22 March 1999

The Secretary
Review of Business Taxation
Department of the Treasury
Parkes Place
CANBERRA ACT 2600

Dear Sir or Madam

SUBMISSION RE: A PLATFORM FOR CONSULTATION

This submission concerns the Australian tax treatment of non-residents investing in Australian Collective Investment Vehicles (CIVs).

Platinum Asset Management ("Platinum") is a boutique funds manager specialising in international equities and currently manages significant funds on behalf of both resident and non-resident investors. Platinum believes that the management of investment funds on behalf of non-residents can be a significant export earner for Australia and consequently it is critical that any proposed tax reforms do not adversely impact on the international competitiveness of Australian based CIVs. I would be delighted to see any tax reform that had a positive impact on the international competitiveness of Australian based CIVs.

1 **Flow Through Treatment For Unit Trusts Must Be Maintained**

The current tax regime provides that ex-Australian source income and gains may flow through an Australian resident unit trust to non-resident unitholders without any Australian tax impost. This design feature works well and allows Australian investment vehicles to be competitive with the major funds management centres around the world, all of which have flow through treatment. There are however some aspects of the current regime which operate as an impediment to fund managers located in Australia seeking to manage funds on behalf of non-residents. Some of these are dealt with at point 3 below.

It is noted that in Chapter 30 of the Discussion Paper two options are outlined for the taxation treatment of non-residents investing in Australian CIVs. Platinum welcomes the concept and objectives of the proposed Non-Resident Investment Funds ("NRIFs"), and in particular the proposed flow through treatment of such vehicles for tax purposes. The proposed exemption from Australian tax for gains on the sale of portfolio interests in Australian equities is a welcome improvement on the current position. Currently gains on the sale of direct portfolio interests in Australian equities by non-residents are free from Australian capital gains tax ("CGT") whereas indirect portfolio interests held via an Australian resident trust are subject to Australian CGT.

However, we believe that the requirement that NRIFs must hold investments solely on behalf of non-residents to be unnecessarily restrictive and inefficient from an economic and administrative point of view. The requirement for a separate trust to be established means that considerable additional cost will be incurred in establishing and maintaining the NRIF. At least in the short term and possibly even in the longer term, the amount of money raised from non-residents may not be sufficient to allow a proper diversification of the investment portfolio of the NRIF. Tax considerations aside the optimum arrangement would be for investment monies of residents and non-residents to be pooled in the one vehicle thus permitting the maximum benefit from economies of scale.

While at first glance the isolation of NRIF's may seem convenient, I proffer some reasons as to this proposal's short-sightedness:-

(a) for each and every CIV that Platinum presently manages we would need to create an NRIF, and for every new product we originate we would need to create two CIV's (one a NRIF). I contend that creation of structural inefficiencies like this, would lead to businesses devoting more resources to non-productive administration of a multitude of parallel products rather than focussing the financial services sector on distributing its products to non-residents in order to increase export earnings.

(b) NRIF's will be unattractive to New Zealand Unitholders as they will potentially be caught in New Zealand's Controlled Foreign Corporation {CFC} and Foreign Investment Fund {FIF} tax provisions. These clients and potential clients will desert Australia in favour of the United Kingdom, our major competitor for New Zealand offshore investment funds.

The tax treatment of non-resident investors in an NRIF as proposed in Option 1 on page 642 and 643 of the Discussion Paper could easily be achieved within the framework of a resident unit trust (comprising both resident and non-resident unitholders) with flow through status for tax purposes. There would be no risk of Australian resident investors enjoying any more favourable tax treatment than would otherwise apply by virtue of their investment being co-mingled with that of non-residents. No revenue leakage should therefore result.

