific region. It is strong, well-regulated and highly regarded around the world."*
>
> *"Yet our exports and imports of financial services are low by international standards. Our funds management sector, one of the largest and most sophisticated in the world, manages only a small volume of funds sourced from offshore. Withholding tax settings contribute to this lack of international competitiveness. "*

These observations remain true today. Australia only sources 3.4% of its total funds management industry from offshore funds.

Funds under management forced offshore



Source: FSC Cross Board Flows Report 2015, Monetary Authority of Singapore 2015, Hong Kong Securities and Futures Commission 2015, Investment Management Association 2015, and FSC Estimates

The current state of Australia's withholding tax rates will not be marketable in the competitive environment that the Asia Region Funds Passport (ARFP) seeks to create. Furthermore, current non-resident withholding tax arrangements are not marketable in any ARFP jurisdiction and are not globally competitive or congruent with Australia's aspirations of becoming a global financial centre and exporting fund management services to the rest of the world and in particular Asia.

At a high level we believe complexity of Australia's non-resident withholding tax regime is a function of there being: multiple rates; complexity and difficulty of determining appropriate rate; no overarching consistent principle of application; and relatively more simplistic approaches in competitor jurisdictions, by that we mean a zero withholding tax rate.

A withholding tax of zero on AFRP eligible products would have no revenue impact as there are no fund managers based in Australia currently servicing ARFP jurisdictions in the retail client space.

Reputation, timing and policy execution matter. Prospective measures, which include the current set of proposals in this consultation and efforts to design new tax and regulatory arrangements for Corporate Collective Investment Vehicles in time for the ARFP must be delivered on time, in a commercially effective and internationally competitive manner, and in a way that enhances Australia's reputation as a global financial centre. Frankly, missteps at this critical juncture could undermine our aspirations permanently and lead to deterioration of our domestic funds management industry.

Competitive threats are real. Over time, Singaporean domiciled funds could grow to a point where economies of scale come into play. This may result in a greater number of fund managers choosing to service Australian investors through their Singaporean domiciled funds, rather than Australian domiciled funds.

International competitiveness needs to be considered with respect to our aspirations to be a regional, if not global financial centre. A rate of zero makes more sense if Australia is to truly compete rather than merely catch-up.

However, we recommend that a rate of zero only be applied to ARFP products, and that a rate of 7.5% be applied to non ARFP products - both of which should be done in a way that excludes Australian source real property income.

The revenue costs to this reform are insubstantial, while the economic benefits could be substantial. Australia only collected $5.7m of non-resident withholding taxes from fixed trust according to ATO statistics in 2013-14. Using conservative assumptions, we estimate that for every $1 billion in additional funds under management sourced from offshore investors, corporate tax receipts alone would increase by $1.8m, suggesting we would only need to attract an additional $3.2 billion in offshore funds under management globally from a $US 71.4 trillion dollar industry (A$ 94.9 trillion)[1].

Research by Deloitte Access Economics for the FSC found that if Australia could grow overseas-sourced funds under management equal to that of Hong Kong over the next decade, our GDP would grow by more than $4.2 billion, tax revenue would increase by $1.2 billion and nearly 10,000 jobs would be created.

[1] http://www.agefi.fr/sites/agefi.fr/files/fichiers/2016/07/bcg-doubling-down-on-data-july-2016_tcm80-2113701.pdf

1. Introduction

Previous analysis by the FSC of Australia's current withholding tax settings suggested that:

- Australia's headline rates are high;
- Australia's actual taxation rates are significantly lower than the headline rates, where taxation treaties exist;
- Taxable Australian real property is the main focus of taxation, through the Managed Investment Trust fund payment withholding tax and the proposed foreign resident capital gains withholding tax;
- Fully franked dividends are not taxed; and
- Exemptions exist for gains from 'portfolio' holdings of Australian assets (e.g. holdings of less than 10%), and for certain fixed interest securities.

Two broad observations arise from this analysis:

1. Australia's headline taxation rates do not reflect the actual rates of taxation;
2. Not all Australian sourced income received by foreign investors is taxed.

The FSC submits that the current state of Australia's withholding tax rates will not be marketable in the competitive environment that the Asia Region Funds Passport (ARFP) seeks to create. Furthermore, we submit that these arrangements are not marketable in any ARFP jurisdiction and are not globally competitive or congruent with Australia's aspirations of becoming a global financial centre and exporting fund management services to the rest of the world and in particular Asia.

The ARFP is focussed on retail clients. It will be necessary for foreign investors located other Passport jurisdictions to receive simple and clear tax advice regarding the consequences of investing in an Australian Passport fund.

It is hard to see how this can be achieved in the current environment.

From a tax perspective, any investment fund structure should meet two key criteria.

First, it should be tax neutral, i.e. as an investment fund essentially operates as a pooling vehicle it should not expose investors to more burdensome taxation than if they were to invest directly.

Second, it should provide certainty of taxation, i.e. it should be possible to determine the tax consequences at every level, from income from investments to the distributions to investors.

Generally, tax neutrality of a fund structure means the following:

- no taxation at the level of the fund itself; and
- no taxes on distributions from the fund to its investors in the location of the fund.

2. FSC's preferred position

The FSC proposed that the ARFP should have a flat and simple non-resident withholding tax rate for Australian sourced income. Since our original proposal, industry participants have raised concerns that competitive threats will undermine the benefits of the passport regime in Australia, the most notable being the disparate headline withholding tax rates in Australia relative to those of key investment fund jurisdictions with established passport regimes such as Singapore and Hong Kong.

A rate of zero makes more sense if Australia is to truly compete rather than merely catch-up.

The ARFP regime presents a significant opportunity for Australian funds to access new foreign capital in an ultra-competitive environment so we believe that a bolder response is required.

Recommendation 1: At a minimum, the non-resident withholding rate should be set to zero for all eligible Asian Region Fund Passport products.

These products are only available for retail clients, and Australia currently earns no non-resident withholding tax revenue from ARFP jurisdictions with respect to transferable security investments such as bonds and equities, as it is currently not possible to market to retail customers. To not provide a zero rate would place Australian domiciled fund managers at a significant disadvantage and, over time, allow international competitors to erode the scale advantages our domestic industry currently holds relative to other ARFP participating countries.

Recommendation 2: In conjunction with recommendation 1, where a nil withholding tax rate is currently applied to Australian source income this should be maintained, and for Australian source income where a rate does apply (excluding taxable Australian real property) a flat withholding tax rate of 7.5% should be applied.

We see merit in further simplifying withholding tax arrangements proposed in recommendation 1 to all MITs and CIVs regardless of the location of the non-resident, with an appropriate exclusion for real Australian property income. Given that Australia only raises $5.7 million in non-resident withholding tax revenue from fixed trusts we believe the budget impact would be immaterial. However, if concerns or arguments could be made that there would be a substitution impact of existing non-resident non real asset investments (of which we see no possibility if the rules are drafted appropriately), then we would proposed a flat rate for all MITs (excluding Australian source real property) of 7.5% per cent.

