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The International Comparative Legal Guide to:

Alternative Investment Funds 2019

7th Edition

A practical cross-border insight into Alternative Investment Funds work

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Publisher
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Oliver Smith

Senior Editors
Caroline Collingwood
Rachel Williams

Group Consulting Editor
Alan Falach

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Global Legal Group Ltd.
59 Tanner Street
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Tel: +44 20 7367 0720
Fax: +44 20 7407 5255
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Australia

Austin Bell

Andy Milidoni

Johnson Winter & Slattery

1 Regulatory Framework

1.1 What legislation governs the establishment and operation of Alternative Investment Funds?

Alternative Investment Funds (AIFs) can take a number of different structural forms in Australia. They may be required to be registered as a managed investment scheme (MIS) and may or may not be listed on a market such as the Australian Securities Exchange (ASX).

Most Australian AIFs are trust structures, but partnerships and limited partnerships and investment contracts are also used as well as stapled structures, where combinations of trust and company structure investments are held by each investor.

For these types of structures, the core regulation is the regulation of MISs in the *Corporations Act 2001* (Cth), *Corporations Regulations 2001* (Cth) and *Australian Securities and Investments Commission Act 2001* (Cth) (ASIC Act) administered by the Australian Securities and Investments Commission (ASIC).

AIFs generally fall within the definition and regulation under the Corporations Act of managed investment schemes (MIS). An MIS is broadly defined as a scheme where:

- people contribute money or money's worth to acquire rights to benefits produced by the scheme;
- any of the contributions are pooled or used in a common enterprise to produce financial benefits or property rights or interests for scheme members (as contributors or their transferees or assigns); and
- members do not have day-to-day control of the scheme's operation (even if they have a right to be consulted or give directions).

Exceptions apply for structures that are otherwise regulated including bodies corporate, debentures, outsize partnerships (generally professional partnerships, such as partnerships of accountants and lawyers) and schemes operated by authorised deposit-taking institutions (ADIs) (i.e. banks and other financial institutions) in the ordinary course of their banking business. ASIC also has power to grant exemptions or to modify the way that the MIS regulation applies.

The main areas of legislative regulation relevant to MISs under the Corporations Act are:

- structural and operational regulation of MISs under Chapter 5C;
- disclosure materials requirements under Chapter 7 and the ASIC Act;
- continuous disclosure and, for listed MISs, takeovers and substantial holding regulation under Chapters 6 to 6CA; and
- marketing and market conduct restrictions, licensing requirements and regulation of dealers, advisers, AIF operators and market operators under Chapter 7.

Privacy, anti-money laundering and taxation (including income and capital gains tax, goods and services tax (GST) and stamp duty) legislation, including the following, is also relevant:

- the *Privacy Act 1988* (Cth);
- the *Anti-money Laundering and Counter-Terrorism Financing Act 2006* (Cth);
- the *Income Tax Assessment Act 1997* (Cth), the *Income Tax Assessment Act 1936* (Cth) and the *Taxation Administration Act 1953* (Cth); and
- *A New Tax System (Goods and Services Tax) Act 1999* (Cth) (GST Act).

The Australian Taxation Office (ATO) administers the taxation system. AUSTRAC is the anti-money laundering and counter-terrorism financing regulator and there are various state authorities that administer state stamp duties collection.

In addition to legislation, the general law must be considered and listed AIFs must comply with the Listing Rules. For MISs, general trust law is particularly relevant as, even if the AIF is not structured as a trust, an MIS will always involve at least a statutory trust of MIS property for the investors under Chapter 5C of the Corporations Act.

There is also proposed legislation to provide for corporate collective investment vehicles (CCIVs) which are intended to be an alternative structure to an MIS. A CCIV will be a collective investment vehicle that is a public company, structured as an umbrella fund incorporating one or more sub-funds.

1.2 Are managers or advisers to Alternative Investment Funds required to be licensed, authorised or regulated by a regulatory body?

Anyone who deals, arranges or advises in respect of, underwrites or makes a market for, a financial product, operates (acts as the responsible entity of) an MIS, provides a custodial or depositary service or otherwise carries on a financial services business in Australia is required to hold an Australian financial services (AFS) licence that is issued by ASIC under the Corporations Act.

Limited exceptions apply. For example, as at the date of this publication, conditional exemptions apply to some advisers and dealers with UK, US, Singapore, Hong Kong, German or Luxembourg local licences where their activities in Australia are

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confined to wholesale clients, not retail clients – foreign financial service provider (FFSP) exemptions. These conditional exemptions available to regulated FFSPs are under review by ASIC. They are due to expire on 30 September 2019, but ASIC has proposed that they be extended until 31 March 2020 and then be further extended for a further two years until 31 March 2022 during which time FFSPs that currently rely on the exemption can obtain a "foreign AFS licence", as proposed in ASIC Consultation Paper 315.

1.3 Are Alternative Investment Funds themselves required to be licensed, authorised or regulated by a regulatory body?

AIFs that are MISs made available to retail investors are generally required to be registered and to comply with Chapter 5C of the Corporations Act.

Registered MISs are subject to regulation by ASIC, and must have an operator called a 'responsible entity' (RE), auditors and, in some cases, a Compliance Committee. They must also have a Constitution and a Compliance Plan, both of which comply with the requirements of Chapter 5C of the Corporations Act.

Registration of an MIS is required under Chapter 5C if the AIF has more than 20 members or was promoted by a person, or their associate, who was in the business of promoting schemes when the scheme was promoted. In counting the 20 members, ASIC can aggregate the members of closely related schemes and there is a look through to the underlying members of trust investors where any beneficiaries of the investor trust are presently entitled to a share of the trust estate or income, or to control the trustee.

However, if the only issues of interests in the AIF did not require a disclosure document under Chapter 7.9 of the Corporations Act (i.e. a product disclosure statement or "PDS") when the issues were made, then the MIS need not be registered. Disclosure under that Chapter is generally required for 'retail clients' but not for 'wholesale clients' (see section 3 below). Therefore AIFs that are offered and issued only to wholesale clients typically do not require registration under Chapter 5C and are not subject to the detailed disclosure document requirements applicable to a PDS in Chapter 7.

