



POSITION PAPER

Investment vehicles and taxation arrangements

Future Fund tax profile

- The Future Fund is exempt from Australian income tax.
- The Future Fund is exempt from income tax in certain foreign countries in accordance with the principle of sovereign immunity. This is the case for the bulk of the Fund's investments overseas.
- The Future Fund holds certain investments via wholly owned Australian corporate holding companies. The Australian tax paid by these companies is recoverable via imputation credit refunds to which the Future Fund is entitled. Accordingly at the whole of Future Fund level these companies are effectively non-taxable in Australia, consistent with the Australian tax exempt status of the Future Fund.
- In managing a global investment portfolio, the Future Fund adopts a conservative approach to the use of wholly-owned entities, collective investment vehicles and taxation. This paper is intended to provide context and insight to the Future Fund's approach to these matters.

Offshore entities and collective investment vehicles

Overview

- The Future Fund, like many other institutional investors in Australia and globally, may invest through low or nil tax jurisdictions, using a variety of vehicles such as multi-investor collective investment vehicles and wholly-owned entities. Using these structures is a very common part of global investing for most institutional investors.
- The Future Fund uses these structures in a conservative way for legal, tax and commercial reasons to enhance the Fund's efficiency, performance and approach to risk management. In doing so, the Future Fund explicitly rejects tax evasion.
- Put simply, these structures are primarily used to build a diversified portfolio and access opportunities alongside other investors in an efficient way. These arrangements provide a neutral framework through which multiple investors can pool capital while avoiding duplication of taxes.
- The Future Fund's activity is not about avoiding tax but rather about avoiding *duplication* of tax by preventing the unnecessary addition of another layer of taxation in the country where the collective investment vehicle is formed. The investment returns remain taxable in the underlying source country and in the investor home country.
- These structures allow the Future Fund to invest alongside other institutions from diverse countries in an efficient way, increase the economies of scale by allowing

investors to pool their capital, reduce investment risk through portfolio diversification, and gain exposure to assets the Future Fund may not otherwise be able to access directly. Using these arrangements also allows the Future Fund to pool its own investments together to improve risk management and efficiency.

- The Future Fund, like other sovereign wealth funds, also uses these structures to help protect its rights to sovereign immunity for US tax purposes.
- The Future Fund is audited by the Australian National Audit Office (the "**ANAO**"). All investments are audited either by the ANAO or by a 'Big Four' audit firm. Clear policies and procedures are in place to ensure the Future Fund and its wholly-owned entities pay all the tax they should and operate in accordance with best practice for institutional investment.

The following notes provide more detailed information and context on the Future Fund's approach to using these structures.

Detailed notes

Background

The Future Fund's legal framework obliges it to maximise investment returns over the long term with acceptable but not excessive risk, consistent with international best practice for institutional investment. Institutional investors include large superannuation and pension funds, life insurance companies and sovereign wealth funds.

Like many institutional investors domestically and overseas, the Future Fund invests around the world in both listed (publicly traded) and unlisted assets. This document focuses on unlisted assets. Many assets are only available for investment via the unlisted route.

The Future Fund may use collective investment vehicles and/or wholly-owned entities which invest through low or nil tax jurisdictions. These arrangements are described below.

Collective Investment Vehicles

The Future Fund may have the choice of investing in unlisted assets either directly, or indirectly via collective investment vehicles (the "**CIVs**") which pool capital raised from multiple investors in a single investment holding entity.

CIVs have a number of potential advantages over direct investment:

- Economies of scale through pooling of capital - investment exposure to larger assets; operating cost efficiencies.
- Better investment risk management through portfolio diversification.
- Access to specialist manager expertise.
- The *Future Fund Act 2006* prohibits direct investment in non-financial assets; accordingly, for assets like infrastructure and real estate, minority stakes in CIVs may be the only permissible way to invest.

Investors in CIVs come from diverse home countries with diverse home country tax regimes.

CIVs established in low or nil tax jurisdictions allow investors to pool their capital in a tax neutral manner. The investment returns remain taxable in the underlying source country and in the investor home country. It is not about avoiding tax but rather about avoiding *duplication* of tax by preventing the unnecessary addition of another layer of taxation in the country where the CIV is formed. Indeed, investors may actually pay *more* source country tax investing via say a Cayman CIV compared with investing directly (due to the loss of tax treaty benefits on dividends and interest income).

