Private Equity

Asia Pacific

Private Equity Tax*

Insights into topical tax issues, trends and developments in the private equity industry throughout the Asia Pacific region

April 2010

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Introduction

Welcome to our second edition of Asia Pacific Private Equity Tax*. This is looking like an exciting year already for the industry, and we have put together a valued collection of articles from our specialists to assist our clients and friends on their investment structures, portfolio management and activities throughout the region.

This issue we start with a special look back at the decade just closed from the perspective of one of the region's most respected analysts, Kathleen Ng of the Centre for Asia Private Equity Research Limited, and also a round up of 2009 and a forecast on what the next 12 to 18 months might hold.

We then take a look at historical developments in the infrastructure funds market, and the opportunities that should exist due to strained public finances throughout the region.

Compliance is never too far from the headlines these days, and we consider the impact of ASC 740-10 (formerly FIN 48) on private equity firms and their fund accounting; and lessons learnt from the first period of its adoption for private companies.

We review Singapore's tax incentives that make it an ideal location for an Asian hub, and not just as a South-East Asia base.

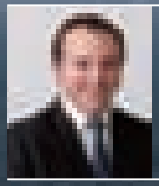
With increased focus on portfolio company performance, we consider the nature of 'sweet equity' arrangements for incentivising portfolio company executives.

We include insights from a number of our country experts on legislative updates from the very active China and India markets, an update on President Obama's tax proposal, as well as updates from other jurisdictions across the region, including Indonesia, which has attracted recent interest as a market opportunity due to its population growth and level of natural resources.

A consistent theme this year is the increased focus by governments and taxing authorities on the activities and structures employed by private equity firms in their investment activities, which is highlighted specifically by recent developments in Australia.

I do hope you enjoy this edition of Asia Pacific Private Equity Tax*. Please feel free to contact any of our specialist authors listed, our country leaders or your usual PricewaterhouseCoopers contacts to discuss any of the subject matters raised in this edition.

With warmest regards,



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The state of the private equity market in the Asia Pacific region - A defining decade

When the curtain fell on the last day of 2009, the Asian private equity industry bid farewell to a decade during which its viability as an investment model had been queried; but subsequently hailed as the asset class for the region. At the end of 2009, the industry's aggregate fund pool had towered to US$282.9 billion. This, compared to the US$86.5 billion recorded for 2000, was a surge of more than three-fold (Fig. 1). During the past decade, Asian private equity has not only solidly defined its position in the region's asset management industry, but has set the stage to become a central force in shaping the future course of this asset class as a whole.

Growth of Asian Private Equity Fund Pool (2000 - 2009)

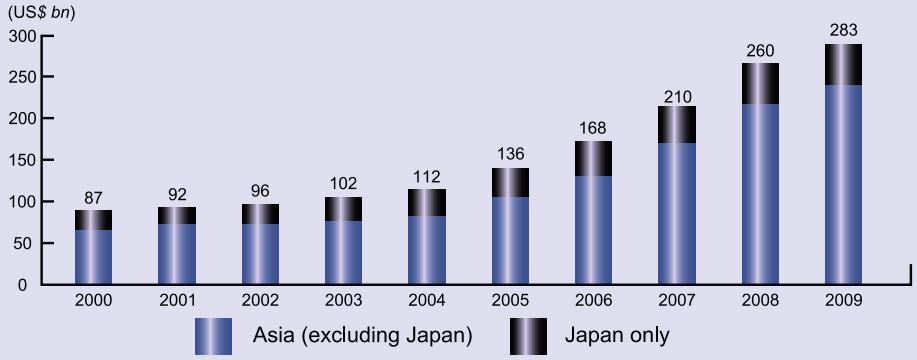


Fig.1 *source.* Asia Private Equity Review

From Winters to Spring

The industry entered the first decade of the 21st century with a feeble pool of fund managers who were still nursing wounds inflicted by the 1997-1998 Asian Financial Crisis, an event that brought about the "death of the emerging market growth story" at that time. In April 2000 when the technology bubble burst, it led to the onset of "the nuclear winter" of venture capital. This was soon followed by the deadly severe acute respiratory syndrome (**SARS**) that paralysed Asia's key economic centres. It was also during these 36 unsettling months that the industry bid "adieu" to a long list of foreign institutions, while more than 115 senior managers were known to have tendered their resignations. It was a low ebb in the history of the Asian private equity industry.

The light at the end of the tunnel shined through in December 2003 when Ctrip.com, China's largest online travel website that was backed by The Carlyle Group, made its debut on NASDAQ. The global private equity firm chalked up an envious internal rate of return that exceeded 106%. The watershed for Asian private equity took place in February 2004 when Japan's Shinsei Bank, which rose to life under the control of a group of private equity investors, made its debut on the Tokyo Stock Exchange. It was the first billion dollar in returned capital that was deposited into buyout investors' vaults. The listing of Shinsei Bank also marked the beginning of Asian private equity's first Golden Era which stretched from 2004 to the end of 2008.

The Golden Era

The Golden Era of Asian private equity saw a staggering annual inflow of fresh capital into the market, with each sum surpassing that for the preceding 12 months by billions. Between 2004 and 2008, in a matter of 60 months, the industry attracted over US$158.3 billion in new capital and billion dollar funds have became the norm in the industry's fund pool profile. CVC Asia Pacific's third Asian buyout fund took the crown as the largest to date, achieving a final closing at US$4.1 billion in 2008, followed by Kohlberg Kravis Roberts & Co.'s (**KKR**) maiden Asian buyout fund which received US$4 billion in commitments. In 2004, there was only one fund launched with billion dollar size, but by 2008, 18 newly launched funds joined the Asian billion dollar fund club (Fig. 2).

Growth of Billion Dollar Funds

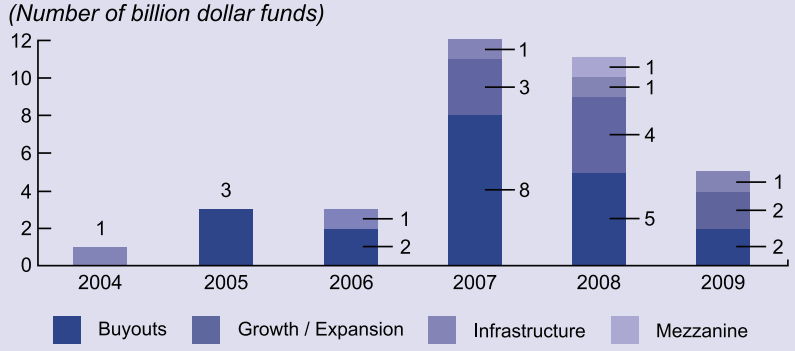


Fig.2 *source.* Asia Private Equity Review

Powered by such an enlarged pool of capital, private equity investors were able to deploy capital to those deals that were once beyond their monetary reach. In late 2006, CVC Asia Pacific committed to the A$5.5 billion (US$4.1 billion) recapitalisation and establishment of PBL Media. It was also virtually at the same time that KKR teamed up with Seven Network Ltd. to form the Seven Media Group for A$4 billion. Both remain unrivalled as two of the largest buyout transactions in the Asian deal log, and were naked illustrations of investors' boldness.

Reasons for Exuberance

If private equity in Asia appeared to have expanded too fast, with both fund and investment sizes having ballooned by multiples during this Golden Era, the industry's general partners had powerful reasons to feel confident. In these 60 months, a total of US$74.8 billion was returned to investors' coffers. Since 2004, no less than US$10 billion each year has been returned to investors (Fig. 3).

Capital Returned Profile (2004 - 2009)

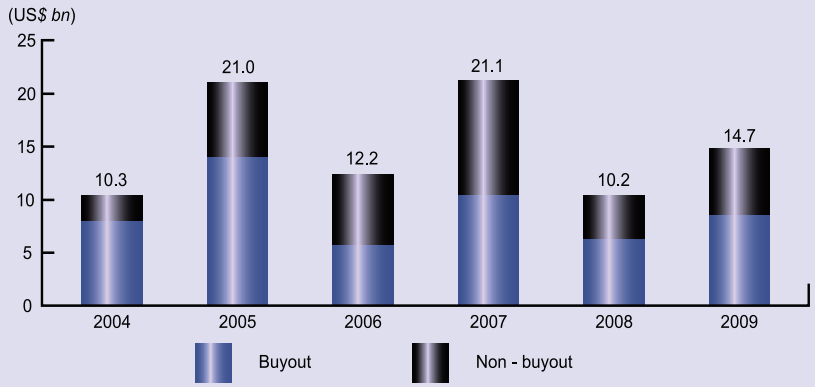


Fig.3 *source.* Asia Private Equity Review

Observation

In the last year of this decade of exhilarating growth, Asian private equity joined all other asset classes in suffering the toll from the global financial crisis. For the first time since 2004, both the pool of fresh capital and the transaction aggregate witnessed sharp declines - at US$23.1 billion and US$19.1 billion respectively, they were the lowest recorded since 2004. These contractions also marked the end of the Golden Era. Yet in 2009, the industry surprised market analysts when it recorded over US$14.7 billion in returned capital. The amount even surpassed the US$10.2 billion recorded for 2008.

Asian private equity's success, as manifested during its Golden Era, has become a double-edged sword. It has awakened a giant, China. To China, private equity embodies multiple qualities and merits that would further advance its economic reform. In 2009, for the first time China's renminbi fund pool exceeded those denominated in foreign currencies (Fig. 4). With this surging pool of domestic currency funds entrusted to a growing list of home-grown fund management firms, it remains to be seen how foreign private equity firms can effectively compete for quality assets in China. As Asian private equity greets a new decade, the China factor will be a central component.

Growth of the Renminbi Funds (2006 - 2009)

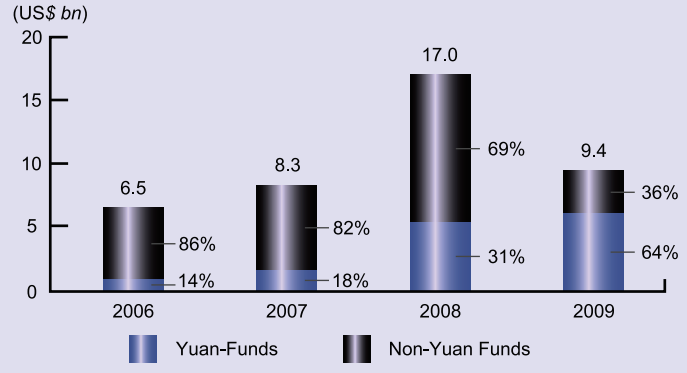
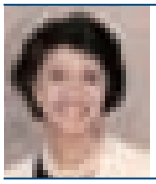


Fig.4 *source.* Asia Private Equity Review



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Ms Kathleen Ng joined the Asian private equity/venture capital industry in 1989. She is a founder of the Centre for Asia Private Equity Research, which publishes the Asia Private equity Review (**APER**), the leading monthly publication on private equity investment in Asia.