Whether an investor is a wholesale client for this purpose, depends on the amount that they invest in the particular AIF, the amount of money that the investor controls or the type of body that the investor is. For example, an entity is a wholesale client if they fall within one of the following categories (or if they are a foreign entity which, had they been Australian, would be covered by one of the categories):

(a) the price or value of the AIF interests to be acquired by the investor is at least A$500,000 (excluding amounts borrowed from the AIF offeror or their associate);

(b) the AIF investment is provided for use in conjunction with a business that is not a small business (being a business that has less than 100 employees (for a business of, or including, the manufacture of goods) and otherwise 20 employees);

(c) the investor provides a certificate given within the preceding 24 months by a qualified accountant stating that the person had net assets of at least A$2.5 million or gross income for each of the last two years of at least A$250,000;

(d) the investor holds an AFS licence, is a body regulated by the Australian Prudential Regulation Authority (APRA) (for instance, a bank), is registered under the *Financial Corporations Act 1974* (Cth), is an exempt public authority or is a listed entity or one of the listed entity's related bodies corporate;

(e) the investor controls A$10 million or more or is the trustee of certain superannuation funds where the fund has net assets of at least A$10 million; or

(f) the investor is a body that carries on the business of investing in financial products, interests in land or other investments and invests funds raised from the public on terms which provide for use of the funds raised for that purpose.

Application can be made by ASIC or an investor in the AIF to have it wound up if it has not been registered when required.

A registered MIS must be operated by a public company that has an AFS licence that authorises it to operate the MIS. This company is called the "responsible entity" (RE). It has various duties to the investors in the MIS, as does the board of directors of the RE (that override any conflicting duties to the members of the RE company).

If at least 50 per cent of the members of the board of the RE are not "external" (which requires satisfaction of standards of independence), then there must also be a Compliance Committee for the MIS (comprised of at least three members and at least 50 per cent of the members must be 'external' to the RE). The Committee is appointed by the RE and is to monitor the extent of compliance by the RE with the MIS's Compliance Plan, report to the RE about breaches of the Corporations Act or MIS Constitution, and report to ASIC if the Committee is of the view that the RE is not taking appropriate action to deal with any matter that the Committee has reported. The Committee must also assess the adequacy of the Compliance Plan at regular intervals and report to the RE any changes that the Committee considers should be made. Requested changes must also be reported to ASIC where they amount to a breach of the Corporations Act. The Committee has authority to commission independent legal, accounting and professional advice or assistance at the reasonable expense of the RE and must also assist ASIC where ASIC conducts surveillance checks of the RE's compliance with the Constitution, the Compliance Plan and the Corporations Act.

The MIS must have a Constitution and Compliance Plan:

- The Constitution sets out the rules governing the operation of the AIF and must contain adequate provisions about pricing, investment powers and borrowing, how complaints are dealt with, an investor's withdrawal rights (if any), the RE's fees and indemnity and winding the AIF up.
- The Compliance Plan must specify adequate measures that the RE is to apply to ensure that the AIF is operated in accordance with its Constitution and the Corporations Act.

A Compliance Plan auditor must be appointed by the RE, who conducts an annual audit of compliance with the Compliance Plan, provides a report to the RE (which the RE lodges with ASIC with its annual financial statements) and, in circumstances of continuing non-compliance, to ASIC.

An AIF is, for the purposes of the GST Act, considered to be an entity and will need to register under that Act if the annual turnover of the AIF for the previous 12 months (or projected annual turnover for the next 12 months) in relation to supplies of the AIF that are not input taxed, is A$75,000 or more.

Further authorisation or registration requirements may apply to particular types of AIFs. For example, an AIF structured as a limited partnership must also be registered under the relevant state partnership legislation. AIFs listed on the Australian Securities Exchange (ASX) must also comply with the ASX Listing Rules and are under the regulation of the ASX as well as ASIC.

1.4 Does the regulatory regime distinguish between open-ended and closed-ended Alternative Investment Funds (or otherwise differentiate between different types of funds or strategies (e.g. private equity v hedge)) and, if so, how?

The regulatory regime in Australia does not distinguish between open-ended and closed-ended AIFs.

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The main regulatory distinction between AIFs depends on whether the target investors are retail clients or wholesale clients. AIFs offered to retail investors are subject to a highly regulated regime affecting their structure, operation, initial and ongoing disclosure and distribution. In contrast, the requirements applicable to AIFs offered only to wholesale clients are subject to more general requirements as to licensing for offerors, disclosure and conduct.

There are also distinctions in disclosure documents for simple MISs (that do not qualify as a 'hedge fund' within the meaning of ASIC RG 240) so that a short (eight-page) PDS is required to be used, with further information available on the AIF's website. Whether an AIF qualifies as a simple MIS will depend on whether at least 80 per cent of the AIF's assets are in short-term bank deposits or are realisable at market value within 10 business days (see question 3.2 below).

ASIC also imposes some AFS licensing conditions for particular types of funds, and disclosure standards have been developed based on the fund type. For instance, there are licensing conditions associated with registration of interests in land for primary production schemes, and ASIC has developed a regime of 'If not, why not?' reporting against particular disclosure standards based on fund types including agri-business, direct real property, infrastructure and hedge funds.

1.5 What does the authorisation process involve and how long does the process typically take?

Authorisation for an AIF requires the licensing of the operator RE (see question 1.2 above) and registration of the AIF (see question 1.3 above).

Licensing entails meeting various competencies including financial, resource, education and experience criteria.

To register the AIF, the name of the AIF must not be the same as an existing registered fund and application must be made to ASIC by lodging the required form together with a complying MIS Constitution, Compliance Plan and a statement of compliance made by the directors of the RE. Arrangements must also be in place for engagement of an eligible Compliance Plan auditor and, if required, a Compliance Committee (see question 1.3 above).

Following lodgment of the application, ASIC must register the MIS within 14 days unless it appears to ASIC that there is non-compliance with requirements about the registration application, the RE, the Constitution or the Compliance Plan.

Since April 2019, ASIC has new powers to make 'product intervention orders'. These are generally referred to as the PIP – product intervention powers. Subject to certain limitations, if ASIC is satisfied that a financial product, such as an AIF, is, or is likely to be, available to retail clients and has resulted in, or will or is likely to result in, significant detriment to retail clients, ASIC may order that a specified person must not engage in specified conduct in relation to the product, either without or except in accordance with conditions.

