FINANCIAL
SERVICES
COUNCIL

Corporate Collective Investment Vehicle draft legislation

FSC Submission

September 2021

FSC FINANCIAL SERVICES COUNCIL

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1. About the Financial Services Council

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

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advice licensees 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 over $3 trillion on behalf of more than 15.6 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. General comments

The FSC is a strong supporter of the introduction of a Corporate Collective Investment Vehicle (**CCIV**). We welcome the revised exposure draft legislation to introduce a CCIV, which was released by the Government for comment on 27 August 2021 (**The Bill**). The Bill has dealt with numerous issues raised in our previous CCIV submissions and for that we commend the Government and Treasury for their assistance and receptiveness to industry feedback.

In particular, the latest draft of the CCIV legislation includes many significant improvements to the problems identified in the earlier drafts, including:

- Aligning taxation of CCIVs with the Attribution Managed Investment Trust (**AMIT**) regime for managed investment schemes (**MISs**);
- Removing the requirement for CCIVs to have an independent depositary;
- Permitting listing of retail CCIVs, so long as they have only one sub-fund; and
- Allowing a sub-fund of a CCIV to make a cross investment in another sub-fund of the same CCIV in certain circumstances.

There remain some further issues with the latest revised drafts of the CCIV framework which, although not "deal breakers" to the same extent as the issues mentioned above, are still important for the smooth operation of the CCIV regime and broad adoption by the funds industry, both domestically and internationally. These are discussed in more detail in this submission. Some important examples are:

- Material disparities between the CCIV framework and existing MIS framework. For example, in the current draft of the Bill the redemption provisions are not aligned with how MISs work, and there are inappropriate rules relating to capital preservation;

- a lack of flexibility and certain regulatory requirements that may reduce the appeal of CCIVs to wholesale fund managers and operators, particularly international businesses who are not familiar with the Australian MIS and CCIV frameworks;
- the need for the CCIV to be able to make all forms of distributions (including income and capital) from a sub-fund, not just "dividends";
- concerns with the application of trust principles in the tax legislation;
- the ability for ASIC to direct changes to the constitution of the CCIV; and
- the inability to administer certain aspects of a CCIV on a sub-fund basis.

It is also vital for Government to provide certainty that there will be comprehensive transition provisions for MISs to be able to convert existing funds with scale and track records into CCIV sub-funds. This will ensure that the CCIV regime can be embraced by industry as a viable alternative to existing structures.

We also note the draft CCIV legislation is more extensive and more prescriptive than certain other jurisdictions, for example Singapore where their adoption of the Variable Capital Company (**VCC**) regime appears successful, and is also more extensive than the current Australian registered MIS regime.

3. Aligning with existing MIS regime

The FSC submits that in relation to the regulatory framework, there should as far as possible be parity between the CCIV framework and the MIS framework. The FSC highlights below some areas where, in the FSC's view, this alignment could be increased.

3.1. Redemption

Redemption pricing not in line with market practice (section1231Gsection 1231G(2)(b))

The Bill requires the redemption price of a share referable to a sub-fund to be based on the net asset value of the sub-fund at the time of the redemption.

In contrast, the formula for the redemption price for a registered MIS is required to be set out in the constitution and can vary – it is not prescribed by legislation. It is almost always adjusted by a "transaction cost factor" (e.g. buy/sell spread) that is included in the redemption price to fairly attribute the cost of selling assets to fund the redemption (or an estimate thereof) to the withdrawing investor so that the interests of the non-redeeming investors are properly considered. Also, in a typical MIS, general practice is that the price is usually struck at the next valuation time after receipt of the request, even if the redemption does not occur for a few days. Although the CCIV Draft Explanatory Materials (**EM**) suggests this may be possible, it needs to be clear in the law that the position is no less restrictive than for a MIS. The legislation should take the same approach as for MIS, and require that the CCIV constitution provide for the formula or method for calculation of application and redemption prices.

A fixed redemption price may need to be specified in the CCIV constitution, for example for a cash fund similar to those where units are always priced at $1.00 for both entry and exit, and it is the number of units that varies.

Recommendations

1. In section 1231G(2)(b) change drafting to: A retail CCIV must not redeem shares if … the redemption price is not calculated in accordance with the CCIV's constitution.
2. A new paragraph 1223H(2)(d) be added [The provision must] …(d) *state the price, or formula for calculating the price, at which shares referable to a sub-fund may be redeemed.*

The requirement for a retail CCIV constitution to specify a period within which a redemption must be satisfied (while the sub-fund is liquid) must incorporate some flexibility

The requirements for redemptions in retail CCIVs should be aligned with sections 601KA and 601GA(4) for MISs. The issuer should be able to offer a product where redemption is at its discretion, and also specify the time at which the price will be calculated, to suit the assets and how and when they are valued. If there is a strict obligation to allow withdrawals on demand while the fund is liquid, this removes the corporate director's ability to manage the fund in members' interests overall, and instead permits the 'first in' to make a withdrawal, potentially forcing asset sales at inopportune times and poor prices.

The drafting also does not allow for the essential ability to pause processing of redemptions at times when markets are frozen, or if due to market dislocation it is not possible to determine fair prices for assets, and therefore for the shares. It is appreciated that the reason for this change could be that the period for redemption is the period of reference for determining whether a fund is "liquid", however it should be drafted to allow for circumstances where the intended timing for redemptions simply cannot be met. This occurred during the financial crisis of 2007–08 when quite suddenly it became impossible to calculate a fair price for the assets of funds. Under the current framework for registered schemes, ASIC has discretion to allow a constitution to include such qualifications on the redemption period, but the CCIV law as drafted would prevent that outcome.

Recommendation:

3. change drafting of 1223H(2)(a) so that [The provision must] specify a period within which *a redemption will ordinarily be satisfied* …[while the sub-fund is liquid]

Redemption must be in accordance with "terms of issue" (section 1231F)

This provision is vague and we submit it should at the least be clarified in the legislation or deleted . It is not clear what "terms of issue" are. Does this refer to the terms of the constitution, the terms of offer, or some other documents? Given that this is a fault-based offence provision with a maximum term of imprisonment of 5 years where dishonesty is

involved, we submit the drafting should be very clear. The solvency requirement in (2) is reasonable, but the parameters for redemptions should be dealt with in the CCIV's constitution. See section 601GA(4) of the Corporations Act for the limited extent to which that legislation constrains flexibility in redemption arrangements for registered schemes.