Since then, the Centre has also launched APER – Greater China Edition, the first private equity journal that covers the Greater China market. Most recently, the Centre launched the APER Index, the first and only private equity return benchmark for Asia.

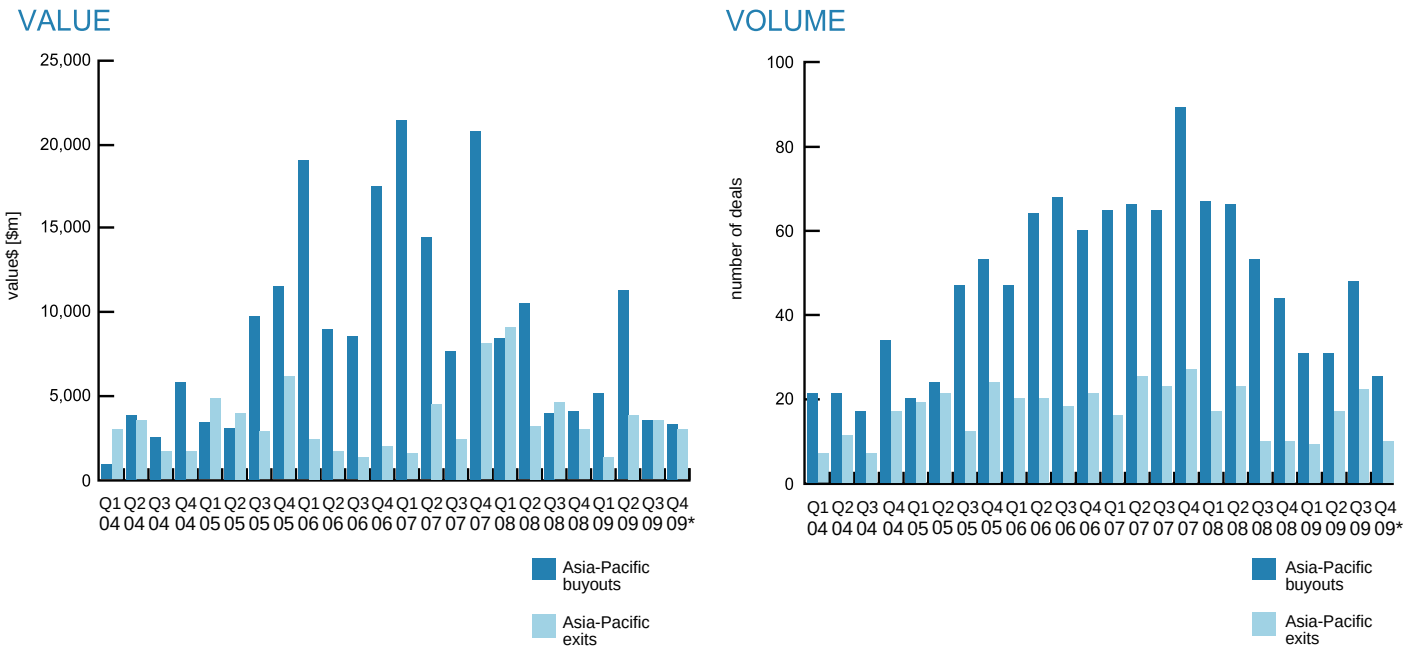
Ms Ng is the industry's longest serving analyst and is regarded as an authority on the Asia private equity/venture capital industry.

The state of the private equity market in the Asia Pacific region - The adviser's view

Mergers and acquisitions (**M&A**) activity in the Asia Pacific region in 2009 was positive, with the region presenting much stronger resilience during the Global Financial Crisis (**GFC**) when compared to global M&A activity, boosted by several large deals in Australia, China and Japan.

Whilst total deal volumes in Asia Pacific declined by 5% (to 2,194 deals), total deal value increased by 5% on prior year to US$421.4 billion according to Mergermarket group. This contrasts with the 27% decline in both volume and value of deals worldwide in 2009. As shown in the graph below, the volume and value of PE buyout activity remained subdued.

ASIA-PACIFIC M&A QUARTERLY PRIVATE EQUITY TREND



Capital market valuations remained relatively high through 2009 resulting in a rush of private equity (**PE**) portfolio exits via initial public offering (**IPO**). This momentum is evidenced by the re-opening of IPO market in China including launch of the Growth Enterprise Market in Shenzhen, with over 200 companies still in the IPO pipeline. However, with some fragility in markets during late 2009 and early 2010, plus poor equity pricing performance of recent PE backed IPOs, the bulk of the outstanding IPO pipeline has been delayed/deferred at least 3 to 9 months – and a number of PE portfolio exit processes have been cancelled altogether due to poor valuations. On the plus side, a number of corporate sell downs of non-core divisions or geographic businesses via public market transactions (IPOs or demergers) have moved to dual track processes offering an opportunity for PE funds to participate – high vendor price expectations are an ongoing impediment but this gap should shorten as valuation multiples fall to more realistic levels. In addition there are ongoing opportunities for cornerstone investments although many PE funds are clearly hesitant of private investment in public equity (**PIPE**) deals.

A trend of increasing globalisation has been evident in the PE industry with funds seeing the potential strategic advantages of holding portfolio companies in a variety of geographic locations. In addition PE funds have been targeting new markets, regions and specific sectors – this is most evident in the finance sector which was the most targeted industry globally and in Asia Pacific. A major theme in 2009 was the sale of Asian assets by US and European financial services firms including Citigroup and Bank of America, AIG, ING and RBS – this trend should subside as the world economy stabilises, although tax and other government incentives should see ongoing banking sector consolidation activity in Asia Pacific. Thailand and Malaysia are finalising new financial sector master plans and Taiwan, Vietnam and India are changing banking competition rules that should lead to further consolidation and entry of a greater number of foreign players. PE is likely to play a role in this consolidation process. In addition, within PE fund managers there is a renewed focus on understanding prospective investments resilience throughout various market cycles.

Other targeted sectors were energy and resources and healthcare. Interest is also growing in technology, media and telecommunications, agribusiness and infrastructure. Emerging markets are attracting a considerable amount of attention from North American and European limited partners (**LPs**) and China is drawing the most investor interest by presenting some of the best investment opportunities, along with Indonesia, Malaysia and Taiwan. The resilience of China's domestic stock markets, rising demand for energy and resources and further consolidation in the food and beverage sector, technology sub-sectors and telecoms will fuel increased deal activity.

Activity across China was strong during 2009 with a number of PE funds raising renminbi denominated funds – approximately US$8.7 billion of renminbi denominated capital was

raised in China during 2009, more than 50% higher than US dollar denominated equivalents. Further evidence of increased PE focus in China was the direct investment in Apax Partners by China Investment Corporation. Sovereign government investment into the PE sector was also seen outside of China with the Malaysian government investing US$2.8 billion into the launch of Ekuinas and Singaporean Government backed Temasek announced the launch of a new fund (Seatown). Korean PE activity levels are expected to increase in near term due to restructuring opportunities around Kumho group and Indonesia provides greater opportunities for PE funds to acquire undervalued companies in energy and mining, consumer products and financial services. Japan PE activity in second half of 2009 was dominated by the auction of Bell System 24 and a number of other pending secondaries. Taiwan offers PE deal flow opportunities in banking and insurance sectors with the Kbro/Taiwan Mobile deal being a watershed deal for the PE sector there. India is also showing signs of improvement particularly in financial services and IT. In Australia, the global PE funds spent much of 2009 focussing on restructuring and recapitalising portfolio companies although an IPO window in Q309 saw a number of portfolio company exits with a pipeline of a further 50 IPO's in the queue.

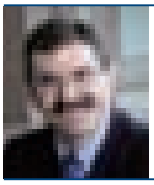
PE is no longer considered to have played a major role in exacerbating the GFC and conversely it is likely to play a leading role in getting global markets out of it. Whilst PE has sat on the sidelines during the bulk of 2009, the various disaster scenarios many predicted have not eventuated. Since 2008 the level of fundraising for global PE funds has slowed as a result of GFC - whilst 2008 witnessed a similar amount of capital raised to 2007 (c.US$133 billion), in 2009 42 global PE funds secured only US$44 billion of funds. However it's fair to say there remains a substantial level of capital raised during 2005-2007 yet to be invested, and PE fund managers will begin to see pressure from LPs to allocate this capital into investments or alternatively return cash to investors. This pressure will increase when you take into account the fact that global PE funds are currently on the road for new funds with US$165 billion of commitments being sought in Asia Pacific (US$670 billion globally). This all points to significant dry powder.

The last quarter of 2009 was the best in deal value terms since 3rd quarter of 2008 and coincided with several global PE funds achieving successful acquisitions and exits through both the public to private and secondary markets. There is a sense that debt markets will return to more normal levels of availability towards the second half of 2010, with most PE managers expecting an increase in acquisition and divestment activity to follow. Most fund managers expect to see some increase in current equity/ debt multiples to enable larger transactions, plus this should enable the secondary and trade sale markets to compete somewhat evenly with the higher (but not necessarily sustainable) multiples being offered through the capital markets.

PE in 2010 will continue to focus on the basic fundamentals of value

creation through identifying undervalued assets in stable growth markets instead of simple leverage and multiple arbitrage. We will also see more focus on efficiency and value creation at portfolio companies. No matter where you look in the Asia Pacific region, there is strong evidence of an ongoing recovery in sponsor activity, of corporates sitting on record levels of cash and looking at demergers and carve-outs of non core businesses and a thawing credit market which auger well for strong M&A activity towards second half of 2010.

Buckle up for the ride!!



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Infrastructure fund developments

Global development of the infrastructure asset class

In 2005 and 2006 the investment community saw the rapid recognition and development of infrastructure as an asset class. Institutional investors were keen to invest and there was some indication that the ability to raise funds for infrastructure projects was almost unlimited at the time. US and European banks' investment management groups began establishing infrastructure funds with global investment mandates and fund structures that could accommodate investors of any nationality. Private equity funds soon followed. Many funds were raised with equity commitments well over US$1 billion, giving those funds substantially more purchasing power when infrastructure industry-standard debt gearing of 70-85 per cent was taken into account.

The new global infrastructure funds often took the form of unlisted limited partnership structures, with several different feeders to allow for investors from different jurisdictions with different tax characteristics to invest (**Global Infrastructure Funds**). The asset managers – investment banks' asset managers or private equity houses – would enter into investment management agreements with the funds to provide investment advisory and ongoing asset management. In many cases the manager would also invest in the fund. Global Infrastructure Funds were generally closed-end structures with a fixed-period for investment, although there were exceptions where perpetual funds were established.

