

Investment Manager Regime: boosting foreign investment in Australia

Australia's fund (including hedge fund) market is set to grow, as the final element of the Investment Manager Regime (**IMR 3**) received Royal Assent on 24 June 2015. The IMR 3 provides tax concessions to foreign entities (such as foreign hedge funds investment in Australia and foreign hedge funds which invest through independent Australian fund managers), thereby making Australia an attractive market in which to invest and opening the Australian market to the global funds industry.

How did we get here?

With the aim of making Australia a leading regional financial services centre, the Australian Government has introduced the IMR regime in order to remove uncertainty for foreign investors, including those that use Australian-based fund managers

The Australian Financial Centre Forum (established in 2008 to examine ways to position Australia as a leading regional financial services centre), released a report in 2009 known as the 'Johnson Report'. That report highlighted that features of Australia's tax system could impede certain investment made by foreign investors into or through Australia.

As a result of the Johnson Report, the Board of Taxation recommended that a tax exemption regime apply to widely held foreign funds that invest directly in Australia, and also to certain investments made through an Australian based intermediaries or fund managers.

The 3 elements of the IMR

The three elements address uncertainty faced by foreign investors in respect of Australia's income tax laws

The IMR reforms include three elements:

- **IMR 1** – Mitigated the consequences of 'FIN48' by exempting foreign funds from Australian tax on passive investments.
- **MR 2** – Exemption from Australian tax where widely held foreign managed fund engaged an Australian-based financial services intermediary and the only reason why the foreign fund was taxable was because the fund engaged the financial services intermediary.
- **IMR 3** – Tax concessions for foreign investors deriving Australian sourced revenue.



Concessions under the complete IMR: an overview

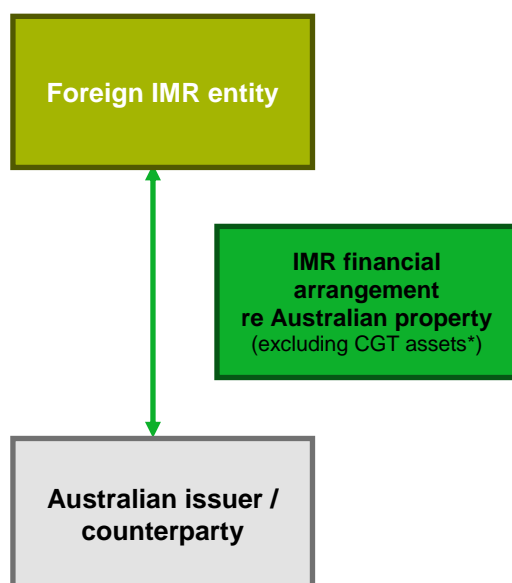
IMR 3 includes two concessions: a direct concession and an indirect concession.

The **direct concession** applies where a foreign investor (being one that is widely held) invests directly in Australia without engaging in a local manager to manage the asset.

The **indirect concession** applies where an Australian investment or fund manager is engaged. That is, the foreign investor invests through a local manager.

While the tests are a little more complex, the diagrams below highlight the key elements of each of the direct concession and indirect concession.

IMR direct concession

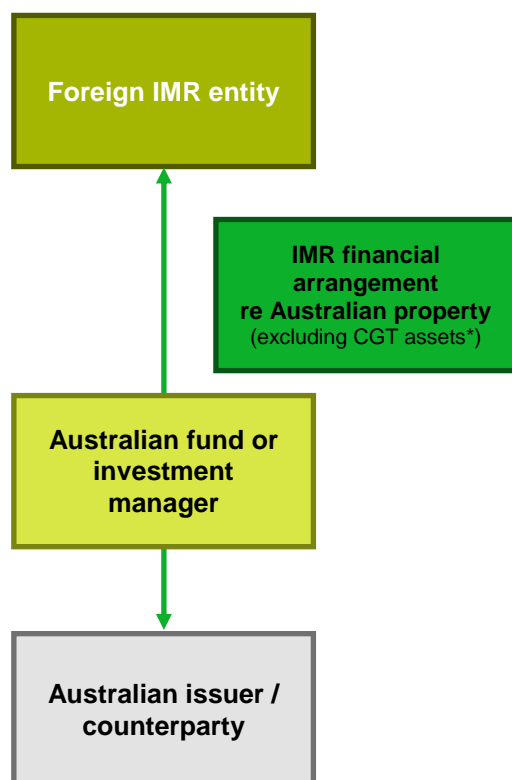


In order to qualify for the **direct concession**:

- The IMR entity must be **widely held**. That is, it must:
 - be a life insurer
 - be a managed investment trust
 - have no member that has total participation interests in the IMR entity of 20% or more, or
 - there are no five or fewer members who have a combined participation interest of at least 50%.
- The interest of the IMR entity in Australian issuer / counterparty must not exceed the '**non-portfolio interest test**'. This is satisfied if the IMR entity and its associates hold direct participation interests of less than 10%.
- No returns, gains or losses from the IMR arrangement are attributable to a **permanent establishment**.

*CGT assets include taxable Australian property and indirect Australian real property interests.

IMR indirect concession



*CGT assets include taxable Australian property and indirect Australian real property interests.

In order to qualify for the **indirect concession**:

- The IMR financial arrangement must be made on the IMR entity's behalf by an **independent Australian fund or investment manager**. That is, the Australian manager must:
 - carry out investment management activities for the IMR entity in the ordinary course of its business under arm's length commercial terms; and
 - the IMR entity must be widely held or the manager must not derive more than 70% of its income from the IMR entity (or its associates).
- If the Australian issuer / counterparty is an Australian resident, the interest of the IMR entity in Australian issuer / counterparty must not exceed the '**non-portfolio interest test**'.

In addition, it is important to note that if an Australian manager is entitled to 20% or more of the foreign IMR entity's profits for a year, then the IMR concession is reduced by an equivalent percentage for that year. For example, if the manager is entitled to receive 40% of the IMR entity's profits, then the IMR concession is reduced by 40%.

How Clifford Chance can help

Our funds and investment management team can help you to establish and advise on a suitable structure, navigate your way through the IMR and advise on the Australian regulatory regime.

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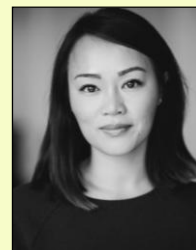
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