Recommendation

4. The provision section 1231F is vague and we submit it should at the least be clarified in the legislation or deleted.

3.2. Fund names

Sub-fund name change requires a special resolution (section 1222Y)

A fund name does not affect the rights of members and the law should not require a member meeting to change it. MISs can typically have a name change under the constitution by the responsible entity resolving and lodging a notice with ASIC and this does not require member approval.

Recommendation

5. The corporate director of a CCIV should, subject to the CCIV's constitution, be able to decide to adopt a new name for a sub-fund of the CCIV.

3.3. Majority Independent Board

No option for a non-majority independent board with a compliance committee (section 1224G)

This section states that at least half of the directors of the corporate director of a retail CCIV must be independent, with no provision for a compliance committee in the absence of a majority external board. The Explanatory Materials states the distinction between this provision and Chapter 5C is as follows:

> "*the requirement that at least half the directors of a corporate director of a retail CCIV be external directors aligns with the circumstances in which a responsible entity is relieved of the requirement to have a compliance committee under Part 5C.5.*"

As currently drafted, section 1224G fails to accommodate responsible entities that have established an operating structure that maintains a compliance committee in accordance with Part 5C.5 of the Corporations Act.

In the spirit of alignment with Chapter 5C of the Corporations Act, it is not clear why the CCIV regime does not also provide the equivalent of an executive board and a compliance committee. Without an equivalent to Part 5C.5 of the Corporations Act, current operators without majority independent boards will either need to restructure their board and operational framework to accommodate the offering of CCIV sub-funds, or establish a new

entity to do so alongside. These options are likely to incur costs and a compliance burden that may deter uptake of the CCIV structure.

Recommendation
6. An equivalent to Part 5C.5 of Chapter 5C of the Corporations Act be made available under the CCIV legislation.

3.4. Compliance plans

The scope of obligations under a compliance plan is expressed differently to that for a MIS (section 1227A)

The CCIV provision refers to measures to be applied by the corporate director *in fulfilling its responsibilities in relation to the CCIV* to ensure compliance with the Act and constitution. This compares with the existing MIS requirement to set out measures that the responsible entity is to apply *in operating the scheme* to ensure compliance with the Act and constitution. While the drafting is similar, the fact that there are differences in language could give rise to unnecessary discussion and uncertainty as to why these differences exist.

Recommendation
7. Unless there is a particular reason for using different language (which should be explained) it is suggested that the same language used in section 601HA(1) of the Act concerning the content of an MIS compliance plan be used in relation to a CCIV.

Compliance plan of a retail CCIV – incorporate by reference the compliance plan of a registered MIS (EM Ref 3.207)

The proposed section 1227B allows the compliance plan of a retail CCIV to incorporate by reference specified provisions of a compliance plan of another CCIV. This flexibility is useful as it is expected to reduce administrative costs where the corporate director is the corporate director of more than once CCIV.

It also likely that some corporate directors may also be a responsible entity of a registered MIS. Where this is the case, there will already be a compliance plan for the registered MIS. If that compliance plan can be allowed to be incorporated by reference into the compliance plan of the retail CCIV, it could make it easier for fund managers to take up the CCIV regime in addition to their existing responsible entity structure. We note that the facility to incorporate by reference a compliance plan into another compliance plan is widely used by responsible entities.

Recommendation
8. Section 1227B be amended to allow the compliance plan of a retail CCIV to incorporate by reference the compliance plan of a registered MIS where the corporate director of the retail CCIV and the responsible entity of the MIS is the same entity.

3.5. Custody of fund assets

Requirements to hold property on trust and separately should align with MIS (sections 1233ZA and ZC)

The change in the revised Bill to move away from a compulsory depositary for a CCIV is very welcome. The Bill deals with requirements for holding of assets in a CCIV in a similar way to MIS, however it does not recognise the major modifications that have been made by ASIC via Class Orders (CO 13/1409 and 13/1410). The Class Orders insert provisions in the Corporations Act that apply broadly to licensees that hold assets such as custodians. That method of introducing the asset-holding reforms after the Global Financial Crisis was a quick way of achieving a regulatory outcome without taking it to Parliament but was concerning, both because it is not ASIC's role to legislate, and because it makes it more difficult for industry to understand the law and comply if major provisions of the Corporations Act are to be found in documents outside the act itself. There is the opportunity in the CCIV legislation, which is drafted anew, to make greater provision for these requirements.

First, we note that the legislation states (section 1233ZA) that CCIV assets held by a third party such as a depositary or custodian must be held on trust for the CCIV. But this does not take into account the fact that CCIV assets will often be held outside Australia in jurisdictions which do not recognise the legal concept of a trust, or where it is not possible to have a custodian agree to such terms. Exception should be made, or at least clearly facilitated, for CCIV assets held in such jurisdictions along the same lines as the ASIC Class Orders.

Second, the legislation also requires (section 1233ZC) that CCIV money and property held by a custodian or depositary must be held separately from other assets. However, this does not take account of the reality that assets are often "fungible" and co-mingled in an omnibus account. The Class Orders allow this, and impose appropriate conditions such as the requirement for regular reconciliation and records that allow assets to be traced. Where a custodian holds assets for multiple CCIVs, the same exceptions from the requirement to hold assets separately will be required.

Recommendation

9. Provide the exceptions from holding property on trust where it is held in jurisdictions that do not recognise trusts or holding on trust is not practical, and provide for the standard industry practice of mixing assets in omnibus accounts for cash, securities and similar assets by way of amendment to the Bill or by way of regulation.

3.6. Mandatory valuation of fund property

Section 1224D(2)(f) of the draft Bill requires the corporate director of a retail CCIV to ensure that assets of a sub-fund of the CCIV are valued at regular intervals appropriate to the nature of the assets. The Government is considering whether further requirements should be in place to ensure these valuations are independently reviewed or audited as an integrity measure.

This is impractical and unnecessary and not consistent with the MIS framework. Section 1224D(2)(f) imposes the same statutory duty to value at appropriate intervals as for a MIS and there are no problems with how the industry handles that. ASIC policy requires the constitution to provide for valuations, generally at market price, but there is some flexibility. For funds with frequently traded liquid securities, the value is determined by publicly available information on market closing prices. It is unclear how and why the value would need to be determined independently.

It is particularly important not to impose mandatory valuation requirements on wholesale CCIVs. There needs to be flexibility, for example, for assets that have been recently acquired through an arm's length purchase to be held at the purchase price (which clearly reflects market) for a period before going to the expense of commissioning an independent valuation.

