

1999

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

**POOLED DEVELOPMENT FUNDS AMENDMENT BILL 1999**

EXPLANATORY MEMORANDUM

(Circulated by authority of the Minister for Industry, Science  
and Resources, Senator the Hon Nick Minchin)

## **POOLED DEVELOPMENT FUNDS AMENDMENT BILL 1999**

### **OUTLINE**

#### **Introduction**

The purpose of this Explanatory Memorandum is to provide clarifying information on the 1999 reforms to the Pooled Development Funds (PDF) Program.

Established under the *Pooled Development Funds Act 1992*, the Program was previously amended in 1994. This Explanatory Memorandum should be read in conjunction with the Explanatory Memoranda which accompanied the 1992 Act and the 1994 Amendment to the Program.

#### **What is the Pooled Development Funds (PDF) Program?**

The PDF Program arose out of recognition that there were imperfections in the capital markets and that small and medium sized enterprises (SMEs) often have difficulty obtaining equity capital, especially those that are in the early stages of development. The risks associated with such investments, and the long time frame before returns on such investments can be realised, have in the past limited the availability of equity capital or venture capital for such firms.

Through the establishment of commercially operating private sector funds (the PDFs), the PDF Program aims to develop and demonstrate the potential of the market for patient equity capital to small and medium sized Australian enterprises that carry on eligible businesses.

By providing concessional tax treatment for income received from investing in eligible businesses, the Program also aims to make these investments more attractive to investors.

#### **What are PDFs and what is their tax treatment?**

PDFs are private sector investment companies, registered to operate under the PDF Program. They attract funds from investors to develop a pool of capital available for private equity investment in eligible Australian companies.

The establishment of PDFs is encouraged by giving both companies registered as PDFs, and shareholders in PDFs, concessional tax treatment.

- Companies registered as PDFs have a concessional 15 per cent tax rate for PDF income earned from eligible SME investments. Other income, such as income from unregulated investments, is taxed at a concessional rate of 25 per cent.
- For shareholders in PDFs, unfranked PDF dividends are tax exempt. Franked PDF dividends are also tax exempt in the hands of investors, unless an investor elects to be taxed. Where investors elect to be taxed they can use the imputation credits attached to the franked dividend to offset other tax obligations.
- Further, gains made by investors as a result of trading shares in PDFs are exempt from capital gains tax. To ensure symmetry of gains and losses, any losses from disposals of shares in PDFs can not be used to offset investors' other taxable capital gains.

PDFs may invest in new equity in SMEs (total assets of not more than \$50 million) that will either establish a new business; substantially expand production capacity or services; or expand or develop markets. PDFs are not permitted to invest in companies whose primary activities are retail sales operations or property development.

PDFs are companies that are free to operate, within the broad parameters of the Program, with minimal government involvement in their activities.

### **PDF Program Review**

In 1998, the PDF Program was comprehensively reviewed. The review recommended the Program be modified to make it more attractive to investors.

The modifications agreed to by the Government will offer PDF Program participants more commercial flexibility and will make PDFs a more attractive proposition for Australian superannuation funds, overseas pension funds and other investors. The expected increase in capital invested in PDFs will increase the supply of patient equity and venture capital available to small and medium sized Australian enterprises.

### **Extension of the Program**

The PDF Program has been extended until 30 June 2003. The Program will be reviewed again before that date.

## **FINANCIAL IMPACT STATEMENT**

While the PDF Act has no sunset clause, funding for the Program expired in 1997-98. The Department of Industry, Science and Resources absorbed funding for the Program in 1998-99 pending completion of the review of the Program and Cabinet's consideration of its future. The estimated outlays reflect the estimates agreed by the Department of Finance and Administration.

The table below provides the estimated cost to revenue of the PDF tax concessions in the absence of any change to the Program and the additional cost of the changes.

Projected cost to revenue (\$m)	1999-00	2000-01	2001-02	2002-03
PDF Program – no change	3	3	5	6
PDF Program - additional cost of changes	0	2	3	5

Note: These projections are necessarily based on assumptions about aggregate PDF investments and earnings. All projections are subject to revision as new information becomes available.

