PITCHER PARTNERS
ADVISORS PROPRIETARY LIMITED

Level 19
15 William Street
Melbourne
Victoria 3000

Postal Address:
GPO Box 5193
Melbourne Vic 3001
Australia

Level 1
80 Monash Drive
Dandenong South
Victoria 3175

Tel: +61 3 8610 5000
Fax: +61 3 8610 5999
info@pitcher.com.au
www.pitcher.com.au

EXECUTIVE DIRECTORS
B J BRITTEN, M W PRINGLE, D A THOMSON, M J LANGHAMMER, M C HAY, V A MACDERMID, P A JOSE, M J HARRISON, T SAKELL, G I NORISKIN, K L BYRNE, S D WHITCHURCH, D J HONEY, G J NIELSEN, N R BULL, A M KOKKINOS, G A DEBONO, F V RUSSO, A T CLUGSTON, M G JOZWIK, B POWERS, K J DAVIDSON, J C CHENG, M DAWES, M J WILSON, R RIGONI, G M RAMBALDI, D A KNOWLES, J BRAZZALE, S SCHONBERG, S DAHN, A R YEO, P W TONER, D R VASUDEVAN, A T DAVIDSON, C D WHATMAN, A E CLERICI, P MURONE, A D STANLEY, D C BYRNE, P B BRAINE, R I MCKIE, M R SONEGO, S J DALL, D W LOVE, A SULEYMAN, D R DOHERTY, J L BEAUMONT, B A LETHBORG

Ref: AMK:amk

9 February 2018

Mr David Hawkins
The Treasury
Langton Crescent
PARKES ACT 2600

By Email: *CIVreform@treasury.gov.au*

Dear David

CCIV EXPOSURE DRAFT LEGISLATION - TAX TREATMENT

Overview

1. We welcome the opportunity to provide comments on the proposed Corporate Collective Investment Vehicle ("**CCIV**") regime and Exposure Draft legislation ("**ED**") and Explanatory Memorandum ("**EM**") outlining the proposed tax treatment of CCIVs.

2. We believe that the CCIV regime provides a significant opportunity for the Australian managed funds industry, with the ability to run multiple sub-funds under a single umbrella CCIV. We believe that this could significantly reduce the cost of establishing and running numerous schemes.

3. However, for the regime to work (and to work coherently with the AMIT regime) a number of critical policy choices need to be made. These policy choices need to be consistent with the current regime and also need to be consistent with the proposed Corporations Law framework.

4. In our view, the proposed tax treatment does not meet these thresholds. Although we highlighted the key items that we believe needed to be taken into account in drafting the tax provisions in our submission dated 6 October 2017, those issues were predominantly ignored. Unless these issues are addressed, we cannot support the ED in its current form. We strongly recommend that Treasury appropriately deal with these significant issues properly in the next version of the ED.

Liability limited by a scheme approved under Professional Standards Legislation ACN 052 920 206

Pitcher Partners is an association of independent firms
Melbourne | Sydney | Perth | Adelaide | Brisbane | Newcastle

an independent member of BAKER TILLY INTERNATIONAL

Treatment of the CCIV and sub-funds

Outline of problem

5. Under the proposed Corporations Law, a CCIV will be able to establish segregated sub-funds. This is similar to the concept of a "protected cell" in OEIC regime. The clear advantage of this concept is that multiple independent sub-funds could operate under a single umbrella, whereby assets and liabilities of each sub-fund would be segregated from other sub-funds. This advantage is clearly stated in the draft Explanatory Memorandum to the Corporations Law amendments.

> *4.5 The purpose of the sub-fund framework is to allow managed funds to offer a variety of investment options through multiple sub-funds under a single 'umbrella' CCIV, and to protect investors in respect of a particular sub-fund of a CCIV by quarantining them from the consequences of activities in respect of other sub-funds of the CCIV. This is achieved by segregating the assets and liabilities allocated to a sub-fund of a CCIV from the assets and liabilities of other sub-funds of the CCIV.*

6. While one benefit of a sub-fund would be to "quarantine the consequence of activities in respect of other sub-funds", it is unfortunate that the proposed tax provisions are drafted inconsistently with this objective. That is, under the current draft, the actions of one sub-fund could directly affect the tax treatment of another sub-fund. For example:

   6.1. If one sub-fund breaches the public trading trust provision, an unrelated sub-fund would be taken to breach the public trading trust provision and would therefore be taxed as a company due to the actions of another sub-fund[1].

   6.2. If one sub-fund has 100,000 members, yet another sub-fund fails to reach the widely held test, the first sub-fund would be taxed as a company due to the inactions of the second sub-fund[2].

   6.3. If one sub-fund has a foreign individual investor that holds greater than a 10% interest in the sub-fund, an unrelated sub-fund would also be taken to breach the closely held test and would therefore be taxed as a company due to the actions of another sub-fund[3].

7. Where any of these events occur, a sub-fund could be subject to significant income tax and penalties for both the fund and its investors. That is, (a) the sub-fund could be taxed as a company on its last four years[4] of taxable income (that would have otherwise been distributed on a flow through basis); and (b) all distributions to investors could be treated as unfranked distributions[5]. It is noted that the corporate director would not have cash to pay the tax liability in the first instance, as the cash would have already been distributed in prior years.