The newly created Global Infrastructure Funds were keen to invest the committed funds through the purchase of large established infrastructure assets – toll roads, airports, electrical generators and water utilities – at widely publicised competitive auctions. There was hope that extensive sales of government assets in the United States would occur (particularly for toll-roads). However, this has not materialised in many respects primarily due to national interest concerns. Where assets were not put up for sale by vendors in an auction process, many listed companies were taken private by infrastructure fund buyers.

In England where the foreign investment laws were considered transparent and less stringent than other countries, many listed companies were taken private by infrastructure fund investors – and in some circumstances – by sovereign wealth funds seeking to purchase infrastructure assets. As examples, over a relatively short timeframe, P&O was purchased by Dubai Ports World, ultimately owned by the Government of Dubai, ABB Ports was purchased by a consortium of investors including Goldman Sachs and BAA (owner of Heathrow and Gatwick Airports) was purchased by Ferroval, a Spanish infrastructure owner. Although many companies were acquired by infrastructure funds, there remain a number of significantly sized publicly traded infrastructure companies across the world, in particular in England, France, Spain, the United States and Australia.

Comparison to the Australian listed infrastructure market

Looking back, the recognition of infrastructure as an investment class arguably started in Australia and Canada. Government asset sales of the 1980s and 1990s combined with those countries well developed pension funds – in Australia well supported through compulsory pension contributions made by employers – ultimately created an excellent opportunity for financial intermediaries to establish funds to hold such assets.

Many large infrastructure investments in Australia have historically been held as publicly listed entities - either in the form of (i) publicly listed asset operators (toll road companies, utility companies, listed infrastructure companies) or as (ii) listed infrastructure funds holding a selection of assets in a specific area within infrastructure (for instance, airports, toll-roads or telecommunication towers) (**Listed Infrastructure Funds**) which have been managed by a separate asset manager – which itself may be listed or unlisted. (Both (i) and (ii) are hereafter referred to as **Listed Infrastructure Groups**).

An unusual feature of Australian taxation law is that unit trusts (so-called Australian REITs) can be utilised for holding infrastructure assets. Unit trusts in Australia can be treated as 'flow through' entities for tax purposes where they do not undertake active businesses. A stapled structure provides for units in one or more flow-through trusts and shares in one or more companies to be stapled together and traded as a single security. The stapled structure allows investors to receive pre-tax returns on income derived from 'passive income' and dividends from the company undertaking 'active' activities like management. By way of example – for Listed Infrastructure Groups, the stapled security may consist of two trusts and one company where each stapled security comprises one unit in each of the trusts and one share in the company.

The 'flow through trust' allows for the distribution of cash flow, known in Australia as 'tax deferred distributions' which is treated like a return of invested capital. This can be particularly useful for infrastructure investments which often have cash flows which exceed profits given their substantial non-cash depreciation deductions.

As a product of the above, Australian Listed Infrastructure Groups differed in a number of key respects:

- In order to supplement their cash distributions, Listed Infrastructure Funds have historically utilised increasing asset valuations to draw down on debt and pay debt-funded distributions. This results in the distribution yield on the asset being greater than the underlying net cash flow provided from the revenue on the infrastructure assets. The ability of Australian Listed Infrastructure Funds and companies to draw down further debt is constrained by Australia's thin capitalisation provisions which provide a safe harbour debt limit based on a percentage of asset values. In many respects, as the debt markets tightened up and there has been a reversal in asset values during the global financial downturn, a number of publicly Listed Infrastructure Funds moved away from this policy to pay only distributions represented by profits. Generally, it could be said that the Global Infrastructure Funds did not ever adopt a similar policy. However, in the case of Global Infrastructure Funds and many other private equity funds it is important to note that it is not unusual for those funds to significantly refinance their assets from time-to-time as underlying asset values increase – albeit such refinancings, rather than being regular in line with distributions would occur on an ad-hoc basis many years apart.
- As publicly traded vehicles, Listed Infrastructure Funds need to report their results on a six-monthly basis and their prices fluctuate daily, often in line with the broader equities market. The Listed Infrastructure Funds were also seen as attracting individual investors seeking yield. In many respects, these aspects were seen as a peculiar aspect of the Australian market. By contrast the more recent Global Infrastructure Funds are either closed end (with no practical opportunity for redemption of funds invested until the end of the fund's life) or perpetual in nature and provided only limited opportunities for price discovery and redemption (for example, every six months). Infrastructure assets, with their cash flow are often seen as providing stable cash flow yields over the very long term, with revenues being tied to population growth and fees for use of the assets increasing in line with inflation (often mandated pursuant to government's concession agreements). This cash flow profile arguably makes these assets ideally suited to meet the long-tailed liabilities of pension funds and life insurance companies where the decision to invest and divest is made over a much longer term than the equities market.

Recent developments

On a global basis, there is strong indication that the infrastructure sector is now back in favour. Analysts have reported that many infrastructure funds and pension funds have either recently acquired infrastructure assets or indicated firm intentions to increase allocation to the sector. One analyst, citing toll roads in Europe as an example, compared current long bond yields ranging between three to five per cent to indicative internal rates of return for toll-road equities between ten to 12 per cent with distribution yields alone of four to six per cent. The motivation of pension funds to increase their exposure to the sector can be seen as compelling. The increased interest of foreign pension funds has clearly been seen in Australia.

In the last two years, coinciding with the global financial downturn, we have seen significant changes in the listed infrastructure sector in Australia. Most importantly, it is noted that there has been an increased role of active foreign investment in the sector by foreign asset managers and foreign pension funds, particularly from Canada. If Australia can be seen somewhat as a trend setter in the infrastructure sector, the increased interest from foreign asset managers and pension fund investors may be a sign of things to come in the listed infrastructure sector in other countries.

There has also been a trend towards the 'internalisation' of management of listed infrastructure funds. As highlighted above, Listed Infrastructure Funds have historically been managed by a separately listed or unlisted asset manager. The clear trend has been for a number of listed infrastructure funds to 'internalise' their management, so that going forward, management of the asset portfolio is carried out by the listed group itself. Structurally, the 'internalisation' has been via the stapling of the management company to the fund. As clearly independent publicly traded groups, it is reasonable to assume that these entities now have greater freedom to participate in mergers and acquisitions activity.

The increased interest of foreign investors and the need to structure for efficiencies

In light of developments and particularly the competitive market for infrastructure assets, tax efficiencies for infrastructure funds on a global basis are important and need to be managed:

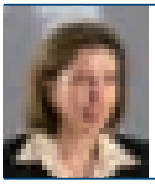
- Foreign pension funds and life insurers are often tax exempt in their own countries and may not gain any benefit from underlying taxes paid. As a result, it is important to seek to minimise any underlying corporate tax paid within the overall structure as well as minimise withholding taxes suffered on offshore investments and those suffered by its shareholders. It is important for any infrastructure group to continually ask the question whether there are tax efficiencies that a third party purchaser – either foreign or domestic – could extract which the infrastructure group has not.

- Where infrastructure entities hold foreign assets, it is important to be conscious that pension funds in the country where the asset is located may be able to hold the same assets more efficiently if held directly. For example, if an Australian Listed Infrastructure Fund holds a Canadian asset and is incurring dividend or interest withholding tax on the repatriation of profits out of Canada, then this creates a clear tax inefficiency as a Canadian pension fund investing in the same asset would not suffer withholding tax. As a comparison, global infrastructure fund structures that are wholly transparent (i.e., flow through entities, vis-à-vis corporations) throughout (for instance, in the form of limited partnership structures) may provide such efficiencies.

- However, complexities may arise in respect of filing requirements, different countries' viewpoints as to whether an entity is transparent or opaque and third country taxes which need to be managed.

- A developing problem for infrastructure entities which hold foreign assets is the negotiation of new double tax treaties which provide for zero per cent dividend and interest withholding tax between certain countries where the investor is a pension fund. This can create clear inefficiencies, for example, where an opaque infrastructure fund in Country A holds an investment in Country B and the repatriation of cash-flows from Country B to Country A results in withholding tax being suffered by the infrastructure fund. However, if a pension fund in Country C were to hold the investment in Country B and were entitled to zero per cent withholding tax, then it would be more efficient for the pension fund to hold the asset directly.

These tax structuring considerations should be addressed both at the time of acquisitions but also monitored on an ongoing basis as well for law changes and new double tax treaties that are negotiated over time.



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Private equity funds adoption of FIN 48 - Lessons learnt

ASC 740-10 (formerly **FIN 48**) addresses accounting for uncertain tax positions (**UTPs**) under US generally accepted accounting principles (**US GAAP**). (Refer to the summary below for a general explanation of ASC 740-10.) The ASC 740-10 standard was issued in June 2006, and was initially applicable to public companies issuing US GAAP financial statements for calendar years ending December 31, 2007 and subsequent years. As funds are not included in the definition of a public company, funds were initially not required to comply with ASC 740-10. However ASC 740-10 is now effective for all funds (and other private companies) who prepare US GAAP accounts for annual periods beginning after December 15, 2008. As a result funds preparing US GAAP accounts on a calendar year basis are required to adopt ASC 740-1 in their accounts for the year ending December 31, 2009.

The adoption of ASC 740-10 by funds gives rise to a unique set of issues and special considerations as many of the funds concerned will be preparing their accounts using Investment Company accounting. Under this accounting practice, a fund accounts for its investments at fair market value regardless of the percentage size of the holding or the level of control exercised over an investment. In such cases, the fund will need to distinguish between those UTPs that may result in a tax liability for the fund itself and those that will merely impact the valuation of the fund's portfolio investments.

To date we have assisted a number of funds formulate an action plan to assess their tax positions within the framework of ASC 740-10 as well as prepare the required ASC 740-10 documentation and disclosures. We typically either assist management with the full preparation of a fund's ASC 740-10 implementation process and related documentation/disclosures or act in an advisory role throughout the implementation process. In both cases we can help ensure the ASC 740-10 implementation process is also used to assess the fund's existing investment structures and related tax issues.

We can also assist our attest clients in both the development and implementation of an ASC 740-10 adoption plan provided that certain conditions are met. Implementation assistance could include helping a client identify potential uncertain tax positions, advising the client whether those tax positions meet the more-likely-than-not threshold, and calculating the related unrecognised tax benefit.

Based on our involvement in the review and documentation of ASC 740-10 for a number of funds, there have been a number of lessons learnt to date. In this article we first summarise common fund ASC 740-10 issues and then outline lessons learnt.

Common fund ASC 740-10 issues

For any fund or special purpose vehicle (**SPV**) preparing accounts under US GAAP the following potential issues may be encountered and require documentation as part of a fund's ASC 740-10 implementation:

- Does the fund have a taxable presence (i.e., a permanent establishment) in any of the locations in which it has investments or where the management of the fund is carried out?
- Where have the fund and SPVs established "residency" for tax purposes?
- Does the fund and any SPVs have the necessary substance in the locations in which they are established?
- Will the fund and/or the SPV it has established be able to successfully secure the benefits of any double tax agreements (**DTAs**) to which they may be entitled?
- Will indirect transfers of underlying group subsidiaries be subject to local tax? This is of particular significance in relation to indirectly held People's Republic of China (**PRC**) investments due to the recent release by the China tax authorities of Circular 698.

