CCIV tax rules – January 2019 exposure draft

Submission to Treasury

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1. About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in Australia's largest industry sector, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing almost $3 trillion on behalf of more than 14.8 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

2. Introduction

The FSC has been a strong supporter of the proposal for a Corporate Collective Investment Vehicle (CCIV) for Australia.

In relation to the regulatory (or non-tax) aspects of the CCIV, we consider many of the industry's concerns with proposal have been addressed in the draft legislation released in January 2019. The remaining issues from a regulatory perspective are addressed in a separate FSC submission.

This submission considers the tax aspects of the CCIV.[1] By contrast with the regulatory (non-tax) issues, there has been very limited progress on the tax issues. The improvements relate to removal of sub-fund contagion,[2] improved rollover relief, and clarified tax administration rules.

While these are improvements, we have strong concerns that a number of critical problems with the proposed tax rules remain, in particular:

- The imposition of punitive taxation on CCIV sub-funds that fail the eligibility or trading tests.
- Tighter penalties for attribution 'unders and overs' for CCIVs (and AMITs).
- The removal of the CGT discount at fund level for CCIVs (and AMITs).
- The proposed application of the widely held and closely held tests to foreign investors in CCIVs.
- The complex rules and internationally uncompetitive rates of non-resident withholding tax imposed on foreign investors into Australian funds.
- The lack of stamp duty rollover, particularly for property funds.

If these issues remain in the CCIV as enacted, this will place Australia at a substantial competitive disadvantage, particularly now that the Asia Region Funds Passport (**the Passport**) has commenced – the barriers to entry for funds from other Passport countries have been substantially removed.

The risk from foreign managed funds entering Australia will be significantly heightened if Singapore joins the Passport. If global fund managers use offshore structures instead of Australian, such as existing Luxembourg SICAV and Irish UCITs and the highly competitive new Singapore Variable Capital Company and Hong Kong Offshore Fund Company, then this will result in Australian jobs (and tax revenue) being lost.

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[1] Several sections of this submission reflect previous FSC submissions, particularly the FSC's 2019−20 Pre-Budget submission, available from: https://fsc.org.au/resources/resource-detail/?documentid=324ee583-4341-e911-a96b-000d3ae13a46
and the FSC submission from November 2018 on draft CCIV tax rules, which has not been publicly released.

[2] The contagion issue related to an earlier draft of the CCIV rules and is detailed in this FSC submission: https://www.fsc.org.au/resources/resource-detail/?documentid=49cae31b-ae7d-e811-8159-70106fa11a21

The competitiveness of funds management is also discussed in the FSC's submission on the regulatory aspects of the CCIV draft framework in Sections 3 and 8 of that submission.

As a result of the significant concerns with the current CCIV framework, a number of FSC members have indicated to us that they have no interest in making use of the CCIV structure in its currently proposed form. We would be happy to facilitate a discussion between Treasury and the FSC members who have this view.

Given the above concerns, there remains a significant risk that the CCIV regime will not succeed.

2.1. Stated goals of the CCIV

The draft CCIV legislation states objectives of the regime; the FSC strongly supports these objectives, including the following (highlights added):

- In developing the CCIV framework, a key policy objective has been to **increase the competitiveness of Australia's managed fund industry** through the introduction of **internationally recognisable investment products** (see draft EM for regulatory framework at 1.10);
- The introduction of the CCIV is intended to support the establishment of the Passport as it will provide Australian fund managers with a vehicle that is compliant with Passport requirements and is **similar to the European-style corporate funds already popular in parts of Asia** (EM at 1.13);
- The legislation advances the more general objective of global regulatory alignment. The introduction of the CCIV advances this objective by helping to create a cohesive regional managed funds industry and facilitate more efficient participation in the global market-place (EM at 1.14);
- Aligning Australia's regulatory framework with well-developed international regimes can **lower the barriers to entry for new fund managers seeking to operate in Australia**. This can **increase competition** and **allow Australian consumers greater product choice, including exposure to new asset classes** (EM at 1.15).
- By introducing **regulatory structures that are similar to overseas regimes**, the legislation should, over time, also make substituted compliance processes simpler for Australian fund managers seeking to offer products overseas (EM at 1.16).