2 Definition Of "Widely Held" CIVs

Platinum welcomes the Treasurer's announcement of 22 February 1999 that in principle the flow through tax treatment of widely held CIVs will be preserved. Platinum's concern however relates to how the concept of widely held may ultimately be defined and whether it will adequately deal with the start up and run down phases of the life of a CIV. Platinum has recently launched two new resident CIVs which are being marketed primarily in New Zealand. Our concern is that it takes quite a deal of time to build up the unitholder base and there may be a period of up to years during which the currently mooted widely held threshold will not be satisfied. We believe it would be inequitable for CIVs in this start up phase to be taxed as companies and subsequently be treated as flow through vehicles.

Even in situations where the widely held test may not be satisfied we believe that it would be inequitable for the CIV to be taxed as if it were a company. Investment in a CIV is never considered by the investor to be an alternative to investing in a company. Rather it is an alternative to direct investment and one which, by way of pooling, allows more efficient investment and greater diversification than would be able to be achieved under an individual investment management mandate.

Consequently Platinum submits that the test for being granted flow through status should be that the CIV is treated as a "managed investment scheme" as defined in section 9 of the Corporations Law <u>and</u> the CIV carries on only "eligible investment business" as defined in section 102M (Division 6C) of the Income Tax Assessment Act 1936 ("the 1936 Act").

By applying the eligible investment business test, trusts which carry on an active business will be subject to the entity regime (i.e. will be taxed as companies) which is in accordance with what is understood to be one of the Government's main desires.

3 Capital Gains Tax ("CGT") Regime And 10% Threshold For Non-Residents

Under Division 136 of the Income Tax Assessment Act 1997 ("the 1997 Act"), a non-resident unitholder in an Australian resident unit trust will be subject to CGT on any gain realised on the disposal of their units if they, together with any associates, beneficially owned at least 10% of the units in the unit trust at any time during the five years prior to disposal. The rationale for seeking to tax gains realised by investors in unit trusts in such circumstances is not clear and Platinum is not aware of other equivalent jurisdictions applying a similar rule. It is particularly nonsensical when the underlying investments of the unit trust are ex-Australian equities which, if invested in directly by the non-resident unitholders would not attract any Australian tax.

In Platinum's experience, non-resident investors will avoid making an investment which would expose them to Australian CGT in this fashion. This means that they either invest in an Australian resident trust which is of sufficiently large size so that their investment is comfortably below the 10% threshold or they do not invest in an Australian resident vehicle at all.

In practice, this means that small fund managers are at a competitive disadvantage to large fund managers when seeking to attract investment from non-resident investors. This uneven playing field would appear to be contrary to the Government's competition policy.

In relation to fund managers such as Platinum which are predominantly managing international i.e. ex-Australian equities, the current CGT regime would appear to be inconsistent with the general proposition that foreign source income and gains should be permitted to flow through an Australian resident trust to non-resident unitholders without any Australian tax impost. Where a non-resident unitholder in Australian resident trusts redeems units at a gain, which reflects unrealised capital gains on the underlying foreign investments, the current CGT rules operate contrary to that general principle.

Where an Australian unit trust realises a gain on disposal of Australian equities or other Australian securities, the non-resident's share of that gain is subject to tax in the hands of the trustee under Section 98(3) or 98(4) of the 1936 Act. Consequently, there is already the machinery in place to ensure that Australian sourced income and gains are subject to tax in Australia.

Platinum recommendation is that section 136-25 of the 1997 Act be amended such that a unit holding of any size in an Australian resident trust which holds portfolio interests in listed equities and/or other marketable securities should not be regarded as a CGT asset having the necessary connection with Australia. Given that there are unlikely to be current non-resident unitholders with 10% or greater unit holdings in such trusts, such an amendment is unlikely to result in a loss to the revenue. In fact, the additional funds which it will attract will lead to higher revenues and higher tax payments by the Australian resident managers i.e. a positive impact on the revenue should be anticipated.

Should you wish to discuss any aspect of this submission please do not hesitate to contact Malcolm Halstead at Platinum Asset Management on (02) 9255 7520 or e-mail at halstead@platinum.com.au.

Yours faithfully

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