1.6 Are there local residence or other local qualification requirements?

As mentioned in question 1.3 above, an AIF that is registered as an MIS would need a public company RE. A public company must have at least three directors and at least two must ordinarily reside in Australia.

If an off-shore entity engages in offerings in Australia, then the foreign operator may be conducting business in Australia. If that is the case, then it must be registered as a foreign company under the Corporations Act and must appoint a local agent.

1.7 What service providers are required?

As mentioned in question 1.3 above, the main service providers required for registered MISs are: an RE to operate the AIF; auditors; and possibly a Compliance Committee. To meet AFS licensing requirements, a custodian may be appointed to hold fund property if the RE does not meet the required net tangible assets threshold. Otherwise, there is no legislative requirement to engage any service provider.

If the RE of a registered MIS does engage any agent or service provider, then, as between itself and the AIF investors, the RE will be liable for the acts of the appointee, even if the appointee acts outside the scope of their authority but because of the appointment. Also, as the acts and omissions of the appointees are taken to be the acts or omissions of the RE, if the appointee's conduct is not the proper performance of the RE's duties, this can affect the RE's indemnity and entitlement to payment of fees from the AIF property.

1.8 What rules apply to foreign managers or advisers wishing to manage, advise, or otherwise operate funds domiciled in your jurisdiction?

Generally, the rules that apply to domestic managers or advisers wishing to manage, advise or otherwise operate AIFs domiciled in Australia, also apply to foreign managers or advisers wishing to do the same. If the activity amounts to carrying on a financial services business in Australia, the foreign manager will need to hold an AFS licence or have the benefit of an exemption from holding an AFS licence. As noted in question 1.2 above, certain FFSPs that are regulated in certain foreign jurisdictions can register with ASIC to have the benefit of a conditional exemption for most activities. The exemptions do not extend to operating an AIF that is registered with ASIC as a managed investment scheme.

The same distribution, disclosure and fund registration requirements applicable to domestic advisers and managers also apply to foreign advisers and managers.

1.9 What co-operation or information sharing agreements have been entered into with other governments or regulators?

ASIC is a signatory to the International Organization of Securities Commissions (IOSCO) Multilateral Memorandum of Understanding (MOU) and 52 bilateral MOUs. The MOUs set out ASIC's mutual assistance and information exchange for the purpose of enforcing and securing compliance with laws of the signatories.

This includes MOUs signed in July 2013 with 28 European Union states for mutual assistance in the supervision and oversight of managers of AIFs. These arrangements have been approved by the European Securities and Markets Authority (ESMA).

The bilateral MOUs are with Austria, Belgium, Brazil, Bulgaria, Canada, China, Cyprus, Czech Republic, Denmark, Estonia, the European Securities and Markets Authority, Finland, France, Germany, Gibraltar, Greece, Guernsey, Hong Kong, Hungary, Iceland, Indonesia, Ireland, Isle of Man, Israel, Italy, Japan, States of Jersey, Kenya, Korea, Latvia, Liechtenstein, Lithuania, Luxembourg, Malaysia, Malta, Netherlands, New Zealand, Norway, Pakistan, Papua New Guinea, Poland, Portugal, Romania, Singapore, Slovak Republic, South Africa, Spain, Sri Lanka, Sweden, Taiwan, Thailand, Turkey, United Arab Emirates, United Kingdom and United States.

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Australia is also signatory to the Asia Region Funds Passport (ARFP). The ARFP is a multilaterally agreed framework intended to facilitate the cross-border marketing of managed funds across participating economies in the Asia region. Since 1 February 2019, complying funds in Japan and Thailand can apply to register their fund in Australia under the passport.

Registered passport funds will need to comply with the Passport Rules. These rules cover permitted investments, portfolio restrictions and limits, breach reporting obligations, reporting obligations in connection with a fund's home jurisdiction, financial reporting obligations, redemptions and valuations.

2 Fund Structures

2.1 What are the principal legal structures used for Alternative Investment Funds?

See question 1.1 above.

2.2 Please describe the limited liability of investors.

The potential liability of investors depends on the AIF structure.

For example, for an AIF structured as a trust, the trust is not a separate entity and the trustee/operator is personally liable for all investments and activities of the AIF. The legal position of the AIF investors is based on the case law and the terms of the trust under the trust deed. Whilst the position is not entirely clear, state case law indicates that the liability of the investor is limited if there is a suitable clause in the trust deed that limits the liability of the investor, for example, to the amount of their investment.

For an AIF structured as a partnership, the partner investors will be jointly and severally liable for the partnership liabilities, unless the partnership is registered as a limited partnership under the relevant state partnership legislation. For example, under the *Partnership Act 1892* (in the state of New South Wales) a limited partner who does not take part in the management of the business of the partnership (within the meaning under that Act) will have no liability, merely by virtue of its status and capacity as a limited partner, for the liabilities of the partnership or the general partner and will not be bound by the conduct of any other limited partner in the partnership. However, some liabilities associated with a partnership (such as pay as you go withholding tax amounts and the associated general interest charge, and GST liabilities) may be liabilities of the partners themselves, in which case they will be unlimited.

Many contract-based AIFs take this form as it is important that the investments are part of a business conducted by the investor. In those cases, the AIF operator contracts as agent for the investor and the investor's liability will only be limited to the extent that each of the arrangement's third parties validly limits that liability.

2.3 What are the principal legal structures used for managers and advisers of Alternative Investment Funds?

As noted in question 1.3 above, the RE operator of a registered MIS AIF must be a public company under the Corporations Act.

Managers and advisers of AIFs are, in any event, typically structured as proprietary limited or public companies in Australia due, for instance, to the limited liability of the shareholders.

2.4 Are there any limits on the manager's ability to restrict redemptions in open-ended funds or transfers in open-ended or closed-ended funds?

Redemptions

For a registered MIS, the terms of the investors' withdrawal rights must be specified in the MIS Constitution and must be fair as between the members of all classes of interests issued in the fund. If any restrictions are to apply to those rights then they must also be specified in the Constitution. Further, where the fund is 'illiquid' (i.e. where less than 80 per cent of the MIS assets are liquid – as determined in accordance with the Corporations Act) then withdrawal is only permitted in compliance with Part 5C.6 of the Corporations Act. That part only permits *ad hoc* offers of withdrawal to investors where the offer is open for at least 21 days, the source of funds and estimated amount of money to meet the requests is identified, and requests received are met *pro rata* where all requests cannot be met in full.

