Australian Private Equity &
Venture Capital Association Limited

Briefing note on key design considerations of proposed new Limited Partnership CIV

Key points

- **Australia's current suite of collective investment vehicles (CIVs) is out of step with international practice**, necessitating complex, costly structures, and deterring foreign investment
  - Having a simple, internationally competitive CIV regime is critical to Australia's ambition to be a regional financial services hub, which will in turn, drive significant local employment opportunities
  - Australia's use of trusts (e.g. managed investment trusts (MITs)) is unusual internationally and deters foreign investors
  - Over the last five years (FY2013 to FY2017), around 64% of commitments to Australian private equity funds came from offshore investors, underlining the importance of having a CIV which is well-understood overseas.
- If Australia wishes to grow the funds available for investment into unlisted assets such as high growth, Australian businesses, a new limited partnership (LP) CIV must be created as soon as possible
  - LPs are the globally accepted private equity (PE) and venture capital (VC) vehicle of choice, and could transform the flow of capital into high growth Australian businesses.
- **A new LP CIV could be quickly introduced given there are only a limited number of issues** to address.
- The new LP CIV will assist the Australian managed funds industry by encouraging PE funds to set up Australian investment structures, thereby generating highly skilled investment manager jobs in Australia.
- A new LP CIV will cut red-tape by creating a more equal and competitive landscape with competing foreign funds management hubs such as Singapore, the US and the UK.

Summary of key features of commonly used international CIVs

Jurisdiction	Tax transparent in relation to income and losses	Ability to prevent permanent establishment for foreign investors	Carried interest is on capital account/capital incentive regime	No undue investment restrictions/no control test
Germany (*Kommanditgesellschaft*)	Yes[1]	Yes	Yes	Yes
Ireland (Limited Partnership)	Yes	Yes	Yes	Yes
Luxembourg (SICAR)	Yes[2]	Yes	Yes	Yes
New Zealand (Limited Partnership)	Yes	Yes[3]	n/a[4]	Yes
Switzerland (Limited Partnership)	Yes	Yes[5]	Yes	Yes
UK (English & Scottish Limited Partnerships)	Yes	Yes[6]	Yes	Yes
USA (Limited Partnership)	Yes	Yes	Yes	Yes

[1] Where the limited partnership is structured as a non-entrepreneurial limited partnership.
[2] Where the SICAR is established as a fiscally transparent entity – an elective regime.
[3] Although no specific deeming exists, this is the generally adopted position.
[4] Note New Zealand does not have a capital gains tax regime.
[5] This is the general position under Swiss tax law in respect of non-residents.
[6] This is the general position under UK tax law except where the limited partnership conducts trade in the UK (this will generally not cover private equity funds holding shares in investee companies)

Recommended design features of an Australian LP CIV

1. **Flow-through tax treatment and consistent tax treatment of PE and VC gains**
    - Consistent with the MIT regime and consistent with the Board of Taxation's recommendation, the LP CIV should have a deemed CGT treatment for its eligible investments.
    - A partnership "flow-through" treatment should be adopted, consistent with the Early Stage Venture Capital Limited Partnership (ESVCLP), Venture Capital Limited Partnership (VCLP), and AFOF rules.

2. **There should be no prohibition relating to "control" of a trading company in order to retain tax transparent status**
    - **The current MIT control test is inconsistent with Australia's funds management competitor jurisdictions** like the US, UK and New Zealand
        - In such jurisdictions, their respective LP CIVs are not prohibited from controlling a trading company in order to maintain their tax transparent status.
        - A new Australian LP CIV that retains a control test restriction will experience limited up-take from industry and investors.
    - **The current MIT control test rules are out-dated, and premised on policy concerns that have been progressively addressed** by tax reforms over the last 30 years, such as the introduction of refundable imputation credits and a stronger Part IVA general anti-avoidance regime.
        - Controlled companies are taxed at the corporate tax rate
        - CIVs are widely held and typically closed-ended funds which are not being used to avoid corporate taxation
        - The control test is particularly difficult for the PE industry as it prevents the fund vehicle from taking a majority interest in an underlying company.
        - The new MIT arm's length rule now addresses any integrity concerns associated with transactions with investees

    - **ESVCLPs and VCLPs do not have a control test**

    - **If there are still remaining corporate tax integrity concerns, consideration should be given to a "safe harbour" exception** to ensure that the control test is not breached if the only assets which the CIV has are shares in an investee company and the making of loans to investees.

Next steps

- AVCAL would welcome a dedicated discussion with Treasury to discuss the proposed new LP CIV. We note that different tax and policy considerations will be at play to those for the corporate CIV, partly given investors into PE and VC are generally institutional or sophisticated investors.
- AVCAL recommends that Treasury closely examines LP structures in other international jurisdictions so as to ensure that any new vehicle matches with global best practice.