Recommendation

10. Do not include provisions that require independent valuation of assets.

3.7. Breach reporting timeframe

EM Reference: 3.222

The proposed section 1227H requires the auditor of the compliance plan of a retail CCIV to notify ASIC of certain contraventions within 7 days of becoming aware of those circumstances. In contrast, the existing section 601HG requires the auditor of the compliance plan of a registered MIS to notify ASIC within 28 days of becoming aware.

The explanatory material does not clearly outline the reasons for this difference in the timeline for breach reporting by the compliance plan auditor between the MIS and CCIV regimes. Unless there is a particular reason for this difference, it has the potential to create confusion between various breach reporting requirements for the compliance plan of a retail CCIV and that for a registered MIS.

Moreover, under the new breach reporting regime effective from 1 October 2021, the corporate director (as an AFS licensee) will have 30 days to notify ASIC of a 'reportable situation'. It seems inconsistent for the compliance plan auditor to notify ASIC of a matter within 7 days when the corporate director is still investigating the matter and has 30 days to notify ASIC.

Recommendation

11. Section 1227H be redrafted in line with the existing section 601HG allowing at least 28 days for a compliance plan auditor to notify ASIC of prescribed contraventions.

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3.8. Definition of assets

The proposed section 1233H contains the meaning of "assets of a sub-fund". The wording and language used to describe the assets of a sub-fund is different to the definition of "scheme property of a registered scheme" contained in section 9.

Unless there is a reason for these differences, which should be articulated in the EM, they can give rise to a disparity between the calculation of assets of a retail CCIV and that of a registered MIS.

This could also have a consequential impact on other areas such as net tangible asset requirements for the corporate director or the responsible entity (assets of the sub-fund/scheme property of a registered scheme are taken into account when calculating the net tangible asset requirement).

Recommendation
12. Section 1233H be amended such that the definition of assets of a sub-fund is consistent with the definition of scheme property of a registered MIS in section 9.

4. Capital concepts

4.1. Buy backs and other issues regarding sub-fund capital

Making an "unauthorised reduction" in capital has serious consequences (section 1231S)

The CCIV is, in concept, a collective investment company with variable capital rather than a trading company, so it seems particularly inappropriate for a provision such as this to be included, let alone carry a 5 year term of imprisonment. Subsection (2) may be useful to retain in some form, but allowing withdrawal from an open-ended fund, the very intention of the structure, should never be a crime. In addition:

- in the wholesale space, even funds which are not technically 'open-ended' often have managed 'liquidity events' or similar arrangements included in their constituent documents that allow for withdrawals before the end of the fund's life in certain circumstances.
- wholesale funds may also have 'compulsory withdrawal' mechanisms under which the trustee can require withdrawal of investors whose continued holding of interests might jeopardise the interests of other members or the operation of the fund. For example this may occur due to tax or regulatory issues or changes in status, such as where the U.S. Employee Retirement Income Security Act might cause a fund with certain investors to be subject to additional U.S. tax and reporting requirements.

Allowing withdrawal in the above circumstances should similarly be catered for.

It is also important to have an unrestricted ability to make capital distributions so that a sub-fund can work in a comparable way to a MIS.

Buy-back prohibition doesn't accommodate on-market buy backs or internal market making (section 1231T)

Generally, capital reduction rules are contrary to the concept of open-ended variable capital investment vehicles. Listed trusts buy back their own units on market and cancel them, as facilitated by the Listing Rules. The same should be possible for CCIVs. Also, exchange traded managed funds on the AQUA and Chi-X trading platforms undertake internal market-making to provide liquidity for investors. This involves the fund buying or selling its own securities and cancelling or issuing at the end of the trading day to true up. This should not be prohibited.

Prohibition on directly acquiring own shares also contrary to market making and buy-backs, and holding forfeited shares pre-sale (section 1231Z)

These sections seem to arise from a misconception that traditional corporate capital preservation rules appropriate for a trading company should apply to a collective investment vehicle such as the CCIV. The sub-funds of a CCIV are intended to be able to act as open-ended investment funds with variable capital and, as such, will allow redemptions and have capital that varies all the time. The specific concerns with this section include a requirement that a buy-back of shares should be a capital reduction authorised by law.

Although redemption is the usual approach, there is no policy reason why a CCIV should not be permitted to buy back and cancel shares. This occurs in the case of on-market buy-backs for listed trusts, up to an annual or securityholder-approved limit and is governed by the Listing Rules. The responsible entity buys units on market and cancels them. The same should be allowed for CCIVs. It is also essential for shares to be bought back in an exchange traded managed fund on the AQUA market that has internal market making. This is an increasingly popular form of investment. The potential market integrity issues where a product issuer deals in their own securities are addressed in ASIC's Information Sheet 230 and media release 20-088.

Recommendations

13. The best approach would be to disapply the whole of the capital reduction and self-acquisition rules for CCIVs, as they are not appropriate for open-ended investment funds.
14. If the provisions are not removed, we suggest at least that section 1231T be amended to remove the limitations on buy-backs and simply state that the CCIV may do so.
15. Regarding the ability to buy back shares, we suggest adding a provision such as s601FG which provides that a responsible entity can only buy units in a managed fund at the price another person would pay.
16. To the same end, we suggest that section 1231Z should state that section 259A (the self-acquisition rules) does not apply to a CCIV.

4.2. Expenses and distributions

Section 1233T does not expressly authorise sub-fund assets being applied to acquire investments, pay expenses and distribute capital

It would be helpful to put beyond doubt in the legislation that CCIVs are able to apply funds to acquire investments or pay expenses. It is also important to ensure that paragraphs (c) and (i) of section 1233T together cover the standard practice of paying small amounts of capital along with an income distribution, as this happens all the time in MISs, particularly where the precise amount of distributable income is not known at the time of a distribution, perhaps because the payment is made before audit is completed.

It is also necessary to ensure that *pro rata* distributions of capital can be made for the purposes of mergers and stapling, where a portion of the value held in a fund is exchanged for acquiring a security in another fund. For a sub-fund to work the same way as a MIS, capital distributions should be able to be made freely as determined by the corporate director for a sub-fund. This issue is discussed more generally in Section 4.1 above.

Recommendation

17. Amend section 1233T to refer to investments and expenses, in the EM confirm that all types of capital distribution are permitted, and ensure there are no other sections in the Bill that prohibit this.