For any AIF, any restrictions imposed on withdrawals must be consistent with any duties of the operator/manager and the constituent documents of the AIF. For example, for AIFs structured as trusts (whether or not they are a registered MIS), the trustee/RE has various duties to the investors including duties to treat the investors equally/not discriminate between investors. So, any restrictions on redemption must apply equally to the investors (at least where they hold the same class of investment).

AIFs listed on the ASX generally cannot be redeemed (unless they are listed as exchange-traded funds (ETFs)), although buybacks may be permitted.

Transfers

For AIFs that are not listed on the ASX, the manager may restrict transfers. The Listing Rules for ASX-listed AIFs require the unrestricted transferability of the quoted interests in the AIF.

For a registered MIS, any restrictions on transfer must be specified in the AIF's Constitution. It is common for a constitution for an unlisted AIF to impose at least minimal restrictions on transfer – the AIF operator may have discretion whether to accept transfers and typically it is provided that transfers do not take effect until registered in the register of AIF investors. It is also an offence under various states' stamp duties legislation to register transfers that have not been stamped as required, and this will generally be reflected in the MIS Constitution.

2.5 Are there any legislative restrictions on transfers of investors' interests in Alternative Investment Funds?

Transfers of interests in an AIF that is a registered MIS must comply with some Corporations Act requirements, principally as to form and signature.

Listed AIFs are also subject to takeover restrictions that (subject to certain exceptions) limit relevant interests to less than 20 per cent without making a regulated takeover offer, as well as compulsory acquisition provisions and substantial shareholding and relevant interest reporting requirements.

2.6 Are there any other limitations on a manager's ability to manage its funds (e.g. diversification requirements, asset stripping rules)?

The law does not impose any limitation on a manager's ability to manage its funds. See, however, question 1.5 above in relation to ASIC's new powers to make product intervention orders in certain circumstances.

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3 Marketing

3.1 What legislation governs the production and offering of marketing materials?

Marketing materials for AIFs are regulated by Chapter 7 of the Corporations Act, and the ASIC Act. ASIC has also issued Regulatory Guide 234: Advertising financial products and services (including credit): Good practice guidance.

Part 7.8A of the Corporations Act will commence in April 2021 – "design and distribution requirements relating to financial products for retail clients" (DD Obligations). Pursuant to the DD Obligations, an issuer of AIFs offered to retail clients will need to prepare a target market determination (TMD). A TMD must, among other things, describe the class of retail clients that comprises the target market for the AIF; specify any conditions and restrictions on retail product distribution conduct in relation to the AIF (other than restrictions imposed by the Corporations Act); specify events and circumstances (review triggers) that would reasonably suggest that the determination is no longer appropriate; specify the maximum period from the start of the day the determination is made to the start of the day of the first review. The issuer of an AIF must review the TMD at intervals that are reasonable in the circumstances and maintain records in accordance with Part 7.8A. The issuer of an AIF that made a TMD must also take reasonable steps that will, or are reasonably likely to, result in retail product distribution conduct in relation to the AIF being consistent with the TMD.

In addition to the applicable legislation, requirements and restrictions under general law may also apply.

3.2 Is the concept of "pre-marketing" (or equivalent) recognised in your jurisdiction? If so, how has it been defined (by law and/or practice)?

From April 2021, the DD Obligations will apply to issuers of AIFs. See question 3.1.

3.3 What are the key content requirements for marketing materials, whether due to legal requirements or customary practice?

A product disclosure statement (PDS) is required to be given to a retail client investor in a financial product such as an MIS.

A PDS must be up to date and 'clear, concise and effective' and must contain prescribed statements and disclose the following in relation to the AIF:

- the significant benefits and risks;
- the costs, fees and charges;
- details about dispute resolution;
- significant taxation implications;
- details of payments that may affect returns;
- in some cases, information about the availability of accounts; and
- whether ethical considerations are taken into account in investing.

However, a short-form PDS may be used if the AIF is a "simple managed investment scheme" – i.e. one where the RE can reasonably expect to realise 80 per cent of the AIF assets for market value within 10 days – and is not a 'hedge fund', as defined in ASIC Regulatory Guide 240. A PDS for a simple MIS must be no longer than eight pages and must contain specified information about the RE, how the AIF works, benefits and risks, the AIF investments, fees and costs, tax and how to apply.

The application form for investment must be in, or accompany, the PDS.

3.4 Do the marketing or legal documents need to be registered with or approved by the local regulator?

A PDS for interests which are, or are to be, tradable on a financial market (such as the ASX) must be lodged with ASIC. A PDS for an AIF that is not listed does not need to be lodged with ASIC, but ASIC must be given an 'in use' notice prescribed form within five business days after a PDS is first given and an 'out of use' notice within five business days after the PDS ceases to be used.

For PDSs that are lodged with ASIC, there is an exposure period during which investments cannot be issued or sold. That period is seven days, subject to extension by ASIC to up to 14 days after the PDS was lodged.

3.5 What restrictions are there on marketing Alternative Investment Funds?

In addition to the regulated disclosure document requirements referred to in questions 3.1 and 3.3 above, all financial products are subject to prohibitions under the Corporations Act, ASIC Act and general law against dishonest, misleading, deceptive and unconscionable conduct.

Registered MISs are subject to advertising restrictions under the Corporations Act that require specific reference to the AIF PDS, anti-hawking restrictions and the DD Obligations regulate the way in which advertising and PDS material can be distributed.

Further, there are limited circumstances in which an AIF that needs to be registered as an MIS can be referred to prior to such registration.

3.6 Can Alternative Investment Funds be marketed to retail investors?

AIFs may be marketed to retail investors. However, the disclosure requirements referred to in questions 3.1 to 3.3 above apply.

3.7 What qualification requirements must be carried out in relation to prospective investors?

Anti-money laundering and counter-terrorism and fraud checks must be carried out in respect of all investors in an AIF. This requires the gathering of typical "know your client" information.

Otherwise, there are no general qualification requirements for prospective investors in an AIF unless the terms of the AIF restrict the investors that may acquire interests in the AIF. In recent times, some more complex AIFs have required that the investor obtain independent financial advice before they may invest.

