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AUSTRALIAN TAX ALERT

INVESTMENT MANAGER REGIME (IMR) – BILL TO IMPLEMENT ELEMENT 3 IS NOW LAW

INTRODUCTION

Tax and Superannuation Laws Amendment (2015 Measures No. 1) Bill 2015 (**the Bill**), containing the third element of the IMR, has been passed by the Australian Parliament and received Royal Assent on Thursday 25 June 2015. This IMR reform furthers the Australian Government's broader initiatives to remove certain tax impediments for foreign investors investing into Australia in order to attract foreign investment and to promote the use of Australian fund managers.

We also expect the Australian Government to further explore expanding the range of collective investment vehicles to assist capital formation, as well as examine possible reductions in withholding taxes to attract foreign capital.

We recap, updating for IMR changes in the Bill, as compared to the Exposure Draft legislation on the IMR released in March 2015.

ELEMENT 3 OF IMR

This Bill contains the third element of the reform program in this area (Element 3). Element 3 of the IMR exempts Australian sourced capital and revenue gains realised by a widely held foreign fund in respect of portfolio Australian investments (that is, less than 10%) from Australian tax. Further, a foreign investor that engages an independent Australian fund manager to invest in portfolio Australian investments will also disregard Australian sourced capital and revenue gains realised in respect of those investments.

In particular, these proposed amendments allow an IMR entity to qualify for the IMR concession either by investing:

- directly in Australia (referred to as the **direct IMR concession**);
- indirectly in Australia via an Australian fund manager (referred to as the **indirect IMR concession**).

IMR CONCESSION

Generally, the IMR concession disregards certain Australian income tax consequences (such as income or capital gains) arising to an IMR entity in respect of derivative and non-derivative financial arrangements. However, the IMR concession does

not apply to income in respect of the following: a direct interest in Australian real estate; or an interest of 10% of more in an entity that principally holds Australian real estate (**direct and indirect real estate interests**).

IMR ENTITY

An entity will only be an IMR entity if it is not an Australian resident and not a resident trust for CGT purposes.

An IMR entity may include individuals, companies, beneficiaries of non-resident trusts and partners in partnerships.

IMR FINANCIAL ARRANGEMENT

IMR financial arrangement is defined to generally include arrangements to raise finance and excludes: derivatives used solely for managing financial risk; and direct and indirect real estate interests (refer above). On this basis, the portfolio (or 10%) requirement in respect of IMR financial arrangements (discussed below) only applies to equity type investments (and not derivatives).

DIRECT IMR CONCESSION

An IMR entity may qualify for the direct IMR concession if:

- it is widely held entity;
- the interest of the IMR entity in the issuer of, or counterparty to, the IMR financial arrangement is less than 10%;
- none of the returns, gains or losses from the arrangement are attributable to an Australian permanent establishment; and
- it does not carry on a trading business in Australia or control/able to control the affairs or operations of such a business.

An IMR entity may qualify as being widely held where either: it is specifically listed; or meets certain membership requirements.

The entities specifically listed as being widely held include foreign or Australian life insurance companies; managed investment trusts (**MITs**), complying superannuation funds etc. The listed entities are identical to the entities that are taken to be widely held under the MIT rules in sub-section 12-403(3) of Schedule 1 of the Tax Administration Act 1953 except for the exclusion of foreign collective investment vehicles.

Alternatively, an IMR entity may also qualify as an IMR widely held entity if:

- no member of the entity has a total participation interest in the entity of 20% or more; or
- there are no five/fewer members who have combined participation interest of at least 50%.

The interests of entities specifically listed count as nil in the participation tests.

These rules are based on the requirements contained in the United Kingdom's (**UK**) Investment Manager Exemption (**IME**). These rules allow tracing through certain interposed entities to individuals to determine if the total participation interest thresholds are satisfied. Unlike the exposure draft these rules also allow for tracing through for entities specifically listed.

In addition, there are specific rules which apply when the IMR entity is starting up, winding down or there are temporary circumstances outside an IMR entity's control. However, if the IMR entity does not satisfy the requirements of the IMR concession during the start-up period (18 months), the concession is taken never to have applied to the entity (that is, concession is removed retrospectively).

INDIRECT IMR CONCESSION

An IMR entity may qualify for the indirect IMR concession if:

- the IMR financial arrangement is made on the IMR entity's behalf by an independent Australian fund manager;
- if the issuer, or counterparty to, the IMR financial arrangement is an Australian resident – then the interest of the entity less than 10%; and
- does not carry on a trading business in Australia or control/able to control the affairs or operations of such a business.

However, if the independent Australian fund manager has a right to receive (either directly or indirectly), more than 20% of the IMR entity's

profits for that year, then the IMR concession is reduced by an equivalent percentage.

Independent Australian fund manager

A fund manager will qualify as an independent Australian fund manager where the following are satisfied:

- the managing entity is an Australian resident;
- the managing entity carries out investment management activities for the IMR entity in the ordinary course of its business;
- the managing entity's remuneration is an arm's length amount; and
- either of the following are satisfied:
  - the IMR entity is an widely held entity (refer to comments above); or
  - 70% or less of the managing entity's income for the income year is received from the IMR entity or its connected entities; or
  - If the managing entity has been carrying out investment management activities for 18 months or less – it is taking all reasonable steps to ensure that income received from the IMR entity or its connected entities will be reduced to 70% or less.

RELATED AMENDMENTS

One of the related amendments is to exclude business carried on by a partnership that solely relates to IMR financial arrangements from being used to determine if the partnership carries on business in Australia for the purposes of section 94T of the *Income Tax Assessment Act 1936*. This section deems a partnership to be an Australian resident where it carries on business in Australia and therefore, results in the partnership being subject to Australian tax in respect of its worldwide income. However, these amendments do not ignore the business carried on by the partnership (or its fund manager) for the purposes of the central management and control test contained in section 94T.

DATE OF EFFECT

These proposed changes are to apply to assessments for the 2015-16 income year and later income years. Further, the taxpayers may choose to apply the new rules (except taxpayers who are specifically listed widely held types of entities) to assessments for the 2011-12 to 2014-15 (inclusive) income years.

MORE INFORMATION

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