5. Listing

The FSC welcomes the decision to allow for a CCIV with a single sub-fund to be listed. Generally, the application of the takeover rules in Part 8B.7 is appropriate for a listed CCIV, but we query whether it is intended to allow section 618 to apply so that off-market takeover bids may occur even if the CCIV is unlisted, or if that should be disapplied. The unsolicited offer rules in Division 5A of Part 7.9 would seem a more appropriate regime for offers to holders in unlisted retail CCIVs.

In terms of technical amendments, the FSC considers:

- It may be helpful to include a requirement that a target's statement issued by a CCIV in response to a takeover bid should include information about the corporate director. This could be achieved by adding a new sub-paragraph in s638(2): "(f) material information concerning the corporate director".
- The list of sections in section 1243AA(2) should include a reference to s639(1).

6. Regulation at the sub-fund level

A sub-fund of a CCIV is analogous to a managed investment scheme, in that each sub-fund will have different assets and different investors. For the CCIV regime to function properly, a

number of provisions need to be tailored so that they apply at the sub-fund level rather than to the CCIV as a whole.

6.1. Disclosing entity test

Disclosing entity test not applied at sub-fund level (section 1232F)

In item 36 in Schedule 2, section 111AF is amended so that the disclosing entity test is appropriately applied at a sub-fund level. However in section 1232F, the requirement to provide half-year financial reports only refers to the CCIV as a whole. It should be clear that the reporting requirement applies only to those sub-funds that are disclosing entities under section 111AF.

Also section 1232C appears to require a CCIV to prepare a financial report for the CCIV as a whole. We query if this is a meaningful form of disclosure, given that the sub-funds hold particular portfolios for different groups of investors, and if all assets and liabilities have been properly allocated as required by law, the CCIV itself will have no separate assets or activities. Accounts and reports for each sub-fund will be the only meaningful and useful form of disclosure.

Recommendation

18. Amend section 1232F so that the reporting requirement only applies to sub-funds that are disclosing entities under section 111F, and do not apply to the CCIV as a whole.
19. Amend section 1232C so that the requirement to prepare a financial report only applies to sub-funds, and not to the CCIV as a whole.

6.2. Constitution amendment

The CCIV constitution should be able to be amended at a sub-fund level (section 1223D(2)(a))

If a change to a constitution would affect only that group of members whose shares are referable to a particular sub-fund, those members only should be able to pass a special resolution to make the change. A vote across the whole CCIV should only be required where the change is to the terms that affect all sub-funds in the CCIV.

Recommendation

20. Add a new sub-section 1223D(2)(a)(iii) “by special resolution of the members holding shares referable to a sub-fund if the modification only affects the terms of the constitution that are applicable solely to that sub-fund”

6.3. Best interests duty in section 1224D is only at CCIV level

As per the consultation paper, the relevant interests to consider are those of the group of investors that hold shares of the class referable to a sub-fund.

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Recommendation

21. The duty should be to "act in the best interests of the members of each sub-fund of the CCIV considered as a separate group"

6.4. Product Disclosure Statement for each sub-fund

A Product Disclosure Statement (PDS) should be able to be prepared for an offer of shares referable to a sub-fund, not necessarily the whole CCIV (section 1244N)

Existing MISs with liquid assets are considered "simple managed investment schemes" and must prepare a PDS no longer than 8 pages under special rules in Schedule 10E of the Corporations Regulations. Liquid CCIV sub-funds should be permitted to be offered in the same way so that disclosure for products with similar underlying assets is comparable for investors.

The FSC submits it needs to be clear that a PDS does not have to include information about all the other sub-funds of a CCIV if it is only offering shares referable to a particular sub-fund.

Recommendation

22. Add to 1244N(1) "applies separately to securities in each sub-fund of a CCIV"

7. Tax issues

7.1. Dividends vs distributions

It is important that the sub-fund of a CCIV has the same flexibility regarding the ability to make distributions and payments on redemption as exist for a conventional unit trust.

The proposed legislation introduces differential treatment for dividends and capital returns. We submit this differential treatment is not appropriate.

The key to an AMIT is its ability to make distributions of amounts whether from the capital or income of the relevant fund. As the funds are to be assessed as AMITs, the sub-funds are likely to use the aggregate of the tax component of the relevant income of the fund as a benchmark for periodic distribution. The introduction of the differential treatment between capital and income raises the question as to whether, in order for dividends to be paid, they must be paid from the profits of the sub-fund. This is an unnecessary complexity.

The suggestion that the concept of a dividend implies that it must be sourced from profits was examined in detail when the proposed revisions to section 254T were to be undertaken. The view of Senior Counsel to the ATO, who provided an advice which was published by the ATO, was that the concept of dividend implied that it was sourced from profits of the company.

Penalties under the capital redemption rule

The key for the success of a sub-fund is its recognition as a variable capital entity. For that reason, it is not appropriate to include the conventional solvency rule regarding capital distributions that is contained in the proposed section 1231R. The penalties in the proposed section 1231A for failure to comply with this rule are too severe for what would most likely be a technical breach with no creditor going unpaid (see also Section 4.1 above).

Recommendation

23. The ability of a sub-fund to make a distribution should not be dependent or have a distinction as to whether it is at law a dividend or from capital. There should be no differential test or penalty. The critical criteria should simply be that the distribution may not be made at a time when the relevant fund is not solvent.

7.2. Proposed trust concepts create issues with attribution

Proposed sections 195-120 and 195-125 seek to fix entitlements by reference to capital and dividends.

We submit it is not appropriate to include a concept of 'dividend' as the relevant basis for dealing with an entitlement to the income of the fund.

As discussed in Section 7.1 above, we submit it is not appropriate to introduce corporate concepts in the application of Division 6. It raises potential ambiguity as to whether an amount must be paid from profits in order for it to constitute a dividend which is unnecessarily complex.

Creation of clearly defined rights to income and capital

An important aspect to the attribution regime is that there are clearly defined rights to income and capital in the constitution of the relevant sub-fund. This ensures that there is a reasonable attribution of each of the tax components to members in the sub-fund.

The terms of a sub-fund's constitution should determine the basis upon which the shares in the sub-fund may be issued or redeemed and the basis upon which distributions of capital income of the sub-fund may be made to a member.

The basis on which these entitlements exist will vary significantly between specific sub-funds. This is because there is no standard basis upon which unit prices and income entitlements are determined for all funds.

The prescriptive manner in which the entitlements are expressed to apply in proposed sections 195-120 and 195-125 are not necessarily consistent with the basis upon which those entitlements would exist under the CCIV constitution. It is not appropriate to create a specific form of deeming which does not relate to the entitlement under the fund.