This rate would reverse withholding tax rates for Australian source income, excluding property income, to the rate previously in place in 2012.

Recommendation 3: The Government commit to reduce the flat withholding tax rate of 7.5% introduced in recommendation 2 over time towards an internationally competitive rate for a financial services centre.

Recommendation 4: For Recommendation 1 and 2 it would be quite simple to stop the application of Division 11A and instead have all amounts that would otherwise be subject to withholding subject to one rate prescribed in a new part of subdivision 12H.

3. FSC views on Treasury's Policy Consideration Framework Presented in Appendix D

International approach to taxing non-residents

The appropriate context for these reforms needs to be understood in order for policy makers to provide appropriate advice.

There is an inconsistency of description between what the consultation paper describes as "international approach to taxing non-residents" and "International competitiveness". This is because the consultation paper suggests that jurisdictions 'typically' tax non-residents on domestic source income. However, this is not the case for all jurisdictions, and in particular is not the case for jurisdictions that are seeking to operate as financial services centres. The appropriate and relevant international approach to taxing non-residents in financial centres is the right context, specifically Singapore, Luxembourg, Hong Kong, the UK and Ireland.

Furthermore, a forward looking approach is required. We do not live in a static world. Policy makers should set tax policy in this space in anticipation of where they believe the international approach to taxing non-residents in financial centres is heading. There is clear evidence to suggest it is a rate much closer to nil than current policy settings.

Government policy has highlighted that this criteria should be viewed in the context of Australia's ambition of becoming a regional, if not global financial centre. For example, the Financial System Inquiry Final Report noted:

> *"Tax impediments to the free flow of capital add to the cost of doing business in Australia. They limit the capacity for Australia's financial system to exploit new and developing product areas".*[2]

Fiscal considerations

The FSC acutely understands the fiscal context Australia faces.

However, we would argue that fiscal considerations in a pure budget accounting sense are not an appropriate policy metric. Policy should always be considered on a cost versus benefit basis. It would be disingenuous to reject welfare enhancing policies with net benefits to the Australian people because of accounting conventions used in the budget.

This interpretation has implications for how we assess the impact of a policy on the fiscal outlook as well. Policies that have upfront revenue or expenditure costs, but longer term revenue or expenditure gains would always be rejected under a decision rule that mandates a policy only be approved if it leads to a revenue gain or an expenditure saving over the estimates period. This is because the revenue or expenditure costs would be captured in the estimates period, no offsetting revenue or expenditure gains would be considered if they are considered 'second round', nor would any timing difference between costs and gains outside the four year estimates period be considered.

The benefits that could be unlocked from adjusting the non-resident withholding tax regime for passive investments clearly outweighs the costs. In particular, Australia only collected $5.7m of

[2] Financial System Inquiry – Final Report, (2014), page 21

non-resident withholding taxes from fixed trust according to ATO statistics in 2013-14. Using conservative assumptions, we estimate that for every $1 billion in additional funds under management sourced from offshore investors, corporate tax receipts alone would increase by $1.8m, suggesting we would only need to attract an additional $3.2 billion in offshore funds under management globally from a $US 71.4 trillion dollar industry (A$ 94.9 trillion)[3].

International competitiveness

International competitiveness needs to be considered with respect to our aspirations to be a regional, if not global financial centre.

The 2009 Johnson Review noted:

> *"Australia has arguably the most efficient and competitive full service financial sector in the Asia-Pacific region. It is strong, well-regulated and highly regarded around the world."*
>
> *"Yet our exports and imports of financial services are low by international standards. Our funds management sector, one of the largest and most sophisticated in the world, manages only a small volume of funds sourced from offshore. Withholding tax settings contribute to this lack of international competitiveness. "*[4]

These observations remain true today.

Treasurer Scott Morrison has consistently noted a pragmatic and sensible approach to budget considerations with respect to international competitiveness, noting on several occasions:

> *"In the 45th parliament, it's about getting things done, and you've heard me say often and the Prime Minister, that 80 per cent of something is better than 100 per cent of nothing"*

If withholding taxes are not set at a competitive rate which is determined in the appropriate international context, Australia will receive 100% of nothing, and miss out on revenue, jobs and growth of our asset management industry.

Simplicity

We believe simplicity needs to be considered in an appropriate context. A single rate would be simpler. However, a single rate at an uncompetitive rate would yield no advantage.

For retail investors in foreign jurisdictions, where they may be unable to get access to advice on foreign tax jurisdictions, simplicity in rate is essential. However, it needs to be the right rate – an internationally competitive rate.

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[3] http://www.agefi.fr/sites/agefi.fr/files/fichiers/2016/07/bcg-doubling-down-on-data-july-2016_tcm80-2113701.pdf

[4] http://www.theaustralian.com.au/national-affairs/politicsnow-live-from-canberra-senate-house-of-reps/news-story/599b37d0b304e32fb2ba6d243c9564a8

4. Responses to specific questions

1. To what extent do you expect growth in funds and the funds management sector to come from:

1.1. Increased investments by non-residents in foreign assets (conduit investments); and

1.2. increased investments by non-residents in Australian assets?

If we don't fix issues for Australian assets we will be unlikely to gain any traction internationally as a global fund manager.

While there are intuitive arguments to suggest that over time we would manage more global assets if Australia is an economy with a comparative advantage with respect to funds management services, such as their proportionately being more global assets than Australian assets to manage in the world, there are practical reasons why this may not occur immediately.

First, current withholding tax arrangements and other policy settings with respect to non-residents have in fact acted as a barrier to both conduit and non-conduit investments because of the poor reputation these settings have given Australia in an international setting as a viable financial services centre.

For example, early efforts to implement Investment Manager Regime (IMR), which was originally proposed by the Johnson Report over 6 years ago, led to serious confusion, uncertainty and ultimately an unworkable regime, which required a series of amendments and the final tranche of reform last year to appropriately implement this policy initiative. Practically, this uncertainty has been exploited by Australia's trade adversaries to dissuade foreign investors from utilising Australian based investment managers. A further complication is that despite improvements to the IMR being legislated last year there is little evidence foreign investors are aware of the improvements to the regime.

A second example of Australia's poor reputation with respect to certainty of policy setting that would promote a stable business environment free of political risk and uncertainty in this space relates to the 2012 increase in the Managed Investment Trust Withholding Tax Rate (MIT WHT) in 2012 from 7.5% to 15%. This damaged Australia's reputation as a competitive funds management centre with tax certainty for foreign investors. The goodwill, momentum and reputation built when MIT WHT was decreased from 30% to 7.5% was lost. Furthermore, we do not believe the measure raised anywhere near the proposed additional $260 million in tax receipts from MIT's from our members that were projected in the Budget's forward estimates.

Second, we note that it is traditional that many export industries evolve first with a focus on domestic markets, and that these goods or services then spill over or expand into international markets once a clear comparative advantage is established. In a funds management context we believe this means foreign investors are more likely to buy Australian based fund management services for Australian asset classes, and once the quality of these services are established for Australian asset classes there will be a natural expansion into foreign assets. However, this view is dependent on fixing withholding tax arrangements that act as a barrier to non-residents purchasing Australian assets via an Australian fund manager.