---

[1] See proposed section 276-20(1)(c)
[2] See proposed section 276-20(1)(b)(i)
[3] See proposed section 276-20(1)(b)(ii)
[4] Assuming the four year amendment period under section 170
[5] As there is a timing mismatch between the distribution and the payment of tax.

8. This level of risk would be unacceptable in comparison to operating a managed investment trust and therefore would detract from the use of the regime.

Recommendation

9. We believe the solution to this problem is quite simple. That is, it would require tax entity to be identified at the sub-fund level rather than at the CCIV level. A sub-fund would be treated as a separate tax entity for income tax and GST purposes under section 960-100.

10. In order for the sub-fund to be subject to flow-through taxation, the sub-fund would need to meet the relevant CCIV tests. That is: the sub-fund would need to: (a) be a sub-fund of a CCIV; (b) not carry on trading business; (c) meet the widely held test; (d) satisfy the not-closely held test. If the tests are satisfied on a sub-fund level, then the provisions would allow for flow-through taxation. Alternatively, the sub-fund would be taxed as a company.

Drafting of the provisions

Outline of problem

11. We do not support the mechanism used for including both a CCIV and AMIT as an AIV. This proposed drafting would result in a large majority of the provisions for AMITs being moved or changed, including section references, definitions and concepts.

12. Managed investment trusts have gone through a large process of updating their constitutional documents to be compliant with the AMIT regime. Most of these updates required definitions and references to the Tax Act. The proposed drafting will require those constitutions to be further updated, as many of the trust deed provisions will be inoperative once the legislative amendments are made. On many occasions, this will also require unit holder approval. On other occasions, this will require notification of compliance with ASIC instrument 2016/489.

13. In addition to this, the change in terms will also impact on tax stationary (such as tax returns, tax distribution statements, ATO guidance etc).

14. This added compliance cost in our view is unnecessary. In the United Stated, the Real Estate Investment Trust ("REIT") legislation applies to both companies and trusts. We make reference to section 856 which defines a REIT as a corporation, trust or association. We also make reference to the interchangeable concepts such as trustee or director in that section. We also note that the majority of entities that utilise this legislation are (in fact) companies. The reference to a "trust" in the title of the legislation does not detract from the fact that the regime applies to companies.

Recommendation

15. We note that our recommendation below is not too dissimilar to the approach taken by Treasury. However, it would involve minimal changes to Division 276 and would look to incorporate a sub-fund of a CCIV into the existing regime. For example, it would involve retaining the use of the term AMIT, trust components, etc contained in Division 276 and provide for the CCIV to use the same concepts.

16. Under this approach, the ED would first identify the entity to which the legislation would apply (e.g. a sub-fund of a CIV or an Attribution CIV sub-fund (say an "**ASF**")). The definition of an AMIT would then include an ASF. Deeming provisions could then be used to modify key terms in the legislation (e.g. a reference to the trustee of an AMIT would be taken to be a reference to the corporate director of the CCIV), similar to section 102S and 102R in Division 6C. Finally, each section of the Division 276 could be slightly tweaked to ensure that the provisions worked (which is similar to what is done in the ED).

17. In our view, this approach would be much simpler and would not impede on the majority of managed funds that wish to continue to operate under the AMIT provisions. It would also result in very little compliance costs for trusts that are already complying with the AMIT provisions.

Application of other taxes and regimes

Outline of the problem

18. The ED is labelled as covering the "tax treatment" of CCIVs, however the ED only covers the income tax treatment and provides no commentary on other important taxation issues such as the application of GST, stamp duty and land tax. In many cases, these taxes can be more significant than the income tax applicable to a CCIV.

19. For example: Would two independent sub-funds of a CCIV be grouped for the purpose of land tax holdings? Would the issue of interests in one sub-fund have potential implications under the landholder duty provisions of another sub-fund? Would the identification of an entity for GST purposes impact on the availability of input tax credits in one sub-fund (e.g. RITC entitlements) based on the activities in another sub-fund of the same CCIV.

20. The legislation is also silent on how other tax regimes may apply to the CCIV (e.g. whether the relevant provisions would apply in the first instance and (if so) whether it would apply to the sub-fund or the CCIV). For example, section 202D (for investment bodies), the CRS and FATCA legislation contained in the Taxation Administration Act. Again, to the extent that the legislation is within the control of Treasury, we would highly recommend a consistent approach to identifying the relevant entity with respect to the application of the legislation.

Recommendation

21. It is imperative that Treasury outline the proposed tax treatment of CCIVs and sub-funds for all tax legislation, including GST, stamp duty, land tax etc.

22. Given that Treasury would have carriage of the GST treatment of a CCIV, we would recommend that each sub-fund of a CCIV be treated as a separate entity for GST purposes, consistent with our proposal regarding the income tax treatment of sub-funds. This should also be the same for other forms of legislation which need to apply to a CCIV (e.g. section 202D, CRS and FATCA).

23. With respect to state taxes, to the extent that the Federal Government does not have universal support of the SRO of the various states, it should at least consider how the various states may see a CCIV (e.g. for the purpose of its stamp duty and land tax

provisions) and the impact that this may have on the practical application of the CCIV regime.

*** ***

If you would like to discuss any aspect of this advice, please contact me on (03) 8610 5170.

Yours sincerely

A M KOKKINOS
Executive Director