Given the FSC's significant concerns raised in this submission (and to some extent in the FSC submission on regulatory issues), this suggests the CCIV regime will not meet the objectives stated above.

3. Punitive taxation for failure of the eligibility requirements to be an ASF

The FSC supports the changes in the latest draft so that the penalties for the failure of attribution sub-fund (**ASF**) eligibility tests are quarantined to the individual CCIV sub-funds concerned.

However, we remain strongly concerned about the punitive nature of penalties proposed for failure of these eligibility tests. It is proposed that a CCIV sub-fund that fails the widely held, closely held, or trading business tests, would be taxed at 30% and be unable to frank dividends paid to members. This would result in an overall tax burden of up to 63% on such income earned by Australian resident individual investors and an Australian tax burden of 40.5% for non-resident investors resident in a country which has a DTA with Australia (higher for residents of a country without a DTA).

This is effectively double taxation of the income of the relevant sub-fund, and results in a much higher rate of tax than direct investment, or indirect investment through any other type of entity, whether LIC, ordinary company, MIT, trading trust, discretionary trust or partnership.

The approach overall is especially punitive given the approach for MITs that fail the same tests – a MIT/AMIT either retains flow through tax treatment, or is taxed as a corporate that is able to frank distributions, as shown in the table below. In either case, the trust is able to return to being a MIT/AMIT if and when the relevant tests are passed again.

Failure of requirements (beyond temporary circumstances where relevant)	Tax provisions that apply following failure	Tax outcomes following failure
Trust fails MIT/AMIT e.g. failure of widely held test	Division 6 of ITAA 1936	• Retains flow through tax treatment • Can regain MIT/AMIT status if requirements met in future income years
Trust fails the MIT/AMIT requirements as it becomes a “public trading trust”	Division 6C of ITAA 1936	• Loses flow through treatment (taxed as company) • Able to pay franked dividends • Can regain MIT/AMIT status if requirements met in future income years
CCIV sub-fund no longer satisfies ASF requirements	Corporate tax provisions but is not considered a franking entity	• Loses flow through tax treatment (taxed as company) • Unable to pay franked dividends • Unable to regain flowthrough status if requirements met in future income years

This approach is made worse by the inability for the sub-fund to exit the punitive tax treatment other than by rollover into an ordinary company. The provision of an option to rollover is a small improvement over the previous approach which permitted no exit at all – but this is taking the regime from a ***very*** punitive regime to a merely punitive regime.

The draft CCIV Explanatory Memorandum indicates this outcome reflects the Government's policy intent that the CCIV is a new form of passive investment vehicle and is not intended to be a hybrid investment vehicle that derives trading income. However, this does not explain why the approach for CCIVs should be more punitive than the approach for MITs/AMITs that fail the same tests.

The proposed approach in the draft legislation is harsh where a sub-fund fails to qualify through unintended reasons that may be outside the control of the corporate director, and could be more than temporary, notwithstanding best efforts to rectify the failure. For example, this could include a change in corporate control of a major shareholder.

- The temporary circumstances safe harbour (see EM at 1.77 and following), which enables a sub-fund to continue to be taxed on a flow-through basis, is of only limited assistance, for reasons outlined in the FSC's submission of February 2018,[3] in particular a punitive rule does not become lenient by adding exclusions to it; and there is substantial uncertainty about whether the safe harbour will apply.

This outcome does not encourage the adoption of CCIVs – by contrast an alignment of outcomes with a MIT/AMIT would be more conducive to the promotion of CCIVs as an integral component of Australia's participation in the Passport.

The MIT provisions provide a "start-up" concession, providing up to two years to meet the widely held and closely held requirements – by contrast, a CCIV sub-fund must meet the relevant requirements by the end of the income year in which it was established, unless the Commissioner allows a further period (subsection 276-20(4)(b)).

