

ARTHUR ROBINSON & HEDDERWICKS
LIBRARY

1992

THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

HOUSE OF REPRESENTATIVES

POOLED DEVELOPMENT FUNDS BILL 1992

EXPLANATORY MEMORANDUM

(Circulated by authority of
the Minister Representing the Minister for
Industry, Technology and Commerce
Senator the Hon John N Button)



POOLED DEVELOPMENT FUNDS BILL 1992

OUTLINE

The purpose of this Bill is to set up a mechanism for channelling patient equity capital to eligible small and medium sized Australian companies. The benchmark for small and medium size is total assets of no more than \$30 million. The mechanism involves concessionally taxed investment companies to be called Pooled Development Funds (PDFs).

2. While the program allows PDFs a wide choice of the area for investment, the Government believes a significant portion of the funds raised by PDFs will assist the growth and development of industries and firms, commercialisation of research, and facilitating the internationalisation of Australian industry.

3. PDFs will raise capital through the issuing of shares.

4. PDFs will be taxed at 30% which is less than the general company tax rate of 39%. Any gains made by shareholders in PDFs on the sale of their shares will be tax exempt.

PDF Registration Board

5. The Bill establishes a Pooled Development Funds Registration Board (the Board) to register eligible companies as PDFs. Applications may be lodged at any time with the Board and there is no limit on the number of PDFs that may be registered. The Board will also monitor PDFs to ensure compliance with the rules under this Bill.

6. The Board will consist of five members from the private sector with experience in industry, finance, commerce, marketing or technology. Board representation by the Commonwealth will be through an officer of the Department of Industry, Technology and Commerce who will be an ex officio member of the Board.

Qualifications for PDF status

7. The Bill sets a number of criteria in order to gain PDF status.

8. An applicant must supply investment plans and have articles of association which satisfy the requirements of this Bill. A PDF must be a trading or financial corporation, formed within Australia, which has not previously carried on a business.

9. The PDF must convince the Board that it is able and intends to carry out its plans.

10. Capital raising strategies will also be an important part of the PDF's operations and PDFs will be expected to have a spread of investors.

Restrictions on PDF's activities

11. The Bill imposes restrictions on a PDF's activities which will ensure that the funds raised are used in accordance with the intent of the program and the objects of the legislation.

12. A PDF cannot buy back its own shares or invest in other PDFs. A PDF must invest only in new equity in companies and only for the purpose of establishing new businesses or substantially developing new production capacity or markets for established businesses.

13. A PDF may not borrow except for short term liquidity purposes, and may not invest in companies with total assets of more than \$30 million. PDFs cannot invest in retailing operations and property development and must invest a minimum portion of their raised capital within a specified period.

FINANCIAL IMPACT STATEMENT

14. Additional expenditure of some \$400,000 annually will be incurred on an on-going basis to cover extra costs associated with the administration of the program. Tax revenue forgone is estimated at \$5 million commencing in 1994-95, with higher levels being possible as the program develops.

NOTES ON CLAUSES

PART 1 - PRELIMINARY

Clause 1 - Short title

15. When enacted, the short title of the Bill will be the *Pooled Development Funds Act 1992*.

Clause 2 - Commencement

16. This Bill will commence on the day it receives Royal Assent.

Clause 3 - Object

17. The object of this Bill is to establish a program in which qualifying companies that provide long-term patient equity capital to small or medium sized Australian companies receive concessional tax treatment. This program also allows certain income tax concessions for the shareholders of those qualifying companies.

18. Patient equity capital is the taking up of significant shareholdings by PDFs in companies with growth potential with a view to holding the investment for the longer term. Often, there may be no, or little, dividend stream in the early years, and where this is the case the expectation is that there will be compensation in later years from substantial growth in the value of investee companies. Often this type of investment involves the provision of managerial assistance by the investor. However, this program also allows investment by PDFs in companies that pay regular dividends.

