



28 February 2011

Mr Richard Warburton AO
Chairman, Board of Taxation
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Dear Mr Warburton

SUBMISSION ON THE REVIEW OF TAX ARRANGEMENTS APPLYING TO COLLECTIVE INVESTMENT VEHICLES

Brookvine Pty Ltd (ABN 53 098 072 390; AFSL 246450) (Brookvine) is a leading Sydney-based business focussed on the establishment, support and marketing of specialist investment businesses in emerging and alternative investment opportunities. We have been doing so since 2001 and have raised over \$7.5 billion of investment funds on behalf of a group of funds managers. Many of these managers are now widely recognised by Australian and offshore investors as leaders in their respective fields. We have also been at the vanguard of the introduction of new investment asset classes into the Australian market.

Focus of Brookvine's Submission

We are pleased to have the opportunity to input into the Board of Taxations review, specifically in relation to the application of Division 6C and question 2.2 regarding the rules for defining "Primarily Passive Investments" and the appropriateness of the current definition of "eligible investment business" in Division 6C of the ITAA 1936 as a prerequisite for a wider range of Collective Investment Vehicles.

The Critical Problem with the Current Definition of Eligible Investment Business in Division 6C of the ITAA 1936

The current definition of "eligible investment business" in Division 6C of the ITAA 1936 does not sufficiently accommodate the evolution of new passive investment activities.

By way of background the S102M definition of an “eligible investment business” was extended in 1998 (Taxation Laws Amendment Bill (No. 4) 1988) with the inclusion of a reference to “any similar financial instruments”. The reference to “any similar financial instruments” in subparagraph 102M(b)(xiii) was intended to obviate the need for further amendments to the term “eligible investment business” if further acceptable variants of existing financial instruments were developed. However there remains a lack of clarity as to how the emphasis on “acceptable variants of existing financial instruments” should be interpreted and consequently insufficient guidance in the approach to new asset classes.

The downside to the lack of qualification for Division 6C is significant. If the investment does not qualify then Division 6C (broadly) treats the investment vehicle as if it were a company for taxation purposes. Moreover an investment activity must be an “eligible investment business” as a prerequisite for Managed Investment Trust (MIT) status. An MIT is an ideal vehicle for investment managers to attract and commingle foreign capital with Australian investor capital.

Thus currently investors are faced with the danger of significant downside if the investment does not qualify for Division 6C, and the situation is made worse by confusion over the acceptability of financial instruments that are not very clearly in the form of a single eligible investment business in section 102M, such as a bond, stock, debenture or share in a company. Worse it creates an uneven playing field between traditional and newer passively managed investments.

Examples of investment opportunities that are impacted by the lack of clarity and potential disadvantages are opportunities to invest in water entitlements and certain other emerging carbon and environmental credit markets.

For example, an investment in Australian water entitlements constitutes a right or contract with respect to an underlying asset, derives value from an underlying asset, derives a return via holding, trading and portfolio management, and trades in a regulated market where buyers and sellers agree price, terms and conditions of the transaction. It does not involve the physical delivery or storage of an underlying asset, there is no provision of services or conduct of any business activity to derive an income return, and there is no application of human labour and/ or capital to improve value, transform or otherwise develop the security and/ or the underlying asset. Accordingly it shares a set of core characteristics common to all of the single financial instruments listed in paragraph 102M(b), but may fail to meet all of the core characteristics of any single financial instrument.

Why is this Important?

The attraction of long term and patient institutional investment capital from Australian and offshore investors is critical to the development of new Australian investment markets, the emergence of new Australian investment opportunities and the fostering of a more vibrant universe of Australian investment managers. Failure to be clear about the inclusion of financial instruments such as those discussed above as an “eligible investment business” actively discourages investment in Australian investment vehicles by both Australian and offshore investors. It significantly diminishes the attractiveness of these opportunities from the perspective of Australian investors. Further it disadvantages Australian investors over non-resident investors. The latter are encouraged to pursue investment via an offshore fund that is not likely to be taxed as if it were a company.

Brookvine’s Recommendation

Brookvine recommends the Board of Taxation consider a regime that has adequate flexibility to recognise and include within the definition of “eligible investment business” and the rules contained within Division 6C of the Income Tax Assessment Act, new and emerging investment activity of a primarily passive nature.

We recommend the following:

1. The current definition of eligible investment business contained within section 102M, and in particular section b (xiii) referring to “any similar financial instruments”, should be changed or guidance provided such that the ATO may allow situations where new and emerging classes of investment which are materially similar to presently existing financial instruments can be included within the definition of eligible investment business; and/ or
2. The ATO include a new subsection or paragraph for new and emerging classes of investments (such as water entitlements and certain other emerging carbon and environmental credit markets) provided they are conducted passively.

An evidence based approach to the inclusion of new and emerging classes of investment based on the actual nature of their investment activity would be useful in ensuring more flexible yet equitable outcomes consistent with the intent of the legislation, rather than a strict deeming in or out approach.

Yours sincerely

Steven Hall
Chief Executive Officer