This approach is particularly punitive for a CCIV sub-fund with largely overseas investments and largely overseas investors – in other words, funds likely to be included in the Passport. For these types of funds, there is practically no Australian tax revenue at risk. Therefore, the FSC considers the eligibility and trading tests should not apply to globally invested CCIV sub-funds – see Section 6 of this submission.

Given these observations, the FSC can see no public policy reason for the punitive tax treatment of ASFs that fail eligibility tests.

The FSC therefore strongly recommends that CCIV sub-funds that fail the relevant ASF eligibility tests should be treated similarly to a MIT/AMIT that fails the similar test (see the table above), including eligibility to return to normal ASF treatment once the relevant requirements are met.

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[3] See: https://fsc.org.au/resources/resource-detail/?documentid=49cae31b-ae7d-e811-8159-70106fa11a21

4. Attribution penalties

The CCIV draft retains the proposal for an extension of the penalty for attribution 'unders and overs' that result from a lack of reasonable care. This change will also apply to AMITs. FSC members completely oppose this change. If this penalty remains in the final legislation, it will prove to be a significant disincentive for any fund manager to elect into the CCIV (or AMIT) regime for its funds.

This proposal is revisiting a key AMIT provision less than a year on. The CCIV rules should not be an exercise in making a change of this type.

Early exposure drafts of the AMIT Regime legislation included administrative penalties relating to 'unders and overs' where there had been a lack of reasonable case. However, this was removed as part of the consultation process, in recognition of stakeholder concern about the application of the reasonable care concept. The absence of the reasonable care requirement in the AMIT rules was not an oversight that requires correction. It was a deliberate removal based upon Treasury consultation on that point, based upon recognition of commercial factors particular to the member reporting of the industry. Adding it into the CCIV and AMIT regime without evidence of the need for this requirement would be ignoring this consultation.

We also note the alleged mischief from attribution 'unders and overs' is negligible. AMITs and CCIVs are, in general, not meant to be taxpaying entities; and any unders or overs would be expected to largely cancel out over time. As a result, the amount of tax at risk over time is very small.

Penalties in the tax system should be proportionate – an approach that should apply across all government policy. However, in this case, proportionality does not apply. A potentially substantial penalty is being applied in relation to a negligible tax liability.

The non-zero risk of a reasonable care penalty will be a further discouragement from using CCIVs and AMITs compared to international vehicles and other domestic vehicles.

The main argument in favour of the proposed change is that it will mean the same penalty regime will apply to all Australian taxpayers. This argument is without substance:

- AMITs currently operate (and CCIVs would operate) in a different commercial environment to other taxpayers. For example, other taxpayers (in general) do not use estimates to calculate taxable income in one tax period and then 'true up' the estimates in a later period. Other taxpayers are not permitted to use the 'unders and overs' approach that is central to the attribution system. If the goal is to be consistent across all taxpayers, then this would lead to the impractical conclusion that *no* taxpayers should be able to use 'unders and overs' (a conclusion that fund managers would naturally oppose).
- AMITs and CCIVs could be penalised for attributing *too much* assessable income to investors. It appears CCIVs and AMITs would be the only classes of taxpayer subject to reasonable care penalties where there has been no tax shortfall. Again if the goal is to be consistent, then this would lead to another impractical conclusion: penalties

should apply to *all* taxpayers who pay too much tax (again, a conclusion that fund managers would oppose).

These points naturally lead to the conclusion that AMITs and CCIVs *are* different from other taxpayers – and so therefore the consistency argument for penalties fails.

We also strongly object to the retrospective nature of this proposal on MITs that have already elected into the AMIT regime and are unable now to exit this regime due to the irrevocable election made at the time. Arguably, there would not be a retrospective element to the proposal if AMITs were able to exit the regime, but the fact that there is no possibility of exit means the proposed penalty change operates to some extent retrospectively on AMITs that are now in the regime.

Furthermore, if MIT operators had the benefit of hindsight that the reasonable care test would be inserted at a later date, then it would have been significant factor impacting the decision to elect into AMIT. Changing the penalty regime after the decisions is moving the goalposts after the game has started.