Lessons learnt

The following outlines a number of lessons learnt by our fund clients in relation to the review and documentation of ASC 740-10:

Talk with your auditors before commencing work

The most important first step should include a discussion with the fund's auditors to agree on ASC 740-10 implementation scope and documentation requirements. This will ensure your fund's ASC 740-10 implementation work product is tailored to your auditor's expectations.

What investments should you focus on?

All investments that have been disposed of by a fund for a profit and existing investments that have unrealised gains at balance date may need review.

The tax implications of unrealised investments held at balance date should be assessed assuming the investments are disposed of at balance date for a fair market value. A review of disposed investments may only be required if the position is not time barred. The treatment of any other income of the fund should also be considered.

Generally investments that have been disposed of at a loss or are held at balance date at cost or an unrealised loss can be ignored for the purposes of your ASC 740-10 review, as there should be no potential tax implications with these investments (the exception may be countries, such as Indonesia, who impose capital gains tax on a gross proceeds basis).

Consolidation versus Investment accounting treatment of tax exposures

If an uncertain tax position is discovered as part of your review you will need to determine if the ASC 740-10 liability should be recorded at the holding company, the fund level or included in the valuation of the investment at the fund level. This analysis will generally depend on how the investments are accounted for (i.e., consolidated versus investment accounting). The accounting treatment will normally depend on whether the holding company/SPV entity is consolidated or not. If the fund consolidates (i.e., the holding company/SPV is a look through entity), then any tax liability/provision at the holding company/SPV level becomes a tax of the fund. However, if the holding company/SPV is not a look through entity and records the fair value of its investment in the holding company/SPV's accounts and lists the holding company/SPV in its schedule of investments, then any tax at the holding company/SPV level should be a valuation adjustment.

Implications if the fund is a look through

If an ASC 740-10 liability is at the fund level and the fund is a pass through entity, arguably the fund liability is actually a liability of its investors. This is a common issue since many funds are partnerships (e.g., Cayman LPs). When determining if the UTP is a liability of the fund or the fund's investors, consideration should be given to who the respective taxing authorities would pursue to recover the tax liability. In our experience many tax authorities in the Asia region would seek to recover such tax from the fund's investors and not the fund itself. A notable exception is the PRC where the tax treatment of offshore partnerships and other similar vehicles is unclear. If the fund pays tax on behalf of investors then the tax should be reflected as a receivable from the investors. If the fund is a pass through entity note disclosure of any material ASC 740-10 exposures should be considered in the funds' accounts as appropriate.

Roll forward to next year

ASC 740-10 analysis is required to be rolled forward on a yearly basis. Significant work is required in the first year as a number of prior years may need to be reviewed and documented, however for subsequent years only an update of this original work should be required.

What documentation are funds preparing?

As a minimum, funds are generally preparing the following documentation to provide to their auditors in respect to their ASC 740-10 review:

- A memorandum detailing the implementation scope as well as procedures undertaken to identify and support the identification of potential UTPs;
- Management's assessment of the accuracy of each UTP after applying the framework of ASC 740-10 to each tax position (i.e., unit of account, recognition and measurement). Management should also consider subsequent recognition and measurement;
- A calculation of each UTP's associated interest and/or penalties;
- Reconciliation of gross unrecognised tax benefits to the net ASC 740-10 liability recorded; and
- ASC 740-10 financial statement presentation and disclosures.

It is important to emphasise that the above work must be performed for all previous years that are not time barred. If the fund has disposed of investments, these disposals should be reviewed to ensure that the correct amount of tax was paid on disposal and whether there are any historical risks.

Conclusion

The adoption of ASC 740-10 by funds is a difficult, complex and a time consuming process. Most funds with a December 31, 2009 balance date are well under way with their ASC 740-10 adoption process and the dealing with the challenges and complexities during implementation. ASC 740-10 may also require management to make significant estimates and judgements related to their tax positions. As a result, extensive dialogue should be conducted with the fund's tax advisors and audit firm.

A number of funds are taking the opportunity to perform a health check of their holding company structures and other fund tax issues during ASC 740-10 implementation. This may result in tax advisors issuing updated opinions on whether the current holding company structures of investments will act as intended to minimise any tax on disposal and to achieve the desired dividend withholding tax rate on the repatriation of dividends.

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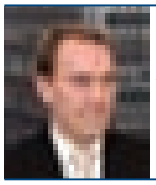

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Summary of general application of ASC 740-10

ASC 740-10 addresses accounting for UTPs under US GAAP. The standard was issued in June 2006 and was initially applicable only to public companies issuing US GAAP financial statements for calendar years ending December 31, 2007 and subsequent years. The application of the guidance to private companies was previously deferred; however the standard is now effective for all non-public companies for annual periods beginning after December 15, 2008. As a result, non-public companies preparing US GAAP accounts on a calendar year basis need to adopt ASC 740-10 in their accounts for the year ended December 31, 2009.

As well as its application to any US private companies and their subsidiaries who prepare US GAAP accounts, the application of ASC 740-10 to non-public entities (companies, partnerships, etc.) is relevant to private investment funds and other similar collective investment vehicles (i.e., funds) who are preparing their accounts under US GAAP.

ASC 740-10 requires entities to identify and measure all UTPs using a “two step” recognition and measurement process. A tax position is defined as “a position in a previously filed tax return or a position expected to be taken in a future tax return that is reflected in measuring current or deferred income tax assets and liabilities.”

The two step approach is summarised in the following diagram:

Step 1 - Recognition

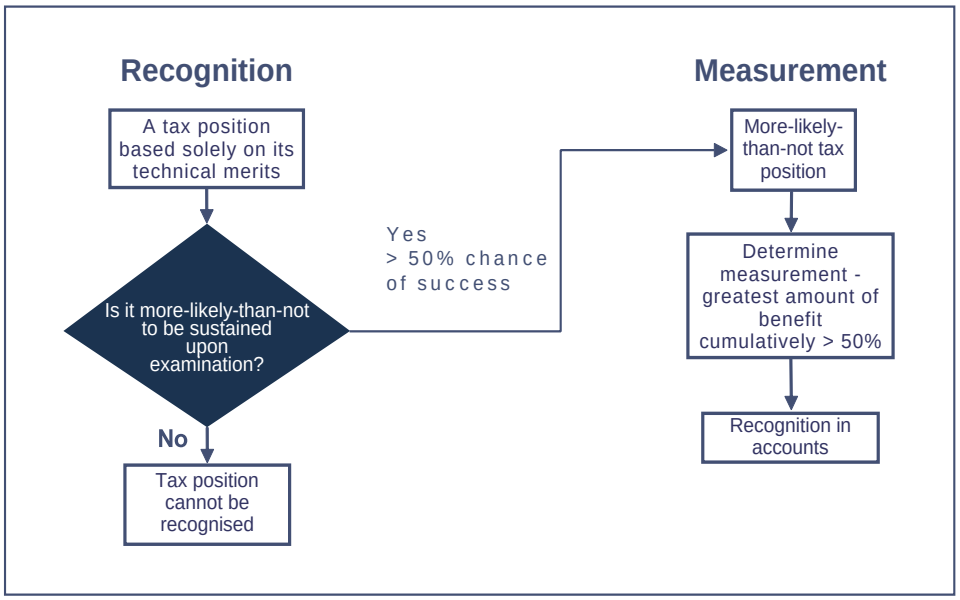
Evaluate whether the UTP will more likely than not (i.e., more than 50% likelihood) be sustained on an examination by the tax authorities based solely on technical merits. If it is not more likely than not that the position will be sustained, then no benefit for the position taken should be reflected, and a liability for the full amount of the UTP should be recorded.

Step 2 - Measurement

Once Step 1 is passed, Step 2 requires an assessment of the UTP and the amount of the benefit that can be recognised, and that which can not, using a cumulative probability approach.

When applying ASC 740-10 there are a number of key considerations including:

- Detection risk cannot be assumed in evaluating recognition in Step 1. Must assume that full knowledge of all the facts is available to the tax authorities;
- Administrative practices followed by tax authorities may be considered in evaluating the recognition of the UTPs;
- Judgement is required to determine cumulative probability during Step 2, measurement;
- Interest and penalties may also be recognised in addition to the liability for the UTP; and
- Extensive disclosures relating to ASC 740-10 liabilities are required in the accounts of public companies; for private companies some of the disclosure requirements are relaxed.



Singapore as a fund location

Singapore is attracting increasing attention as an alternative fund domicile location. Fund managers may ask why they should consider Singapore as a location for fund domicile, when there are other more commonly used locations such as the Cayman Islands and Mauritius (with respect to Indian investments) to choose from. Although many fund managers default to the use of familiar jurisdictions, with the increasing focus by tax authorities on substance and treaty shopping, many are looking at alternative fund structures that can offer tax efficiency and at the same time withstand tax authority scrutiny. Recent examples of scrutiny from the tax authorities include the TPG/Myer case in Australia and circulars issued by the Chinese State Administration of Taxation in relation to claiming tax treaty benefits for passive income.

Singapore has thus emerged as an attractive option. This can be attributed to the Singapore government's efforts in developing the investment management industry by introducing a series of tax benefits, and providing both infrastructure and an environment that are conducive to business operations.

Reasons for choosing a Singapore fund

There are a number of reasons for considering Singapore as a fund domicile:

Different legal forms for funds

A fund can be set up either as a company or a unit trust in Singapore. With the Singapore Limited Partnership Act coming into force on May 4, 2009, the Singapore limited partnership is also an available option.

Network of double taxation agreements

Singapore has a wide network of double taxation agreements (**DTAs**). To date, Singapore has concluded more than 60 DTAs with countries including China, India and Japan.

Notably, the tax treaties which Singapore has concluded with certain Asian countries generally offer lower withholding tax rates on dividends and interest payments compared to the domestic withholding tax rates in those countries. In some cases, the tax treaties also provide for capital gains tax exemption.

To enjoy these benefits, the fund, or its investing vehicle, has to be set up as a Singapore resident company.

Certainty of tax treatment of Singapore funds

Trading gains and income derived by a fund constituted in Singapore are generally taxable in Singapore to the extent that they are sourced in Singapore or received in Singapore from sources outside Singapore. Several tax incentive schemes which provide for the certainty of tax exemption on such income are available. These are discussed in detail below.

Fund manager can be in the same location as the fund

Singapore is strategically located and offers financial institutions a pro-business environment, excellent infrastructure, cost competitiveness and a highly skilled labour force, making it easy for a fund manager to set up its operations. The co-location of the fund and its fund manager in Singapore should make the administration of the fund less cumbersome and assist the fund in maintaining substance in Singapore.

