
NEW TAX REGIME FOR MANAGED FUNDS WILL HELP CREATE CERTAINTY FOR INVESTORS & INCREASE COMPETITIVENESS FOR AUSTRALIAN FUNDS IN ASIA

Australia could potentially double its financial services industry and be more attractive and competitive in the Asian region if we embrace innovative and attractive funds management regimes in Australia, said Pitcher Partners tax partner Alexis Kokkinos.

Mr Kokkinos's comments follow the release today of the long-awaited exposure draft legislation for the new managed investment trusts taxation regime.

“Consistent with the Intergenerational Report, Australia is faced with key challenges in terms of declining productivity. Accordingly, it is not surprising that the Government has recently been focused on promoting funds management business opportunities in Australia, with a real potential to export services to the Asian region,” he said.

Mr Kokkinos said Australia has a strong funds management business sector in Australia, with a reported \$2,489 billion under management as at 31 December 2014. However, of this amount, only \$90.1 billion represented funds managed on behalf of non-residents by Australian fund managers – that is, only 3.62% of funds under management.

“In 2009, 525 million people in the Asia Pacific region were classified as middle class. By 2020, this number is predicted to increase to 1,740 million people, further increasing to 3,228 million in 2030. This will represent two-thirds of the global middle class.

“There is no doubt that this exponential growth in the Asian middle class will result in a significant cross border demand and opportunities for funds management products and pension products. Australia needs to quickly adapt to ensure that it is in a competitive position to provide these services. If we get this right, we have the potential to significantly grow our funds management business sector in Australia.

“Our taxation regime for funds management is heavily geared at the domestic superannuation economy. We need to be more attractive and competitive in the Asian region. With only 3.62% of funds managed on behalf of non-residents, Australia could potentially double its financial services industry if we are quick to develop innovative and attractive funds management regimes in Australia.

“Importantly, over the past five months, the Government appears to be heavily focused on seeking opportunities to develop our funds management regime in Australia. Since November 2014, there was the release of the Murray Report recommendations into the financial services system, exposure draft legislation on a revised investment manager regime (IMR), a draft MOU on the proposed Asian funds passport rules, a discussion paper on crowd source equity funding proposals, and the proposed enhancements to the Significant Investment VISA (SIV) regime.

“It is positive that there has been a strong focus by the Government over the last six months on the development of our funds management regime in Australia. The release of the managed

investment trust rules will not only address uncertainty in our taxation regime for managed funds, but has the potential to also support the creation of innovative funds in Australia, such as peer-to-peer multi class funds,” he said.

Mr Kokkinos said while the exposure draft will seek to codify existing administrative practices, the draft contains over 200 pages of complex proposed legislation and explanatory material. He said it is proposed that managed funds will be able to elect to apply the rules from 1 July 2015, with a hard start date of 1 July 2016.

“New positive aspects of the proposed regime include the “attribution regime” (which will allow a trustee to attribute taxable amounts to members based on a fair and reasonable basis rather than applying old outdated trust rules), a new cost base adjustment regime that will help to eliminate double tax for members of the fund, a deemed “fixed trust” provision to remove the current uncertainty for many funds in being able to carry forward losses and distribute franking credits, and a codified “under and over” regime that will allow errors to be carried forward to subsequent years in most cases.

“However, the proposed regime will also require significant systems changes as well as introduce new integrity provisions such as the ‘arm’s length’ rule for dealings with associates.

“The new regime is complex and will require a large number of systems and process changes. However, there are some positive aspects to the new regime, which could make the 1 July 2015 start date attractive for many funds. The ability to opt-in early will be dependent on whether the fund qualifies for the new regime and whether the fund can become compliant with the new rules in time.

“In many cases, a fund will only be able to qualify if third party providers (such as fund administrators and custodians) are able provide compliant systems and reports to the fund. Accordingly, in many cases, funds will need to be liaising with these third party providers to determine when they expect to be compliant with the proposed new rules.

“For a fund to comply with the new rules, a member’s rights must be “clearly defined” under the constituent documents. Furthermore, where the fund is an unregistered scheme, it is proposed that there will need to be certain restrictions on the ability of the trustee to modify the constituent documents to the detriment of a member. Accordingly, funds will need to review their trust deeds to determine whether they need to be updated to comply with the provisions.

“In order to qualify as an attribution MIT, a managed fund may be required to modify its constituent documents. In many cases, this may require simple modifications. However, in other cases, this may not. Care will always need to be taken to ensure that modifications do not trigger significant capital gains under a resettlement. Care needs to be taken that changes to the trust constituent documents do not result in taxation consequences for the fund or members of the fund.

“While the proposals are only an exposure draft, the consultation period is proposed to last for only two weeks, with the Government looking to push through the legislation before the optional 1 July 2015 start date. Accordingly, managed investment trusts will have a limited period to be considering whether they qualify for the new regime and their compliance with the current proposals. It is therefore imperative that they commence reviewing these proposals as soon as possible,” Mr Kokkinos said.

Pitcher Partners is an association of independent firms located in Melbourne, Sydney, Perth, Adelaide, Brisbane and Newcastle. Pitcher Partners are independent members of Baker Tilly International.

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