## REGULATION IMPACT STATEMENT

### Description of the PDF Program

The *Pooled Development Fund Act 1992* (PDF Act) provides for the registration of investment companies called Pooled Development Funds (PDFs) on application to the PDF Registration Board (the Board). The Program is administered by the Board with support from the Department of Industry, Science and Resources.

As companies, PDFs can raise capital by issuing shares to investors. Under the PDF Act, income earned by these funds from investments in eligible small and medium sized enterprises (SMEs), is taxed at a concessional rate of 15 per cent. PDF income that is not SME equity income, predominantly unregulated investment income, such as interest earned on capital raised but not yet invested in SMEs, is taxed at a concessional rate of 25 per cent. In addition, dividends in the hands of investors in PDFs are exempt from tax and gains made by investors as a result of trading shares in PDFs are exempt from capital gains tax. To ensure symmetry of gains and losses, any losses from disposal of shares in PDFs can not be used to offset investors' other taxable capital gains.

### Reviews of the PDF Program

The PDF Program was considered by the (Mortimer) Review of Business Programs, which reported in June 1997. The Mortimer Review recommended that the Program should be retained but that the Program's objective should be amended so that the Program more clearly targeted investment in small, high technology firms.

The PDF Program was reviewed by a task force of officers from the Department of Industry, Science and Resources, the Treasury and the Australian Taxation Office with support from a consultant as part of the Commonwealth's Legislation Review Program under the National Competition Policy Agreement. In addition, the Prime Minister announced in his December 1997 statement *Investing for Growth* that as part of the review the Government would consider options to improve the effectiveness of the Program.

In the 1998 election campaign, the Coalition's industry policy statement *Making Industry Stronger* promised to: remove current restrictions which limit ownership to 30 per cent of a PDF for regulated Australian superannuation funds and similar overseas pension funds and limited partnerships of such funds; permit PDFs to buy back their own shares subject to Corporations Law and allow funds to return capital to their shareholders under specified conditions; permit funds to make loans to equity investees, including through investment in convertible notes, subject to a maximum 20 per cent of the value of their capital base; and permit the merger of PDFs where no cash consideration is paid to shareholders as part of the merger, other than a genuine dividend.

### Problem

At the broadest level, the problem addressed is a perceived market failure in investment decisions, whereby growing SMEs have difficulty attracting patient equity and venture capital to commercialise new ideas and to finance rapid expansion of growing businesses. Market participants suggest these difficulties reflect such issues as information difficulties (both availability and cost) and risk aversion. Further, there are views that the tax system may inhibit

investments through restrictions on the use of tax losses and a capital gains tax that does not match preferential treatment overseas, thereby discouraging international venture capital investments in Australian SMEs.

The Government has announced a package of responses to this issue, including specific proposals to improve the operation of the PDF Program as discussed here, and complementary initiatives. Several other Government programs have recently been announced or extended to assist innovative firms to commercialise new ideas. The *Innovation Investment Fund* program provides support to high-technology start-ups (it delivers higher levels of support but is more tightly targeted than the PDF Program). The *Commercialisation Emerging Technologies* program will educate emerging early stage companies about the requirements of investors. The *Venture Awareness* program will establish a set of investment benchmarks for Australian venture capital, and help Australian investment funds to improve their evaluation of venture capital investments. These programs are complementary to the PDF Program.

The problem addressed by the changes considered here is therefore the narrower issue of how to improve the effectiveness of the PDF Program by improving its commercial flexibility and attractiveness whilst maintaining the integrity of the tax incentive. The Government is addressing broader tax policy issues through its response to the Review of Business Taxation.

## Objectives

The PDF tax concession does not attempt to address directly the perceived market failure concerning investment decisions discussed above. Rather, its broad approach of reducing tax rates on PDF investments aims to encourage a higher level of investment in growing SMEs than would otherwise occur. Over time, successful PDFs should provide a positive demonstration effect to investors generally.

