

MEMO# 11413

November 18, 1999

INSTITUTE SUBMITS COMMENT LETTER REQUESTING REAFFIRMATION OF TAX- NEUTRAL POLICY FOR U.S. MUTUAL FUNDS SOLD IN AUSTRALIA

1 See Institute Memorandum to International Members No. 21-99 and Tax Members No. 23-99, dated August 2, 1999. 2 Prior to July 2, 1998, an Australian investor in a U.S. mutual fund generally was taxed each year on the fund's realized income, as well as any unrealized gain in the securities held by the fund, thereby accelerating recognition of income to the investor. 3 For example, the Report would treat capital gain distributions by U.S. mutual funds as ordinary income (taxed at rates up to 48.5%), while allowing capital gain distributions by Australian funds to retain their character and, accordingly, be taxed at lower, effective capital gains rates (up to 24.25%). 1 [11413] November 18, 1999 TO: INTERNATIONAL COMMITTEE No. 49-99 TAX COMMITTEE No. 32-99 RE: INSTITUTE SUBMITS COMMENT LETTER REQUESTING REAFFIRMATION OF TAX-NEUTRAL POLICY FOR U.S. MUTUAL FUNDS SOLD IN AUSTRALIA

The Australian Government is contemplating significant changes to its domestic tax rules through a project entitled the "Review of Business Taxation" (Review). Pursuant to the work of the Review, a report entitled "A New Tax System Redesigned" (Report) was recently released. The Report makes a number of recommendations for changes to the Australian tax rules, including changes to the rules for taxing capital gains and collective investment vehicles. Earlier this year, and prior to the release of the Report, a favorable change to the Australian tax rules was enacted to exempt U.S. mutual funds treated as regulated investment companies from the Australian foreign investment fund (FIF) rules.¹ This change to the FIF rules was intended to encourage the entry of U.S. mutual funds into the Australian funds market and to permit competition between similarly-situated U.S. and Australian funds on a tax-neutral basis.² Following enactment of the FIF exemption, several U.S. firms entered the Australian funds market. The ability of U.S. mutual funds to compete on a tax-neutral basis with similarly-situated Australian funds, as a result of the new FIF exemption, has been called into question by the Report. Of particular concern, the Report contemplates preferential, "flow-through" taxation for investors in Australian funds, but not for investors in any non-Australian funds.³ If the recommendations in the Report were adopted in their current form, it appears that U.S. mutual funds effectively would be precluded from competing in the Australian funds market, even if they otherwise qualified for the FIF exemption. 2The Institute has submitted the attached letter to the Australian Treasurer and the Australian Minister for Financial Services and Regulation requesting that, in light of the uncertainty created by the Report, the policy rationale underlying the FIF

exemption for U.S. mutual funds be reaffirmed as soon as possible (1) to assure Australian investors that they will continue to receive favorable tax treatment for their similarly-situated Australian and U.S. fund investments and (2) to assure U.S. funds that, upon entering the Australian funds market, they will be able to compete on a tax-neutral basis with Australian funds. Deanna J. Flores Assistant Counsel Attachment

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