If the AIF is restricted to wholesale investors (and so does not need to issue a PDS or be registered with ASIC and comply with Chapter 5C of the Corporations Act), then information will have to be gathered to establish that the investor falls within one of the categories of wholesale client referred to in question 1.3.

Depending on an individual issuer's policies and the circumstances pertaining to a particular AIF, an issuer may have additional obligations under the DD Obligations.

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3.8 Are there additional restrictions on marketing to public bodies such as government pension funds?

There are generally no additional restrictions on marketing to public bodies. However, various government bodies are subject to restrictions on establishing new entities, participating in joint ventures or making particular types of investments.

3.9 Are there any restrictions on the use of intermediaries to assist in the fundraising process?

Intermediaries assisting in a fundraising process who deal, advise, underwrite, make markets or otherwise carry on a financial services business in assisting in the fundraising process must hold an AFS licence with appropriate authorisations, a relevant exemption or act as a representative of an AFS licensee.

3.10 Are there any restrictions on the participation in Alternative Investment Funds by particular types of investors, such as financial institutions (whether as sponsors or investors)?

No, but there has been some discussion about the suitability of complex products for investment by retail investors, and from April 2021, the DD Obligations mentioned in question 3.1 above will need to be taken into account when offering products to retail investors.

4 Investments

4.1 Are there any restrictions on the types of activities that can be performed by Alternative Investment Funds?

There are no particular restrictions on the types of activities that an AIF can conduct. The activity must be permitted by the AIF's constituent documents. It is typical to include broad powers in such documents.

For AIFs structured as trusts and registered MISs, strict restrictions in related party dealings apply. For trusts, under general law the dealing is not permitted unless it is clearly permitted by the relevant trust deed. For registered MISs, any related party dealing from or endangering scheme property is not permitted unless it is on arm's length or less favourable (to the related party) terms or has the prior approval, in meeting, of the AIF investors.

Market conduct restrictions that apply to everyone will apply to the AIF operator and managers such as short selling restrictions, insider trading and market manipulation prohibitions.

4.2 Are there any limitations on the types of investments that can be included in an Alternative Investment Fund's portfolio whether for diversification reasons or otherwise?

There are no particular restrictions on the types of investments that an AIF can hold. The investments must be permitted by the AIF constituent documents. It is typical to include broad investment powers in such documents.

As noted in question 1.4 above, particular disclosure requirements may be applied by ASIC policy to MISs based on the types of investments that are made.

4.3 Are there any restrictions on borrowing by the Alternative Investment Fund?

For AIFs structured as trusts and registered MISs – if borrowing or giving security from the AIF property, then the power must be clearly specified in the AIF constituent documents.

5 Disclosure of Information

5.1 What public disclosure must the Alternative Investment Fund or its manager make?

In addition to the disclosure requirements referred to in section 3 above, ongoing and periodic reporting obligations apply for registered MISs and continuous disclosure obligations apply for listed and unlisted MISs.

The RE of a registered MIS must give an investor confirmation of transactions about their investing and redemptions, and a report for each reporting period (of up to one year) including details for: the period of their opening and closing balances; termination value; transactions; and any change in circumstances affecting the investment and not previously provided.

The RE must also inform members, lodge notice with ASIC/ASX of any material change or significant event in relation to the MIS and comply with the continuous disclosure obligations where the AIF is a "disclosing entity" (generally, where there are 100 or more members of the AIF or the AIF is listed).

5.2 Are there any requirements to provide details of participants (whether owners, controllers or investors) in Alternative Investment Funds or managers established in your jurisdiction (including details of investors) to any local regulator or record-keeping agency, for example for the purposes of a public (or non-public) register of beneficial owners?

The RE of an AIF that is registered MIS must allow anyone to inspect the register of investors, as well as certain other registers. This register of investors must contain the name and address of the investor. Subject to certain restrictions, persons can also apply to the RE to obtain a copy of the investor register. Managers that are structured as companies will generally have their shareholders listed on ASIC's database, and details of those shareholders are available from ASIC for a nominal fee.

5.3 What are the reporting requirements in relation to Alternative Investment Funds or their managers?

In addition to the disclosures referred to in question 5.1 above, the RE of an MIS must file reports with ASIC in respect of the fund, including:

- a written report of "significant breaches", and breaches of the Corporations Act that relate to the fund AIF and have (or are likely to have) a material adverse effect on the interests of investors in the AIF;
- an annual audit report;
- an annual audit report for the RE;
- an annual audit report for the Compliance Plan;
- notice of any change of officers and "responsible managers" (i.e. the persons nominated under the AFS licence as having the skills, education and experience to provide financial services);

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- notice of any changes of "key persons", if any, noted on the AFS licence;
- an "in use" and "out of use" notice in relation to a PDS (as noted in question 3.3 above);
- (once the DD Obligations commence) written notice to ASIC upon becoming aware that a significant dealing has occurred that is inconsistent with the TMD (made pursuant to the DD Obligations); and
- any other information requested by ASIC in accordance with its powers under the ASIC Act and the Corporations Act.

REs must also file certain reports with AUSTRAC, including suspicious matter reports.

5.4 Is the use of side letters restricted?

The use of side letters is not expressly restricted or regulated, however, there is an obligation on REs, that operate AIFs that are registered with ASIC as an MIS, to treat members of the same class equally, and members of different classes, fairly. This "equal treatment" rule limits the potential scope of what may be agreed to in a side letter.

6 Taxation

6.1 What is the tax treatment of the principal forms of Alternative Investment Funds identified in question 2.1?

As mentioned in section 1 above, in Australia, most retail AIFs are trusts. Trusts are defined as entities for tax purposes but are generally established and managed so that tax is paid by the investors, not the trust. However, this requires care in drafting the trust Constitution and in managing the trust's accounts and distributions.

Unit trusts are generally taxable on a flow-through basis provided that the trustee (i.e. responsible entity or **RE**) distributes all trust income for each tax year. This treatment is not available if the RE carries on active business activities such that the trust is a trading trust as defined in the taxation legislation. Trading trusts are taxed as companies and taxed at the trading trust level.