The review task force recommended that the objectives of the PDF Program be changed from “to encourage the provision of patent equity capital to small and medium sized Australian companies” to a more precisely stated objective that explicitly recognises but does not restrict the Program to venture capital and explicitly points out the Program is targeted to growing SMEs rather than the wider range of all SMEs. Thus the new objective of the PDF Program is “to develop and demonstrate the market for patient equity capital, including venture capital, for growing small and medium sized enterprises and to provide a more competitive tax regime for patient equity and venture capital investments in growing small and medium sized enterprises.”

## Options

The perceived problem with the PDF Program, as stated by the Mortimer review (in 1997) amongst others, is that “PDFs have been underutilised to date”. To this end, options to improve the utilisation of the Program were considered.

A package of options is being implemented to increase the attractiveness of the PDF Program by increasing its commercial flexibility so that PDFs can operate more like other venture capital funds, by allowing, for example, the repayment of capital by PDFs to investors, the use of options and the issuance of loans to investee companies. The potential importance of superannuation funds and overseas pension funds as a source of patient equity and venture capital for growing SMEs has also been accommodated by allowing complying, but not excluded, superannuation funds and similarly regulated overseas pension funds (or limited

partnerships of such funds) to own up to 100 per cent of a PDF, in the same way that banks are already allowed.

The task force was concerned to prevent the tax concession being abused as a tax minimisation vehicle without providing additional patient equity and venture capital to growing small and medium enterprises. In considering a tax incentive such as that provided by the PDF Program, the ability of taxpayers to restructure existing arrangements to benefit from the concession without changing their underlying behaviour, and so not contribute to the objectives of the Program, needs to be recognised. For this reason the task force placed some restrictions on the options it developed and did not recommend other possible options to make the Program more attractive. It also proposed options to improve the efficacy of compliance monitoring and enforcement to ensure that the Program meets its objective, while at the same time does not impose an undue burden on participants.

### **Impact Analysis**

Between 1992 and October 1999, 72 PDFs have been registered by the Board, of which 26 are active in the sense that they have collectively raised over \$350m of capital, over \$70m of which was raised in 1998-99. Of the capital raised, over \$210m has been invested in 200 SMEs, including \$60m in 1998-99. The balance is deposited in bank accounts waiting to be invested. Interest in PDFs in recent years suggests the Program is growing strongly after a slow start.

As at 30 June 1998, in the order of 85 per cent of PDF investments have been in firms with total assets of less than \$30m, well below the statutory limit of \$50m. Most initial investments by PDFs are between \$0.5m and \$2.0m, which most commentators believe to be the weakest area in the equity market. A significant proportion (at least 25 per cent) of PDF investments appear to be supporting the commercialisation of R&D. Some 35 per cent of PDF investment is at the start-up and early stage of investment, about 50 per cent of investment is at the expansion stage, with the remainder at the later stage (eg, management buy-outs).

The cost to taxpayers of the PDF Program in 1999-2000 is estimated to be approximately \$3 million per annum in forgone tax revenue and slightly less than \$400,000 per annum in administrative costs. The forgone revenue is expected to rise as the Program continues to grow and investments are realised, while the administrative costs are expected to be relatively stable.

Most of the changes increase the commercial flexibility of the PDFs. The effect of these changes in increasing the attractiveness of the Program will be to encourage the provision of additional patient equity and venture capital to growing SMEs through the PDF Program.

On the supply side, the increased flexibility of the Program will improve its attractiveness to investors and specifically to superannuation funds and similarly regulated overseas pension funds that will be able to own up to 100 per cent of a PDF, rather than be limited to a maximum 30 per cent. On the demand side, the new ability of PDFs to lend to their equity investees will improve the attractiveness of the financial support that PDFs may provide to growing SMEs.

The behavioural response to the proposed improvements to the PDF Program is difficult to estimate. It is therefore difficult to be specific about the expected impact of the changes on the amount of money in the PDF Program and available for investment in growing SMEs and on the cost to revenue.

Increased compliance monitoring requirements have been implemented. These changes will not have an onerous effect on participants. Indeed many PDFs voluntarily provided some of the additional information in their annual return for 1997-98, and other changes will simply change the timing of information provision. These changes are necessary to ensure that the Program is not being abused and to assist the PDF Registration Board in alerting PDFs to any potential concerns when they arise, rather than after the annual return is provided.

