

***Investment Manager
Regime for foreign
managed fund***

***Final measures announced
following release of the Board
of Tax report***

20 December 2011

Following recommendations in the Johnson report, the Government has announced that it will introduce an IMR for foreign managed funds. The IMR aims to remove tax impediments and uncertainty and place Australia's taxing arrangements for portfolio investments in line with international practice. In turn, this is expected to make Australia a more attractive place to do business for foreign funds.

The Government will embark on consultation with industry and tax experts on the development of the legislation to implement the IMR.

Investment Manager Regime “IMR” announced

Following key recommendations in the Johnson Report, in 2010 the Government commissioned the Board of Taxation to prepare a report with recommendations for an Investment Manager Regime (“IMR”), which was completed in September 2011. The Government has announced that it will introduce an IMR for foreign managed funds, which follows recent announcements of interim elements of the IMR.

Two “interim” IMR elements

The first element, announced on 17 December 2010, addressed concerns raised in applying the US reporting requirements for uncertain tax liabilities (widely known as ‘FIN 48’) for foreign managed funds, on profits made on listed Australian equities. The lack of certainty was seen as harming Australia’s reputation as an investment market, thereby discouraging investment in to Australia. This is known as the “FIN 48 measure”.

The second element, announced on 19 January 2011, confirmed that foreign funds having a permanent establishment (“PE”) in Australia, by reason of using an Australian intermediary, would not be subject to tax on profits made on foreign assets. This issue historically discouraged foreign funds from engaging the services of an Australian based intermediary. This is known as the “conduit income measure”.

On 16 August 2011 the Government released exposure draft legislation on the interim measures. Legislation is now being finalised for introduction into the Australian Parliament in the first half of 2012.

Third “final” IMR element - 16 December 2011 announcement

In broad terms, Australian sourced income, gains or losses from portfolio interests or financial arrangements of a foreign managed fund will be exempt from Australian tax. However, Australian sourced income or gains from ‘taxable Australian property’ will remain taxable, with the exception of portfolio interests in listed companies.

The central themes of the IMR are classifying the foreign funds that are eligible for relief and the income and gains covered by the measures. To qualify, foreign funds (including non-entity collective investment vehicles) will need to:

- not be a resident of Australia (subject to proposed changes to residency tests for IMR purposes);
- be domiciled in a country with a recognised exchange of information (“EOI”) arrangement with Australia;
- be widely held (with the ability to trace through to underlying investors); and
- not carrying on a trading business in Australia (subject to eligible investment guidelines).

Context of interim and final measures

The FIN 48 measure – to 30 June 2011

This clarifies the treatment of past realised gains and losses from certain Australian investments by foreign managed funds to “provide certainty of tax treatment for funds that have invested in Australia”. This is most relevant for foreign funds in non-treaty countries where gains on Australian securities are considered to be Australian sourced ‘revenue gains’ for Australian income tax purposes.

The Australian Taxation Office (“ATO”) will be unable to assess Australian tax in respect of IMR income derived by IMR foreign funds. This will extend to non-resident investors in transparent vehicles being partners or beneficiaries of the IMR foreign fund. This measure will apply to income and gains realised up to 30 June 2011 but does not apply where:

- a fund has been notified of an audit or review by the ATO before 18 December 2010;
- the Commissioner is of the opinion that there has been fraud by the ‘IMR foreign fund’;
- a fund has lodged a tax return in respect of the 2010-11 income year or previous income year;
- unrealised gains are realised after 30 June 2011; and
- the income or gains are subject to withholding tax.

The conduit foreign source income measure

This measure is designed to encourage foreign funds to appoint an Australian based manager, but who have not previously done so due to the risk of creating a PE in Australia.

Foreign managed funds will not be taxed on foreign sourced income or gains from portfolio investments in financial arrangements which are currently taxable solely because the fund retains an Australian based investment manager or intermediary who is deemed to create a PE in Australia for the fund.

Importantly, this measure is directed at foreign source income and does not address Australian sourced income.

Final IMR announcement - 16 December 2011

The announcement extends the interim measures for foreign managed funds by confirming that:

- the exemption for Australian sourced income or gains on portfolio interests in certain Australian investments will apply from 1 July 2011 (with different conditions); and
- the conduit income measure will extend to foreign non-portfolio interests. A foreign managed fund will not be deemed to have a permanent establishment in Australia (nor be a resident of Australia for IMR purposes) merely because it uses an Australian intermediary.

Importantly, the exemption does not affect income such as interest and dividends subject to existing withholding tax rules for non-residents. It would be sensible for the legislation for the interim measures and the final IMR to be aligned.

Board of Taxation (“BoT”) recommendations

The BoT made 12 key recommendations, of which 10 have received unqualified support from the Government. The Government will further consider recommendations on:

- changes to the residency tests for certain types of funds covered by the IMR; and
- the possible expansion of a prescribed list of eligible investments made by foreign funds following consultation on draft legislation to implement the IMR.

Points to bear in mind

1. Foreign funds domiciled in non-EOI countries such as Luxembourg, Switzerland and Korea will be disqualified from the IMR, whereas funds domiciled in Cayman Islands and Bermuda will be eligible to qualify.
2. The tests for determining a ‘foreign managed fund’ will be critical. Appropriate diligence will be needed to confirm eligibility status for the IMR exemption.
3. It remains to be considered whether the IMR will later be extended to parties beyond foreign managed funds, as contemplated in the Johnson report.

Things to consider

1. Does the announcement affect the FIN 48 position currently adopted by foreign funds?
2. Should investment structures of foreign managed funds be reviewed?
3. Should the operations of existing Australian trading desks be expanded to offer services to foreign managed funds?
4. Should an Australian trading desk be established to offer services to foreign managed funds?
5. When should personnel be transferred to Australia to provide intermediary services?
6. How should fee arrangements for intermediary services be negotiated?

If you require advice on this topic, please contact your PwC representative or alternatively:

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