Therefore, if the change in the penalty regime is retained in the final legislation, then FSC recommends that AMITs be provided with the option to leave the attribution regime to ensure the retrospective element of the proposal is removed.

5. CGT discount at fund level

The draft legislation maintains the proposal to remove the CGT discount at the fund level for CCIVs. The application of this change to MITs/AMITs was announced in the 2018–19 Budget. The FSC has major concerns with this policy.

Most importantly, the proposal contradicts its own stated policy goals. The 2018–19 Budget states[4] this proposal is designed to ensure that MITs and AMITs operate as genuine flow through vehicles, so that income is taxed in the hands of investors as if they had invested directly. However, the proposal has the **exact opposite effect** of this policy goal.

The proposal would disadvantage indirect investment by Australian individuals through CCIVs, MITs and AMITs compared to direct investment. It removes the current neutral treatment of individuals and replaces it with a non-neutral treatment. Using the terms from the 2018–19 Budget, under the *current* tax system MITs and AMITs are taxed as genuine flow through vehicles for individual investors, "so that income is taxed in the hands of investors as if they had invested directly". The proposal replaces this approach with a system that **disadvantages** individuals that invest through CCIVs, MITs and AMITs.

The specific reasons the proposal causes this disadvantage are:

- In allocating deductible expenses against assessable income components, a CCIV, MIT or AMIT would be required to allocate deductions against gross capital gains instead of only the assessable discount capital gains component; and
- In recouping prior year or current year revenue losses, the CCIV, MIT or AMIT would be required to recognise as assessable income the gross amount of the capital gain rather than only the discount capital gain.

A briefing from Greenwoods HSF provides an example (at Attachment 1) where an individual would pay no tax if they invested directly; but pay significant tax if they invested in the same way, but through a CCIV, AMIT or MIT.

5.1. Example

Another example is shown below.

Where a CCIV/MIT / AMIT derives a $100 discount capital gain, but has expenses of $20 that are to be allocated against the capital gain, the difference in the trust net income would be as follows:

Fund level	Current	Proposed
Discount capital gain	100	100
50% discount	50	-
Net gain	**50**	**100**
Expenses	-20	-20
Net income	***30***	***80***

[4] See Budget Paper 2, page 44

Once the net income is distributed, the impact on an individuals' investor's taxable income could be illustrated as follows (with direct investment included for comparison):

Individual level	Invest through CCIV/MIT/AMIT		Direct investment
	Current	Proposed	
Distribution	30	80	100
Gross up	30	-	-
Gross gain	**60**	**80**	**100**
1/2 discount	-30	-40	-50
Individual expenses	**-**	**-**	**-20**
Taxable income	***30***	***40***	***30***

The example above equally applies if fund-level expenses are replaced by carry forward revenue losses.

The examples above shows where expenses or carry-forward revenue losses are offset against these discount capital gains at the CCIV/MIT/AMIT level, the proposed measure will result in members that are entitled to discounting (resident individuals, superannuation funds and trusts taxed under Division 6) being worse off under this proposal than if they had invested in assets directly under the same scenario.

The examples clearly show the proposal does not meet the principle of *horizontal equity* which is a long-standing tax policy principle accepted by governments, and one of the stated objectives in relation to the establishment of the AMIT Regime. Broadly, the principle is that investors should bear the same tax burden regardless of whether they invest directly or indirectly. The proposed measure runs counter to this principle.

5.2. Discussion

The FSC submits that, across the investment life-cycle of a managed fund, many (perhaps nearly all) CCIVs, AMITs and MITs would allocate expenses, or current year or carry forward revenue losses, against capital gains. This means that the proposed measure will disadvantage many or all CCIVs AMITs and MITs relative to direct investment by individuals and super funds.