Clause 4 - Interpretation

19. This provision defines terms used throughout the Bill.

20. For example, "excluded activity" means an activity prescribed in the regulations to the Bill for the purposes of this definition. An excluded activity is one involving:

- (i) retailing operations; and
- (ii) real estate investment other than property investment which is integral to broader eligible activities. For example PDF investee companies will be allowed to invest in tourism projects where the project is operated by the investee company and industrial buildings used by the investee in a manufacturing project.

21. However, the precise definition of "excluded activity" may be subject to variation as the PDF program develops and accordingly, it is set out in the regulations to this Bill so that it may be amended in a timely way.

PART 2 - ESTABLISHMENT, FUNCTIONS AND POWERS OF THE PDF REGISTRATION BOARD

Clause 5 - Establishment

22. This provision establishes the Pooled Development Funds Registration Board.

Clause 6 - Functions

23. The Board's functions include evaluating and providing advice to the Minister about the operation of the PDF program. The Board will also publicise the advantages of, and requirements for, PDF status. The Board also has the functions assigned to it in other provisions of the Bill such as registering and monitoring PDFs.

Clause 7 - Powers

24. The Board has the power to undertake the functions assigned to it in the Bill.

Clause 8 - Directions by Minister

25. The Minister has the power to give the Board written general directions, with which it must comply. A copy of any directions, and a statement of reasons for giving them, must be tabled in each House of Parliament within 15 sitting days of giving them.

26. The Minister cannot make a direction in respect of the registration, or deregistration, of a particular PDF, or direct the Board to perform its functions in a particular way in regard to a specific case.

Clause 9 - Minister may require provision of advice

27. The Board is required to provide advice sought by the Minister in relation to the operation of this Bill or the Commonwealth's income tax laws relating to PDFs.

PART 3 - BECOMING A PDF

Clause 10 - How a company becomes a PDF

28. A company will become a PDF once the Board decides that it meets the requirements of the Bill and declares it to be a PDF. PDF status will continue until the Board revokes it. This clause provides that a company becomes a PDF when a registration declaration is made or at the date set in the declaration.

Clause 11 - Application for registration declaration

29. A company may apply to the Board for registration as a PDF. The application must include the information required under this provision. The applicant may supply other information. In general terms, the applicant will need to convince the Board that it intends raising capital and using that capital to purchase new equity in Australian companies.

Clause 12 - Further information may be requested

30. The Board may request the applicant to provide further information to assist it in deciding whether to register a PDF.

Clause 13 - Period within which registration application to be decided

31. The Board must decide a registration application within 60 days of receipt of an application. The Board may extend that limit by a further 60 days by written notice to the applicant. If the Board does not make a decision during the limit set in the legislation then it will be taken as a decision to refuse the application.

Clause 14 - Deciding a registration application

32. The Board must grant a registration application and declare the applicant to be a registered PDF if it is satisfied that the criteria set out in this provision are met. The Board will need to be convinced that the proposed PDF has a genuine strategy of raising capital for investment in Australian companies and that it has the resources and expertise to implement that strategy. In addition to the information provided by the applicant, the Board may take into account any other relevant information when deciding an application.

33. Where the Board is not convinced about the applicant's ability to satisfy these criteria, it will refuse the application.

Clause 15 - Applicant to be notified of decision

34. The Board must notify the applicant of its decision as soon as practicable after it is made, including the reasons for refusing the application.

Clause 16 - Board to publish notice of registration declaration in the Gazette

35. The Board must publish the name and date of effect of registration declaration of a PDF in the Gazette as soon as possible after making the declaration. The purpose of this provision is to make a company's PDF status publicly known.

Clause 17 - A PDF's approved investment plan

36. A registered PDF must have an investment plan approved by the Board. This clause defines that plan and sets down the procedure for varying that plan. It will be important for the Board in its on-going monitoring of the PDF Program to be informed of the investment strategies of individual PDFs.

Clause 18 - Conditions of registration declaration

37. A PDF is registered subject to it complying with this Bill and any direction given or requirement made by the Board under this Bill.

PART 4 - REGULATION OF PDFs

Division 1 - Making investments

Clause 19 - Investments to be in accordance with this Division

38. The investments undertaken by a PDF must be in accordance with this Division, with the exception of unregulated investments which are short term investments made by the PDF pending use of its funds in making equity investments in Australian industry.