2. What is the likely impact of past and announced initiatives on attracting inbound investment?

Reputation, timing and policy execution matter. Prospective measures, which include the current set of proposals in this consultation and efforts to design new tax and regulatory arrangements for Corporate Collective Investment Vehicles in time for the ARFP must be delivered on time, in a commercially effective and internationally competitive manner, and in a way that enhances Australia's reputation as a global financial centre. Frankly, missteps at this critical juncture could undermine our aspirations permanently and lead to deterioration of our domestic funds management industry.

Previous initiatives are not being considered in their appropriate historical and international context. A linear representation of policy changes as presented in Appendix B, while technically correct, gives a false sense of progress.

First, as noted in question 1 (with respect to the IMR and MIT WHT Rate changes), we believe there have been significant policy lags with respect to the implementation of recommendations of previous reviews which have ultimately damaged Australia's reputation as a financial centre, removed certainty for foreign investors, and undermined the policy intent and aspirations of successive Governments.

While we are supportive of current announcements and initiatives, previous attempts have not delivered the full impact expected, so there is some scepticisms internationally as to whether announced changes will be implemented in an effective manner. This likely means that any announcement effect is unlikely. For example, Ken Woo, Sydney based tax Partner at PricewaterhouseCoopers has noted:

> *"Australia is known for making progressive announcements that can take quite a long time to implement".*

Second, we note that many of the relevant initiatives with respect to promoting fund management services were reactive, rather than proactive, and represented Australia seeking to catch up with its competitors rather than get ahead. However, KPMG has noted that with respect to setting non-resident withholding tax rates to zero for ARFP products:

> *"If the rate of WHT on distributions from participating MITs was reduced to nil, this would not only align the taxation of distributions with that of UCITS funds but would result in a lower overall effective tax rate on distributions, providing our funds with a competitive advantage over UCITS funds and potentially a real "game changer for Australia".*

Furthermore, these efforts were stifled by significant policy implementation lags, in particular in many cases the time to legislate has taken too long.

For example, in the 2003 Review of International Tax Arrangements noted IFSA's (the FSC's predecessor) evidence with respect to how other jurisdictions were winning international business due to more favourable withholding tax arrangements in other jurisdictions:

> *"IFSA Case Study 3*
> *A New Zealand fund manager won a contract to manage an international portfolio of approximately A$500 million for a large institution. The obvious choice to perform the*

asset management role was its Australian associate where there is significant capability. However, for various tax reasons, it was decided that the services were better performed out of Europe. As a consequence, Australia lost out on significant amount of management fees that could have been generated. The key tax issues were:

- *the 10 per cent threshold would have been exceeded giving rise to CGT consequences that the client was not willing to accept; and*
- *there was a significant risk that given the presence of the asset manager in Australia, the gains arising on the sale of the international assets would give rise to an Australian sourced gain which would be subject to Section 98(3) and (4) withholding.*

The IFSA reported that rates of withholding are punitive and not internationally competitive. Non-residents seek to invest through other jurisdictions, where they are tax exempt or do not have to chase tax credits it stated. A significant proportion of international investments of the New Zealand managed investment industry is undertaken through the use of open-ended investment companies in the United Kingdom, rather than through Australia for this reason, it noted.

According to an IFSA survey, income other than capital gains distributed from non-property trusts is estimated by the IFSA to be less than 3 per cent of the total section 98(3) and (4) of the 1936 Act withholding payments annually. Of the total annual collection of A$14 million, this translates to A$420,000 per annum, noted the IFSA."[5]

Over a decade later, industry concerns are yet to be address.

Policy in this space needs to be set with a forward looking mindset. We are not in a static world.

Box 1 – Competitive threat: Singapore

Singapore is strategically located in the heart of Asia, and offers financial institutions excellent infrastructure, a highly skilled and cosmopolitan labour force, and access to investors. The Singapore government makes continual efforts to develop the fund management industry by providing a stable economic and political environment that is conducive to business operations.

Qualifying funds managed by Singapore-based fund managers are exempt from tax on "specified income" from "designated investments". Qualifying funds also enjoy withholding tax exemption. Designated investments include stocks, shares, securities, derivatives etc. Qualifying funds can be either Singapore resident or offshore. Resident funds (section 13R) have access to tax treaties. There is also a tax incentive for fund managers, which are taxable at 10% instead of the general corporate income tax rate of 17%.[6]

These factors make Singapore the choice location for setting up fund management operations focused on investments in Asia, particularly India and Southeast Asia.

[5] http://taxboard.gov.au/files/2015/07/international_taxation_arrangements_report_volume_2.pdf
[6] http://www.kpmg.com/SG/en/IssuesAndInsights/tax/taxalert-201414.pdf

Singapore places great emphasis on its attractiveness as a financial centre. Currently Singapore represents the greatest threat to Australia's success in the Passport regime for a number of reasons:

- Foreign investors are not charged withholding tax on investments into Singaporean based funds. Whilst investors will be taxed by their home jurisdiction on income, the impact on returns of tax leakage at the fund level is a significant consideration for fund managers when designing products. Tax leakage at the fund level effectively means that the fund's performance is lower when comparisons are made with funds that do not experience this tax leakage;
- A new open-ended investment company (OEIC) is being developed to encourage more funds to be domiciled in Singapore ; and
- Incentives are offered to financial services businesses to set up operations in Singapore.

Further, Singapore has withheld its signature from the Passport Memorandum of Cooperation until 'tax issues' are resolved. It is the FSC's understanding that the particular tax issues Singapore is concerned with relate to equal treatment for Singaporean funds investing into Australian assets, as compared to Australian funds investing into Australian assets (i.e. tax issues at the fund level, not the investor level). If these tax issues are resolved in Singapore's favour they will further enhance the country's strong competitive position as a natural location for Passport funds to be domiciled.

From a tactical perspective, we expect it is highly likely that Singapore will re-join the Passport once these fund level tax issues are resolved and its new domestic OEIC structure is finalised. If Australia's withholding tax position is not clear (and our Corporate CIV is not finalised) by this point we expect fund managers will choose to locate their Passport operations in Singapore, in preference to Australia. This means the flow-on benefits and economic activity associated with supporting new investment vehicles will be lost.

We further expect Singapore to emphasise that its effective tax rate is 0, and to potentially seek to offer further subsidies to capture market share.

Over time, as Singaporean domiciled funds grow and economies of scale come into play, it may also result in a greater number of fund managers choosing to service Australian investors through their Singaporean domiciled funds, rather than Australian domiciled funds.

3. How important is tax in determining the international competitiveness of Australia's funds management industry compared to other factors, such as the level of fees, the lack of an internationally recognised investment vehicle and the products offered?

We do not believe that these issues can be considered in isolation. The jurisdiction that wins across all of these metrics simultaneously will be the most internationally competitive.

Australia has a strong and innovative domestic funds management industry because of superannuation. However, these skills and resources in Australia are unable to be exported due to ineffectual policy settings in Australia that act as a barrier.