Furthermore, a fund management company that manages a fund in Singapore may also apply for a concessionary tax rate of 10% on income arising from its fund management activities in Singapore.

Other tax considerations

While income tax exemption may be available for a fund set up in Singapore under the various tax ncentive schemes, other types of taxes may still apply. Examples of such taxes include goods and services tax (**GST**) on expenses incurred by the fund and withholding tax on interest payments by the fund to non-residents (say to the prime broker). Whilst the GST leakage has been substantially reduced as a result of a recent remission scheme announced by the Monetary Authority of Singapore (**MAS**), the withholding tax on interest continues to remain a potential cost. These potential tax costs require a careful review of options and a thorough cost benefit analysis in order to minimise.

Tax exemption schemes for Singapore funds

As mentioned earlier, several tax exemption schemes are available for funds set up in Singapore, which cater for different circumstances. The following sections outline two such schemes.

Singapore resident fund company scheme

The tax exemption scheme for Singapore resident fund companies (**SRF Scheme**) was introduced in November 2006, and grants tax exemption for 'specified income' in respect of any 'designated investment' derived by any approved Singapore resident fund set up as a company that satisfies the 'qualifying fund' test.

To enjoy tax exemption under the SRF Scheme, an application has to be submitted to the MAS. To be approved, a fund must undertake to meet the prescribed conditions, including the following:

- It is a tax resident of Singapore;
- It is a company, the value of issued securities of which is not 100% beneficially owned, directly or indirectly, by investors in Singapore; and
- It uses a Singapore based fund administrator.

The investors will be split into two categories: qualifying and non-qualifying investors. A non-qualifying investor will have to pay a financial penalty to the Inland Revenue Authority of Singapore. The financial penalty is calculated by attributing a percentage of the net profits in the fund's audited accounts to that non-qualifying investor based on his interest in the fund on the last day of the financial year of the fund. The main type of investor who will be considered a non-qualifying investor appears to be a non-individual person based in Singapore (other than certain Singapore government entities) who take large (more than 30%) stakes in the fund.

An approved fund is required to comply with certain reporting/tax return filing obligations.

Enhanced-Tier Fund Tax Incentive Scheme

To provide Singapore based fund managers with greater flexibility in sourcing for mandates, the MAS introduced the Enhanced-Tier Fund Tax Incentive Scheme (**ET Scheme**) for fund vehicles in 2009. The key benefit of the ET Scheme is that the concept of qualifying and non-qualifying investors has been removed, and thus no investor is liable to a financial penalty. Also, under this scheme, fund vehicles can be set up as limited partnerships.

Funds approved under the ET Scheme (**ET Funds**) will be granted tax exemption for 'specified income' in respect of any 'designated investment'. To be approved for the ET Scheme, the fund must undertake to meet the prescribed conditions, including the following:

- It is a company, trust (with certain exceptions) or limited partnership;
- It has a minimum fund size of S$50 million at the point of application (in the case of a private equity fund, this includes committed capital); and
- It uses a Singapore based fund administrator if the fund is a company incorporated in Singapore, with its tax residency in Singapore.

All ET Funds are required to comply with certain reporting/tax return filing obligations.

Conclusion

In contrast to other fund locations, Singapore should stand out as a viable option, as it is possible to demonstrate substance out of Singapore where actual business activities can be conducted, thereby providing stronger grounds for claiming DTA benefits. The fund structure may also be simplified, reducing overall compliance costs. These benefits would need to be weighed against potential tax leakages on account of GST and withholding tax, and the issue of investor familiarity with Singapore. However, it is fair to say that serious consideration should be given to using Singapore as a fund location before the set up of any fund structure, with a view to improving overall economic returns for the two key stakeholders – the investors and the fund manager.

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Sweet equity - Incentive arrangements for portfolio company management

Aligning the financial interests of portfolio company executives with those of investors has proved no surprise to be the most effective motivational tool in driving them forward. Senior portfolio company executives are often asked to co-invest funds in their company, and can expect significant gains when performance objectives are met. Such reward structures are less common throughout Asia due to the relative maturity of the market, and this article seeks to introduce the conceptual structure of these arrangements and some of the associated taxation considerations for the private equity firm, portfolio companies and their executives.

Sweet equity

Sweet equity is simply a name for the portion of equity subscribed by the portfolio company's executives.

Typically, a private equity firm funds its acquisition with a combination of equity (which may include shareholder loans and preferred shares) and third-party debt.

Portfolio company executives may be given the opportunity to commit funds to the investment so as to align their financial interests with those of the private equity (**PE**) firm, together with additional performance style incentives, to help maximise the return to the PE fund.

The allocation of investment interests (shares and other financial instruments) between the PE fund and the portfolio company executives is generally structured such that the executives derive a return from their investment once an agreed performance level has been reached (equivalent to a 'hurdle rate' included in a carried interest arrangement).

An **incentive ratio** reflects how far the portfolio company executives are rewarded for their investment. This ratio is between the price paid by the PE fund and that paid by the management team for their respective shares in the equity. The incentive ratio may thus be calculated as follows:

$$\frac{\text{PE fund total investment}}{\text{Percentage of company equity held by the PE fund}} \Big/ \frac{\text{Management total investment}}{\text{Percentage of company equity held by management}}$$

If the incentive ratio is three (3), this means that the investment made by management to share in the return on equity is three times lower than the investment made by the PE fund. The PE fund's total investment will of course include funds invested in other forms of securities like shareholder loans, preferred shares, etc. The incentive ratio does not provide any information on whether the management have in fact invested at below or above fair market value (**FMV**).

If the incentive ratio is high, this would suggest that management is too highly incentivised, which may evidence a misalignment of their financial interests to those of the PE fund.

Where the funds committed by the executives are too low (which is reflected by a high incentive ratio), they may be inclined to adopt 'high-risk' decisions, which could be detrimental to the overall performance of the PE fund investment.

If the incentive ratio is too low, this may mean that management is poorly incentivised, and might not be supportive of successful behaviours.

The mechanism of the portfolio company management incentive may be best illustrated by an example as follows:

Example

Data and assumptions (in US$ million)

Source of financing of Newco (purchase price of Target is 100)	
Senior debt	50
Mezzanine / Bond	20
Shareholder loans	20
Preferred shares	5
Ordinary shares	5
Total	**100**

Financial returns	
Senior debt	5.00%
Mezzanine / Bond	6.00%
Shareholder loans	7.00%
Preferred shares	8.00%

Allocation of shareholder loan and equity			
	Fund	**Management**	**Total**
Shareholder loan	20	0	20
Preferred shares	5	0	5
Ordinary shares	4	1	5

Exit value of financing at exit (after seven years)		
	Time (T)	**T + 7**
Senior debt	50	70.4
Mezzanine / Bond	20	30.1
Shareholder loans	20	32.1
Preferred shares	5	8.6

In this example, the incentive ratio for the management is calculated as follows:

$$\frac{29/80\%}{1/20\%} = 7.25$$

This means that the investment made by the management to share in the return on equity is 7.25 times lower than the investment made by the PE firm.

Let us now assume that, seven years after being acquired, the portfolio company is sold. The following table illustrates possible exit values ranging from US$110 to 200 million, and also shows the allocation of each exit value amongst the different stakeholders.

Exit proceeds	110	120	130	140	150	160	170	180	190	200
Senior debt	70.4	70.4	70.4	70.4	70.4	70.4	70.4	70.4	70.4	70.4
Mezzanine / Bond	30.1	30.1	30.1	30.1	30.1	30.1	30.1	30.1	30.1	30.1
Shareholder loans	9.6	19.6	29.6	32.1	32.1	32.1	32.1	32.1	32.1	32.1
Preferred shares	0	0	0	7.5	8.6	8.6	8.6	8.6	8.6	8.6
Ordinary shares	*0*	*0*	*0*	*0*	*8.9*	*18.9*	*28.9*	*38.9*	*48.9*	*58.9*
Fund	0	0	0	0	7.1	15.1	23.1	31.1	39.1	47.1
Management	0	0	0	0	1.8	3.8	5.8	7.8	9.8	11.8
Total	**110**	**120**	**130**	**140**	**150**	**160**	**170**	**180**	**190**	**200**

Finally, the last table shows the money multiples for each of the PE fund and management (expresses the value of the financing instruments at exit as a multiple of the stake invested).

Money Multiple* for the level of exit proceeds:

Exit proceeds	110	120	130	140	150	160	170	180	190	200
Fund	0.3	0.7	1	1.4	1.6	1.9	2.2	2.5	2.8	3
Management	0	0	0	0	1.8	3.8	5.8	7.8	9.8	11.8

** Shareholder loan + preferred shares + ordinary shares at exit / shareholder loan + preferred shares + ordinary shares at inception*

This shows how portfolio company executives are rewarded for performance in a PE environment. For poor and moderate performance, the money multiple is lower than the money multiple of the fund – it can even be nil. From moderate to good performance, there is a catch-up effect as the money multiple of the management tends towards the money multiple of the PE fund. For out-performance, management's money multiple may be several times the money multiple of the fund.

Changes to sweet equity

One consequence of the current financial and economic crisis is that PE firms may now have to cope with underwater equity and may consider resetting portfolio company management incentives so that they continue to deliver what they are intended to: retention, motivation, reward and alignment.

Starting from the example above, while an expected exit value of the company below US$140 million might have been regarded as below investors' expectations two or three years ago, in the current economic environment it could well be acceptable. Unfortunately, according to the originally agreed incentive arrangements, ordinary shares will not entitle the management to any proceeds for that level of exit value. The incentive arrangements will thus be ineffective to retain management, and the PE firm could thus consider resetting them. Resetting the incentive arrangement should result in the creation of gain expectations for management so as to restore their motivation and ensure their retention. In our example, the PE fund could sacrifice part of the return on the preferred shares and the shareholder loan in favour of management.

There are several possibilities for resetting sweet equity. In this respect it may be helpful to think of a deal as a cake, with the debt and equity forming the various slices. For portfolio company management, resetting the incentive may be done by waiving shareholder debt, reducing or turning off the coupon on shareholder debt, converting shareholder debt into equity, restructuring management's holding to rank ahead of shareholder debt, amending equity, creating new ratchets, creating new categories of shares, granting share options, and so on.

All the alternatives will potentially result in additional value flowing into the sweet equity held by the portfolio company managers, which may potentially trigger a tax cost in most jurisdictions for one of management, the PE fund or the portfolio company. PE firms will need to consider carefully the taxation implications of the various options outlined above and the existing attributes of the relevant parties to assess whether modifications will result in a current tax cost.

It may be possible to grant share options to structure this flow of value to sweet equity in a tax effective manner, although the PE firm will need to consider the commercial implications of any limitations or restrictions that may be required to achieve tax deferral.