Clause 20 - Kinds of investments permitted

39. The PDF must invest in newly issued equity, either as newly issued ordinary shares or other kinds of newly issued shares, as approved by the Board.

40. The Board may also allow a PDF to buy pre-owned shares (ie shares previously issued or allotted to another party), as a supplement to other PDF shareholdings in the investee business if the Board is satisfied that the value of the investee company will thereby be increased and if existing shareholders are impeding the general welfare of the investee business and are willing to vacate the company.

Clause 21 - Intended use by investee company of money invested by PDF

41. Unless otherwise approved by the Board, the PDF must believe that the money it invests in a company will be used for one, or more, of the following purposes:

- (i) the establishment of an eligible business, either alone or with another party or parties;
- (ii) substantially expanding production capacity or the capacity to supply services of an established eligible business; and
- (iii) substantially expanding existing markets, or developing new markets for goods and services of an established eligible business.

Clause 22 - Investee company must not be a PDF

42. A PDF must not invest in another PDF. The intention is that PDFs invest in growing Australian companies.

Clause 23 - Primary activity of investee company must not be an excluded activity

43. A PDF must not invest in a company which is primarily engaged in excluded activities. In the current context, this means that PDFs cannot invest in companies which are engaged primarily in retail operations or property development.

44. The Board, however, may approve such an investment if it is satisfied that the purpose of the investment is to change the investee's primary activity to one that is not excluded. Furthermore, it is possible that a PDF could hold an investment where the primary activity of the investee business subsequently changes to an excluded one. In such circumstances the Board may approve further investments despite the ineligibility of the investee business where it is clear that the new investment is required to protect the PDF's earlier investment.

Clause 24 - Limit on size of investee company

45. This clause limits the size of the investee company at the time of the initial investment by the PDF to total assets of no more than \$30 million. The intention is that PDFs invest in small and medium sized companies and \$30 million in total assets has been chosen as the benchmark. The clause sets out how the value of assets should be verified, which is essentially through audited financial statements.

46. The clause also provides scope for the Board to permit the PDF to retain investments and to further invest in companies where the value of the total assets in the investee business exceeds \$30 million after the PDF's first investment in that company. For example, the Board may allow a PDF to provide further financial support to protect existing investments.

Clause 25 - PDF not to commit more than 20% of its committed capital to investee company

47. A PDF may not invest more than 20% of its funds in any one investee company. The purpose of this provision is to ensure that PDFs have a spread of at least five investments.

Clause 26 - PDF not to commit more than 5% of its committed capital to start-up companies

48. A PDF's investments in start-up companies may not exceed 5% of the total of its shareholders' funds and the uncalled amounts on its partly paid shares. A start-up company is one which does not have any established business activities.

49. If it is not certain whether an investee company is a start-up company or one that has established business activities, the Board, after considering the situation, may declare that it is an established business. The PDF's investment in such a company will not be included in the 5% limit.

Clause 27 - Amount invested in investee company to be at least 10% of its paid up capital

50. A PDF is required to take up at least 10% of the raised capital of an investee company. The Board may approve a PDF taking up a lower percentage, for example, where the investee company issues partly paid shares and the initial payment by the PDF does not equal 10% of the raised capital.

Clause 28 - Provisions relating to approvals by the Board

51. This clause makes it clear that where the Board has discretion to approve certain investments, the approval must be given before the investment is made. Also, the Board is not required to approve an investment merely because the investment would satisfy the conditions for giving the approval.

Division 2 - Other provisions regulating the capital structure and activities of PDFs

Clause 29 - PDF to carry on a business of making and holding PDF investments

52. A PDF is required to carry on the business of investing in small or medium sized companies in accordance with this Bill. The clause allows a PDF to undertake the normal commercial transactions necessary to conduct such a business.

Clause 30 - Restrictions on raising money etc

53. PDFs may undertake permitted short-term borrowings which are defined in clause 4. However, they may not borrow money for other purposes.