Australia's withholding tax regime is extremely complicated and has high headline rates. The rates applying to different types of income are based on a combination of international tax treaty rules, domestic taxation rules, and the character (or type) of income being generated.

Regardless of fees (which are we note are subject to market forces of competition internationally), the complexity of the Australian withholding tax system will put Australian managers at a competitive disadvantage in the ARFP, where other economies offer lower rates and simpler regimes for investors in their collective investment vehicles. Singapore for example, does not impose withholding tax on distributions received by foreign investors investing into Singapore based funds.

The complex nature of Australia's withholding tax rules, and the interactions with tax treaty rules, will mean that disclosure of possible tax consequences for foreign investors in a simple and easy to understand manner will be very difficult. The Passport regime is specifically designed for retail investors so the ability to simply explain tax consequences will be a key advantage.

Having to identify potential high headline rates and then explain how different types of income are levied different rates of withholding, as well as potential reductions in headline rates in certain circumstances, will be a disadvantage for Australian fund managers.

The following items are also important in ensuring Australian based fund managers can capitalise on the ARFP initiative.

Item	Description	Comments	Priority
FX hedging treatment	Passport vehicles must receive appropriate treatment under TOFA subdivision 230E in relation to portfolio FX hedging	This issue must be fixed for Passport funds to operate effectively. Without this change it is not possible to operate multi-currency class unit trusts	Legislation is required to have royal assent before the end of 2017.
Receive treaty benefits	Future treaty negotiations to contemplate Passport funds so that the receive treaty benefits either under "CIV" provisions or the addition of Passport specific provisions	Treaty benefits should be applied to any new Australian CIVs	Ongoing

4. To what extent would any reduction in Australian withholding tax rates be clawed back by higher foreign taxes (through reduced foreign tax credits)? Please provide examples in other jurisdictions.

Many, but not necessarily all, foreign jurisdictions have a foreign tax credit regime whereby credit is given for foreign taxes paid. Typically this operates by grossing up the foreign income received by the foreign tax deducted, determining notional local tax payable in that jurisdiction and then providing a credit for the foreign taxes deducted. At first blush this would lead to a conclusion that a reduction in withholding tax merely benefits foreign revenue authorities.

However, this is too simplistic.

- First, some investors have a tax rate (nominal or effective) in their home jurisdiction that is less than the withholding tax imposed on an Australian distribution.
- Second, some jurisdictions do not have a foreign tax credit regime but a deduction regime whereby the net amount received is taxed in the home country.
- Third, an investor looks for the best economic outcome, faced with a choice of $100 from country B or $90 from Australia the obvious choice is to invest in country B. The fact that after credits the result may be equivalent is a second order factor that most investors will not consider.
- Fourth, most jurisdictions with a foreign tax credit regime will have various limitations whereby income falls into different classes or expenses are required to be allocated. Hence it is more accurate to suggest that in countries with a foreign tax credit regime credits MAY be available.
- Fifth, investors may choose not to repatriate distributions but to reinvest leaving any foreign tax credit to the future. In these circumstance withholding taxes result in reduced reinvestment.

Implicit in this question is a concern over forgoing tax revenue already being collected, which is misguided for two reasons.

- First, the total collection of withholding tax from 2013-14 ATO Taxation Statistics for fixed trusts was $5.7 million.[7] These numbers are so small that it is not imprudent to consider the second round effect. One billion dollars of additional funds under management will produce $6 million of management fees at 0.60%. Tax on these fees at the corporate tax rate of 30% would be $1.8 million. Hence a quite small increase in internationally sourced FUM would generate tax revenue of equal to the total current withholding tax collections.
- Second, the revenue that relates to ARFP vehicle is not being collected at all hence anything obtained from these products would be beneficial.

5. What are the key factors that contribute to the complexity of Australia's non-resident withholding tax regime?

At a high level we believe complexity of Australia's non-resident withholding tax regime is a function of there being:

1. Multiple rates;
2. Complexity and difficulty of determining appropriate rate;
3. No overarching consistent principle of application; and
4. Relatively more simplistic approaches in competitor jurisdictions, by that we mean a zero withholding tax rate.

The complexity of the withholding tax system that applies to MITs and unit trusts is due to the transparent nature of trusts and that their distributions take on the same characteristics as the underlying revenue. Transparency is a virtue and one of the key attractions of a trust vehicle. One of the prices of this transparency is, currently, an overly complex withholding system. The

[7] https://www.ato.gov.au/About-ATO/Research-and-statistics/In-detail/Taxation-statistics/Taxation-statistics-2013-14/?anchor=Statistics#Statistics

complexity that flows from this should be addressed directly rather than trying to eliminate the root cause because that would destroy the overarching advantages of transparency.

The table below outlines non-resident withholding tax rates. Broadly distributions can be divided into two. Those subject to withholding and those that are not subject to withholding. Putting aside the question income and gains from property (which are excluded by the discussion paper) it can be seen that the only items subject to withholding tax are interest (non 128F), unfranked dividends [which comprise only 9% of dividends from the ASX top 100] and other income which is a catch all.

Australian Source	
Interest	10%
Interest 128F bonds	Nil
Franked dividends	Nil
Unfranked dividends	15/30% on treaties
Dividends CFI	Nil
Rent	15% (unless an environmentally accredited building, in which case 10%)
Other income	15% (or 30% for non-information exchange (EOI) countries)
Capital gains TAP	15% (or 30% for non-information exchange (EOI) countries)
Capital gains NTAP	Nil
Foreign Source	
All income	Nil
All gains	Nil

Note: For convenience the impact of treaties and exchange of information matters has been excluded.

6. How important is the principle of simplicity in Australia's non-resident withholding tax regime relative to the importance of the withholding tax rate?

The question assumes a scenario that does not currently exist in Australia. There is no single rate. Rates that exist are uncompetitive. A single rate would be simpler. However, a single rate at an uncompetitive rate would yield no advantage.

For retail investors in foreign jurisdictions, where they may be unable to get access to advice on foreign tax jurisdictions, simplicity in rate is essential. However, it needs to be the right rate.

Andrew Clements, Melbourne-based tax partner with law firm King & Wood Mallesons, told Bloomberg BNA Nov. 9 that:

> *"Foreign investors would still consider Australian funds less attractive than their global peers if they had to pay a 5 percent withholding tax. Five percent would "still be higher than the rate they would regard as being competitive," and that " The government should instead consider dropping the rate to zero"."*[8]

[8] https://www.bna.com/australian-practitioners-urge-n57982082670/

7. What options are there for simplifying Australia's non-resident withholding tax regime? To what extent do exemptions contribute to complexity?

We have proposed alternative options in our preferred position in this paper. We have also considered the options presented in the consultation paper. We do not believe complexity is a relevant policy consideration in the context of a system that is already too complex to understand by foreign investors to the point that it acts as a barrier to them sourcing Australian based fund management services.

8. To what extent do fund managers rely on marketing or their local distributors to explain the effective tax rates for non-resident investors? Does the approach differ between countries?