Legal structuring of 'sweet equity'

Typically, sweet equity will be structured in the form of a shareholding in the acquisition company (Newco in our example). As is the case for carried-interest units, flexibility of company law in defining the rights attached to shares and profit-sharing certificates will need to be considered in structuring the sweet equity arrangements to ensure that these are supportive of successful behaviours and corporate performance.

General tax treatment of sweet equity

Generally, where portfolio company executives invest at FMV, they should not be deemed to receive a taxable benefit in kind (taxable pay) at the time of subscribing. However, tax authorities are likely to carefully scrutinise the pricing, terms and conditions of the portfolio company executives' investment, and therefore, careful consideration should be given to the documentation of the pricing arrangements.

If all funding instruments in which investors other than the portfolio company executives invest display market-compliant returns, then it may be argued that the instrument in which management is investing is fairly remunerated. By contrast, if the shareholder loan, preferred shares, etc. held by the PE fund display returns below market practice, management is likely to be receiving excessive returns and the tax authorities are likely to pay particular attention to the pricing.

Generally, at exit, when the portfolio company executives sell their shareholdings in Newco, the proceeds should not be considered to be taxable pay provided the sale price is not higher than the FMV of the shares. Where the gains are considered capital, then in many jurisdictions management should be subject to tax at concessional rates. We note that there has been increased attention to the taxation treatment of sweet equity outside of the Asia region, and in some jurisdictions there is a trend to treating gains realised on exist as income taxable as salary.

Careful planning and consideration of the particular jurisdictional rules is necessary to ensure any favourable taxation treatment is accepted by the taxing authorities in Asia.

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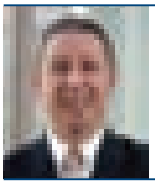

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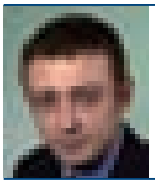

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Australia: TPG / Myer and ATO's subsequent tax determinations

On November 11, 2009 the Commissioner of the Australian Taxation Office (**ATO**) took steps to prevent the sale proceeds from an initial public offering (**IPO**) of Myer Holdings Limited (**Myer**) from being remitted to a non-resident private equity investor, TPG, on the basis that Australian tax was payable on the disposal.

The ATO asserted that a A$678m tax debt (comprising the primary tax liability and penalties) arose in respect of the gains realised on the disposal, and in order to enforce that debt prior to funds being sent offshore, sought injunctions to freeze bank accounts.

Although the injunctions were subsequently lifted when it was discovered the funds had already been transferred out of Australia, it is expected that the ATO will continue to pursue the non-resident investors where they believe a liability to Australian tax could exist.

As disclosed to the Court, the Myer shares disposed of under the IPO were directly held by a company resident in the Netherlands. This Dutch company was in turn owned by a Luxembourg company, being itself a wholly-owned subsidiary of a company established in the Cayman Islands.

The ATO issued alternative tax assessments against the Cayman Islands and Luxembourg companies, but no assessment was issued to the Dutch company who was the seller of the Myer shares.

Australian tax laws as they apply to non-resident investors

The disposal by a non-resident investor of an asset held on capital account should only be subject to Australian capital gains tax (**CGT**) where, broadly, the asset has been used in carrying on a business through an Australian permanent establishment or is 'taxable Australian property' which includes interests in 'Australian real property' and in the context of a sale of shares, an 'indirect Australian real property interest'.

However, the disposal of an asset by a non-resident investor who holds its investment on revenue account should be assessable in Australia where the gains realised on disposal are Australian sourced and protection is not available under an applicable double tax treaty.

Whether a gain is Australian sourced is a question of fact. Importantly, whether or not a non-resident investor in an Australian company holds its investments on 'capital' or 'revenue' account is also a question of fact.

The Commissioner's draft tax determinations

Following its actions in relation to the TPG / Myer transaction, the ATO issued two draft tax determinations in mid December 2009. The release of these draft determinations highlights the importance in Australia of:

- The capital vs. revenue distinction; and
- How Australian investments / exits are structured and executed.

Draft Taxation Determination 2009 / D17 – Anti-Avoidance

TD 2009 / D17 contains the Commissioner's preliminary view of whether Australia's anti-avoidance provisions will apply to investment structures relying on a double tax agreement. This draft determination is broadly in line with the stance adopted by the Commissioner in the TPG / Myer case.

The Commissioner's view is that the insertion of a company resident in a treaty country between an Australian entity and the investment fund (often established in a tax haven) may give rise to a tax benefit. The Commissioner argues that a tax benefit arises in this situation because the taxing rights to the gain, that Australia would ordinarily be allocated had the investment

fund invested directly into Australia, are removed from Australia and allocated to the treaty country.

In determining whether the anti-avoidance provisions would apply to investment structures in which a treaty country is in place, the Commissioner has indicated that it will require a consideration of the particular facts of each case. However, the Commissioner has strongly signalled his position by stating "in the absence of any significant commercial activity in a treaty country by a company resident in that jurisdiction, the presence of a company in that jurisdiction in the context of a cross-border structure is normally to be explained by tax considerations".

So what are we hearing? In order to refute a suggestion by the ATO that they can ignore the existence of interposed entities, strong commercial rationale for the existence and substance to the operations of the entity are key. The Commissioner with his arguments is also ignoring the residence of the investors in the investment fund.

Draft Taxation Determination 2009 / D18 – Private Equity Investment Gains

The question posed in TD 2009 / D18 is 'can a private equity entity make an income gain from the disposal of the target assets it has acquired?' (private equity entity not being a defined term). The draft determination does little more than restate the existing case law surrounding revenue profits which is, broadly, that an isolated gain might be ordinary income where the gain is:

- A profit from the carrying on of a business, whether as part of that business or an isolated transaction; or
- A profit from a transaction entered into in carrying out a business operation or commercial transaction.

These core propositions are not discussed any further in the body of the draft taxation determination itself.

In answering the question posed in TD 2009 / D18, the ATO relies on its understanding of private equity investments to conclude that the treatment of any gains derived by a private equity entity will depend on the circumstances of each particular case. The ruling does not provide a 'bright-line' test as to when a gain would be treated on revenue or capital account.

The ruling is the formal indication by the Commissioner that, in the absence of evidence to the contrary, he will be assuming that profits or the disposal of shares by 'private equity' funds are on revenue account. Evidence to support a contrary position would be the intention that the taxpayer's investment was long term (and potentially with the purpose of deriving dividend income from its investment). Arguably this could be the case as the investors in private equity funds themselves are passive investors.

Other relevant matters – Source of gain/profit

The Commissioner has not provided guidance on the source of the revenue profits which is relevant to foreign investors and whether Australia has taxing rights in the first place.

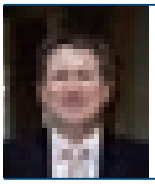
The question of source is relevant to both rulings, and is an additional factor that needs to be considered on each asset disposal to determine whether non resident investors have an Australian tax obligation at all.

Future considerations

With the amounts at stake, the positions adopted, and the issues involved, there are unlikely to be significant concessions by the ATO. The ATO has asked for submissions on both draft determinations from interested parties and meetings have been held to try to give the ATO a better understanding of private equity fund structures and transactions. We should see some amendments in the final determination, but at this point it is unclear how many and what may change. In the interim, the actions taken by the Commissioner have reverberated throughout the investment community and in particular among those in the private equity and hedge fund industries.

Until there is a greater degree of certainty, prospective investors need to be apprised of the potential tax implications of investments into Australia, and the arguments which are expected to be raised by the Commissioner if an investment is sold for a profit.

Furthermore, this is a matter that needs the immediate attention of the Government so that foreign investors have certainty when considering making investments in Australia, as the ATO's actions do not appear to be aligned to the Government's stated objectives of attracting foreign investment and developing Australia as a financial services centre.



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China: Key recent tax developments affecting private equity industry

In the private equity sector, structuring investments into China through an offshore holding structure has been seen as a common best practice. Use of a suitable offshore intermediate holding company structure for Chinese projects may not only increase the flexibility in the future exit options, but also offer tax treaty protection on future repatriation of earnings and capital gains arising from the project.

However, the People's Republic of China (**PRC**) tax authorities have gradually extended their tax net to combat abuses in relation to the use of offshore holding platforms to reduce tax leakage. Matters like treaty shopping, indirect offshore exit and beneficial interest are now on the radar of the Chinese tax authorities.

Set out below is an outline of recent regulations introduced by the PRC State Administration of Taxation (**SAT**) that may significantly affect the way in which offshore private equity firms structure their entry and exit of investment projects in China.

Circular [2009] No. 2 – Special tax adjustment rules to attack treaty abuses

Circular 2, which was issued on January 8, 2009, sets out the following scenarios where a general anti-avoidance rule (**GAAR**) investigation may be triggered: (i) abuse of preferential tax treatments; (ii) abuse of tax treaties; (iii) abuse of corporate structure; (iv) use of tax havens for tax avoidance purposes; and (v) other "arrangements" that do not have a reasonable commercial purpose.

The rules have adopted the principle of "substance over form". Where an enterprise that is lacking adequate commercial substance, especially those in tax haven countries, is interposed in an investment structure, the Chinese tax authorities may disregard the existence of such enterprise. Chinese tax benefits secured under such "tax avoidance" arrangements could be revoked or not honoured. Further, it is necessary to note that GAAR can be applied to both related and unrelated party transactions. Obviously, the application of GAAR could be very wide.

Circular [2009] No. 124 – New reporting requirements for claiming treaty benefits

Circular 124, which was issued on August 24, 2009, provides that treaty resident enterprises are not automatically granted treaty benefits but are required to comply with the administrative rules in order to enjoy the treaty benefits. It is the first time that the Chinese tax authorities have introduced such comprehensive and detailed administrative rules for treaty residents to claim treaty benefits.

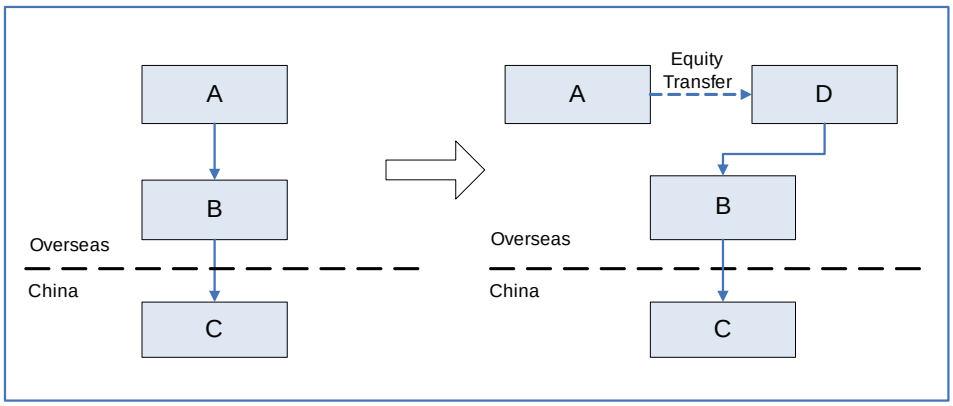
The rules classify income derived by treaty resident enterprises into two categories, active income and passive income, and impose different procedures for treaty resident enterprises claiming treaty benefits for either class of income. An approval-application procedure is required for passive income, while a record-filing procedure is required for active income. The Circular attaches six forms to be used for the different procedures. The forms require the disclosure of a lot of information, including the treaty resident enterprises' own particulars, their shareholders, as well as related-party transactions in third countries, etc. These forms could mean more disclosure of sensitive information.