The concern if the proposed provisions are retained is that they will undermine the basis upon which a proposed sub-fund would otherwise allocate income or capital between members.

Recommendations

24. The specific allocation mechanism in proposed sections 195-120 and 195-125 to create fixed entitlements to income and capital are unnecessary and should be removed.
25. The deemed present entitlement concept, if it is to be retained, should only operate for periods when the sub-fund is assessed under Division 6.
26. The proposed sections dealing with fixed entitlements should simply deem that there are fixed entitlements to income and capital and allocation should be determined by reference to a sub-fund's constitution.

7.3. Default to trust law

The default position for a CCIV or the relevant sub-fund should depend on the nature of the failure. In the discussion below, Division 6 relates to the *Income Tax Assessment Act 1936* (Cth) (**ITAA36**).

Trading activity

If the relevant default is associated with the conduct of a trading activity then it is appropriate for the CCIV or the relative sub-fund to be assessed under the provisions of Division 6C. This maintains a consistent outcome with the same failure by an AMIT.

Widely held requirement

If the widely held requirement is failed, then the policy outcome should be to provide for a continued look-through tax outcome. This could be achieved either by Division 6 deeming or a differential penalty outcome under the AMIT rules. We submit it is significantly simpler to adopt the second model, as discussed further below.

The application of Division 6 on a deeming basis to the relevant CCIV or sub-fund would in our view achieve the outcome. However, it would have some significant disadvantages:

- It could adversely affect the marketability of the CCIV regime, particularly overseas.
- It is more complex to enact. Details on the difficulties are outlined in Section 7.5 below.
- It requires unnecessary complication in the preparation of the constitution for the CCIV or the relevant sub-fund to deal with the default tax outcome.
- It may cause problems for the application of tax treaties.

Instead, the FSC recommends that the CCIV or relevant sub-fund continues to be assessed under the AMIT regime. This is to achieve a consistent attribution pass through treatment. The deemed capital gains tax status should not be available if the relevant widely held criteria are not satisfied.

We believe this should be relatively easy to achieve under the existing regime and could be achieved as follows:

- **Gateway to AMIT rules:** The CCIV or relevant sub-fund being treated as an AMIT derives from section 276-10(1). It is through the recognition of the CCIV or relevant sub-fund as a managed investment scheme or equivalent body. This could be achieved without the requirement for a CCIV sub-fund to meet the widely held test to obtain the consequent look through tax treatment. This would ensure that there is a consistent and appropriate treatment for the members even when the widely held test is failed.
- **Gateway to CGT concession/reduced withholding tax rates:** To retain parity treatment with MITs that fail the widely held requirements, this would mean the removal of the concessional deemed capital gains tax status for CCIVs and the concessional MIT withholding rates if the relevant widely held requirements are not satisfied. These outcomes could be achieved through the gateway provision which applies to the concessional deemed capital gain tax status in section 275-10. These provisions could include an additional requirement of the equivalent widely held provisions which currently exist for a managed investment trust to be able to take advantage of the concessional capital gains status.

In suggesting this approach, we are not seeking to alter the tax treatment which would apply to an existing or new trust which failed to satisfy the widely held requirements in order to be an attribution managed investment trust. While we consider there are good policy reasons to have the same treatment, we recognise that it may be beyond the scope of the current review.

7.4. Default tax should not be dependent on Division 6 concepts

The retention of the Division 6 rules if the widely held test is not satisfied will mean that CCIV constitutions will need to ensure that there are relevant distributions of the amount which constitutes net income for the purposes of Division 6. As the concept of present entitlement is currently deemed to exist via virtue of a relevant payment, the ability to create a relevant present entitlement only through payment causes difficulty in the context of the distribution provisions.

The FSC therefore recommends the CCIV tax treatment does not rely on Division 6 concepts for the purposes of the default tax treatment for a sub-fund. Reliance on a payment-based system to create a present entitlement would mean that, unlike a trust, a present entitlement income could not be created in circumstances where a distribution is unable to be made.

If Division 6 concepts are to be used, then it must be possible to create a present entitlement to the income without an actual distribution. This would need to be achieved through the tax provisions. If the Division 6 concepts do not allow the create of a present entitlement without an actual payment, it should be possible to satisfy the present entitlement with a form of distribution in circumstances where the sub-fund may be insolvent. That is, where the

solvency requirements limit the ability of the sub-fund to make a payment. This issue does not arise if the AMIT rules were to continue to apply as there could simply be an attribution of the relevant income even if distribution was not possible.

If this outcome is not satisfied, then the default tax rules will mean that if a distribution cannot be made there is a default tax rate on top of the marginal rate paid in respect of the income of the fund. This would not be appropriate.

Recommendation
27. The concept of default tax system should not be dependent upon Division 6 concepts.

7.5. Areas to be considered if the Division 6 default position is retained

If the Division 6 approach is to be applies should a sub-fund fail to meet the AMIT requirements, a number of complex areas in relation to the application of Division 6 to CCIVs would need to be addressed.

Present entitlement – Dividends to be considered should not be limited to those paid within the income year

In proposed section 195-125, it is indicated that: *“A *beneficiary of a *CCIV sub-fund trust is taken to be presently entitled to a share of particular income of the trust estate. That share consists of so much of each *dividend (if any) that the *CCIV has paid to the beneficiary as represents any of that income.”*

In relation to this mechanism, paragraph 1.83 of the Draft EM notes that: *“If there is income in the CCIV sub-fund trust in an income year, and a legal form dividend is paid to a member before or at year end out of that income [year], then under subsection 195-125(1) and Division 6, the beneficiary will be deemed to be presently entitled to a share of income of the trust in relation to that income year” (Emphasis added).*

In this paragraph, the Draft EM reads in a requirement for when dividends must be paid in order to be considered for the application of present entitlement that is not reflected in proposed section 195-125 (that is, there is no reference to dividends being required to have been paid within the relevant income year in considering this application).

It is submitted that this restriction is not workable and would lead to inappropriate results that are not consistent with the application of Division 6 to trusts that are outside the operation of the CCIV provisions. The limitation for a present entitlement to arise only when a dividend is paid effectively undermines the aim of creating flow through tax treatment. It will not be practical for a sub-fund to make a distribution of all income for a relevant year of income prior to the end of the year. It is usual in relation to the operation of existing managed funds that a final distribution is determined at year end and likely to be paid after year end, but where relevant, would still be considered (under the terms of a trust’s Constitution) to be part of the income of the trust for the income year that members may be presently entitled to. Section 97 of the ITAA36 does not confine consideration of present entitlement to income

arising within the relevant income year. This approach will result in part of the sub-fund's income being taxed at a penal rate and disadvantage the relevant CCIV sub-fund members compared to the operation of Division 6 outside of the operation of the CCIV provisions which does not appear to be the aim of the changes.