Currently, regulatory and tax barriers prevent the marketing and distribution of fund management services across jurisdictions. The ARFP is designed to remove regulatory obstacles to market access for retail fund products.

The tax sections in marketing materials dealing with Luxembourg, Irish and Singapore funds are relatively short, as they exempt non-resident investors from withholding tax, and are therefore more palatable and easily understood to the average retail investor. By contrast, there would need to be a comparatively longer discussion of Australian tax implications, which would be highly complex and not easily understood.

However, we understand that marketing documents would likely suggest individuals get their own tax advice if the effective tax rate for non-resident investors remained as it currently stands for Australian products. Furthermore, with such complexity of taxation treatment, local distributors would be reluctant to offer a view. In the context of a retail investor, which is the situation with respect to the ARFP, suggesting to a foreign retail investors that they need to get tax advice on Australian withholding taxes (where an offer document provides a summary which is too complex based on current policy settings) would present an obvious barrier to the investor choosing the product. The obvious barrier is that they would be incentivised to seek out an easier to understand product (including a product from the local jurisdiction).

9. What are the merits of limiting the concessional rate of non-resident withholding tax to CIVs and MITs in the ARFP?

It is imperative that at a minimum a simple, transparent, and competitive rate of non-resident withholding tax is applied to CIVs and MITs in the AFRP. As noted in our preferred position at the introduction we believe this rate is a 0% withholding tax on AFRP eligible products. We believe this would have no revenue impact as there are no fund managers based in Australia currently servicing ARFP jurisdictions in the retail client space. We further note that the ATO taxation statistics suggest total withholding tax revenue of $5.7 million for fixed trusts (ATO Statistics 2013-14), of which only a segment would relate to traditional bond/equity funds.

From a practical perspective, as the AFRP is limited to retail clients we believe that most, if not all, products offered to AFRP countries by Australian domiciled fund managers will likely be structured to take advantage of the certainty that should be provided by CIVs currently being developed in parallel with this consultation on non-resident withholding tax rates. Furthermore, the AFRP Rules effectively limit the eligible investments to bond/equity like products, so there is no risk to Australian sourced real property income.

Limiting the new withholding tax rate to AFRP eligible products would have the advantage of road testing any uncertainty around likely potential revenue impacts or substitution effects in an area where there is clearly no potential for a revenue loss.

However, the downside of this approach is that it would miss the opportunity to fix non-resident withholding tax arrangements in the broader and more service export focus of wholesale funds management, and in particular Australia's poor reputation for tax certainty. If a broader approach was adopted, we believe there would be insubstantial revenue leakage based on the ATOs current statistics for the 2013-14 income year which suggest only $5.7 million in non-resident withholding tax was collected from fixed unit trusts. Appropriate rules could be crafted and are elaborated on below.

Dealings in global assets

The withholding tax rates on income or gains related to dealings in global assets should be zero. This outcome is consistent with Australia's general taxation policy and the more specific objectives of the IMR.

Currently some income or gains related to dealings in global assets do not have a zero withholding tax rate.

This is because of the source rules dealing with certain transactions, particularly hedging and foreign currency. A number of these transactions are inappropriately treated as having an Australian source and accordingly being liable to Australian withholding tax.

In contrast, the same dealings if undertaken by a non-resident fund through an Australian adviser would not have an Australian source under the IMR rules.

There should be a corresponding deeming of currency dealings to not have an Australian source and accordingly, those gains should be treated as having a zero withholding tax rate.

Similarly, certain hedging and Forex transactions which are related capital assets should be treated as having capital gains tax status. In that case, those gains or losses would be treated as capital gains and capital losses. Accordingly, the gains would also be treated as having zero withholding tax rate.

These changes do not alter the withholding tax rate but simply provide clarity as to the range of transactions which may obtain the benefit of a zero withholding tax rate.

Dealing in Australian assets.

Australian real property

The withholding tax rates associated with gains or income associated with Australian real property should be treated separately. There is a macroeconomic decision which should be made as to the extent to which taxes should be imposed on non-resident investors investing into Australian real property.

Dealings and income not related to Australian real property

Currently the level of withholding tax generated from distributions through managed funds to non-resident investors is limited (approximately $5.7 million – ATO Taxation Statistics 2013-14).

It includes withholding tax on:

- Unfranked dividends
- Interest income
- Other Australian source income, for example, income related to Australian assets other than dealings treated as being on capital gains tax account.

As noted above the rules dealing with hedging and currency transactions associated with capital gains tax assets should treat those gains and losses as being capital gains and capital losses respectively.

The withholding tax rate for qualifying funds should be

ARFP	All other MITs/CIVs	
0%	0%	Capital gains not related to Australian real property, including Gains associated with hedging and currency transactions not associated with Australian real property
0%	0%	Franked dividends
0%	0%	Interest on debt which satisfies the public offer test or other concession
0%	7.5%	Unfranked dividends
0%	7.5%	Interest on the debt which does not satisfy the public offer test or other concession
0%	7.5%	Residual Australian source income. This would exclude the gains associated with hedging and currency transactions associated with Australian property which is not Australian real property

Note: Non-Australian funds are not taxable on certain residual income (such as redemption gains on bonds) while currently, An Australian MIT would need to withhold at 15% as a bond redemption gain would be treated as ‘other income’. This is an example of an anomaly should be removed.

A strong argument can be made that the residual category should also be 0%. This is because very limited Australian withholding tax is currently imposed on those categories of income which are distributed to non-resident beneficiaries in collective investment vehicles.

Scope of the concessional regime

The consultation paper raises the possibility of the concessional withholding tax rate only applying to collective investment vehicles or managed investment trust which qualify under the Australian regional funds passport.

This has the advantage that simple rules can be created. The ARFP rules effectively limit the holding of Australian real property. As a result, it means that there would not need to be specific rules which apply if the collective investment vehicle or managed investment trust held sufficient real property.

The scope of the concessional regime should not be limited in it this way.

The ARFP rules are specifically limited so as to satisfy the corporate prudential rules of each of the member nations.

The effect of limiting the regime to funds which qualify for the ARFP would unnecessarily restrict the funds which could be made available to non-resident investors.

It would also create unnecessary complexity and ambiguity as the disclosure dealing with the withholding tax rates would need to disclose that if the fund ceased to qualify for the funds passport that the withholding tax concession would no longer be available.

The regime should be more broadly based.

The beneficiaries which may take advantage of the regime should not be dependent upon the non-residents being a resident of an information-exchange jurisdiction.

Inconsequential views from the Productivity Commission

The Productivity Commission has suggested that the addition of a special withholding tax rate for ARFP funds would add an additional distortion to Australia's taxation regime.

Foreign investors will be choosing which ARFP products to invest in based on a number of factors and the impact of taxation will be a significant consideration. The attraction of highly mobile investment capital represents one of Australia's greatest opportunities to increase productivity and gross domestic product in the future.

Discounts to headline withholding tax rates should not be seen as 'lost revenue' or 'distortions' but rather as a pricing decision made by the government to ensure Australian managers are not at a competitive disadvantage compared to their peers in the ARFP regime.