Clause 31 - Limit on shareholding in a PDF

54. Any investor (together with associates) may not hold more than 20% of the issued shares in a PDF unless specifically approved by the Board. The intention of the Program is that PDFs should have a spread of investors. At times, however, it will be necessary to provide for a lead investor. This restriction does not apply to banks and life offices.

Clause 32 - Timetable for investing funds raised by PDF

55. This clause requires a PDF to invest 50% of its raised capital within five years. The Board may specify a lower percentage or a longer period in respect of a particular PDF and in respect of a particular capital raising by a PDF.

56. The 50% and five year limits may be altered by regulation, in order to ensure that the parameters in the PDF Program reflect economic conditions and market cycles.

57. This provision is intended to ensure that PDFs undertake a reasonable level of investment activity within a reasonable period. This provision also sets out the method of calculating whether the PDF has complied with this requirement.

Division 3 - Board's powers to give directions

Clause 33 - PDF to comply with directions in relation to its approved investment plan

58. The Board will monitor a PDF's investments to ensure that the PDF is complying with its approved investment plan. If the Board considers that a PDF is not implementing its investment

plan, it may seek an explanation from the PDF. If the PDF fails to offer an explanation within 30 days of being asked, or the Board finds the explanation unacceptable, the Board can direct the PDF to take appropriate action, including the making or selling of investments.

Clause 34 - PDF to comply with directions if investee company's primary activity is an excluded activity

59. This clause empowers the Board to direct a PDF to sell its holding in an investee company which is engaged primarily in an excluded activity.

Clause 35 - PDF to comply with other directions

60. If the Board is satisfied that the PDF has contravened certain provisions relating to its investment activities or capital raising activities, or has not complied with directions in relation to those provisions, the Board may direct the PDF to take appropriate action in respect of those contraventions and non-compliance.

Clause 36 - Shareholders to comply with directions about shareholdings in PDFs

61. If the Board is satisfied that a person holds more than 10% of the issued shares in a PDF, the Board may direct the person to dispose of a number of those shares. The purpose of this provision is to allow the Board to enforce the limit on shareholdings in a PDF.

Clause 37 - Board to advise of reasons for giving directions

62. When giving directions in relation to certain investment provisions, the Board is required to give reasons for its decisions. If the Board does not give reasons, the direction remains valid.

Division 4 - Consequences of contravention of this Part

Clause 38 - Acts in contravention of Part not invalid

63. If any of the provisions in this Part of the Bill are contravened, the particular transaction is not invalidated.

PART 5 - MONITORING COMPLIANCE

Clause 39 - Board to monitor compliance

Clause 40 - Board to consider compliance on receipt of annual return

64. The Board is required to monitor a PDF's compliance with the provisions of this Bill. The Board is required to judge a PDF's compliance by considering its annual return and may consider a particular PDF's compliance at other times.

) Clause 41 - Annual return by PDF

65. Within four months of the end of each financial year, a PDF must provide an annual return to the Board. This is to include information such as details of the officers of the PDF and its investment managers, investments made and sold during the year, investment plans and capital raisings. The Board may specify other information to be included in a PDF's annual return. This information allows the Board to monitor a PDF's compliance with the legislation.

Clause 42 - PDF to notify Board of events affecting information previously given

66. A PDF must advise the Board, in writing, about certain changes during the year. The purpose of this provision is to ensure that the Board has up-to-date information about the management of the PDF and its capital structure, in order to assess a PDF's compliance with the legislation.

Clause 43 - Board may require certain persons to provide information or produce documents

67. The Board may seek from a PDF, or a present or former officer or investment manager of the PDF, information about any of the PDF's present or past investments. Failure to comply with such a request is an offence.

Clause 44 - Board may request persons to provide information or produce documents

68. The Board may make a request to any other person to provide information about a PDF or its investments.

PART 6 - REVOCATION OF REGISTRATION DECLARATIONS

Clause 45 - Automatic revocation if PDF is not an eligible corporation

69. A PDF's registration declaration will automatically be revoked if the PDF is not a trading or financial corporation formed within Australia.

