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To Financial Services Unit
Financial System Division
The Treasury
Level 5
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Attention: Mr Percy Bell

Corporate Collective Investment Vehicles – Submissions in response to consultation by Treasury

Introduction

We refer to the Corporate Collective Investment Vehicle ("**CCIV**") draft bill released for public comment on 25 August 2017 ("**Draft Bill**") and the invitation by the Treasury for submissions on the proposals made in the Draft Bill.

We welcome the opportunity to make a submission, as the Draft Bill proposes a very significant change to the way Australian collective investments are offered and regulated.

We have very much appreciated the open and consultative approach in roundtable discussions with industry since the Draft Bill was released.

Key Comments

Australian CCIVs need to be as competitive as registered managed investment schemes and funds established in other Asia Region Funds Passport ("**ARFP**") countries. In support of this objective, our key comments on the tax framework of the Draft Bill below. They relate to:

- **Treasury policy position:** Our submission seeks to take into account the policy position with respect to CCIVs.
- **Alignment with the tax treatment of managed investment trusts ("MITs"):** The alignment of the tax treatment of CCIVs with the tax treatment of MITs should reflect the Treasury policy objective to create a sustainable CCIV regime and must facilitate the ability for the funds to create economic scale.

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Executive Summary

In a 2016 Budget announcement[1], the Government proposed the introduction of the CCIV with the stated purpose of making it "easier to invest in Australia" and encourage foreign investment. This purpose can only be achieved if CCIVs are flexible, efficient and competitive, as well as in a form familiar to investors in the global market for investment funds.

We agree with and applaud many aspects of the proposed regime for CCIVs, especially the proposal to largely mirror the tax regime for attribution managed investment trusts ("**AMITs**") and the consideration that has been given to the different position of CCIVs for wholesale investors.

1 Alignment

We understand that Treasury's position is there will be a broad alignment with the tax treatment of MITs but the alignment will not be pure.

Generally, the approach which should be taken will be limited changes to the tax treatment of MIT's. (This is unless there is particular difficulty associated with the current construction of the rules dealing with AMITs.) We support this approach.

The changes in approach should reflect the policy objective to create a sustainable CCIV regime which will provide a long-term alternative to the current trust model. The CCIV must also be a globally competitive vehicle.

The basis of the CCIV regime must facilitate the ability for the funds to create economic scale. The creation of economic scale will not be sufficient through a simple organic growth in the use of CCIVs.

Some of the differences in relation to the alignment are:

- **Default tax system.** The default tax system which applies is a significant departure from the existing AMIT rules.

  Under the AMIT rules, the responsible entity is treated as a public trading trust and has an ability to pay franked dividends if the "trading trust" rules are not satisfied. In addition, if the "widely held" rules are not satisfied the trust rules will approach on a look through tax status.

  It is recognised that there is a reluctance by Treasury to create sub-funds which may have these tax outcomes.

  There is concern in relation to the adverse tax treatment of the default outcome for a CCIV. Consideration should be given to allowing the sub-fund to convert into a trust vehicle without a tax cost.

- **CGT discount election.** It is understood that it is intended that the economic outcome for investors in a CCIV should not be different to that which is currently available to investors through an AMIT.

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[1] Budget 2016, "Jobs & growth", *Making it easier to invest in Australia*, Tax fact sheet 05

It is appropriate that the same outcome and approach is taken in achieving this result. A different approach will result in confusion to Members and significant administrative costs. A key part of a successful transition into the CCIV regime is the ability to leverage off the existing systems.

This outcome would also have an adverse impact on the expense allocation.

For these reasons an AMIT approach should be adopted.

- **Tax losses.** It is understood that is it currently contemplated that the tax loss rules which are to be applied are to be based on the corporate "loss carry forward" rules. Our strong view is this is not appropriate. The same approach to losses carried forward should apply to both AMITs and CCIVs.

  It is recognised that, in the event that the conduct of a sub-fund does not satisfy the requirements in order to obtain a look-through taxation treatment, the loss carry forward rules that apply to that sub-fund would also be the corporate carry forward loss rules.