### **Consultation**

The PDFs, their investors and investee companies, potential investors including superannuation funds, advisers to superannuation funds, State Government departments and other participants and interested parties in the patient equity and venture capital markets were consulted during the review of the PDF Program.

Those consulted were generally supportive of the PDF Program and a large number of possible improvements to the Program were canvassed. Those suggestions that could be implemented without adversely affecting the integrity of the Program or the tax system generally are being adopted.

### **Conclusion and Recommended Option**

To continue the PDF Program, with a further review to be conducted in 2002-03, and adopt the following measures to make the Program more effective and commercially attractive.

1. Amend the objective of the Program to better reflect its rationale, to become "to develop and demonstrate the market for patient equity capital, including venture capital, for growing small and medium sized enterprises and to provide a more competitive tax regime for such investments."
2. Permit widely-held complying Australian superannuation funds and similarly regulated overseas pension funds and limited partnerships of such funds to wholly own a PDF.
3. Permit PDFs to buy back their own shares and to return capital to their shareholders, subject to a waiting period of two years for a new or merged PDF, and permit PDFs to make loans to equity investees subject to a maximum of 20 per cent of the PDF's capital base.
4. Allow the PDF Registration Board to approve the acquisition of non-transferable options in investee companies as additional investments and to approve the merger of PDFs as long as no cash consideration is paid to shareholders as part of the merger, other than a bona fide dividend.
5. Amend the PDF Act to improve compliance and performance monitoring and to provide the PDF Registration Board with the power to revoke registration for non-compliance with any of the provisions of the Act.
6. Change the test that the PDF Registration Board must be satisfied that an applicant for a new PDF 'can and will' take certain action in the future to one where the Board must be satisfied that the applicant is, on the evidence presented, reasonably capable of implementing the plan provided to it.
7. Amend the current definition of the term 'associate' to state that it does not apply where the association did not exist prior to the persons becoming shareholders in the PDF.

## **Implementation and Review**

Amendment of the *Pooled Development Fund Act 1992* will be required to give effect to the conclusions of the review.

A second review is proposed in 2002-03, based on the additional information that will be available at that time as a result of the proposals to improve the monitoring of the Program.

### **Subsequent amendments (Lower Tier Investments)**

In keeping with its commitment to continuously improve the PDF Program, the Treasurer, the Hon Peter Costello MP, and the Minister for Industry, Science and Resources, Senator the Hon Nick Minchin, recently announced that the *Pooled Development Funds Act 1992* would be amended to close a loophole in the Act, thereby creating a more equitable program for all relevant PDFs.

The *Pooled Development Funds Act 1992, Part 4.28A: Indirect Investments*, specifies that the Act applies to investments made by a PDF through controlled interposed entities as if the PDF had made the investments directly.

The change will prevent PDFs from participating indirectly in investments that are not in keeping with the objectives of the PDF Program. Some PDFs had undertaken, or were considering, investments in businesses, through controlled eligible investee companies, which would not satisfy the Act's eligibility criteria if they were made directly by the PDF. The changes to the Act specify that from 4 August 1999, the date of an announcement of the change, any lower tier investments by controlled investee companies must comply with the requirements of the Act.

The subsequent amendment is expected to have a negligible impact on the existing PDFs. For example, out of a total of 210 investees who have received funds from PDFs registered with the PDF Board, only 2 businesses, invested in by one PDF, could be adversely affected by the closing off of this loophole. Further, the size of the investments by the relevant PDF are relatively small. Overall, the amendment is unlikely to have a substantial direct, or indirect, effect on business and is not likely to restrict competition.

### *Consultation*

This amendment was suggested by the PDF Registration Board. Consultations were held with the Department of the Treasury, and the Department of the Prime Minister and Cabinet. Any prior public consultation, as part of a comprehensive RIS, would have encouraged additional investments by some PDFs to take advantage of the loophole.



## NOTES ON CLAUSES

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The following new arrangements will apply to existing PDFs as well as new entrants to the Program from the start of the 1999-2000 income year, except as indicated under Item 27.