If considered necessary, a specific addition should be made to the section that dividends paid after year end will be considered in determining present entitlement to the extent that they reflect income of the previous income year.

Recommendation

28. If considered necessary, a specific addition should be made to section 195-125 to allow for the creation of a present entitlement to income for a particular period if the relevant income is distributed within a prescribed period following the end of the relevant year. The time for this payment should be equivalent to the existing period in relation to which an attribution managed investment trust member annual statement is required to be issued by an AMIT.

Ability to create specific entitlements to particular classes of income

Under the existing rules, the determination of the basis upon which a beneficiary may be assessed depends not only on whether a present entitlement is created, but also in some cases whether a specific entitlement to the relevant income has been created, which should be mirrored in the CCIV rules. This is important to ensure that the relevant streaming provisions which were introduced following the High Court decision in *Federal Commissioner of Taxation v Bamford* (2010) 240 CLR 481 are effective.

Recommendation

29. A sub-fund be able to create a specific entitlement to either franked dividends or capital gains for the purposes of applying Division 6.

Retention of character of capital gains and income by a sub-fund – application of Division 6

The tax treatment of amounts derived by a trust depend upon the retention of the status of those amounts when distributed to beneficiaries (see the High Court decision in *Charles v Federal Commissioner of Taxation* (1954) 90 CLR 598).

The retention of character is an essential element of an actual trust relationship existing. The deeming of certain characteristics for the application of the tax rules will not of itself create this essential character and enable the amounts to retain their character when derived by a beneficiary. It is therefore critical that there be confirmation that in applying Division 6 in relation to a member of a sub-fund in a CCIV, the relevant amounts retain their character as reflected in the calculation of net income for the purposes of section 95 of the ITAA36, beyond the draft legislation indicating that a beneficiary of a CCIV sub-fund trust is taken to have an individual interest in a share of the trust's exempt income and non-assessable non-exempt income (proposed subsections 195-125(2) and (3)).

We submit this outcome is important in the application of a number of areas including the following:

- **Determination of non-resident withholding tax** – e.g. application to interest, franked dividend components etc have different withholding tax outcomes.
- **Completion of member tax statements** – so that those members can meet their Australian income tax obligations in relation to their investment in the sub-fund.
- **Treatment of tax offsets** – Allocation to members of franking credits and foreign income tax offsets.

Recommendation
30. A specific deeming provision should be added which facilitates the retention of character of net income when allocated to beneficiaries.

Section 100BA – recognition of status of a sub-fund of a CCIV

It is important that a sub-fund of a CCIV be excluded from the operation of these provisions in the same way that MITs are currently excluded.

Tax treaty issues

By deeming the CCIV to be a trust for tax purposes, the International Tax Agreements Act will arguably make the CCIV a collection of trusts for the purposes of tax treaties. Many of our treaty partners will consequently take the view that the CCIV is not an entity for the purposes of their treaty and therefore is not entitled to the benefit of the treaty.

One of the primary reasons for our industry arguing for a corporate vehicle was to overcome this problem of not getting treaty relief but the proposed legislation does not do that.

A way needs to be found to achieve both AMIT treatment for domestic purposes while retaining the corporate status for the purposes of the treaties. Perhaps a provision in the International Tax Agreements Act could stop the deeming for domestic purposes from applying to the treaties.

Treaty issues are discussed further in Section 8.1 below.

7.6. Industry experience of failure of widely held test

There are varied experiences in the industry about the frequency with which MITs fail the widely held test and become subject to Division 6. The most typical reason why a MIT might fail the tests is because they are in start-up/wind down phase. The FSC considers the existing start up concession is too short, which can be why some MITs fail this test.

One of the Big 4 accounting firms have advised that currently 10% of their clients' managed investment scheme trusts are unable to qualify as MITs/AMITs due to issues in the current tests and the overly complex rules including:

- Australian and foreign tax exempt charities not qualifying as "white-listed" investors under s 275-20(4);
- Australian federal and state governments not qualifying as "white-listed" investors under s 275-20(4) as s 275-20(4)(i) only applies to wholly owned entities of Governments not to Governments themselves;
- The technical issue that a single investor trust may not qualify as a MIS under the Corporations Law;
- The difficulty in reaching 25 investors for some wholesale funds which only have wholesale individual investors;
- The ATO's overly wide interpretation of control to include negative control results in many venture capital and private equity trusts being considered to be trading trusts and unable to qualify as MITs;
- Inadequate period of operation of the start-up concessional rules in S 275-10(6).
    - The FSC has a separate proposal to extend the start-up concession which should address this issue (see attachment).

Failure of the widely held tests and the resulting Division 6 treatment of CCIVs is a problem which is not a remote nor unusual and will materially reduce the attractiveness of the CCIV regime given the unattractiveness of the default Division 6 treatment of CCIVs outlined earlier.

However, regardless of the frequency of MITs failing the widely held test, the application of Division 6 principles to CCIVs would require additional complexity in the constitutions of *all* CCIVs to reflect the *possibility* that a sub-fund of the CCIV might fail the test. This issue affects all CCIVs regardless of the probability of the widely held test being failed.

7.7. Division 6 and foreign investors

Many foreign investors are reluctant to invest into Australian trusts

This is a function of both a lack of understanding of the legal form in some jurisdictions and the existing complexity that exists for the taxation of Australian trusts.

An example of that complexity is the potential application of section 99B of ITAA36 to the distribution of amounts which have been protected from tax by virtue of capital losses. Some investors are concerned about the need to lodge Australian tax returns if they invest in Australian trusts.

The existing withholding tax rules associated with Division 6 trusts are a significant barrier to foreign investors taking interests in Australian trusts. This was a significant factor in the introduction of the AMIT regime and the simplified withholding tax rules. Some foreign investor concern is based on misunderstandings of the operation of tax rules dealing with

trusts. It is critical for the success of the regime that we minimise the risk of this misunderstanding.

The introduction of deemed trust status for sub-funds is likely to create concerns regarding the CCIV regime and has the potential to undermine its success.