Clause 46 - Revocation on application by PDF

70. It is expected that there will be circumstances in which a PDF will wish to give up its PDF status. For example, a PDF and its investors may decide to undertake investments that do not meet the requirements of this Bill. The PDF may apply to the Board to have its registration declaration revoked and the Board is required to revoke the declaration.

Clause 47 - Revocation at discretion of Board

71. The Board can revoke the registration of a PDF if the PDF has breached certain provisions of the Bill. (Most of these provisions regulate the structure or activities of the PDF.)

72. The Board may also revoke a PDF's registration if its articles of association no longer comply with the requirements of the Bill or if the PDF has breached certain of its articles. A PDF's registration may be revoked by the Board if it has bought shares in itself.

73. Before revoking a PDF's registration, the Board must give the PDF notice of the grounds for revocation and allow it to make a submission within 14 days about those grounds.

74. The Board must inform the PDF about the material facts and evidence on which the decision to revoke was based and also give reasons for the decision.

Clause 48 - Board to publish notice of revocations in the Gazette

75. The Board must publish in the Gazette notice of the revocation of registration of a PDF and the date of revocation. This ensures public notice is given of loss of PDF status for a company.

Clause 49 - Company to notify its shareholders if it ceases to be a PDF

76. A company that has ceased to be a PDF must write to its shareholders notifying them of this fact as soon as possible after it finds out. This ensures that shareholders know of the loss of PDF status, which affects the tax treatment of returns from PDF investments.

PART 7 - OFFENCES RELATING TO PDFs

Clause 50 - Criminal consequences of contravening certain provisions

77. This provision sets out penalties applying to PDF officers and investment managers when PDFs breach the provisions specified in the table. PDFs themselves are not guilty of those offences. Officers of a PDF which does not inform its shareholders of its deregistration are guilty of an offence if involved in that contravention.

Clause 51 - Other offences

78. Shareholders whose shareholdings in a PDF exceed 10% and who do not comply with directions of the Board to reduce their shareholdings in a PDF are guilty of an offence.

Clause 52 - False or misleading statements and documents

79. It is an offence to give false or misleading statements and documents to the Board in a registration application or knowingly or recklessly make a false statement in an annual return or when providing information requested by the Board.

PART 8 - REVIEW OF DECISIONS

Clause 53 - Notification of certain decisions

80. As soon as practicable after making a reviewable decision, the Board must give the person affected by the decision a written notice setting out the reasons for making the decision. Reviewable decisions include refusal to register a PDF, refusal to approve a variation to an investment plan or refusal to give certain approvals or determinations.

Clause 54 - Notification of right to seek internal review

81. The notice sent to a person concerning a reviewable decision must advise the person that he or she has the right to seek a review of the decision.

Clause 55 - Internal review of decisions

82. This provision sets out the circumstances in which a person affected by a decision can request the Board to reconsider that decision. The Board has 60 days after the request is made to review a decision but if it fails to confirm, vary or revoke the decision then it will be taken to have confirmed the decision.

Clause 56 - Review of decisions by Administrative Appeals Tribunal

83. A person affected by a reviewable decision of the Board may apply to the Administrative Appeals Tribunal for a review of that decision which the Board has confirmed or varied.

PART 9 - ADMINISTRATIVE PROVISIONS RELATING TO THE BOARD

Division 1 - Provisions relating to members

Clause 57 - Membership of Board

84. The Board consists of six part-time members - a Chairperson, an officer of the Department and four other members. The non-Government members are appointed by the Minister on the basis of their expertise in industry, commerce, finance, economics, marketing, management or a field of technology.

Clause 58 - Term of office

85. Members are appointed to the Board for a maximum of three years. The length of the appointment is set out in the instrument of appointment. The Commonwealth representative on the Board holds office until the Secretary of the Department directs otherwise.

Clause 59 - Remuneration and allowances - appointed members

86. The Remuneration Tribunal determines the remuneration payable to appointed members. If there is no determination, the appointed members receive remuneration as prescribed in the regulations.

