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Dear Sir/Madam

Collective Investment Vehicles – Withholding Tax

The Australian Custodial Services Association ("ACSA") appreciates the opportunity to review the policy proposals in relation to collective investment vehicles (CIV) withholding taxes and is pleased to be able to provide the submission set out in the letter in response to the issues raised in the Consultation Paper released in November 2016.

About ACSA

ACSA is the peak industry body representing members of Australia's custodial and investment administration sector. Collectively, the members of ACSA hold securities and investments valued at more than AUD $2.5 trillion in custody and under administration. Members of ACSA include NAB Asset Servicing, JP Morgan, HSBC, State Street, RBC Investor Services, BNP Paribas, Northern Trust, Citigroup and Bank of America Merrill Lynch.

Executive Summary

ACSA generally supports the initiatives of Government to promote Australia as a regional financial centre of which development of the corporate collective investment vehicle (CCIV) regime is an important part.

ACSA has considered the 3 proposals set out in the Consultation Paper as well as an additional proposal – a flat rate of 5% applying to all non-exempt distributions from CIVs and MITs.

Overall, ACSA believes the additional proposal should be preferred. Broadly, it is:

- the most efficient and straightforward for investors and for ease of implementation; and
- will overall have the most positive impact on encouraging investment in Australian managed funds.

Of the other 3 proposals, we consider Proposal C is slightly ahead of Proposal B but they both have complications. Proposal A is not really a feasible option because it will do nothing to encourage additional foreign investment.

The 3 Consultation Paper proposals have been assessed from the following perspectives:

1. ease of implementation on existing WHT systems for custodians;
2. overall positive impact on encouraging investment in Australian managed funds

Ease of implementation

On the first consideration, Proposal A is best as there is no change (CIVs would be added to the existing category of MITs).

Proposal B would involve creation of a new category of fund (Passport CIVs and MITs) on systems. Existing functionality would need to remain for non-Passport funds. The rates applied to the new fund category are straightforward – 5% or nil. However, alternative rates would potentially need to be applied to investors that are not resident in Passport countries. Furthermore, ACSA members are quite concerned about identifying Passport funds in practice (unless there is a public register maintained for such funds).

Proposal C would seem to involve adding CIVs to the existing category of MITs and applying the relevant rates as already set up on WHT systems. Separate rates would need to be created for real property amounts (rent and capital gains) – it is unclear whether the rate would be existing fund payment rates or some other rate. Identifying real property amounts could be complex (although gains should be aligned to current process for 'taxable Australian property').

On balance, ACSA believes Proposal C would be less complex to implement than Proposal B.

Overall positive impact on encouraging investment in Australian managed funds

Under this assessment it is noted that the Passport funds would represent new funds under management and any incentive to encourage such funds would be beneficial. Any addition to funds under management should be seen as beneficial to the Australian investment industry. Adopting Proposal B first could provide the ARFP the kick start it needs to get off the ground and head towards critical mass.

Proposal C is also seen as having merit, broadly because it would also encourage investment in existing MITs as well as investment in Passport funds.

Ultimately, however, if Government is really serious about creating a competitive fiscal and regulatory environment to attract scalable foreign investment into Australia, ACSA believes this should be achieved by moving to a flat rate of 5% for distributions of interest, unfranked dividends and other non-exempt income for both Passport and non-Passport CIVs and MITs. by a CIV or MIT to reduce the rate to 5% then it might as well extend to non-AFRP funds.

Consultation Questions

1. To what extent do you expect growth in funds and the funds management sector to come from:

1.1. increased investments by non-residents in foreign assets (conduit investments); and

1.2. increased investments by non-residents in Australian assets?

ACSA does not have a firm view on this issue and recommends that input be sought from those stakeholders more directly affected, such as fund managers.

2. What is the likely impact of past and announced initiatives on attracting inbound investment?

ACSA does not have a firm view on this issue and recommends that input be sought from those stakeholders more directly affected, such as fund managers. ACSA members can see the merit in implementing a CIV regime which offers more flexibility than the current regime and is more recognisable to foreign investors. However, ACSA's experience is that in order for any such initiatives to be successful, it should be:

- as simple and cost-effective as possible to implement and operate;
- provide certainty for investors, managers and custodians; and
- be operationally scalable.

3. How important is tax in determining the international competitiveness of Australia's funds management industry compared to other factors, such as the level of fees, the lack of an internationally recognised investment vehicle and the products offered?

Whilst not seeking to rank the relative importance of the various factors listed, ACSA notes that the level of withholding tax that can apply to distributions made by CIV's to non-residents can represent a significant proportion of that investor's financial return from the investment. The incidence of taxes is obviously determined by the nature of the investments undertaken by the Australian CIV.