As discussed above, the majority of income expected to be generated from ARFP funds will be in areas which already receive concessional taxation treatment, such as income from fully franked dividends and capital gains from non-taxable Australian real property, or from interest on bonds.

10. What are the merits and likely impacts (for example, compliance costs, revenue from funds management, employment, substitution effects, investment decisions of non-residents) on inbound investment from each of the proposals outlined above?

The size of Australia's fund management industry is $2.7 trillion. ABS statistics suggest that Australian fund managers currently manage $90.2 billion of overseas assets. Although this is an interesting and important statistics it is not relevant for assessing revenue impacts or economic benefits.

First, withholding tax is only paid on distributions from these funds. The majority of income in these funds are either exempt as they are investments in foreign source income. What remains already received concessional taxation treatment, such as income from fully franked dividends and capital gains from non-taxable Australian real property, or from interest on bonds.

Second, the economic benefit is captured by value added, that is, spending or salaries of those employed, or other services such as rent on a premises, spending on research, information and technology, plus profits made on activity.

In funds management, value added is device from fees charged for managing and servicing those funds under management, typically ranging from 0.6% to 1.5% of funds under management. Fees pay salaries and other costs, with the remainder forming profits for the fund manager.

Summary Table

	Compliance Cost	**Revenue from Funds Under Management**	**Employment**	**Substitution effects**	**Investment Decisions of Non-Residents**
No Change	Multiple rates are currently applied on various types of income.	Demand for Australian assets would remain constant.	Reduce over time.	Corporate tax, income tax, payroll tax, and GST tax base for fund management services will shrink. Funds will be increasingly domiciled in other regions.	No positive impact.
ARFP at 5%	Slightly administratively easier, as no systems are currently utilised for ARFP mandates so a new build would be required.	Would increase demand for Australian assets. We would receive withholding tax on ARFP funds. We may receive increased company tax, GST, payroll, and income receipts if retail investors in other jurisdictions pick Australian domiciled funds.	Neutral to positive impact.	ARFP funds are limited to retail investors where products are not currently sold. Wholesale funds would be largely restricted from these arrangements.	More likely to invest, but withholding tax would still be uncompetitive relative to other ARFP jurisdictions internationally and locally.
ARFP at 0%	No new build required.	We would receive a significant boost in company tax, income tax, and payroll tax receipts.	Positive impact.	ARFP funds are limited to retail investors where products are not currently sold. Wholesale funds would be largely restricted from these arrangements.	Would remove withholding tax barriers to non-resident investment decisions in passport countries.
MIT at revenue neutral rate (ex real Aus property)	Slight build required. Change rates applied.	No direct impact. Indirect impact would be potential revenue foregone from Australian domiciled operations over time.	Reduce over time.	Corporate tax, income tax, payroll tax, and GST tax base for fund management services will shrink. Funds will be increasingly domiciled in other regions.	No positive impact. Potentially a negative impact for asset classes taxed below the revenue neutral rate.
MIT at 7.5% (ex Aus real property)	Slight build required. Change rates applied.	We believe indirect impacts of Australian domiciled funds would offset any loss to withholding tax revenue at this rate.	Positive impact.	No substitution effects between ARFP and MITs/CIVs as taxation treatment would be identical.	More likely to invest, but withholding tax would still be uncompetitive relative to other ARFP jurisdictions internationally and locally
ARFP at 0% and MIT at 7.5% (ex Aus real property) with commitment to MIT at 0%	Slight.	We believe this would yield the greatest net revenue gain.	Most positive impact.	ARFP funds are limited to retail investors where products are not currently sold. Wholesale funds would be largely restricted from these arrangements.	Would remove withholding tax barriers to non-resident investment decisions globally.

Box2 - Understanding the economic benefits of the funds management value chain

Unless Australia acts to ensure it has a competitive withholding tax regime, fund management groups will increasingly domicile funds in other jurisdictions, notably the UK, Ireland, Luxembourg, Hong Kong and Singapore, and any ARFP participant that has more competitive withholding tax arrangements.

The main functions that add value are increasingly being located with the domicile of the fund. There is a strong link between the domicile of the fund and the administration activity and other services that create significant value added.

Many of the activities undertaken in the funds management value chain are driven by where the fund is domiciled. Hence the recommendations in the Johnson report to expand the allowable set of collective investment vehicles, initiatives which are aimed at increasing the number of funds domiciled in Australia so that Australia can benefit from associated fund administration activities occurring here instead of offshore. The chart below provides a breakdown of the different elements of the funds management value chain and what impacts the decision as to where these services will be located. Fund domicile dictates many of these decisions.

Funds Management Value Chain

Activity	Components of activity	Factors determining location of activity
Portfolio Management	Investment management – asset allocation & acquisition/disposal decisions	Skillset, attracting talent, location of research analysts
Research & Analysis	• Fundamental • Quantitative	- Location of assets/investments, skillset - Skillset, attracting talent
Execution/ Trading	Execution of trade – ie actual purchase/sale of asset	Timezone, Skillset, location of asset & sell side brokers
Settlement/ Custody	"Middle office" – Settlement of trades, physical holding of asset or legal title	Cost, timezone
Accounting	Fund accounting – ie unit pricing, tax & distribution calculations	Cost, skillset, timezone, fund domicile sometimes
Registry	Maintenance of unit registry and investor communications regarding holdings	Cost, skillset, timezone, fund domicile
Compliance/ Legal	Oversight of other activities to ensure regulatory/legal requirements are met	Cost, skillset, timezone, fund domicile, location of PM & Trading & Marketing
Marketing	Seeding & promotion of fund	Location of investors, skillset

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The key point is that these associated activities will generate fee revenue in the country in which they're undertaken. This will attract tax at the corporate tax rate. The research by KPMG that was undertaken for the United Kingdom HMRC Treasury illustrates this point in more detail. The greater the number of investment vehicles that are domiciled in Australia, the more associated fee revenue can be taxed by the Australian government.

Potential budget impact

A single withholding tax rate for non-residents invested in ARFP products at 5% or 0%

The FSC is mindful of the potential impact of any policy changes on the Budget, however we expect that a reduced withholding tax rate will have no negative impact on the Budget.

We understand that Treasury's revenue costing methodology compares the impact of a tax rate change to the revenue currently projected in the forward estimates. That is it seeks to quantify the revenue impact on the forward estimates relative to previous estimates of the forward estimates.

Currently it is not possible for Australian fund managers to market to retail clients in the Passport jurisdictions, so no withholding tax is being collected from investors and therefore no actual revenue is currently in the forward estimates of the budget to reflect non-resident withholding tax for these jurisdictions. This means that Treasury's revenue costing methodology should produce a net revenue gain for setting a 5% flat withholding tax for ARFP funds. If this rate were set more competitively at zero, there would also be no revenue impact as the budget's forward estimates have been determined with zero revenue from ARFP participant countries.