The proposal also introduces an inconsistency: Division 6 trusts would be able to access the CGT discount, while CCIVs, MITs and AMITs will not. Discretionary trusts are unaffected by this measure, and these type of trusts are often argued to be used for tax planning by Australians.[5] The proposal adversely affects trusts that are unable to stream income while leaving unchanged the CGT treatment of trusts that can stream income. This appears to be

[5] The use of Australian fixed trusts for tax planning by non-residents is being addressed by the stapled structures legislation currently before Parliament.

perverse. This inconsistency underlines the concern that this proposal is clearly not meeting the policy intent of ensuring direct and indirect investment is treated similarly.

This inconsistent treatment of Division 6 trusts means that any entity that is inappropriately accessing the CGT discount will merely shift from using MITs or AMITs to use Division 6 trusts. The proposal penalises MITs, AMITs and CCIVs to target alleged tax avoidance that could easily shift into other structures. The collateral damage to MITs, AMITs and CCIVs will have little or no offsetting benefit in terms of a reduction in (alleged) tax avoidance.

The proposal will also force fund managers to undertake significant system updates to implement the proposed changes. The change will also necessitate adjustments to registry systems, tax disclosure documents and member reporting templates to take account of the removal of the discount at the MIT or AMIT level.

For most members who have recently completed significant tax compliance projects for the transition into the AMIT regime, the proposed measures would require further changes to significant portions of recent capital investments in IT systems and processes, making recent changes redundant. In this context the subsequent forced re-engineering of systems within 12 months of being commissioned represents a significant impost on the funds management industry.

Given the increased compliance costs from the measure and the distortion in the tax treatment of direct vs indirect investment, the proposed CGT change would likely actively discourage many investors (resident individuals and super funds) from investing in CCIVs, MITs and AMITs, adding to the competitiveness issues raised earlier in this submission.

The added burden on CCIVs, MITs and AMITs caused by higher taxation and higher compliance costs from these combined proposals means the benefit of reforming and moving out of Division 6 has been considerably reduced — possibly negated.

We note that this measure is ostensibly meant to prevent beneficiaries that are not entitled to the CGT discount from getting a benefit from the CGT discount being applied at the trust level. This would be non-resident investors and corporate investors.

However, the actual extent of this supposed mischief is hard to discern. In particular, for non-residents, capital gains are only subject to tax for non-residents when the gains relate to taxable Australian Real Property (TARP). Other gains are not subject to Australian tax.

Additionally, the beneficiaries of apparent concern represent a small proportion of unitholders. According to the ABS, non-government trading companies represent just 1.7% of total investment into managed funds, and foreign investors represent 5.8% of total investment.[6] Most investment is by individuals, superannuation funds and pension funds.

Even if this were a relevant issue, it is not clear why the Government has proposed a measure targeting all investors in CCIVs, AMITs and MITs rather than a measure specifically targeting the smaller cohort of resident corporations and non-resident beneficiaries. Instead,

[6] ABS Managed Funds, March 2018, table 9

the Government proposes a measure that will penalise the majority that shouldn't be targeted and result in individuals and superannuation funds paying an inappropriate amount of tax compared to direct investment.

If the Government wishes to address concerns about corporates and non-residents accessing the CGT discount through CCIVs, MITs and AMITs, or any other concerns, then we submit there would be value in exploring options that are more targeted at the issue. Where these options have fewer (ideally no) unintended consequences, we believe these options should be considered. The FSC has some time ago provided a range of options to Treasury and we are willing to discuss these options in more detail. To date we have not had any correspondence from Treasury on these options.

6. Non-resident withholding tax

The FSC has an ongoing concern with the non-resident withholding tax (NRWT) applying to collective investments, particularly funds that will be part of the Passport. This will include many funds that could be established as CCIVs or converted into CCIVs.

The FSC considers it important for the government to implement reforms to NRWT applying to the Passport as soon as practicable. This will enable Australian fund managers to compete with other countries involved in the Passport. Currently, Australia's rates of NRWT are noticeably higher than the equivalent tax rates in other Passport jurisdictions as shown in the FSC's research. The NRWT system is also particularly complex compared to other competitor countries, as a result of:

- multiple rates
- complexity and difficulty of determining appropriate rate;
- interactions with tax treaties (including how the treaties deal with trusts);
- no overarching consistent principle of application;
- taxation of 'gains' that are illusory (not true economic income); and
- relatively simpler approaches in competitor jurisdictions, with Singapore, Luxembourg and Ireland in particular charging a zero withholding tax rate.