#### **Clause 1 - Short title**

This Clause provides that this Bill may be cited as the *Pooled Development Funds Amendment Act 1999*.

#### **Clause 2 - Commencement**

This Clause provides for the Act to commence on the day on which it receives the Royal Assent.

#### **Clause 3 - Schedule(s)**

This Clause provides that each Act that is specified in a Schedule to this Act is amended or repealed as set out in the applicable items in the Schedule concerned. Any other item in a Schedule to this Act has effect according to its terms.

### Schedule 1 - Pooled Development Funds Act 1992

#### **Item 1**

As a consequence of the Program's 1998 review, the object of the Act has been amended by these items to better reflect its rationale.

Item 1 repeals section 3 of the Act, that the object of the Act is to encourage the provision of equity capital to small or medium-sized Australian companies whose primary activities are not excluded activities.

Item 1 substitutes a new section 3, that the object of the Act is to develop, and demonstrate the potential of, the market for providing patient equity capital (including venture capital) to small or medium-sized Australian enterprises that carry on eligible businesses.

The amended object reflects the PDF Program's aim to develop and deepen the market for equity capital.

#### **Items 2 and 3**

Item 2 clarifies the definition of *shareholders' funds* in subsection 4(1) of the Act.

Item 3 inserts in subsection 4(1) a reference to the definition of a *widely-held complying superannuation entity* in section 4A.

**Item 4**

This item adds section 4A to the Act defining a *widely-held complying superannuation fund*.

**Item 5**

In deciding on a registration, under subsection 14(1) of the Act, the Pooled Development Funds Registration Board (the Board) must grant a registration application if the Board is satisfied that a number of conditions are satisfied.

One of these conditions, subsection 14(1) paragraph (e), is that an applicant can and will implement the applicant's plans. It is more appropriate that the Board base its decision on a reasonable expectation that the plans are likely to be implemented based on the evidence presented in the application.

Item 5 amends subsection 14(1) paragraph (e) so that the Board must now be satisfied that an applicant for PDF registration is reasonably likely to be able to implement the plans it provides, based on the evidence provided.

See also Item 27.

**Item 6**

Subsection 4(3) of the Act states that a PDF's articles of association may not contain either a capital reduction provision or a buy-back provision. Also subsection 18(c) states that a PDF's registration is given on the condition that a PDF not reduce its share capital or buy back its shares. This part of the Act prevents PDFs from undertaking either of these activities.

This item amends subsection 18(c) of the Act to permit PDFs to buy back their own shares and to return capital to their shareholders, subject to a waiting period of two years for a new or merged PDF.

This change will improve the flexibility of PDFs by effectively providing another exit mechanism for investors in PDFs. The change will make investment in PDFs more attractive to some investors who require certainty about the ability to return capital.

**Item 7**

The Act is to be amended to provide greater commercial flexibility to PDFs by adding to the kinds of eligible investment, other than unregulated investment.

This item adds, in section 19 of the Act, the additional kinds of investment a PDF can make.

**Item 8**

This item amends subsection 20(1) of the Act, to reflect the alternative types of eligible investment introduced under section 19. The note to subsection 20(1) changes the heading to section 20.

## Item 9

Subsection 20(1) of the Act states that investments by PDFs must only be made by subscribing for or buying:

- (a) ordinary shares in a company; or
- (b) some other kinds of shares in a company that the Board approves the PDF investing in.

This part of the Act is being amended, by section 20A, to permit PDFs to acquire non-transferable options in investee companies where the PDF has initially satisfied either the minimum 10 per cent equity requirement under section 27, or a requirement set where the Board has granted a discretion to that PDF under section 27. The Board can exercise its discretion to allow PDFs to invest in less than 10 per cent of the total of all amounts paid on the issued shares of an investee in a number of circumstances (many of these circumstances are included in the Board's Policy Papers).

This change is being made to enable PDFs to provide tranches of capital as required by the investee when the investee meets pre-determined milestones. Non-transferable options are a mechanism for facilitating follow-on injections of capital.