Clause 60 - Leave of absence

87. The Minister may grant the Chairperson leave of absence from Board meetings. The Chairperson may grant any other member leave of absence from Board meetings.

Clause 61 - Disclosure of interests

88. This clause requires a member to disclose to the Board any direct or indirect pecuniary interest in a matter being considered at a Board meeting. The disclosure must be recorded in the minutes. Unless the Minister or the Board has determined otherwise, the member must not be present during any deliberations or decisions by the Board relating to the matter in question.

89. This provision creates a mechanism to deal with any potential conflict of interest arising in relation to a member.

Clause 62 - Resignation - appointed members

90. An appointed member resigns from the Board by giving notice in writing to the Minister.

Clause 63 - Termination of appointment - appointed members

91. This clause gives the grounds on which the Minister may terminate the appointment of a member.

92. The Minister may terminate an appointment because of misbehaviour, physical or mental incapacity, bankruptcy, unexcused absence from Board meetings or failure to disclose interests.

Clause 64 - Other terms and conditions - appointed members

93. The Minister may determine terms and conditions of Board members' appointments in relation to matters not provided for in the legislation.

Clause 65 - Acting members

94. This provision sets out the terms and conditions for filling the position of Chairperson or member on an acting basis. The Minister appoints an acting Chairperson if the office of Chairperson is vacant, or the Chairperson is away from Australia or unable to perform the duties of the office. The Minister may appoint an acting member in similar circumstances.

*Division 2 - Provisions relating to meetings*Clause 66 - Convening of meetings

95. The Board can hold any meetings that are needed to perform its functions efficiently. The Chairperson may convene a Board meeting at any time and must convene a meeting when so directed by the Minister.

Clause 67 - Procedure at meetings

96. If present, the Chairperson must chair a Board meeting. However, if the Chairperson is absent, the members must elect from among themselves a member to chair the meeting. A quorum is three members and all questions are decided by majority vote. The Board must keep minutes of its meetings.

) Division 3 - Staff and consultants

Clause 68 - Staff

97. The Board's staff must be appointed or employed under the Public Service Act 1922.

Clause 69 - Consultants

98. The Chairperson may, with the approval of the Minister, engage consultants to the Board, on terms and conditions determined by the Board.

PART 10 - MISCELLANEOUSClause 70 - Board to provide information about PDFs on request

99. The Board must, if requested in writing, provide a list of all PDFs or advice about whether a particular company has PDF status.

Clause 71 - Secrecy

100. This provision prohibits Board members, its staff and consultants from copying, or divulging confidential information except for the purposes of the Bill. However, the Board, its staff and consultants can communicate such information to the Commissioner of Taxation or a court. This provision protects commercial information provided to the Board under this Bill.

Clause 72 - Delegation by Board to a member

101. The Board can delegate all or any of its functions and powers to a member, by means of a resolution other than its powers to make and revoke registration declarations. The Board can vary or revoke such a delegation.

Clause 73 - Delegation by Board to a committee of members

102. The Board can delegate all or any of its functions and powers to a committee of two or more of its members, other than its powers to make and revoke registration declarations. The Board delegates its function by means of a resolution.

Clause 74 - Acts done by Board

103. The Board carries out its functions and exercises its powers, by writing signed by a member pursuant to a resolution of

the Board. A certificate signed by a member or by a person authorised by the Board to sign certificates, stating that the Board has done any act or thing is *prima facie* evidence that the Board has done that act or thing. A certificate signed by a member stating that a person is authorised by the Board to sign certificates is *prima facie* evidence that the person is so authorised.

Clause 75 - Annual report

104. Each financial year the Board must give the Minister a report on its operations. It must include a list of current PDFs, new PDFs, and former PDFs as well as details of any direction given by the Minister. The Minister must table the report in each House of Parliament within 15 sitting days of receiving it.

Clause 76 - Regulations

105. This clause enables the Governor-General to make regulations in relation to matters that are required or permitted by this Bill, or necessary or convenient to be made for carrying out or giving effect to this Bill.