The complexity of the application of Australia's NRWT means the possible tax consequences for foreign investors cannot be explained in a simple and easy to understand manner. The Passport is specifically designed for retail investors so the mere inability to explain these tax outcomes simply will put Australia at a substantial disadvantage.

An example of the NRWT problems relates to foreign exchange hedging. In general, hedging gains and losses are not economic income because gains and losses on the hedge are offset by the opposite movement in the hedge position. Yet in many cases NRWT can apply to a hedging gain. This result is inappropriate, and can never be explained in advance – it results from currency movements that are unpredictable. The FSC has frequently raised concerns about the inappropriate taxation of foreign exchange hedging.[7] These rules can also encourage foreign investors to undertake hedging outside of Australia instead of inside Australia.

There are other situations where an Australian fund can be subject to NRWT but a foreign fund would not be taxed – this includes gains on bond sales and gains on sale of foreign equity where an Australian CGT election has not been made. The existence of NRWT in these cases mean Australian funds are uncompetitive compared to foreign funds.

In summary, Australia's NRWT regime is not globally competitive or congruent with Australia's aspirations of becoming a global financial centre and exporting fund management services to the rest of the world and in particular Asia. The policy argument for reducing or

[7] See for example the FSC's submission from February 2018 on CCIVs: https://fsc.org.au/resources/resource-detail/?documentid=49cae31b-ae7d-e811-8159-70106fa11a21
And the FSC submission on the 2018–19 Budget: https://fsc.org.au/resources/resource-detail/?documentid=a584454b-99f9-e711-812d-e0071b686a81

removing NRWT is similar to the argument for the Offshore Banking Unit (OBU) concession — the lower tax rate encourages funds to come to Australia that would otherwise not come.

We note that competing vehicles such as Singaporean VCCs, Luxembourg SICAVs and Irish UCITs impose no non-resident withholding taxes on foreign investors in these vehicles.

In addition, other countries are reducing their NRWT over time, making our system more uncompetitive as time passes. Therefore, if Australia does not set NRWTs at a competitive rate compared to other Passport countries, investors won't participate in Australian Passport funds and the ATO will receive 100% of nothing, while Australia will miss out on revenue, jobs and growth of our funds management industry (including back end operations as well as higher value added operations such as investment management and advisory and legal services).

As investors will be choosing Passport products from a number of competing jurisdictions, Australia's current withholding tax will place Australian funds behind others on a like-for-like comparison. If tax disadvantages are removed for Australian funds then Australian fund managers will be able to compete on a like-for-like basis. In addition, a globally competitive non-resident withholding tax regime is the key component to remove the largest barrier to the success of Australia's funds management export industry.

7. Utilisation of capital losses

Each CCIV sub-fund is taken to be a separate company for tax purposes and the company tax loss rules *prima facie* apply in determining the utilisation of tax losses.

The draft legislation has been amended so that a sub-fund would not be required to satisfy the continuity of ownership test in order to utilise carry forward capital losses. The intention, as stated in the draft Explanatory Memorandum, is to ensure that the rules are broadly consistent with the requirements that must be satisfied by an AMIT when it seeks to utilise prior year net capital losses.

However, there are a number of other provisions within the company tax rules that may impact a sub-fund's ability to recognise revenue or capital losses for deduction in future income years. It is considered that if they were to apply to a sub-fund, their operation would put the CCIV regime at a disadvantage in comparison to the AMIT Regime in terms of compliance costs and tax outcomes. Further, this result would not align with the intention set out in the draft Explanatory Memorandum noted above.