Trusts whose activities constitute an "eligible investment business" are not trading trusts and may be taxed on a flow-through basis with the investors paying the tax. Activities such as investing in land for the purpose of deriving rent and investing or trading in various debt and equity securities and derivatives are generally considered to be eligible investment business.

Unlisted trusts which have less than 50 members are generally not considered to be public trusts and may be taxed on a flow-through basis even though they carry on a business other than an eligible investment business. The legislation also looks to the type of member, so, for example, a trust in which tax-exempt entities (other than an exempt institution that is eligible for a refund of franking credits) hold more than 20 per cent of the units would not pass this test even if it had less than 50 members.

In some cases, securities in different entities are stapled, for example with one entity carrying on an eligible investment business such as holding land and leasing it to the other entity which carries on an active business (such as managing a toll road or a hotel). The entity carrying on the active business will be taxed as a company either because it is a public trading trust or because it is a company. It is necessary to ensure an adequate split of profit between the entities and in many cases a tax ruling is obtained to confirm that the arrangements are acceptable to the Commissioner of Taxation. If the trust qualifies as a Managed Investment Trust (**MIT**) it may be able to make a capital account election and have its gains and losses from eligible assets treated on capital account.

Concessional rates of withholding tax for non-resident investors in MITs may apply.

MIT status requires satisfaction of a number of conditions, including conditions relating to the Australian residence of the trust and management of the trust's activities, its status under the Corporations Act provisions dealing with managed investment schemes and the spread of ownership of direct and indirect interests in the trust.

Certain MITs may elect to be treated as "Attribution MITs" or "AMITs" for Australian income tax purposes and if so, a separate taxation regime will apply. Under this regime (known as the **AMIT regime**):

- the AIF is treated as a flow-through vehicle for income and tax credits, and the tax consequences for trust income received by investors are the same or similar to those that would occur if the investors had derived the income directly;
- taxable income and credits will be allocated to investors on a 'fair and reasonable' attribution basis, rather than being allocated proportionately based on each investor's present entitlement to the income of the trust;
- where the amount of taxable income estimated for the AIF at year end is different to the amount that is finally calculated, the difference is generally carried forward and adjusted in the year in which the variation is discovered;
- the cost base of an investor's holding is increased where the cash distribution they receive from the AIF is less than the attributed amount that is taxable to the investor (after certain adjustments, e.g. non-cash attributes such as franking credits);
- the AIF will be deemed to be a fixed trust so that losses may be carried forward and franking credits on dividends can be passed through to investors;
- in certain circumstances, capital gains may be specifically allocated to investors. For example, where a large redemption triggers capital gains in the trust;
- a choice is available to treat individual classes of units as separate AMITs (so that, for example, losses of one class will not be offset against income of another class); and
- in certain circumstances (e.g. failure to comply with the AMIT rules), specific penalties may be imposed.

Australia has an Investment Manager Regime (**IMR**) which seeks to ensure foreign funds and their members are not disadvantaged by engaging Australian-based service providers and managers. Under these provisions certain returns, gains, losses and deductions of widely held foreign funds are disregarded where: (a) the returns or gains would otherwise be assessable income of the fund only because they are attributable to a permanent establishment in Australia; and (b) that permanent establishment arises solely from the use of an Australian-based agent, manager or service provider. The main types of gains covered by these rules are Australian-sourced capital gains (other than gains related to interests in land and other limited cases) and foreign-sourced income and gains.

The IMR also exempts from Australian tax the Australian sourced gains or losses made by an "IMR widely held entity" (the **IMR entity**) in respect of an interest which does not pass the non-portfolio investment test (that is, less than 10%) for the whole of the income year and where the gains are not attributable to an Australian permanent establishment of an IMR entity or a trading business conducted in Australia of the IMR entity.

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Australia has various systems of accruals rules. The Taxation of Financial Arrangements (**TOFA**) regime is mandatory for financial arrangements where the value of trust assets exceeds A$100 million. In addition, an election may be made for these rules to apply where the assets are valued at less than A$100 million. Transactions which are not covered by the TOFA regime may be taxed on an accruals basis where they have an eligible return; for example, a zero coupon bond where the income is deferred until the repayment date. Also, accruals rules may apply to some foreign investments made by funds.

Goods and Services Tax

There are rules concerning the treatment of financial supplies which mean that funds cannot fully recoup GST paid in relation to some financial supplies. Under regulations which commenced on 1 July 2012, trusts making financial supplies will receive reduced input tax credits (RITCs) of 55 per cent in the case of supplies and in certain specified cases (for example custodial services) an RITC of 75 per cent of the GST paid.

6.2 What is the tax treatment of the principal forms of investment manager / adviser identified in question 2.3?

Investment managers and advisers are generally companies, and taxed as such. Under the imputation system, dividends and other distributions from companies may carry franking credits (in respect of tax paid by the company) which may be offset against liability to Australian income tax in the hands of Australian-resident shareholders. Non-residents receiving franked distributions are exempt from withholding tax. The current company tax rate is 30 per cent.

Transfer pricing issues may arise where investment managers and advisers have dealings with foreign related parties.

6.3 Are there any establishment or transfer taxes levied in connection with an investor's participation in an Alternative Investment Fund or the transfer of the investor's interest?

Stamp duty is imposed on a state-by-state basis rather than at the federal level in Australia.

Stamp duty is payable on the establishment of an AIF as a trust. This is generally a nominal amount of A$200 or A$500.

Stamp duty may be payable in relation to certain transfers and redemptions and issues of units in land-rich trusts, particularly unlisted land-rich funds. This depends on the location of the relevant land and the extent of the change in ownership effected by the transaction. In some States and Territories (such as Queensland and Western Australia and the Northern Territory, stamp duty is payable where the trust holds other assets such as business goodwill).

6.4 What is the tax treatment of (a) resident, (b) non-resident, and (c) pension fund investors in Alternative Investment Funds?

Position of Resident Investors

The taxable income of the AIF is usually taxed to the investors in proportion to the distributions they receive. If the fund has deductions or allowances that reduce its taxable income below its accounting income then in some cases the amount distributed may exceed the amount of taxable income. This excess is commonly called a "tax-free" or "tax-deferred" distribution. Any such distribution will reduce the cost base of the units in the unit trust in the hands of the investors for capital gains tax purposes. Once the cost base in their units reaches zero, further tax-free distributions are taxed as capital gains in the hands of the investor.