Further, this part of the Act is being amended, by section 20B, to permit PDFs to make loans to equity investees subject to a maximum of 20 per cent of the PDF's shareholders' funds where either the PDF has initially satisfied either the minimum 10 per cent equity requirement under section 27, or a requirement set where the Board has granted a discretion to that PDF under section 27. The Board can exercise its discretion to allow PDFs to invest in less than 10 per cent of the total of all amounts paid on the issued shares of an investee in a number of circumstances (many of these circumstances are included in the Board's Policy Papers). At no time are the outstanding loans allowed to exceed 20 per cent of the shareholders' funds of a PDF.

Where a PDF subsequently raises more capital or retains profits, the aggregate amount that can be loaned increases. On the other hand, where a PDF pays out dividends or reduces its capital, then the aggregate amount that can be on loan may have to be reduced so that the amount does not exceed 20 per cent of shareholders' funds at that time.

This change will improve the commercial flexibility of PDFs by enabling them to provide loans to their investees as part of their financial support service. The cap of 20 per cent will ensure that the equity investment focus of the Program is maintained.

## Items 10 and 11

Item 10 amends subsection 21(1) of the Act in line with the changes in the types of investments allowed, discussed under Item 9.

Item 11 clarifies subsection 21(4) also in line with the changes in the types of investments allowed.

## Item 12

This item clarifies section 22 of the Act by notifying that nothing in Division 1 of the Act, *Making Investments*, prevents a PDF from making an investment in relation to the merger of PDFs, discussed under Item 20.

**Item 13**

This item amends subsection 25(1)(b) so that the total amount invested in and/or lent to an investee company is not to exceed 30 per cent of the PDF's committed capital, unless otherwise approved by the Board. In practice, such approval has been given during the formative stage of PDFs.

**Item 14**

This item amends section 27 of the Act, by the insertion of new section 27A, to require a PDF to provide as soon as practicable or within 30 days full particulars of initial investments made in investee companies.

The provision of such information is required to assist in evaluating the activities of PDFs including capital raising and sources of income. These changes will enable better monitoring and evaluation of the PDF Program against its objectives.

See also Item 27.

**Item 15**

Item 15 changes the Act by inserting a new section 28A which specifies that the Act applies to investments made by a PDF through controlled interposed entities as if the PDF had made the investments directly.

This change is to prevent PDFs from participating indirectly in investments that are not in keeping with the objectives of the PDF Program. Some PDFs had undertaken, or were considering, investments in businesses, through controlled eligible investee companies, which would not satisfy the Act's eligibility criteria if they were made directly by the PDF.

The use of the term "interposed" in section 28A denotes where a PDF is controlling the investment but has some conduit entity or chain of entities perform the necessary legal transactions.

**Item 16**

This item amends subsection 29(2) paragraph (a) of the Act in line with the change to section 32A, discussed under Item 20.

**Items 17 and 18**

Subsection 31(1) of the Act states that unless the Board otherwise approves, a person (not being an ADI or life office), together with associates (not being banks or life offices) of the person, must not hold more than 30 per cent of the issued shares in a PDF. An "ADI" is an Approved Deposit Institution.

These items amend subsection 31(1) to include widely-held complying superannuation funds and similarly regulated overseas pension funds and limited partnerships of such funds among persons or associates of persons not restricted to a 30 per cent holding of the issued shares in a PDF.

Item 18 also updates the term "bank" to "ADI".

In the case of Australian superannuation funds, the term “widely-held complying superannuation fund” is taken to mean a complying regulated, but not-excluded superannuation fund, and is a term used in the Superannuation Industry (Supervision) (SI(S)) Act.

In the case of foreign-owned funds, the PDF legislative amendments require foreign-owned pension funds to provide evidence to the Board that they comply with legislation in their country of origin that requires them to be for the sole or prime purpose of providing retirement income for fund members; and they are “widely held”.

In the context of both Australian and foreign owned funds, by virtue of subsection 4A(1) of the Act as amended by this Bill, the term “widely-held” means that the fund must have 5 or more members.

These amendments have been made to make the PDF Program more attractive to superannuation and overseas pension funds. It will put them on par with Australian banks and life offices, thus improving competitive neutrality in the financial sector. This change is expected to increase investment funds flowing into PDFs.