ACSA notes that other jurisdictions allow for the development of CIV structures that allow for the distribution of income without additional withholding tax amounts levied in that jurisdiction. An example of this is Luxembourg (as noted on page 3 of the Consultation Paper representing the 2nd largest pool of funds under management). ACSA understands that, in part, the attraction of these vehicles is that managers are able to attract investors from multiple jurisdictions into a single investment vehicle / pool of assets giving rise to

efficiency gains without the need to duplicate portfolios into multiple products in multiple jurisdictions. From an investor's perspective, returns are provided free of any additional withholding tax levied in Luxembourg allowing for investors to consider the taxation impacts of their investment in their home jurisdiction only.

4. To what extent would any reduction in Australian withholding tax rates be clawed back by higher foreign taxes (through reduced foreign tax credits)? Please provide examples in other jurisdictions.

ACSA acknowledges and agrees with the commentary included within the Consultation Paper that there may be a degree of revenue transfer depending on the taxation status of the recipient and the taxation regime in its home country.

However, it is worth noting that revenue transfer considerations will not arise for institutional investors such sovereign wealth funds and foreign pension / superannuation funds – these are very important target investors and can provide genuine scale to enhance the feasibility of Passport funds. Most foreign jurisdictions adopt a different taxation model than Australia in that they exempt their pension funds from taxation on the earnings on the earnings derived from investments, regardless of source. Any withholding tax borne by them represents a real cost to these investors and as such, could represent a material consideration after-tax return on their investments. They would, other factors being equal, prefer to invest in a CIV that provides investment returns free of taxation.

ACSA anticipates that the greatest economic impact to Australian fund managers from a reduction in withholding tax would be from investments by large foreign institutional investors. It is most likely that the broader economic benefits (in the form of increased profits for Australian fund managers and associated service providers) arising from these investors would outweigh any revenue transfer that may arise for other investor types.

5. What are the key factors that contribute to the complexity of Australia's non-resident withholding tax regime?

Australia's complex non-resident withholding tax regime and current tax rates place the Australian funds at an immediate disadvantage in a global context and when compared against the counterparts in the UK, Europe and Asia. The removal of tax complexity of non-resident investors could strengthen Australia's international competitiveness and contribute to the expansion of Australia's financial services into the Asian region.

As the peak industry body that collectively represents the largest market share of the non-resident investors in Australia and the significant non-resident tax withholder our experience with the taxation system in this area has been challenging. This is as a result of complexity of the regime and the challenge of explaining and educating the non-resident investors in regards to the difficult tax rules and as such the simplicity of the policy design will be the key to the success.

The key factors that contribute to the complexity of Australia's non-resident withholding tax regime are outlined as below:

- Different tax treatment of various forms and classes of income
- Different tax rates applicable to each classes of income
- Bilateral Tax Treaties and Tax Information Exchange Agreements (TIEA) that impose different rates between countries
- Different basis for determining applicable WHT rate – dividends and interest – address of ultimate beneficial owner, fund payments – address of payee.
- Withholding on deemed payments
- Withholding on non-resident capital gains.

As outlined above, different tax treatment of various forms of income and different tax rates contribute to the complexity of Australia's non-resident withholding tax regime. Bilateral tax treaties including the Tax Information Exchange Agreements (TIEA) add further complexity by imposing different tax rates in different income between countries.

The withholding on deemed payments also known as the 'withholding on air ' adds further complexity and again introduces another level of variation in taxing approach of the non-resident investors. Extension of deemed payment and associated withholding tax to Passport funds will likely be very difficult to explain to potential and actual investors.

In respect of MIT withholding tax, whilst it is described as a 'final' tax, it can have the effect of being a provisional tax for non - resident investors in certain circumstances. This can arise where the ultimate beneficial owner is a resident of a non-Exchange of Information (EOI) country that holds investments through the EOI resident intermediary. The non-resident investor in this circumstance may be required pay further top up tax payment post the withholding.

The application of these rules in practice means that various income types paid to the non-resident investors such as dividend, interest, royalty and the fund payments each attract different tax rates determined by the tax residency status of the investor. This adds complexity in administering the withholding taxes and costing businesses in building complex systems to comply with the regime.

Accordingly, a non-resident investor considering investing into Australian market whom may not necessarily understand the Australian taxation law will find it difficult to navigate through the complex taxation maze and determine the tax cost arising from the investments. In fact the tax consequence can only be understood when the distribution is paid or deemed to be paid and broken down to components. This could act to deter investment in Australian funds with investors preferring alternative investments that provide more attractive and simpler tax settings by the other counterparts.

The recently introduced foreign resident CGT rules are complex for custodians to comply with – see ACSA's prior submissions on this measure, as provided to Treasury when the rules were being developed.