It is also possible that the amount of taxable income attributable to an investor will exceed the actual cash distribution, although funds usually seek to avoid this outcome.

Capital gains made by the AIF may be passed through to investors and will retain that character in the hands of the investor and (if the trust has held the relevant asset for at least 12 months) may be eligible for discount capital gains tax treatment, depending on the type of entity the investor is (i.e. a 50 per cent CGT discount applies to an investor who is an individual while a discount of 33.33 per cent applies to a complying superannuation entity). The CGT discount applies only to residents.

Resident investors are usually taxable on capital gains and capital losses made on disposal of their units. Such capital gains usually qualify for discount capital gains treatment for the units held by a natural person, superannuation fund or trust for a period of 12 months or more.

Position of Non-Resident Investors

If the AIF qualifies as an MIT, non-resident investors will generally be taxed on distributions to them by way of a final withholding tax of 15 per cent, provided they are resident in a country with a tax information exchange agreement with Australia.

By the enactment of *Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Act* 2019, which became law on 3 April 2019, this withholding tax rate will be increased for MITs that are part of certain stapled security structures.

From the later of 1 July 2019 or where the income year is the 2019–20 income year or later years, and where the MIT is the asset holding entity of a stapled structure (as referred to above), the final withholding rate will be increased to 30% in respect of MIT or fund payments which are 'non-concessional MIT income'. This includes MIT payments sourced from certain trading, agricultural and residential housing income. There are transitional arrangements which apply to certain and pre-existing stapled structures.

Distributions of interest, royalties and dividends will be not be taxed at 15 per cent but at their normal withholding rates – 10 per cent in the case of interest (or 0 per cent under certain double tax agreements with Australia) and 0 per cent in the case of franked dividends. If dividends are not franked under the dividend imputation rules then normal dividend withholding tax rates will apply. These rates vary from 0 per cent to 30 per cent depending on the terms of any applicable treaty. Royalties are generally taxed at between 10 per cent and 30 per cent.

The tax position of gains and losses made by non-resident investors on disposal of their units varies depending on the nature of their investment.

If the non-resident investor holds their units on capital account, they are generally not taxed. However, if the AIF is land-rich (i.e. real property, including mining leases, exceeds 50 per cent of the value of the fund) and the investor holds more than 10 per cent of the fund, then they may be subject to Australian capital gains tax on any gains made on disposal of their units. Also, units held by a non-resident investor that are used in carrying on a business through a permanent establishment of the investor in Australia will be subject to capital gains tax on any gain made on their disposal.

Investments on revenue account, for example investments made by a fund for the purposes of short-term gain or as part of business activities, will be taxable in Australia, but subject to the operation of relevant tax treaties.

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6.5 Is it necessary or advisable to obtain a tax ruling from the tax or regulatory authorities prior to establishing an Alternative Investment Fund?

Rulings are often obtained in the case of stapled funds to confirm the share of income derived by each of the stapled entities. In addition, rulings may be obtained to confirm the tax treatment of any aspect of the fund which may be unclear; for example, if the issuer also finances investors to invest in the trust or where greater certainty is required for investors in non-standard funds. Generally, consideration is given to investors' requirements based on the overall tax profile of the trust.

There is a strict penalty regime which applies to people who promote tax exploitation schemes (and this can include advisors) or who implement schemes otherwise than in accordance with a tax ruling.

6.6 What steps have been or are being taken to implement the US Foreign Account and Tax Compliance Act 2010 (FATCA) and other similar information reporting regimes such as the Common Reporting Standard?

On 28 April 2014 the Australian Government signed:

- an intergovernmental agreement with the United States administration with the intention of:
  - facilitating Australian compliance with FATCA in a way that reduces its overall burden on Australian business; and
  - improving existing reciprocal tax information-sharing arrangements between the Australian Taxation Office (**ATO**) and the United States Internal Revenue Service; and
- an MOU which deals with the implementation of the intergovernmental agreement, that contains the following statement:

  "Australia plans to present the Agreement to its parliament for its approval in 2014 and to propose implementing legislation with the goal of having the Agreement enter into force by September 30, 2015. Based on this understanding, as of the date of signature of the Agreement, the United States Department of the Treasury intends to treat each Australian Financial Institution, as that term is defined in the Agreement, as complying with, and not subject to withholding under, section 1471 of the U.S. Internal Revenue Code during such time as Australia is pursuing the necessary internal procedures for entry into force of the Agreement."

The *Tax Laws Amendment (Implementation of the FATCA Agreement) Act 2014* (Cth), to give effect to Australia's obligations under the FATCA Agreement, was passed by Parliament on 30 June 2014. It amends the *Taxation Administration Act 1953* (Cth) to insert – as Division 396 – FATCA regulation.

FATCA applies from 1 July 2014.

Australia has also adopted the Common Reporting Standard (**CRS**) which was legislated by *Tax Laws Amendment (Implementation of the Common Reporting Standard) Act 2016* (Cth). Similar to US FATCA, the CRS requires information about the financial accounts held by foreign tax residents held by certain financial institutions in Australia to be reported to the ATO. In turn, the ATO will provide this information to the foreign residents' tax authorities of participating countries. The ATO will also receive from overseas tax authorities similar information about Australian tax residents with financial accounts held overseas in those countries.

The CRS applies from 1 July 2017.

6.7 What steps are being taken to implement the OECD's Action Plan on Base Erosion and Profit-Shifting (BEPS), in particular Actions 6 and 7, insofar as they affect Alternative Investment Funds' operations?

The main measures that Australia has implemented since the release of the OECD Report. They are:

1. a multi-national anti-avoidance law (**MAAL**);
2. stronger penalties to combat tax avoidance and profit shifting;
3. revised transfer pricing laws which are now more closely aligned with OECD principles and concepts;
4. anti-hybrid laws;
5. adoption of the Multilateral Instrument which is both BEPS Action Item 15 and a response to BEPS Action Item 6 (treaty abuse); and
6. a new reporting regime based country-by-country reporting ("CbC reporting").

These measures apply to "significant global entities" and those entities whose annual and global turnover is in excess of A$1 billion.