Those provisions are:

- The "current year loss" provisions of Subdivision 165-CB of ITAA 1997. This Subdivision contains rules that a company must follow where it has not had the same ownership or control during the income year and has not satisfied the same business test (which will be deemed to have been failed in the case of a CCIV sub-fund). Capital gains and losses must be calculated based upon the relevant income year being split into periods, corresponding with the change or changes in ownership or control. Net capital losses incurred in one period cannot be offset against net capital gains of other periods.
- The "unrealised loss" provisions of Subdivision 165-CC of ITAA 1997, which provide that a company that has an "unrealised net loss"' at the time of a change in ownership or control cannot, to the extent of the unrealised net loss, have capital losses taken into account in respect of CGT events that happen to CGT assets that were owned by the company at the time of the change in ownership or control, unless the company satisfies the "same business test'' (which will be deemed to have been failed in the case of a CCIV sub-fund).
- The "inter-entity loss multiplication" rules of Subdivision 165-CD which may apply where there has been a change in majority ownership or control to reduce the cost base or cost (on revenue account) of certain equity interests held in the company.

The FSC therefore recommends that these provisions should not apply to CCIV sub-funds to the extent that they would impact the utilisation of capital losses by those sub-funds. This would ensure parity in treatment between trusts and CCIVs.

8. Other issues

8.1. Unnecessary compliance costs

The draft CCIV framework continues to propose the change of all references from AMIT to AIV. As a consequence, there will be a compliance requirement on fund managers to change all disclosures made to investors. For example, an AMMA statement will need to be referred to as an AIVMA statement. The change in terminology is quite widespread and also impacts the existing terminology for the various withholding payments and more broadly, Product Disclosure Statements and other communication documents. Furthermore, we expect the ATO will also need to make changes to the reporting requirements for Funds (such as Tax Returns/Schedules and AIIR).

FSC members remain concerned that this change will only add to the confusion of investors, who have just started to gain familiarity with an AMIT. The FSC welcomes the introduction of transitional relief for existing AMITs (to produce AIVMA statements), however we regard this terminology change as an unnecessary compliance requirement and cost. This is particularly the case for any FSC members that decide not to offer any CCIVs, but continue to offer AMITs. They will inevitably find themselves explaining to investors why legislation introducing a Corporate CIV has resulted in disclosure changes for their AMIT investment. The FSC submits that this terminology change and associated compliance obligations are not necessary.

8.2. Rollover relief

The latest draft of the CCIV tax rules contain significant improvements in the tax rules facilitating rollover from AMITs to CCIVs.

Nevertheless, we reiterate existing managed funds are unlikely to be rolled over into the CCIV regime if the issues raised in this submission are unaddressed, with the CCIV regime being uncompetitive with other local or global funds.

Assuming these issues are addressed, a much broader range of rollover options would assist in encouraging the takeup of the CCIV regime, including rollover of the following types of funds/entities into CCIVs:

- Ordinary companies (particularly Listed Investment Companies);
- Non-AMIT trusts (MITs and Division 6 trusts); and
- Non-Australian managed funds.

These rollover scenarios are discussed in more detail in the FSC submission on the draft CCIV regulatory framework. We would be willing to work with Treasury to address any technical issues raised with these scenarios.

The success of the CCIV regime will be reflected in the extent that the CCIV is adopted as a collective investment vehicle. One way to encourage the adoption of CCIVs is to reduce barriers to rationalising existing funds (eg AMITs) into CCIVs. In broad terms, at present CGT rollover relief is proposed to apply in circumstances where an AMIT is entirely rolled over into a new CCIV. While this is certainly positive, there may often be circumstances where part of an AMIT is sought to be rolled over into a new CCIV. However, if a partial rollover is not available, then it is unlikely that the CCIV will proceed. Accordingly, subject to appropriate integrity, we suggest that consideration be given to providing partial rollover relief for AMIT assets and interests being rolled over to a new CCIV.

Partial rollover relief does not presently exist for the partial transfer of assets and interests from an existing AMIT to a new AMIT. Whether a partial rollover would be extended to AMITs or alternatively, be introduced as a 'CCIV only' incentive, to increase the adoption of CCIVs, is a matter that can be considered further.