#### **Item 19**

This item amends subsection 31(2) of the Act, defining the term “associate” by inserting two new subsections 31(2A) and 31(2B).

Subsection 31(2A) amends the current broad definition of the term “associate” to state that it does not apply where the association did not exist prior to the persons becoming shareholders in a PDF. Prior associations will continue to be subject to the associate rule. This will assist individual investors in the process of establishing a PDF who might otherwise, simply by virtue of a work relationship, be deemed associates and restricted to holding together not more than 30 per cent of the issued shares in the merged PDF.

Subsection 31(2B) is inserted to ensure that the existing section 31 does not defeat the purpose of the new section 32A (see Item 20). Subsection 31(1) prevents any person from owning more than 30 per cent of the issued shares in a PDF. This would prevent a PDF from acquiring all the shares in another PDF so as to merge with that other PDF. Subsection 31(2B) therefore creates an exception to the general rule in section 31 so that mergers allowed by section 32A may take place despite section 31.

#### **Item 20**

Section 22 of the Act currently states that a PDF cannot invest in a company that is itself a PDF. This part of the Act effectively prevents PDFs from merging with other PDFs. Section 22 is being amended, see Item 12, so as not to prevent a PDF from making an investment allowed by the newly inserted section 32A.

Section 32A of the Act permits PDFs to merge as long as no cash consideration is paid to shareholders as part of the merger, other than as a bona fide dividend. This change will assist smaller PDFs seeking to create a larger and more viable fund. The change has been structured to ensure that there is no cash leakage out of the PDF Program.

### **Items 21 and 22**

Subsection 41(1) of the Act requires that a PDF must, within 4 months after the end of each financial year, give the Board a written return that includes such information as particulars of investments, disposal of investments and capital raised during the year.

Item 21 amends subsection 41(1) paragraph (d) to improve the compliance and performance monitoring aspects of the Program. This part of the Act has been amended to ensure more regular and comprehensive reporting requirements. A PDF must provide in its annual return to the Board full particulars of the making and disposal of investments by it during the financial year.

Item 22 amends subsection 41(1) by inserting a new paragraph (ia) requiring full particulars of dividends paid by the PDF to shareholders during the financial year.

See also Item 27.

### **Items 23 and 24**

Subsection 47(1) of the Act states that the Board may revoke a PDF's registration if certain parts of the Act are not complied with.

These items amend the subsection to provide the Board with the power to revoke registration of a PDF that is not complying with any part of the Act. The revocation process provides a PDF with an opportunity to make a submission to the Board, before the Board decides what action to take.

See also Item 17.

### **Item 25**

This item repeals subsection 47(4) of the Act.

### **Item 26**

This item amends the table under subsection 50(1) of the Act to specify penalties in terms of penalty units rather than dollars. The item also amends the section 19 provision and inserts a new section 27A provision in the table.

See also Item 27.

### **Item 27**

### **General**

Except as otherwise indicated under this item the amendments made by this Act apply, in relation to a PDF, from the beginning of the PDF's 1999-2000 income year (the transition time). Income year has the same meaning as in the *Income Tax Assessment Act 1997*.

**Registration decisions**

The amendment made by Item 5 applies to a decision about registration that the Board makes after the transition time, even if the application for registration was made before that time.

**Notification of initial investments**

The amendments made by Items 14 and 26 apply to investments made after this item commences.

**Interposed entities**

With respect to the amendment made under Item 15, from 5 August 1999 any lower tier investments by controlled investee companies must comply with the requirements of the Act unless the Board is satisfied that the PDF had a legal obligation before 5 August 1999 to make the investment. For the purposes of section 28A, "investments" includes any additions to investments in place before 5 August 1999.

**Annual returns**

The amendments under Items 21 and 22 apply to annual returns from the 1999-2000 financial year.

**Revocation Power**

The Board's power to revoke a PDF's registration if certain parts of the Act are not complied with, by the amendments under Items 23 and 24, applies to contraventions of this Act, or of a condition of a PDF's registration, that happen after this item commences.