Further, the Passport rules limit the allowable investments to securities such as bonds and equities. The only items in such portfolios that could attract withholding tax (WHT) at present are unfranked Australian dividends, which are a minor part of dividends from an Australian portfolio, and any residual 'MIT Fund Payment' amounts, which we expect would be a very small proportion of income due to property not being an allowable investment. No withholding tax is charged on dividends that are fully franked. We expect most bonds would be either Foreign, Government or Corporate paper (s128F) all of which are exempt from withholding tax.

A single withholding tax rate of 7.5 per cent for all MITs and CIVs excluding property income

In terms of withholding taxes paid by non-residents Australia does not have any tax revenue at serious risk. ATO statistics suggest that for the 2013-14 income year fixed trusts paid $5.7 million in non-resident withholding taxes.

The FSC can provide detailed assistance with costing data and methodology should this be required.

Economic impact

Research by Deloitte Access Economics commissioned by the FSC demonstrated considered two scenarios outlined below. Both scenarios demonstrated that measures that resulted in increased fund management service exports – such as removing non-resident withholding tax barriers, would lead to a substantial increase in economic output, with commensurate increases employment and income tax, corporate taxes, GST and other Commonwealth Taxes, as well as an increase in State payroll tax receipts.

Scenario 1 – doubling Australia's fund management export revenue from its 2012/14 level.

A doubling of funds management export revenue from $442 million in 2012/13 to $884 million would result in an increase of GDP of approximately $330 million by 2029/30. This would result in an additional 1,223 jobs in 2019/20.

Table 4.1: Projected impact from doubling of funds management export revenue

	2015/16	2019/20	2024/25	2029/30
Increase in GDP ($m 2012/13)	48.2	287.5	330.8	325.7
Increase in GNP ($m 2012/13)	86.5	397.4	341.3	351.1
Total employment growth (FTE)	301	1,223	885	776

Source: Deloitte Access Economics

Total Commonwealth tax receipts are estimated to increase by $113 million in 2019-20, before levelling off to $98 million in 2029-30. State payroll taxes are estimated to increase by $10 million in 2019-20, before levelling off to $8 million by 2029-30.

Table 5.2: Taxation implications of a doubling in export revenue ($2012-13 million)

	2015-16	2019-20	2024-25	2029-30
Income tax	15.3	68.7	55.2	53.7
Corporate tax	3.2	18.8	21.1	21.6
GST	2.9	13.4	11.6	12.0
Other	2.7	12.2	10.4	10.6
Commonwealth tax receipts	**24.1**	**113.1**	**98.3**	**97.9**
Payroll tax (state tax)	2.2	9.8	7.9	7.6

Source: Deloitte Access Economics

Scenario 2- growing Australia's fund management exports to Hong Kong's level by 2022/23.

A second scenario, whereby Australia reached Hong Kong's level of offshore funds management, while maintaining the current growth rate in onshore funds management, which is an increase from 3.5% of total funds to 65% of total funds would lead to an additional $4.2 billion in GDP by 2029/30. By 2024/25 this shock would result in an additional 16,900 jobs.

Table 4.3: Projected impact from increasing to level of Hong Kong

	2015/16	2019/20	2024/25	2029/30
Increase in GDP ($m 2012/13)	117.6	1,007.2	4,577.9	4,223.1
Increase in GNP ($m 2012/13)	211.2	1,448.7	6,199.8	4,346.1
Total employment growth (FTE)	733	4,475	16,926	9,982

Source: Deloitte Access Economics

Total Commonwealth tax receipts are estimated to increase steadily, rising to be $1.7 billion above the baseline in 2024-25, before stabilising to $1.2 billion above the baseline in 2029-30.

State payroll taxes are estimated to increase by $109 million above the baseline in 2024-25, before stabilising to be $61 million above the baseline in 2029-30.

Table 5.4: Tax implications of increasing FUM to Hong Kong levels ($ 2012-13 million)

	2015-16	2019-20	2024-25	2029-30
Income tax	37.0	245.6	1,028.1	669.2
Corporate tax	7.6	63.1	286.9	252.8
GST	7.1	47.7	201.7	142.1
Other	6.5	43.3	182.6	126.8
Commonwealth tax receipts	**58.1**	**399.7**	**1,699.3**	**1,190.9**
Payroll tax (state tax)	5.1	30.2	109.3	61.4

Source: Deloitte Access Economics

Box 3 – How Ireland and Luxembourg hollowed out of the UK's funds management industry via competitive withholding tax arrangements

Ireland's decision in 1987 to establish competitive taxation arrangements as part of the Irish Financial Services Centre initiative demonstrates how policies seeking to impact domicile choice of funds management activities can take ten or twenty years for it to become apparent that significant fund flows are being captured. In 1988 Luxembourg became the first member state to transpose the European directive for Collective Investments (UCITS), and introduces competitive withholding tax arrangements.

Between 1991 to the second quarter of 2007, before the UK sought to remove their own withholding tax barriers on non-residents, Ireland's funds under management rose from EUR 2.6 to 813 billion. Over the same period Luxembourg's funds under management grew from EUR 103 to 2,047 billion.

KPMG (2007) notes, in the context of the UK, that "had reform taken place fifteen years ago, and had Funds now in Ireland been established in the UK, tax revenues from UK AIFs would today [2007] have been almost twice as much as they are".

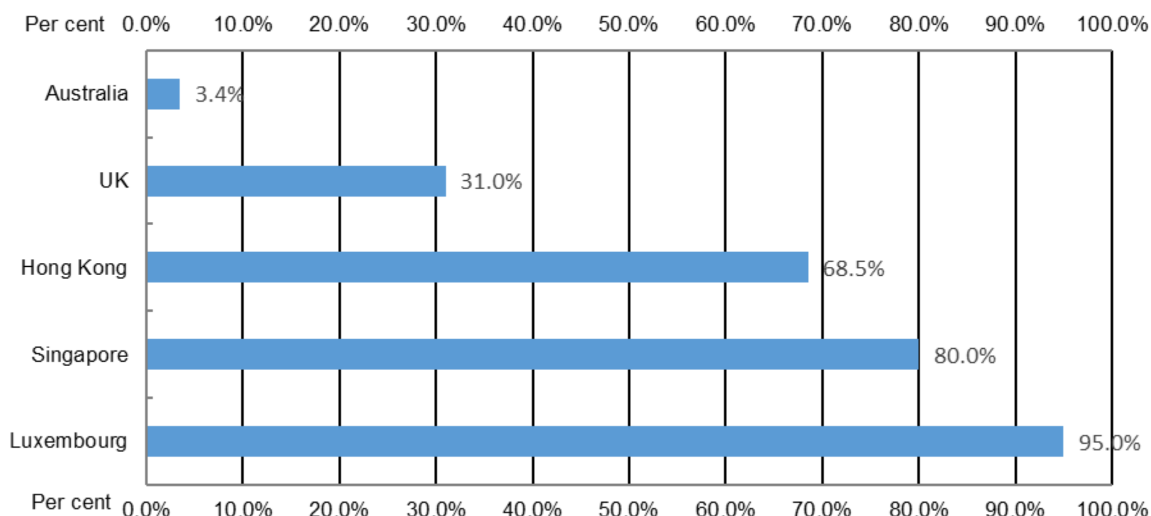
Furthermore, KPMG (2007) has estimated that for every 1 billion of Funds domiciled offshore, which could have been domiciled in the UK, nearly 1 million per annum has been lost by the UK Exchequer.