Circular [2009] No. 698 – New reporting requirement for reporting indirect offshore exit

There have been a number of high-profile cases where the PRC tax authority claimed taxing rights on offshore share transfers made by non-resident enterprises where the underlying assets of the offshore holding vehicles was a Chinese resident enterprise.

However for the first time, Circular 698, which was issued on December 10, 2009, sets out the administrative procedures for taxation of such offshore share transfers.

Circular 698 covers the transfer of equity in a Chinese enterprise that is directly, or indirectly, held by non-resident investors. A typical indirect transfer is depicted as follows:



Circular 698 provides that a non-resident enterprise shall be obliged to report the indirect transfer to the Chinese local-level tax bureau in charge of the Chinese investee company, where the special purpose vehicle (**SPV**) is located in a foreign tax jurisdiction with either of the following profiles: (i) the jurisdiction has an effective tax rate of less than 12.5%; or (ii) the jurisdiction does not tax foreign income of its resident enterprises.

The reporting obligation is to help the Chinese tax authorities detect "suspicious" indirect transfers. Based on the information reported by the non-resident enterprise, the Chinese tax authorities will examine the true nature of the transfer, and may disregard the existence of SPV if they form the view that the non-resident enterprise indirectly transferred the equity in the Chinese company through the use of an abusive arrangement. Once the SPV is disregarded, the transfer should be effectively treated as the non-resident enterprise transferring the equity in a Chinese company, and the transfer gain should be deemed to be of China source and should be subject to Chinese withholding tax.

Circular [2009] No. 601 – Beneficial ownership test for securing treaty relief

Circular 601 which was issued on October 27, 2009 stipulates that only a "Beneficial Owner" can enjoy the beneficial tax treatment under Sino-foreign double taxation treaties (arrangements). A beneficial owner must be engaged in "substantive" business activities in the form of "individual, corporation, or other forms". Circular 601 also states that a pure conduit, or shell company formed merely to fulfil legal registration obligations in a foreign jurisdiction, does not qualify for treaty benefits as a beneficial owner.

Circular 601 articulates seven negative factors that may cause the anti-abuse provision to apply, namely that the enterprise seeking to claim benefits: (i) is required to pay / distribute over 60% of its income within a prescribed timeframe; (ii) has no, or minimal, other business activities; (iii) its assets, scale of operations, and number of employees are not commensurate with the income it derives; (iv) it has no, or minimal, controlling rights or risks; (v) its income is taxed at a nil or very low effective tax rate in its home jurisdiction; (vi) it has entered into back-to-back financing arrangements; or (vii) has entered into back-to-back copyright / patent / technology licensing arrangements.

The applicant seeking to qualify as a beneficial owner entitled to tax treaty benefits will also be required to provide supporting documents that indicate the negative factors listed in Circular 601 do not apply to the structure. Circular 601 appears to only focus on the determination of beneficial ownership for claiming treaty relief on repatriation of dividend, interest and royalties paid from China and is silent on its application to treaty protection for capital gains.

The challenge ahead in China

The new corporate income tax regime which became effective from January 1, 2008 has created new discipline and uncertainties for foreign private equity funds to develop tax-efficient Chinese investment structures.

The last year has seen a rapid introduction of many new PRC tax regulations and reporting requirements which may increase the Chinese tax risks of international buyout firms.

The need for foreign funds to review and develop their China tax strategies for the upcoming challenge is of paramount importance.

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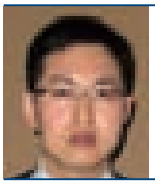

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India: Direct Taxes Code Bill, 2009 – Impact on private equity investors

Since the beginning of the liberalisation process in 1991, India has seen a steady increase in foreign direct investment (**FDI**). Even the global meltdown of 2008 proved to be only a temporary hiccup. FDI inflow to India touched US$19.4 billion during the period April to November 2009, thus reinforcing the revival of investor confidence in the Indian story.

In the next couple of years a number of planned changes in the business environment look likely to take effect in the fields of accounting (international financial reporting standards), law (new company law) and taxation (new direct tax law, and a new law on goods and services taxation).

The Direct Taxes Code Bill, 2009 (**Bill**), released on August 12, 2009, sets out one of these changes and is expected to become effective from April 1, 2011. Some of the changes proposed in the Bill are of far-reaching importance to private equity players investing in India. The important provisions affecting foreign investors are discussed below.

Availability of treaty benefits

Under the current tax provisions, the Government can enter into tax treaties with other countries agreeing to forego taxation rights, and a taxpayer can claim the benefits under the domestic law or a tax treaty, whichever is the more beneficial. India has a wide tax treaty network, and has treaties with more than 80 countries today. As against the current rule of 'whichever is the more beneficial', the Bill proposes that neither the treaty nor the Bill would have preferential status, and the provision that is later in time would prevail.

A question therefore arises whether the provisions of the Bill would override the provisions of India's existing treaties, since the Bill would be 'later in time' when enacted. While the tax authorities have made public statements that most treaties will prevail, this provision has created uncertainty about the Indian tax environment in the minds of foreign investors.

General anti-avoidance rule

The Bill seeks to introduce elaborate anti-avoidance provisions granting very wide powers to the tax authorities to disregard investment structures or re-characterise transactions in whole or in part, and reallocate incomes. While the general anti-avoidance rule (**GAAR**) recognises the importance of commercial substance in investment structures, since the provisions use very subjective tests without any safe harbour provisions, such wide powers substantially enhance the risk of investment structures being challenged and re-characterised by the Indian tax authorities. The stringent GAAR provisions could not only frustrate legitimate instances of tax planning, but would also force foreign investors into protracted litigation.

It will be necessary to determine whether the proposed GAAR would override the provisions of all of India's tax treaties. If so, it could affect foreign investments, since investors would be expected to demonstrate that the investments were not routed through tax friendly jurisdictions only for the purposes of claiming treaty benefits.

Taxation of capital gains and withholding tax thereon

The Bill proposes to tax capital gains arising to foreign investors at a flat rate of 30% on all Indian investments. Thus, the concessionary tax treatment (tax rates ranging from 0% to 20%) provided for listed securities and long-term capital gains under the current law is proposed to be abolished. High tax rates combined with GAAR and treaty uncertainty could severely dent the internal rates of return of private equity funds investing in India, thereby making some Indian investments unattractive.

Additionally, the Bill imposes a requirement to withhold taxes at 30% (as against withholding of 10% to resident investors) in case of capital gains payment made to non-resident investors. With listed securities now taxable, this could lead to several administrative and procedural difficulties in case of purchases on the stock market, with the sellers being unknown.

Tax residential status of foreign companies

Under the proposed Bill, a foreign company would be treated as a tax resident of India if, at any time during the year, the control and management of its affairs is wholly or partly in India. Thus, the worldwide income of a foreign company could be exposed to tax in India even if a part of its control and management is based in India at any time in the year. What is even more worrisome, is that although there are clear and longstanding judicial precedents as to the meaning of 'control and management', the meaning which appears to have been assigned to it by the tax authorities, as seen from recent cases, goes far beyond what the precedents would suggest.

A foreign company which gets classified as a resident would be liable to tax on its global income and also to a dividend distribution tax at a rate of 15% whenever it distributes dividends to its investors outside India.

In cases where a foreign company qualifies as resident both in its home country and in India, the tie-breaker clause of an applicable tax treaty may result in the foreign company being a tax resident of its home country. However, to the extent there is no tax treaty, or where treaty benefits are unavailable (as discussed above), this issue could give rise to litigation.

Indirect transfer of capital asset in India

India levies capital gains tax on non-residents in respect of gains arising from the transfer of any asset situated in India. The Bill seeks to qualify the word 'transfer' by the words 'directly or indirectly'. This provision appears to be a fall-out of the Vodafone controversy (whose outcome is still pending) where the Indian tax authorities have sought to tax gains from the transfer of shares in an offshore intermediate company which held Indian investments.

The intention of the tax authorities seems to be to render all transactions involving the sale of offshore investments with underlying Indian assets taxable in India, which class could also include participatory notes issued abroad with reference to an Indian underlying asset.

This far-reaching amendment is sought to be brought in by inserting only one operative word, viz. the word 'indirectly', in the existing provision. Extremely complex questions relating to how the 'indirect' gain is to be computed are left unaddressed. A change which should be brought about through a few pages of legal text is sought to be brought about through one word. Unfortunately, the word is inapt for its intended purpose, and hence is unlikely to achieve its objective, leading to protracted uncertainty and litigation.

Interest income on offshore loans

The Bill proposes that interest payable by a non-resident would be deemed to accrue in India if the interest is paid for the purposes of making or earning income from any source in India. Thus, interest paid to a lender on offshore loans, which are sourced by a borrower for investment into India, are likely to be taxed in India under the proposed Bill (subject to any treaty benefits that may be available to the non-resident recipient). This proposal is likely to affect leveraged buy-outs by private equity firms.

Minimum alternative tax

Under the Bill, a minimum alternative tax (**MAT**) would be applicable to every company, at the rate of 2% of its gross assets as at the close of the financial year, to replace the existing MAT at 18% levied on book profits under the current law. This tax appears to be intended to apply even to foreign companies, on a basis which is yet to be specified.

Even offshore funds not having any physical presence in India, could be liable to pay MAT in India based on the value of their gross assets. While this may not be the intent, one would need to wait for the final form which the Bill takes.

Associated enterprises

Under the Bill, even a 10% shareholding (26% under the current tax law), would accord the investor with an associated enterprise (**AE**) status, thereby attracting transfer pricing provisions relating to arm's length dealings. A lower threshold would have an adverse impact on private equity deals which typically involve less than 26% stake and could hinder deals and investment activities. In addition to an investee company becoming an AE of an investor, two investee companies of the same investor may become AEs. Also, an investee company could become an AE of more than one investor group.

Conclusion

The proposed Bill has many welcome new provisions and simplifies many other existing provisions, so that the income-tax statute is now available in a very compact book and in a much more accessible form. However, the provisions discussed above clearly give rise to apprehension and uncertainty in the minds of foreign investors.

