



GATEWAY INSIGHTS

March 2011

23Bye to FIF, hello to FAF

At the recent Australasian Financial Forum chaired by David Thomas of ThinkGlobal Consulting, participants had a very informative presentation from Andrew Clements, a taxation partner at Malleson Stephen Jacques. For this Insight we thought it would extremely useful for our clients to translate Andrew's tax speak into investment language. Please note that Gateway are not tax experts so this information is provided on a best endeavours basis!

FIF repealed

The existing Australian Foreign Investment Fund (FIF) rules have been repealed. As at 30 June 2011 there will be no need for bed and breakfasting or any other measures to circumvent the FIF legislation by foreign fund management companies. Instead we are likely to have the FAF (Foreign Accumulation Fund) rules. These FAF rules have not been passed yet, but are likely to be considered during the June sitting of parliament prior to the end of the 2010/2011 financial year.

The position at present is somewhat unusual because of the way Australian tax legislation is typically repealed and introduced. The *Tax Laws Amendment (Foreign Source Income Deferral) Act (No. 1) 2010* took effect on 14 July 2010 and repealed the FIF rules. However, as at that date, legislation dealing with the anti-avoidance rules which were to replace the FIF rules was still at the initial exposure draft stage.

What is FAF?

The FAF (Foreign Accumulation Fund) rules will apply to foreign corporations, limited partnerships and fixed trusts unless the fund is a non-debt fund or the fund is a fully distributing debt fund. In all other instances under the FAF regime, the change in the market value of the interest in the FAF will be taxed as ordinary income.

The Government's aim for the reforms is to reduce complexity and compliance costs, thereby improving the competitiveness of Australian businesses with offshore operations and encouraging foreign groups to establish regional headquarters in Australia.

Under the exposure draft legislation the FAF regime is directed at Australian residents, Australian trusts and Australian partnerships that hold interests in a FAF and that FAF is not a controlled foreign corporation (CFC) for which the resident is an attributable taxpayer. Taxpayers holding such interests will be required to include FAF attributable income in their assessable income for the relevant income year.

Entities proposed to be treated as FAFs

A FAF is proposed to be defined as:

- non-resident company or non-resident fixed trust
- that meets the "investments requirement", and
- that meets the "accumulation requirement".

This definition is critical to the operation of the proposed provisions. An entity will not be a FAF if it lacks any of the above features.

Investments requirement

The investments requirement will be satisfied if the market value of all debt interests held by the entity comprises 80 per cent or more of the market value of all assets held by the entity. Notes released by the Government that accompanied the Exposure Draft legislation indicate that this requirement is designed to "target entities investing to receive low-risk, interest-like returns". This is an important requirement and is expected to significantly limit the types of entities that will be treated as FAF's. An offshore fund that predominantly undertakes equity investments would therefore not be treated as a FAF.

Accumulation requirement

This requirement will be satisfied unless 80 per cent or more of the profits or gains of the entity are distributed within the distribution period. Entities seeking to avoid satisfying the accumulation requirement must, in the case of companies (or entities taxed as companies) ensure that 80 per cent or more of its profits and gains are distributed in the distribution period which starts at the commencement of the entity's "FAF statutory accounting period" (which is the 12 month period for which accounts are prepared for the entity in compliance with the tax laws of a country) and ends 3 months after the end of that period.

A trust will not be caught if an amount of 80 per cent or more of its profits and gains is distributed in the distribution period or otherwise constitutes net income of the trust that is included in the assessable income of 1 or more beneficiaries of the trust.

FAFs may be prescribed by regulation

Regulations may also prescribe kinds of entity that are to be treated as FAFs if they meet the investments requirement and any other requirements set by those regulations.

Implications of the FAF Regime

If the FAF legislation is passed in its current form foreign fund managers will be able to offer foreign funds – funds managed out of other global centres, including the Cayman Islands, Luxembourg, etc without any tax impediments in Australia. This is a very exciting development for offshore fund managers and should create a lot more interest in the Australian market from offshore competitors.

Summary

Anecdotal evidence is that global fund managers have renewed interest in the Australian market as a result of these legislative changes. However those who are concerned about the increased level of competition might also note that there has always been a preference for home based product in Australia, as evidenced by our large allocation to Australian equities in our portfolios versus Australia's global equities weighting.

References:

Australasian Financial Forum run by David Thomas at ThinkGlobal www.thinkglobal.com.au

Australasian Financial Forum Seminar , 17 March 2011

A Brave New World – New investment and Product Opportunities under the new FAF and CFC rules
Andrew Clements, Partner, Malleson Stephen Jacques

Australia: Foreign Accumulation Fund Rules – More Revealed , 10 March 2011; Peter Norman and Fadi Khoury ,
Norton Rose

[About Gateway](#)

Gateway Financial Marketing (Gateway) was established in February 2004 by Amanda Rethus and Edwina Best for the purpose of offering fund managers, other product providers and international new entrants, expert advice, services and assistance in negotiating entry into the Australian Retail Financial Services market. Use of Gateway's services provides the opportunity for clients to overcome the hurdles that can often confront fund managers when transitioning from institutional to retail and hence improve participation in retail funds flow. Prior to Gateway, Amanda and Edwina spent over 30 years combined with major institutions in the Retail Financial Services market.

Our qualifications

Amanda has over 20 years' experience in the Financial Services industry and was formerly a Divisional Director in the Financial Services Group of Macquarie. Amanda managed investment portfolios for over 10 years, and has spent in excess of 10 years introducing investment products to the Australian Retail market.

Edwina has a Bachelor of Business from UTS majoring in Marketing and International Business. She has over 15 years' experience in the financial services market, concentrating in relationship management, product management and marketing. They both have extensive contacts in the retail financial services market especially with key decision makers.

If you would like to confidentially discuss your current approach to the retail market or have any questions on the above please do not hesitate to contact us on – Edwina 0404 046 179 or Amanda or 0414 658 323.