Recommendation

31. The rules dealing with the taxation of a sub-fund in a CCIV should not be based on trust concepts – it should be sufficient that the relevant sub-fund is deemed to be an AMIT, and there should not be the deeming of particular tax attributes as a means of achieving that outcome.

8. International tax issues

8.1. Tax treaties

The FSC welcomes the Government announcement on 15 September that it is working towards expanding Australia's bilateral treaty network,[1] and the FSC will continue its work requesting existing treaties be amended so that treaties deal appropriately with MITs and AMITs.

Tax treaty relief for CCIVs and sub-funds is important to successfully attracting foreign investors that are more familiar with corporate structures globally, rather than the Australian local MIT and AMIT structures, and to expand opportunities for the Australian fund management industry.

Under the CCIV rules that replicate the attribution provisions for AMITs, CCIVs will be liable to withholding tax under a regime which will be common to both CCIVs and withholding MITs. There are issues with eligibility for treaty relief for AMITs which do not apply to international collective investment vehicles, for example Luxembourg SICAVs and UK Authorised Unit Trusts/ UK OEICs are eligible for treaty relief at the corporate (fund) level in both Taiwan and Korean treaties. In the Korean treaty, the Lux SICAVs and UK OEICs satisfy the criteria of Public Overseas Investment Vehicles, having corporation status and satisfying specific criteria for a collective investment vehicle.

We submit that in the expansion of Australia's treaty network and in the amendments to existing treaties, that treaty relief for CCIVs is based on the ability of the CCIV sub-fund to satisfy conditions for eligibility. This is consistent with the administration of the US treaty, and

[1] See: https://ministers.treasury.gov.au/ministers/josh-frydenberg-2018/media-releases/expanding-australias-tax-treaty-network-cover-80-cent

administration of tax treaties in Korea and Taiwan, acknowledging the public (widely held) investment status at the investment entity level.

8.2. Current tax treaty access for Managed Investment Schemes

Where Australian MISs invest in securities in overseas markets, many countries impose a withholding tax on distributions from those investments, and in a limited number of cases, capital gains tax. Reductions may be available on the imposed tax pursuant to the relevant treaty between Australia and the country of investment.

Australian MIS are typically able to secure withholding tax relief on income received from overseas investments. This is on the basis of the fact that they are treated as a resident for the purposes of the relevant tax treaty and the ATO is able to issue a certificate of residence or to certify the necessary tax relief documentation to support the process.

However, there are several markets where practical challenges are experienced for MIS for several reasons. Details of treaty application for MIS are shown in the table below.

- Investment market tax authority treats overseas collective investment vehicles as transparent for tax purposes
  - In the case of Austria, Korea and Taiwan, the percentage of Australian residents is required in order to determine the relevant percentage of Australian residents such that the withholding tax relief is pro-rated.
  - In the case of Switzerland, the ATO is required to certify the percentage of tax residents to apply a pro-rated amount of withholding tax relief. It should be highlighted that the Swiss authorities request details of the underlying investors even where there are multiple layers of intermediaries. This leads to lower percentages being granted than the vehicle should otherwise be eligible for.
- Difficulty in obtaining certification of the necessary documentation on an issuer by issuer basis
- Challenges in recognition of eligibility of MIS
  - In the past we have seen countries challenge the eligibility of MIS on the basis that they don't believe that the MIS should be treated as eligible under the relevant tax treaty. Questions have also been seen over the eligibility of trusts more generally.

It is noted that Australian MIS are not explicitly stated as eligible entities in many tax treaties. Further, except for the treaties between New Zealand and Australia, and Germany and Australia, no minimum percentage of Australian residents in the MIS is required for the entire MIS to be eligible pursuant to the relevant tax treaty. The threshold approach in these treaties may be encouraged where overseas tax authorities challenge the eligibility of the MIS for tax treaty benefits.

Security Issue Country	Treaty	Treaty Reduction Available?	Why not? Challenges?
Argentina (AR)	Yes	No	Domestic rates lower than treaty
Austria (AT)	Yes	Yes, partial	Look through
Belgium (BE)	Yes	Yes	
Canada (CA)	Yes	Yes	
Chile (CL)	Yes	Yes	Notarisation
China (CN)	Yes	No	Domestic rate lower than treaty
Czech Republic (CZ)	Yes	Yes	
Denmark (DK)	Yes	Yes	
Finland (FI)	Yes	Yes	
France (FR)	Yes	Yes	Eligibility questions
Germany (DE)	Yes	No	Domestic rate easier to access than treaty
Hungary (HU)	Yes	No	Domestic rate lower than treaty
India (IN)	Yes	Yes	Eligibility questions
Indonesia (ID)	Yes	Yes	Eligibility questions
Ireland (IE)	Yes	Yes	
Israel (IL)	Yes	Yes	Eligibility questions
Italy (IT)	Yes	Yes	
Japan (JP)	Yes	Yes	
Korea (South), Republic of (KR)	Yes	Yes, partial	Look through
Malaysia (MY)	Yes	No	Domestic rate lower than treaty
Malta (MT)	Yes	No	Domestic rate lower than treaty
Mexico (MX)	Yes	No	Domestic rate lower than treaty
Netherlands (NL)	Yes	No	Domestic rate same as treaty
New Zealand (NZ)	Yes	Yes	
Norway (NO)	Yes	Yes	

Security Issue Country	Treaty	Treaty Reduction Available?	Why not? Challenges?
Philippines (PH)	Yes	No	Practical issues in obtaining relief
Poland (PL)	Yes	Yes	
Russian Federation (RU)	Yes	Yes	Notarisation
Singapore (SG)	Yes	Yes	
South Africa (ZA)	Yes	Yes	
Spain (ES)	Yes	Yes	
Sweden (SE)	Yes	Yes	
Switzerland (CH)	Yes	Yes, partial	Look through
Taiwan (Republic of China) (TW)	Yes	Yes, partial	Look through
Thailand (TH)	Yes	No	Domestic rate lower than treaty
Turkey (TR)	Yes	No	Domestic rate lower than treaty
United Kingdom (GB)	Yes	Yes	
United States (US)	Yes	Yes	

8.3. Comparable overseas regime – United Kingdom

The UK maintains a free choice between a corporate and trust form collective investment vehicle, an OEIC – open ended investment company versus an AUT – authorised unit trust. Both are treated the same for UK tax purposes. The two alternative vehicles achieve the same outcomes from a tax treaty perspective.

Recommendation

32. Eligibility for treaty relief based on conditions being satisfied by the CCIV /sub-fund, as a corporation/investment entity.
33. There should be at least parity of treatment with Australian MIS from a Double Tax Treaty perspective.