CIVs tend to be established in low or nil tax jurisdictions whose legal system is derived from English (eg Cayman Islands) or continental European law since it is familiar, particularly to North American and European investors. The legal and regulatory systems are also usually efficient and low cost. This helps minimise transaction documentation costs.

Example: A private equity fund invests in a portfolio of 10 to 15 large (unlisted) US retail businesses that supply consumer goods and services. The fund is able to access the investment opportunities through the fund manager's specialised retail industry knowledge and network of contacts in the US. The fund investors are institutional investors (pension funds, life insurance companies, sovereign funds) located in North America, the UK, Europe and Asia / Pacific. The fund vehicle is established as a Cayman Islands limited partnership. The partnership is classified as a "flow-through" vehicle for US tax purposes which means that the fund investors are taxed in the US on their share of US source income and gains in accordance with US tax law. The non-US fund investors are also subject to their home country tax rules on the income and gains. This outcome approximates the position had the fund investors invested directly into the US businesses instead of via a Cayman CIV.

Wholly-Owned Entities

There are a number of reasons why the Future Fund may invest via a wholly-owned entity established in a nil tax jurisdiction:

- *Tax Neutral Intermediary Vehicle/Familiar and Efficient Legal Jurisdiction.* As is the case in the use of CIVs, these arrangements may provide tax neutrality that supports pooling of capital alongside other investors while also operating under a familiar legal system. The legal and regulatory systems are usually efficient and low cost.
- *Protect Against Loss of US Sovereign Immunity Entitlements.* As an investor on behalf of the Australian Government, the Future Fund is exempt from US tax on certain categories of income pursuant to Section 892 of the US Internal Revenue Code. This exemption may be lost if Future Fund is taken to derive any income (even \$1) from "commercial activities" undertaken anywhere in the world. To mitigate this risk, the Future Fund may invest into a CIV via an entity that is classified as a corporation for US tax purposes.
- *Concessional Fee Arrangements.* The Future Fund may invest via a Future Fund 100% owned parallel fund where it has secured concessional manager fee arrangements or other commercial benefits not available to other investors.

- *Administrative (Fund of Funds).* The Future Fund may engage a manager to invest in a large number of CIV funds on our behalf. For administrative reasons it is generally simpler to hold these fund interests in an “aggregator”/“separate account” vehicle owned 100% by the Future Fund and managed by the manager, with the manager producing consolidated investment and financial reporting for that vehicle and deducting fees, than for the individual funds to be held directly by the Future Fund.

Tax Evasion

The Future Fund rejects tax evasion. The Future Fund has put in place several measures to ensure that entities it invests in that are formed in nil or low tax jurisdictions are not used to evade tax:

- Before investing, the Future Fund confirms that the fund does not rely on secrecy laws to intentionally conceal income or assets and does not create fraudulent or false tax deductions.
- The Future Fund also assesses whether the jurisdictions through which it invests are regarded by the Organisation for Economic Co-operation and Development (the “**OECD**”) as having substantially implemented the internationally agreed tax transparency standard.
- The Future Fund seeks to include in its fund documentation manager undertakings to file all fund tax returns and pay all tax in all applicable countries.
- The Future Fund fully cooperates with tax authorities in the event of audit.

Australian Investment Companies

- The Future Fund, being owned by the Commonwealth of Australia, is exempt from Australian income tax. The Commonwealth does not tax itself.
- The Future Fund holds certain investments via wholly owned Australian corporate holding companies (known as Future Fund Investment Company No 1 to 5 Pty Ltd).
- These holding companies are used to protect the Future Fund against loss of US sovereign immunity entitlements. This is explained above in more detail in the “Offshore entities and collective investment vehicles” section of this position paper.
- The Australian tax paid by these holding companies is recoverable via imputation credit refunds to which the Future Fund is entitled under the Future Fund Act 2006. Accordingly at the whole of Future Fund level these companies are effectively non-taxable in Australia, consistent with the Australian tax exempt status of the Future Fund.
- The level of Australian tax paid by each Australian holding company is a function of its taxable income for the year. The amount of taxable income may differ significantly from the accounting profit recognised in the financial statements. This is due to a variety of permanent and timing differences including unrealised mark to market gains on investments, special tax accrual / recognition rules for income from foreign investments, non-deductible expenses and utilisation of prior year tax losses.

More information on these topics is available in the Future Fund's annual report and its audited financial statements at www.futurefund.gov.au

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