- **Tax contagion.** The policy position adopted in relation to the draft legislation is that a failure by a single sub-fund will result in a tax contagion for the whole of the CCIV. A key concern is that the contagion should not operate in this way. The contagion tests under the existing "multi-class" provisions under the AMIT rules are not determined on a "whole of fund" basis.

  An important principle underlining the contagion rules is that – to the extent to which these rules require a form of prudential protection – the entities which bear the burden of a failure of those potential protections should be equivalent to the entities which assist in determining whether the prudential rules are satisfied.

  It has been suggested this issue may be solved by reference to the ATO exercising a discretion where there is a temporary noncompliance.

  We do not consider that this approach is practical. It does not provide the investors with acceptable certainty regarding their tax treatment. In particular, if the tax contagion approach was retained it would have a significant adverse impact on the extent of the potential for investment managers to seek to create multi-class CCIVs.

  The tax contagion issue is significant. The more significant issue, however, is the concept that the whole CCIV would cease to be registered if a particular sub-fund failed to satisfy the preconditions required for an entity to be an Australian CCIV.

  The power would make the creation of classes of sub-funds within a CCIV completely unworkable.

  There is a particular concern that the creation of a sub-class, which could be taxed at a corporate rate even with adverse tax consequences for distribution, could be used as a means to seek a tax benefit. There was no clear articulation of what those circumstances may be.

  An additional concern which needs to be addressed in dealing with the removal of the tax contagion issue is the construction of the tax legislation and who is to be treated as a taxpayer for the purposes of the new tax rules.

The approach in relation to the construction of the drafting is based on the assumption that the CCIV would be the relevant taxpayer.

A number of alternatives should be possible. For instance:

- consideration could be given to each of the sub-funds being treated as separate taxpayers; and
- equivalent treatment to a life company.

The preferred approach is that the CCIV retain its status as a single taxpayer that the return for the CCIV is based on a method of determination of the tax liability which is equivalent to the taxation of the particular statutory funds.

It may be preferable to adopt the second alternative; particularly, if the amendments to the corporations laws dealing with CCIVs is amended to allow for joint investment into a single asset. This is because it would potentially remove an argument that the two sub-funds be treated as being in a partnership in relation to the joint investment.

This issue appears to be driven in part by concerns regarding the architecture of the relevant provisions. In particular, the extent to which the creation of a new taxpayer would result in individual tax obligations.

Consideration is to be given to whether it is sensible for a sub-fund which ceases to satisfy the prudential requirements to become a separate taxpayer. A challenge with this approach is to properly deal with the transitional treatment of assets being held by one taxpayer being transferred to another taxpayer.

- **Impact on sub funds**

The tax contagion issue should depend on the extent to which a failure by a particular sub-fund can have an impact on another sub-fund (alternatively, the extent of a failure by a number of sub-funds may have on the balance of the sub funds).

This issue is relevant in a number of ways, the extent to which the testing of the "widely held" and "closely held" tests are to be satisfied at a sub-fund level rather than a whole of CCIV level:

(a) **Operation of the "trading trust" rules**

Generally, the "trading trust" rules should be assessed on a sub-fund basis. Conducting a trading business by a particular sub-fund should not result in other sub-funds also being regarded as carrying on a trading business. Similarly, in assessing the conduct of a trading business the interests of different sub-funds should not be aggregated.

(b) **Operation of the "Widely held" / "Closely held" / "Foreign individual" tests**

Generally these rules should be assessed on a sub-fund basis. It is not generally advocated that the tests be assessed on a "whole of fund" basis. It should be possible for sub-funds to be aggregated to satisfy the potential requirements.

For example, in an unhedged sub-fund investing into global equities invested collectively with a hedged sub-fund the "widely held" test should not be assessed separately.

In this case, we suggest that it should be possible for sub-funds to be aggregated for the purposes of making the assessment of both the "trading trust" provisions and the "widely held" provisions. The consequence of this aggregation is that if the tests are failed then both sub-funds are treated as failing the tests.

(c) **Operation of the "arm's length" rule**

The arm's length rule should be assessed and operated on a sub-fund basis.

(d) **Operation of the withholding tax provisions**

These provisions should be assessed and operated on a sub-fund basis.