8.3. Application of trading and eligibility tests to globally invested CCIVs

The widely held, not closely held, and trading tests apply to CCIVs regardless of the nature of the CCIV investments. However, there are no apparent reasons to apply these eligibility tests to CCIVs that wholly invests in foreign assets. We understand the aim behind the eligibility trading business tests is primarily to protect the Australian tax base in respect of non-residents investing into Australian active businesses and accessing concessional non-resident withholding tax rate on active business income.

These tests are therefore unnecessary for CCIVs investing offshore particularly into assets that are beneficially owned by foreign residents. Amendments to this effect are necessary to make CCIVs internationally competitive with Singaporean VCCs, Luxembourg SICAVs and Irish UCITs vehicles which are all exempt from tax at the fund level.

There are no similar tests applicable to investment in Luxembourg SICAVs or Irish UCITs vehicles. In relation to Singapore VCCs, there are no rules similar to the trading business tests and there are very limited Singaporean eligibility tests which only target certain types of Singapore entities from wholly owning or owning greater than 50% of an entire CCIV. This Singaporean approach does not subject the CCIV itself to any tax, rather it is the investor who suffers a financial penalty.

In order for the CCIV to be internationally competitive, we recommend that sub-funds that invest entirely in foreign assets should be excluded from the eligibility and trading income tests. The requirement that such funds invest entirely in foreign assets could be subject to a *de minimis* exception that would allow such sub-funds to invest up to say 2% in Australian assets. This would allow the inclusion of typical global equity funds within such sub classes, as Australia generally represents less than 2% of global stock market indices.

Such an amendment is particularly important if the FSC's recommended changes to the tax treatment of sub-funds that fail eligibility tests detailed in Section 3 do not proceed (noting the CCIV regime may not succeed if the changes in Section 3 do not occur).

8.4. GST & tax administration

We note the following in relation to GST and tax administration issues for CCIVs:

- It may not be certain that a CCIV sub-fund is 'carrying on an enterprise' for GST purposes, as it has no employees and cannot conduct a business. Therefore, it would be worthwhile stating explicitly that a CCIV sub-fund will automatically meet the 'carrying on an enterprise' test for GST purposes.

- A number of GST provisions relate to managed investment schemes, such as reduced input tax credits (RITCs) for trustee services. These provisions should all be applied to CCIV sub-funds.
- If a tax invoice is addressed or issued to the CCIV or Corporate Director (instead of the relevant sub-fund(s)), the invoice should be able to be allocated to the relevant sub-funds based on the allocation of the relevant cost.

8.5. Technical issues

- Subsection 275-20(4) should be amended to include a CCIV in the list of qualifying widely held investors for AIV status. CCIVs are recognised as “good” widely held investors in the proposed new paragraph 276-20(2)(b) so it seems to be an oversight that subsection 275-20(4) has not been updated.

- Proposed Section 12-384 of the Tax Administration Act (TAA) currently provides that each sub-fund of a CCIV must satisfy the test that a substantial proportion of investment management activities be carried out in Australia in order for the whole CCIV to qualify as a “Withholding CCIV”. If one sub-fund fails this test, then the entire CCIV cannot qualify as a “Withholding CCIV” and access concessional non-resident withholding tax rates. This cross contamination of sub-funds is inconsistent with the legislative scheme which otherwise treats each sub-fund as a separate taxpayer. Unfortunately this Section as currently drafted will mean that events outside of the control of one sub-fund could negatively affect the application of withholding tax in all other sub-funds. Proposed Subsection 12-384 of the TAA should be amended to quarantine the effect of failure of this test to the single sub-fund to avoid contagion of the remaining separate CCIV sub-funds.
    - This is similar to previous FSC concerns that earlier drafts of the CCIV rules involved cross-contamination of CCIV sub-funds.[8]

[8] See this submission: https://www.fsc.org.au/resources/resource-detail/?documentid=49cae31b-ae7d-e811-8159-70106fa11a21