The attached flow chart diagram sets out current processes followed by a typical custodian for withholding tax purposes. As you can see there is substantial complexity.

6. How important is the principle of simplicity in Australia's non-resident withholding tax regime relative to the importance of the withholding tax rate?

The principle of simplicity is an important feature which should guide the design and operation of any taxation regime. Ensuring Australia's international competitiveness is also an important consideration. Each will impact the decisions of non-residents to invest into Australia.

ACSA members are also under obligations to withhold tax from amounts we pay to non-resident clients that have chosen to make investments in Australian entities. ACSA members see simplicity as an important factor. ACSA member will be required to administer any changes to the withholding tax regime, not only for the purposes of ensuring that they meet their own obligations for withholding but also for the purpose of providing registry services to their Australian resident clients who themselves have non-resident investors. In order to ensure that compliance costs are kept to a minimum for ACSA members, a withholding tax regime that is simple to administer will be key.

Further, our non-resident clients would also benefit from a withholding tax regime that is simple and easy to understand. ACSA members often receive feedback from our non-resident clients concerning the complexity of Australia's existing withholding tax regime – one which applies different rates of tax to different income types (dividends, interest and fund payments) and different rates of tax based on different principles, some based on tax residence and others based on the address of the recipient.

Although introducing a new withholding tax rate adds to the complexity of the withholding tax system, the additional complexity is only marginal. The increase in complexity should not be considered to outweigh the benefits from introducing the lower rate.

7. What options are there for simplifying Australia's non-resident withholding tax regime? To what extent do exemptions contribute to complexity?

As outlined in question 5, there are various layers of withholding tax complexity when considering the distinction between different classes of income, coupled with considerations when dealing with treaty/non-treaty countries, or Exchange of Information (EOI) country /non-EOI countries.

The option of simplifying the non-resident withholding tax regime is a welcomed change. The Consultation Paper proposal of a flat rate for CIV's is supported by ACSA. This would

enable foreign investors to better understand the Australian regime, as well as easing the compliance and processing burden on custodians and sub-custodians in the market.

However, it is noted that when determining the flat rate in the context of Government revenue, the rate should not be set *above* the minimum treaty rates, as this may re-introduce the treaty/non-treaty considerations.

Regarding other options to simplify the withholding tax regime, consideration may be given to other international laws being adopted – for example the Common Reporting Standards (CRS). It is noted that many non-EOI countries are adopting the CRS (for example, Hong Kong and Luxemburg) and given there are now information exchange channels being established, whether the distinction for non-EOI country withholding may remain relevant.

Finally, it is acknowledged that exemptions are an important tool within the international tax system, as it enables partner countries to foster and encourage cross-border investments. Nevertheless, introducing new exemptions to a CIV regime, based on either investor types or income classes, may undermine any simplicity that is being achieved through, for example the proposed flat rate of withholding tax.

8. To what extent do fund managers rely on marketing or their local distributors to explain the effective tax rates for non-resident investors? Does the approach differ between countries?

This question is aimed at fund managers so ACSA are not responding at this stage.

9. What are the merits of limiting the concessional rate of non-resident withholding tax to CIVs and MITs in the ARFP?

The merits of limiting the concessional rate of withholding tax are addressed in the Executive Summary of this submission. From an isolated perspective, limiting the concessional rate to ARFP CIVs would provide some impetus to allow the Passport fund initiative to gain traction with foreign investors at a competitive WHT rate. Foreign investors might then view Australian CIV ARFP investments on the same basis or a similar basis to SICAVs, OEICs and other foreign CIV offerings.

If confined to Passport funds, at least part of the existing WHT revenue streams for non-Passport vehicles would still be available. However, it is possible (probably likely) these existing WHT streams would be reduced as the non-Passport investments become less attractive to foreign investors.

Overall, however, ACSA believes the existence of differential rates for Passport and non-Passport funds will prove too confusing to foreign investors and be too complex from an implementation and processing perspective. ACSA recommends that the alternative proposal put forward in the Executive Summary be given careful consideration by Government.

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10. What are the merits and likely impacts (for example, compliance costs, revenue from funds management, employment, substitution effects, investment decisions of non-residents) on inbound investment from each of the proposals outlined above?

The merits and other impacts are difficult for ACSA and its members to assess – we expect the funds and industry bodies directly involved in scoping and establishing CIVs will have more to say on this point.

11. What are the main jurisdictions with which your fund competes in the funds management sector?

11.1. Are the funds management industries in these jurisdictions predominantly focussed on conduit foreign investments or domestically sourced investment?

11.2. What are the withholding rates (including any domestic concessions offered) in those jurisdictions for income from domestic shares, bonds and other income?

This question is aimed at fund managers so ACSA will not be responding at this stage.

