

October 2011

Investment Management Regime

The Government has released exposure draft legislation for the previously announced Investment Manager Regime. The proposed amendments introduce the changes that were announced in the May 2011 Federal Budget. The amendments are intended to assist foreign investment funds comply with FIN 48, but they do produce some bizarre results.

THE AMENDMENTS

The first set of amendments will prevent the Tax Office from raising assessments for the 2010/2011 and previous income tax years for certain foreign investment funds and investors in these funds. The amendment is specifically designed to assist these funds in satisfying their FIN 48 requirements for their United States reporting. We refer to these as the FIN 48 amendments.

The second set of amendments will apply for the 2010/2011 and subsequent tax years. It will introduce the 'Investment Manager Regime', which will provide certain foreign investment funds an exemption from Australian income tax where the funds would have been assessable in Australia only because they used an Australian resident intermediary. We refer to these as the IMR amendments.

THE FIN 48 AMENDMENTS

These amendments will be introduced to allow certain foreign complying funds to satisfy their US reporting requirements under FIN 48. It is the intention of the government to provide certainty of tax treatment for foreign funds that have invested in Australia.

The certainty will be in the form of an exemption from Australian income tax for Investment Manager Regime (IMR) income and losses derived in Australia by IMR funds. The exemption will apply for the 2010/2011 income year and previous income years.

An IMR fund is one that:

- is not an Australian resident for tax purposes;
- is recognised under a foreign law as a collective investment vehicle;
- does not have its day-to-day control reside in the members of the fund;

- does not carry on a trading business in Australia
 - all of its income is passive investment income; and
- is widely held and is not closely held.

In addition, the fund must not have:

- lodged an income tax return in relation to any income year;
- received an income tax assessment (or had its beneficiaries assessed if the fund was a trust) prior to 18 December 2010; and
- been notified of an intention for the fund to be audited (prior to 18 December 2010).

Interestingly, despite the fact this amendment is designed to assist funds to satisfy the requirements of FIN 48, there does not appear to be a requirement that the fund has to be subject to FIN 48. Further, it seems strange that if the fund has not lodged an income tax return (for any year), it and its investors will be exempt from Australian income tax. However, if the fund has lodged a tax return, it cannot access the exemption.

Where these provisions apply, the fund will be exempt from Australian income tax on IMR income and losses. There are also provisions which exempt that income from Australian income tax where it has been paid to a trust or other investor.

IMR income comprises returns or gains deemed to have an Australian source, derived from financial arrangements (defined under the Taxation of Financial Arrangements (TOFA) provisions), in accordance with the articles of the double tax agreements (business profits article and agency article) other than:

- debt or equity interests issued by an entity (including derivatives over those interests) where the fund holds more than 10% of the entity;

- derivatives issued in relation to Australian real property (and indirect interests in real property);
- arrangements where the fund is entitled to vote at a meeting of the issuer, participate in operational decisions, or deal with the assets of the issuer.

THE IMR PROVISIONS

These provisions will operate to exempt from Australian income tax all IMR income and losses (including IMR capital gains and losses), where the IMR fund does not have a place of business in Australia, but it is treated as having a permanent establishment in Australia solely as a result of engaging an Australian-based investment manager who habitually exercises a general authority to negotiate and conclude contracts on behalf of the fund.

These exemptions are restricted to funds deemed to have a permanent establishment in Australia because they engaged an Australian based fund manager. They do not extend to all funds covered by the FIN 48 amendments. The government will make an announcement regarding

the extension of the IMR provisions (or some other form of exemption) to all foreign investment funds.

PKF COMMENT

These provisions are intended to enact the government's announcements from December 2010 and in the Federal Budget of 2011. They are part of the process to reform the Australian income tax system to make Australia a more attractive venue for funds management.

There are further amendments to follow to finalise this process. It remains to be seen whether the further amendments follow through with this process.

In addition, as these amendments are currently in the form of an exposure draft, it will be interesting to see whether these changes ultimately pass through to legislation or whether further amendments will be necessary.

Should you require assistance or additional information, please contact your PKF Tax Adviser or:

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