- **Rollover relief.** The proposed rollover relief is appreciated by its scope and range is too narrow.

Scope of the relief

A critical issue for a responsible entity in determining whether a conversion into a CCIV is appropriate will include a consideration of the overall tax consequences for the fund and investors.

The narrowness of the proposed rollover relief will provide a barrier to a fund successfully transitioning to the new CCIV regime. This will also discourage the creation of new funds under the new CCIV regime as the scale will be critical to reducing the cost for new funds.

Moreover, in some instances the adoption of a regime which allows the successor CCIV to take a different approach may create integrity issues (for example, the ability to have different elections apply to the new CCIV).

We strongly advocate that:

- there should be no tax consequences for any Member of a fund whether the interest is held on capital account or income account; and
- the sub-fund which receives the interests of the AMIT should adapt the existing tax history which applies to the AMIT.

The inability to aggregate assets from particular funds will be a significant impediment to the success of the new CCIV regime.

There are two particular areas where there may be multiple funds transferred into a single sub-fund. These are discussed in detail in the paper provided to Treasury titled "Alignment differences". For example, a fund undertakes the hedging transaction and invests into the underlying unhedged fund providing the investor with an exposure to global assets.

Both these structures create an unnecessary cost. Again, the outcome of this structure should be that there is either a single sub-fund with multiple classes – one hedged and the other unhedged.

1.1 Rollover relief for AMITs into a CCIV

The concepts involved would relatively simple if we seek to merge AMITs into either a single CCIV or sub fund of the CCIV. If the rollover were limited in this way it would significantly limit the usefulness of the new regime. There are a number of variables that need to be dealt with to ensure that we have an effective rollover relief regime.

We think it is important that the scope in relation of these matters should be agreed so that an appropriate rollover regime can be designed. These include variables relating to the:

- source vehicle;
- asset classes;
- target vehicle;
- nature of the asset holding by the Target vehicle; and
- nature of the asset allocation in the portfolio in the Target vehicle.

In order to be able to give effect to the rollover relief it is important that the unit holders and the fund suffer no tax detriment as a result of the statutory merger. It is not proposed that the unit holders or the funds would generate a tax benefit associated with the merger.

Mechanics of statutory merger for AMITs

The statutory merger should involve:

- a compulsory transfer of the units in accordance with the amended Constitution of the original vehicle;
- a statutory vesting of all of the assets and liabilities associated with the portfolio of the original vehicle to the target vehicle; and
- a statutory winding up of the original vehicle.

Specific legislation would authorise the amendment to the Constitution for the original vehicle. It would also provide for the statutory vesting.

1.2 Rollover relief for listed investment companies into a CCIV

Both the tax and legal considerations for listed investment companies vary from those applicable to AMITs. A listed investment company is already in a corporate form and has a specific tax regime which applies to it. The approach taken to the vehicle to be rolled into the CCIV may be simplified as it is unlikely that the listed investment company would have different classes.

Moreover, there is no basis to treat the separate classes in the listed investment company as segregated taxpayers. Also given the unique nature of the existing tax regime it may be appropriate to restrict the target vehicle to a single CCIV.

The suggested approach is that the existing corporation be converted to a CCIV. That is, the existing corporation has its status under the terms of the corporations law altered. This significantly simplifies the conversion process. It does not require a transfer of the original portfolio. Furthermore, the existing members in the listed investment company would continue to hold their existing shares.

Mechanics of statutory conversion

The conversion would require an alteration to the terms of the constitution for the listed investment company so as to ensure its compliance with the requirements for the new CCIV regime. As listed investment companies hold a general meetings each year it may be possible to amend the terms of the relevant constitution at a general meeting.

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This would remove the need for detailed statutory merger provisions in the Corporations law. Rather, the Corporations law would need to accommodate a change in the status of an existing corporation into the new CCIV regime.

Our submissions and contacts

We are making these submissions on behalf of our firm, and the views expressed are our own and not those of any of our clients. We would welcome the opportunity to discuss these submissions with the Treasury. If there are any queries arising from these submissions please contact:

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Yours sincerely