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Please contact the co-chairs of ACSA's Tax Working Group, Mick Giddings on 0429 362 396 or Vera Markovski on (02) 9222 0379 to discuss any of the issues raised in this letter.

Yours sincerely

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Mick Giddings
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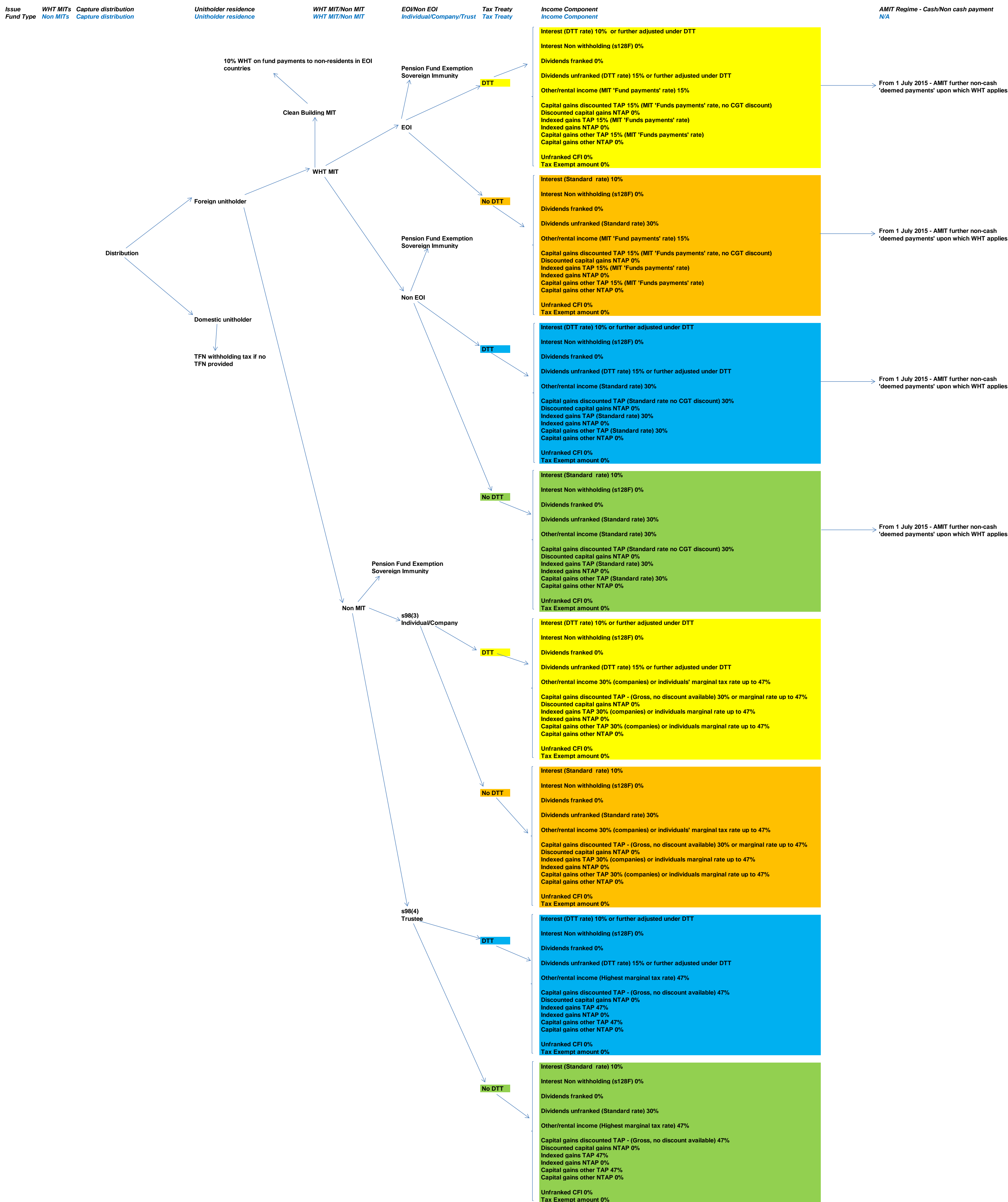
Withholding Tax Decision Tree
MITs/Non MITs



Notes
1. MIT = Managed Investment Trust with is an elgible withholding tax MIT
2. EOI = Exchange of Information Country
3. DTT = Double Taxation Treaty

Issues
1. Need to monitor for changes in DTT rates across all Tax Treaties
2. Need to monitor for updates to EOI/Non EOI countries
3. Need to update domestic tax rates for Non-MITs
4. Need to determine non-resident individual investors marginal tax rates for Non-MITs
5. Need to track deemed non-cash payments for AMITs (from 1 July 2015)
6. Need to monitor for exemptions such as certain foreign pension funds, sovereign exemptions, etc