11. What are the main jurisdictions with which your fund competes in the funds management sector?

11.1. Are the funds management industries in these jurisdictions predominantly focussed on conduit foreign investments or domestically sourced investment?

11.2. What are the withholding rates (including any domestic concessions offered) in those jurisdictions for income from domestic shares, bonds and other income?

Funds under management forced offshore



Source: FSC Cross Board Flows Report 2015, Monetary Authority of Singapore 2015, Hong Kong Securities and Futures Commission 2015, Investment Management Association 2015, and FSC Estimates

With respect to 11.1, Australia is in a fundamentally different position to other jurisdictions that it competes with in terms of having the fund management industry domicile fund and set up functions in Australia. This is because, unlike Luxembourg, Singapore or Hong Kong, Australia has substantial assets and businesses that would be attractive holdings in a diversified global portfolio. As elaborated on earlier in the submission, reputation and simplicity of tax arrangements are the primary concern. Previous policy decisions discussed in question 1 have created uncertainty over all Australian withholding tax arrangements.

Luxembourg is the second largest fund management centre in the world (behind only the US) and a key competitor to Australia in terms of attracting managed funds. Other competitors include Singapore, Hong Kong, the UK and Ireland.

Focusing on Luxembourg as the leader, Luxembourg is able to provide certainty to investors, in terms of regulatory and tax outcomes. This certainty is critical to sophisticated institutional investors that invest billions of dollars globally.

In terms of tax outcomes, Luxembourg does not levy withholding tax on interest income. It is accepted that the benefit to the Luxembourg economy is the economic activity undertaken in the country as a result of the fund management activities undertaken. That is, money is spent in Luxembourg, leading to corporate taxes, individual income tax and VAT amounts being paid.

Box 4 – Increased efforts of Luxembourg domiciled funds to hollow out Australia's fund management industry

The following is an extract from an ALFI press release from 16 November 2017.

"ALFI has successfully negotiated an AFS licence relief for financial services providers regulated by the CSSF.

The Association of the Luxembourg Fund Industry (ALFI) has announced that it has successfully negotiated an exemption from the obligation to hold an Australian financial services (AFS) licence to provide financial services in Australia. The exemption applies to Chapter 15 Management

Companies and UCITS Self-Managed SICAV regulated by the Luxembourg financial supervisory authority Commission de Surveillance du Secteur Financier (CSSF).

This relief will enable Australia's institutional investors, including superannuation funds, to get easier access to Luxembourg UCITS.

As a rule, a foreign financial services provider (FFSP) needs to hold an Australian financial services (AFS) licence to provide financial services in Australia, unless relief is granted.

The Australian Securities and Investments Commission (ASIC) can exempt a foreign financial services provider from this requirement on the twofold condition that the financial services are provided to wholesale (institutional) clients only and that these financial services are regulated by an overseas regulatory authority.

The regulatory regime overseen by the relevant overseas regulatory authority needs to be 'sufficiently equivalent' to the Australian regulatory regime and effective cooperation arrangements must also exist before relief is granted. ASIC and the CSSF have signed such an MoU on mutual cooperation and the exchange of information related to the supervision of regulated entities in September 2013.

An application for a licence relief has to be made through an industry association, such as ALFI, for a group of FFSPs regulated by a particular overseas regulatory authority. When granted, the relief will then apply to all these financial services providers. In this case, the relief will cover all CSSF regulated Chapter 15 Management Companies and UCITS Self-Managed SICAV.
Welcoming this development, ALFI Chairman Denise Voss explains that ALFI has launched the negotiations on behalf of its members in light of their growing interest to do business with Australian institutional players.

"This relief is a further step in strengthening the relations between our two financial centres", Denise Voss says. "ALFI is currently planning a roadshow to Australia next March. We intend to organise seminars in Sydney and Melbourne and will travel with a delegation from our member firms. It will be a good occasion for Luxembourg and Australian players to meet and build even stronger relations."

In the context of the ARFP, it is clear that under current arrangements Singapore will be the most attractive destination to operate a ARFP fund. We are concerned that Australia is in danger of losing its competitive advantage in funds management to Singapore if a more competitive approach to withholding tax is not adopted.

Box 5 – UK Government Approach post losing ground to Ireland and Luxembourg

The UK Government first published its investment management strategy alongside its 2013 Budget on 20 May 2013. This strategy focuses on three broad areas where the UK Government will support the investment management industry – taxation, regulation, and marketing. The then Economic Secretary stated that the UK Government's mission was to make the UK the most competitive location for funds. The strategy in terms of tax was to create a "simple, fair and stable tax regime".

The headline rate of UK corporate income tax is currently 20% and will be reduced to 17% as from 1 April 2020. The UK Government has also indicated its intention to lower the rate to 15% at some point.

Brexit could impact on the ability of UK funds to passport the marketing of their funds in the EU, as well the UK funds industry being able to recruit EU nationals.

If UK funds lose the regulatory passport as a result of Brexit, UK fund managers may target the growing Asian market in order to generate income. Given the strategy of the UK Government, and the importance of the financial services industry to the UK economy, we can expect the UK Government to respond positively to any Brexit downside by introducing measures to maintain the UK's reputation as a major centre for both the domicile and management of funds.

UK Authorised Investment Fund ("AIF") tax regime

Regulated UK AIFs can be structured as Open Ended Investment Companies ("OEIC"), authorised unit trusts ("AUTs"), Property Authorised Investment Funds ("PAIFs"). The aforementioned vehicles can be used in retail products. The UK also introduced in 2013 authorised contractual schemes ("ACAs", structured as co-ownership schemes or as partnerships, which are designed for the wholesale market).

For equity invested funds, dividend income is exempt from UK tax.

Bond funds (more than 60% of portfolio is invested in interest bearing assets) can deduct distributions, and therefore fully distributing bond funds will have no net taxable income. Similarly, PAIFs can deduct interest and property income distributions, which means that they are likely to have no taxable income.

ACAs are tax transparent, and investors in ACAs are treated as if they owned the underlying income. Investors in ACAs retain their own tax treaty benefits.

UK AIFs are exempt from tax on capital gains. As UK AIFs are subject to tax (in principle if not in practice), UK AIFs have access to the UK's large network of tax treaties.

There are no withholding taxes for non-UK investors in respect of dividend and interest distributions. Withholding taxes apply to property income distributions made by a PAIF.

Management fees are also exempt from UK VAT.

While the UK's tax regime for AIFs is attractive, it lacks the simplicity of the tax exemptions that apply to comparable Luxembourg and Irish domiciled funds. However, the UK's tax regime is far more favourable than Australia, and the UK Government is clearly backing its funds management industry to be competitive globally (as do the governments of other key fund jurisdictions such as Ireland, Luxembourg and Singapore).