In summary:

1 The MAAL will apply to schemes where there is a principal purpose of diverting revenues arising from sales to Australian customers by an entity which is neither an Australian resident nor has an Australian permanent establishment and where an Australian related entity undertakes activities (e.g. sales support) in respect of those sales. The MAAL will apply on and after 1 January 2016.

2 Under CbC reporting, significant global entities are required to give the Australian Commissioner of Taxation three Statements which are based on the OECD's report 'Transfer Pricing Documentation and County-by-Country Reporting, Action 13-2015 Final Report'. These statements are:

   (a) the "CbC report", which provides information about where the global group's economic activity takes place and where its profits are reported;

   (b) the "master file", which provides details of the global group's business operations, including its organisational structure, use of intangibles and inter-company financial activities; and

   (c) the "local file", which provides information about the local entity's management structure and business strategy, specific cross-border related-party transactions, the local entity's annual financial accounts and information about how transfer pricing decisions have been made.

3 Australia signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (**MLI**) on 7 June 2017 (BEPS Action 15) and it entered into force on 1 January 2019. It is expected that the MLI will prevent tax treaties of the participating countries from being abused and exploited and to improve tax treaty related dispute resolutions mechanisms. Australia has also agreed to mandatory arbitration in relation to tax treaty related disputes.

In addition to the above measures, Australia has begun to adopt new definition of 'permanent establishment' in respect of the formation and conclusion of contracts in line with the BEPS Action 7 measures. It has done this in Australia's new double tax agreement with Germany.

6.8 Are there any tax-advantaged asset classes or structures available? How widely are they deployed?

In general, limited partnerships are treated as companies for Australian income tax purposes. However, there are two notable

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exceptions, namely, Early Stage Venture Capital Limited Partnerships (**ESVCLPs**) and Venture Capital Limited Partnerships (**VCLPs**).

The main tax benefits of ESVCLPs are that they are afforded tax transparency, an ESVCLP tax offset for the investment made by limited partners, exemptions from income tax and capital gains tax on disposal of eligible venture capital investments and the general partners' carried interest being taxed on capital account rather than revenue account. The main tax benefits for VCLPs is that they are afforded tax transparency, with the partners generally being subject to tax on their share of the income, profits and gains of the VCLP. It should be noted that certain foreign resident limited partners may be eligible for an exemption for tax. Like ESVCLPs, the general partner's carried interest is generally taxed on the capital account rather than the revenue account.

These structures are not common in Australia.

6.9 Are there any other material tax issues for investors, managers, advisers or AIFs?

There are various compliance issues relating to the operation of funds and the operation of investment managers and advisors. These include the production of Tax File Numbers (**TFN**) by resident investors and the relevant associated privacy requirements.

Managers and advisors are required to obtain a TFN and to manage their compliance in relation to payroll tax, and GST and income tax reporting requirements. There are also particular issues where Australian employees of manager and advisory entities with foreign parents receive entitlements to shares or equity, as Australian employee share rules can operate harshly.

Australia also has a temporary resident regime, which may apply to employees of managers or advisers who are resident for up to four years, to exempt certain non-employment income from Australian taxation.

6.10 Are there any meaningful tax changes anticipated in the coming 12 months?

The meaningful tax changes in Australia in the next twelve (12) months are the possible introduction of two (2) new collective investment vehicles which are discussed in questions 1.1 above and 7.1 below.

7 Reforms

7.1 What reforms (if any) are proposed?

As noted above in question 1.1, there is legislation proposed to enable AIF to be structured as a corporate collective investment vehicle (**CCIV**).

As noted above in question 1.2, the current conditional exemption from holding an AFS licence applicable to certain foreign regulated FFSPs is due to expire on 30 September 2019, but is proposed to be extended until 31 March 2020, with a further two-year transitional period during which FFSPs relying on the exemption at 31 March 2020 may obtain a 'foreign AFS licence'. There is also a further 'funds management financial services' licensing exemption proposed by ASIC in Consultation Paper 315 released 3 July 2019. The scope of this proposed exemption is very narrow and is subject to a number of conditions.

As noted above in question 3.1, the DD Obligations will commence April 2021.

There is also legislation currently proposed to abolish 'grandfathered commissions'. These are commissions that were payable to financial advisers pursuant to an arrangement entered into prior to 1 July 2013.

The Australian government continues to consult on the introduction of two (2) new collective investment vehicles (**CIV**) through the recent release of exposure draft legislation. The CIVs are intended to be more internationally recognisable investment vehicles to foreign investors. The CIVs: (1) a company (or CCIV); and (2) a limited partnership, which in both instances meet certain legal and regulatory requirements.

The taxation treatment proposed for CIVs and CCIVs will broadly align with the AMIT regime which is a 'character-flow through' model of taxation. Further exposure draft CCIV legislation was issued on 17 January 2019 and consultations continued until 28 February 2019.

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Austin Bell
Johnson Winter & Slattery
Level 25, 20 Bond Street
Sydney, NSW 2000
Australia

Tel: +61 2 8247 9620
Email: Austin.bell@jws.com.au
URL: www.jws.com.au

Austin is recognised as a leading financial services and funds management lawyer, with a particular focus on investment funds and hedge funds. He advises domestic and international fund managers on all aspects of the Australian regulatory regime, including establishing and restructuring investment vehicles, Australian financial services licensing, disclosure obligations and negotiating contracts.

Austin is admitted to practise in Quebec, Canada, New York and NSW.

Andy Milidoni
Johnson Winter & Slattery
Level 25, 20 Bond Street
Sydney, NSW 2000
Australia

Tel: +61 2 8274 9579
Email: andy.milidoni@jws.com.au
URL: www.jws.com.au

Andy is a tax lawyer specialising in all aspects of taxation, revenue law, trust law and superannuation law.

He advises on the tax implications of corporate, asset and equity and debt market transactions including mergers, acquisitions, restructures and incentive schemes, tax and duty audits and disputes. Andy has extensive experience advising on inbound and outbound investment vehicles, managed funds and financial products including Australian managed investment trusts, limited partnerships and unincorporated joint ventures.

Andy's recent experience includes representing and advising large public and private corporate groups, managed funds, SMEs, family offices and high-wealth individuals, in a range of business sectors and investments.

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59 Tanner Street, London SE1 3PL, United Kingdom
Tel: +44 20 7367 0720 / Fax: +44 20 7407 5255
Email: info@glgroup.co.uk

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