5 April 2012

The Manager
International Tax Base Unit
International Tax and Treaties Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam

RE Exposure Draft - Investment Manager Regime - Stages 1 and 2

We thank you for the opportunity to contribute to the development of Investment Manager Regime (IMR). As you are aware, the matters covered are of considerable significance to members of the Financial Services Council (FSC).

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks. The FSC has 128 members who are responsible for investing $1.8 trillion on behalf of more than 11 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Stock Exchange and is the fourth largest pool of managed funds in the world. The FSC 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 FSC is largely supportive of the amendments that are contained in the current exposure drafts for Stage 1 (FIN 48) and Stage 2 (PE). However, we wish to note our concerns at the possibility of a more limited/narrow approach to Stage 3 ('future IMR'). It is important that the future IMR provides a simple, broad based exemption as previously recommended by the Johnson Report and accepted by the Government.

FSC members are concerned that the FIN 48 exemption is too complex to act as a base for the future IMR (Stage 3). Complexity as a result of the various tests contained in the Regime may result in the Johnson Report recommendations not being fulfilled.

We encourage the government to adopt an approach which reflects the recommendations in the Johnson Report. It is critical to both the effectiveness of the regime and the ability of Australian based fund managers to export their services that the provisions do not introduce significant complexity and uncertainty. As noted extensively in the Johnson Report, this has been the downfall of the present system.

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Please find below specific comments in relation to the FIN 48 exposure draft, in particular, the practicality of the 'widely held' test and regulations for funds to meet the widely held test, definition of an eligible entity for the exemption (i.e. a trust without present entitlement), and board representation.

Thank you again for the opportunity to comment on the exposure draft legislation for our involvement in the consultation process.

We would be pleased to discuss these issues with you further. Please contact Carla Hoorweg or me on (02) 8235 2519 at any time.

Yours sincerely

MARTIN CODINA
Director of Policy

COMMENTS ON ELEMENTS 1 & 2

1. Practicality of the 'widely held' test

1.1 *Tracing /chain of entities*: The Parliament's intention is to enable widely held entities to qualify for this concession with appropriate integrity measures. Whilst the 'widely held' test contained in s842-230 has broadened the concept of tracing through a chain of entities, s842-230 appears overly complex. For instance, many funds use a feeder fund concept to structure the CIV investment, it would seem the broader requirements of an 'IMR foreign fund' (i.e. both the widely held and concentration tests) must be satisfied by each entity in the chain in order for the master fund to be 'widely held'. We request that the legislation to be further amended to reflect (or the EM to state) that the intention is simply for the non-resident investors to be satisfied that it is in fact 'widely held' whereby the widely held and concentration test could be satisfied at either the 'master fund level' (the level of investment that holds the Australian Financial arrangements) or at the feeder fund level.

1.2 *Non-inclusion of sovereign wealth funds and not-for-profit entities such as high educational endowments and charities*: We understand the Parliament's intention is not to exclude them. At times, these entities may desire to invest into CIVs that have demonstrated successful investment strategies, but with some mandated modifications e.g. a tobacco free fund. It is not uncommon for a manager to establish a CIV with a strategy nearly identical to such existing CIVs solely for these investors who have similar interests. As currently drafted, it would seem these CIVs would fail s842-230, which may be unintended. It is therefore consistent with Parliament's intention and appropriate to extend s842-230(2) to specifically include endowments, charities and sovereign wealth funds.

We understand this may be achieved through the use of regulations.

1.3 Technical amendments:

- s842-230(1)(d) reads "….satisfy the requirements in paragraph (a), (b) or (c)". We recommend it should also include (1)(e) wholly owned subsidiaries of entities specified in the regulations.

- Insert in s842-230(2) the following:
  "(d) an IMR foreign Fund;
  (e) an entity specified in the regulations;
  (f) an entity that is wholly owned, directly or indirectly, by one or more entities that satisfy the requirements in paragraph (a), (b), (c), (d) or (e)"

- Insert in s842-230(4)(b): delete "(1)(d)", and insert "(1)(a)-(e)".

2. Structures (s842-210 – s842-216)

As currently drafted, the IMR would seem to apply only to three types of legal entities: trusts, partnerships and corporate tax entities. These are the entities contemplated by Australian tax law and are likely to cover most global structures. However, there are legal structures which conceivably may not be regarded as a trust, partnership or corporate tax entity per se. This would cause this fourth category of entities to fail the definition of an 'IMR foreign fund'. For example:

(a) Funds without present entitlement

Non-resident pension funds may utilise either a corporate vehicle or a vehicle that has the characteristics of a trust with one distinct difference the beneficiaries of the trust will not have present entitlement to the income of the trust (which is similar to Australian superannuation funds that operate via a trust structure). Accordingly the non-resident pension fund that operates via a trust structure is a taxpayer in its own right as similar to Australian superannuation funds and therefore would require an IMR exemption at the entity level (or trustee level) as opposed to the beneficiary level.

(b) US Check-the-box entities

Certain non-publicly traded, unincorporated entities could elect to be treated either as a corporate or a partnership for US tax purposes e.g a Cayman domiciled CIV can elect to be a partnership for US tax purposes. The check-the-box regulations retain the concept that whether an organisation is an entity separate from its owners for tax purposes is a matter of US federal tax law and does not depend on whether the organisation is recognised as an entity under domestic US law.

As such, the inclusion of a fourth (or residual) category of legal entities should be considered to cater for such scenarios that arise under 2(a) and (b) above, possibly via Regulations.

3. Board Representation

Section 842 – 245 (4) a of the Exposure Draft rules out a "financial arrangement" if the IMR foreign fund has someone on the Board of Directors. This is in the view of the FSC is too restrictive and commercially unreasonable. Many arrangements do give a nominal one seat on the Board because even a small holding in some large companies justifies a board seat. The position would not ordinarily cause control but would only be as an observer to protect the portfolio shareholder interest. Further, by way of contrast, an entitlement to a Board seat does not automatically disqualify an investor for the purposes of other exemptions (e.g. the right to appoint 1 out of 8 directors is typically acceptable for the purposes of applying the sovereign immunity exemption – which also requires a "passive" style investment).

As such it is submitted that the requirement be removed or that at the very least a) b) and c) in section 842-245 (4) be cumulative tests and be "and" rather than "or".