In today's economic environment, capital is generally scarce and goes to places offering the best returns. Foreign investors tend to allocate capital to locations offering the highest post-tax returns. Uncertainty in tax costs may reduce the expected returns from a project, and consequently, would lead to an overall increase in the hurdle rate of return required from Indian investments.

The good news is that, in a recent press release in December 2009, the Finance Minister stated that the Bill was aimed at giving a competitive edge to the country while dealing with international taxation issues and gave an assurance that the identified issues are under deliberation and a considered view would be taken on these issues. It is hoped that changes will be brought into the Bill to give effect to this objective, and that these changes will resolve the apprehensions referred to above.

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Indonesia: Tough new rules for claiming tax treaty relief for withholding tax

On November 5, 2009, the Directorate General of Taxes (**DGT**) released two regulations (**DGT Regulations 61 and 62**) setting out new procedures which must be followed for reduced rates of withholding tax to apply to payments made to non-Indonesian residents who are residents of countries with which Indonesia has entered into double tax agreements (**DTAs**). The rate of withholding tax under the DTAs is lower than the rate that applies where the recipient of the income is a resident of a country with which Indonesia does not have a DTA (i.e., 20%).

These new rules are one of the most significant changes in Indonesian tax policy in recent years and have a far-reaching impact. Whilst it is accepted that DTAs should not be used in a tax abusive manner, the compliance burden that will now be imposed on genuine cross-border arrangements has many people questioning whether, at a practical level, DTAs have been rendered ineffective.

To claim tax treaty relief, the non-resident recipient of the income must obtain an original Certificate of Residence (**COR**) from the tax authority in its home country, and establish that it is the beneficial owner of the income. The new rules under DGT Regulations 61 and 62 make it significantly harder for non-residents to meet these requirements.

To obtain treaty relief, the DGT regulations now require "an entity or individual", that is the owner of the income, to demonstrate that it is not considered to be misusing the DTA, by satisfying one of the following criteria:

- An individual that is not receiving income as an agent or nominee;
- An institution that is explicitly named in the DTA or one that has been agreed to by the Competent Authority in Indonesia and its treaty country partner;
- An offshore company which earns income through a custodian from share or bond transactions made on the Indonesian Stock Exchange (except interest and dividends), that is not an agent or nominee;
- A company whose shares are listed on any stock exchange and traded regularly;
- A bank, or
- Any other company which meets the following requirements (herein referred as one of "substance" or "beneficial owner" test):
    - The establishment of the company in the tax treaty partner country and the way the transaction is structured / schemed, are not merely done to enjoy tax treaty benefits;
    - The business activities are managed by the company's own management which has sufficient authority to carry out the transaction;
    - The company has employee(s);
    - The company has activities or active business;
    - Income derived from Indonesia is taxable in the recipient's country; and
    - The company does not use more than 50% of its total income to fulfil its obligations to other parties, such as interest, royalty, or other payments.

The DGT has determined the format of the COR (**Form DGT-1** and **Form DGT-2**). Form DGT-1 is made up of two pages. Page 1 of the Form DGT-1 can remain valid for up to 12 months. It requires the taxpayer to provide details of the foreign income recipient and the Indonesian income payer, a declaration by the foreign taxpayer that the relevant information is true, and include the sign-off of foreign residency by the foreign tax authority. Page 2 of Form DGT-1 must be completed wherever income subject to withholding tax is paid to a foreign taxpayer. Importantly, the page 2 information only needs to be signed off by the foreign taxpayer receiving the Indonesian source income. To be eligible for the DTA relief, a number of specific questions must be answered, based on which the DGT will be able to determine

whether or not the income recipient satisfies the beneficial ownership requirement.

Form DGT-2 applies only to foreign banks, and income arising from share and bond trading transactions conducted through the Indonesian stock exchange. The form can be copied and reused by different Indonesian payers, subject to ratification by the tax office where the Indonesian payer is registered.

The COR must be provided to the payer by the time it lodges its monthly tax return for the period in which the income is paid, i.e., the 20th day of the following month. Technically the COR is valid from the date when the competent overseas tax authority signs the COR.

The key challenge is that the guidance on interpretation of each of the "substance" and "beneficial owner" test is still unclear. Under these regulations, if the legal form of a transaction is different from its economic substance, the tax implications should be based on the economic substance (substance over form). Nevertheless, it is still unclear from the documents required by the DGT whether a taxpayer can voluntarily apply the substance over form approach.

Moreover, if a number of significant overseas tax authorities refuse to stamp the COR form, the relevant DTA will be rendered ineffective. Even if the stamp is obtained, the timeliness of the overseas authority in stamping the forms needs to be considered. Further implementation regulation may be issued in the near future.

We are aware that similar concept for applying tax treaty relief is adopted in other countries, e.g., China, Germany and Korea.

On a more positive note for taxpayers, we believe the release of the new regulations removes the previous limitation on the activation of the new Netherlands DTA. Under that treaty, a zero withholding tax rate applies to interest paid to a Netherlands resident. However, prior to the release of these new regulations, it was unclear what requirements were necessary for the mode of application under the Netherlands DTA.

For most taxpayers, the new regulations will impose more onerous requirements which will be difficult to comply with and/or need longer time to satisfy/obtain the complete signed COR from the relevant overseas tax authority, in practice. For Indonesian taxpayers paying income subject to withholding tax to non-resident recipients, special care will need to be taken, and new procedures put in place, before automatically applying lower withholding tax rates on the basis of DTA entitlements. Under the DGT's compliance approach, in the event of a future audit, any failure to obtain the correct COR documentation and compliance with other administrative requirements will leave the Indonesian payer of the income exposed to payment of the withholding tax shortfall and associated penalties (maximum 48%).

In addition to the above, in order to determine the tax residency, another provision in the Income Tax Law must be considered, i.e., Article 26(1a). The tax residency is not solely based on the COR; however, it should also consider the country of residence in which more than 50% of a corporation's shareholders resides or holds an effective management. In other words, obtaining the complete required COR (Form DGT-1 and Form DGT-2) does not automatically ensure that tax treaty relief is applicable.

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US: Tax proposals in 2011 Budget proposed by Obama Administration

On February 1, 2010 the US Treasury Department released the "Green Book", which outlines the Obama Administration's Budget proposals for fiscal year 2011 (**Green Book**). The Green Book proposals include a revised version of the extensive tax proposals that were introduced in the previous year's budget. Through the tax proposals in the 2011 budget, the US Treasury anticipates to raise approximately US$400 billion in the 10-year budget that lasts through fiscal 2020.

Many important details of the proposals await clarification, as the Obama Administration has yet to provide legislative language or detailed descriptions of its proposals. Although, the tax proposals introduced in the Green Book could have a far reaching impact on US taxpayers, this article summarises below some of the key proposals that could generally impact private equity and hedge funds.

Carried interest

Currently, fund managers, acting in the capacity of a general partner, that receive carried interest in the form of a partnership interest in the fund for services rendered to the fund, are taxed on their allocable share of the income and expenses allocated by the fund. Accordingly, if the fund was to recognise long-term capital gains, the partners, including the general partner that provides services to the fund, would reflect their shares of such gain on their tax returns as long-term capital gains.

Currently, individuals who are US tax residents are taxed at 15% on long term capital gains.

Under the 2011 Budget proposals, a partner's share of income on a "services partnership interest" would be subject to tax as ordinary income, regardless of the character of the income at the partnership level. Currently, under US federal law, individuals are subject to tax at progressive rates, with the highest tax rate being 35%. Accordingly, if the proposal is enacted in law, income derived by the general partner of the fund from the provision of services to the fund would not be eligible for the reduced rates that apply to long-term capital gains (15%). Please note that income attributable to the general partner on "invested capital" in the fund would not be re-characterised as income derived from rendering services to the fund.

Codification of economic substance

Courts in the US have increasingly (but without uniformity) applied the economic substance doctrine when ascertaining whether the transaction meaningfully changed a taxpayer's economic position or not. Under the current law, a 20% penalty is applicable on substantial underpayment of income tax, and whilst this can be reduced in certain circumstances it may also be increased to 30% if the taxpayer does not disclose the listed or reportable transaction as required under the US tax law.

In its proposal to codify the economic substance doctrine under the 2011 Budget, the Obama Administration proposes to clarify the economic substance doctrine, and levy 30% penalty on an understatement of tax attributable to a transaction that lacks economic substance (reduced to 20% if there were adequate disclosure of the relevant facts in the taxpayer's return).

Dividend withholding tax on equity swaps

Currently, withholding tax does not apply to income earned by foreign persons from equity swaps that reference US equities since the income is treated as non-US source income. However, under the 2011 Budget proposal, a 30% withholding tax will apply (unless reduced by an applicable double tax agreement) on income earned by foreign persons with respect to equity swaps that reference US equities to the extent the income is attributable to dividends paid by a US corporation.

Check-the-box

The 2010 Budget proposal introduced by the Obama Administration in 2009 included significant reforms to the check-the-box rules. The check-the-box rules are designed to facilitate entity classification for US income tax purposes. Private equity or hedge funds that invest outside of the US through intermediate holding companies may have elected to treat the intermediate holding companies as fiscally transparent entities for US

income tax purposes. If no election is made to treat the corporation as fiscally transparent for US income tax purposes, the character and timing of income derived by the corporation (blocker) does not flow through to the investors of the fund.

The 2011 Budget proposal does not contain any proposal to repeal check-the-box rules.

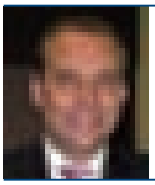
Deny deductions to US insurance companies

Private equity funds that have invested in US insurance companies could end up paying higher income taxes at the portfolio insurance company level. Specially, with respect to US insurance companies that reinsure their risk through an affiliate reinsurance company located outside of US.

Currently, insurance companies are generally allowed deductions for premiums paid for reinsurance. Under the 2011 Budget proposal, however, a US insurance company would be denied a deduction for certain reinsurance premiums paid to affiliate foreign reinsurance companies with respect to US risks insured by the insurance company or its US affiliates to the extent that the premiums (1) are not subject to US income tax, and (2) exceed 50% of the relevant premiums received by the US insurance company and its US affiliates.

Legislative outlook

It is not clear at this time whether Congress will seek action on the Obama Administration's proposals this year. Senate Finance Committee Chairman Max Baucus (D-Mont.) has continued to say that further study is needed to assess the impact of the proposals on the global competitiveness of US businesses, and he does not seem inclined to rush into consideration of the new proposals on a standalone basis. However, specific provisions, particularly those characterised as addressing perceived abuses, may be used in legislation to pay for other legislative priorities. Furthermore, the Joint Committee on Taxation analysis of the FY 2010 Budget proposals offered a number of suggestions that were not adopted in the FY 2011 Budget proposals, leading to questions as to whether Congressional tax-writers might chose to introduce them during the process of drafting legislation on these issues.



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