8.4. Current withholding regime for Managed Investment Schemes

Australian MIS are covered by a final withholding regime. Trustees and custodians are required to undertake withholding on fund payments where they are making a payment to a recipient with an address overseas.

Fund payments represent a distribution of the net income of a MIS. Other elements of fund distributions such as dividends and interest received from the underlying investments of the MIS are withheld at standard rates unless they can be reduced pursuant to the relevant tax treaty.

If the fund payment is made to a recipient with an address in a country with an effective exchange of information agreement with Australia, the withholding is at 15%. Where there is no exchange of information agreement, the withholding is at 30%.

The current withholding regime on fund payments is unique globally. Further, where investors hold investments via a custodian or nominee and there is a mismatch with the residence of the underlying beneficial owner, it can lead to either over or under withholding. This then needs to be corrected via a separate payment or tax reclaim.

Recommendation
34. Remove fund payment withholding to encourage use of CCIVs by foreign investors.

8.5. Withholding tax issues

More generally, 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 Asian 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/CCIVs as soon as practicable. This will enable Australian fund managers to compete with other countries involved in the Passport. Australia's headline rates of NRWT are noticeably higher than the equivalent tax rates in other Passport jurisdictions.[2] The NRWT system is also particularly complex compared to other competitor countries, as a result of:

- multiple rates
- complexity and difficulty of determining appropriate rates;
- 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.

[2] See for example Appendix A to FSC submission to Productivity Commission inquiry into services exports: https://www.pc.gov.au/__data/assets/pdf_file/0008/193148/subdr043-services-export.pdf and Appendix A to Hutt, Tan and Wardell-Johnson (2017) International Trends In Company Tax Collective Investment Vehicles

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 and CCIVs were intended to be 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 previously raised concerns about the inappropriate taxation of foreign exchange hedging.[3]

As a result, 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 removing NRWT is similar to the argument for a renewed version of 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. Therefore, it is particularly important for consideration to be given to a system of reduced and simplified withholding tax rates for CCIVs. We consider that without an internationally competitive withholding tax regime for CCIVs, it would be difficult to successfully market CCIVs for foreign retail investors resulting in little or no take up of the regime by the industry.

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 Asian Passport countries, investors won't participate in Australian 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.

[3] See for example FSC submission to 2020–21 Budget in section 4.4 and FSC's February 2018 submission on CCIVs.

8.6. Catering for international investments

For CCIVs to be generally successful, they need to be regulated and taxed competitively to attract local Australian investors wishing to have global investment exposure, rather than seeing those Australians bypass CCIVs to instead invest via foreign pooled investment funds.

For this, adverse tax interactions for CCIVs between Australia's controlled foreign company tax rules, foreign hybrid tax rules, and trading trust tax rules that will render CCIVs uncompetitive need to be resolved. For example it is uncompetitive for a CCIV to be forced to use an offshore feeder fund structure to stop trading trust tax issues arising from minority holdings in US unlisted investments when a consequence of that is 22% of the investment return is forfeited through denial of Australian tax credits on US income tax paid.

A CCIV needs to be an appropriately competitive vehicle for Australians to invest through globally as a fundamental step.

9. Retail vs wholesale

As raised in our 2019 submissions on previous drafts of the CCIV legislation, a fund manager, promoter or consortium leader is likely to choose a less heavily regulated vehicle, all things being equal, than a more heavily regulated one – there are obvious savings in time, cost and complexity, and less regulation often allows more flexibility to establish a vehicle compatible with the requirements of investors and the relevant transactions.

To maximise the appeal of the wholesale CCIV to fund operators, managers and investors, we submit that the following aspects of the proposed CCIV framework should be amended to be in line with the existing wholesale MIS regime.

9.1. Best interest and equal treatment duties applied to wholesale CCIVs

Section 1224D(1) applies a number of retail-standard statutory duties to directors of wholesale CCIVs. However, we submit the duties of directors of a corporate director should not be more onerous in relation to a wholesale CCIV than those of directors of a trustee of a wholesale MIS. While a duty of honesty is appropriate for both retail and wholesale, the imposition of retail-standard requirements of equal treatment and a best interests duty in particular (paragraphs (c) to (f) inclusive) are well beyond general trust law requirements of wholesale trustees. Trustees of a wholesale MIS have analogous but not identical duties of loyalty and impartiality, but they can be modified by the terms of the trust deed (which is appropriate in a negotiation with an institutional investor) whereas a statutory duty cannot be so modified.

We also submit it is preferable to omit paragraph (b), which effectively imposes a statutory general negligence standard which, similarly, may be negotiated with institutional investors under existing schemes, for example by referring to gross negligence or excluding some aspects of a fund service from that standard.

Recommendations

35. The changes in section 1224D(1) other than paragraphs (a) and (g) should be reversed.
36. Drafting should be made more consistent so that here (and elsewhere in the Bill) references are to the "corporate director" where this is the case, so that it is clear this section applies to the corporate director. Natural person director duties are in section 1225

9.2. Contracting out of statutory duties

More generally, the statutory duties imposed on the corporate director of a wholesale CCIV cannot be contracted out of. By contrast, the duties that apply to the trustee of an unregistered MIS are subject to the trust deed and commonly negotiated between the trustee and the wholesale client investors. See also section 9.1 above.

Recommendation

37. Some flexibility should be given to allow statutory provisions concerning certain corporate director duties for wholesale CCIVs to be disapplied by agreement among the members.

9.3. Changing the corporate director and other meetings

Retirement and replacement of the corporate director should be able to occur under the constitution without a meeting in cases where the investors are all wholesale

Wholesale MISs can change their trustee without a meeting by following procedures in the trust deed. There is no reason why the same should not be the case for wholesale CCIVs. Under the legislation, the incoming corporate director would have to be licensed, and the terms of the change would have been negotiated with wholesale/institutional investors, so there is no policy reason to impose a meeting requirement.

Recommendation

38. Section 1224T(1) "If the corporate director of a retail CCIV wants to retire … And add: "The corporate director of a wholesale CCIV may retire and be replaced in accordance with the CCIV's constitution."

Members can replace corporate director of wholesale CCIV

As above, if the wholesale/institutional investors are to have a right to remove the fund operator it should be only as stated in the constitution.

Recommendation

39. If the members of a wholesale CCIV are to have any right in relation to the replacement of the corporate director of the CCIV, the right must be specified in the CCIV's constitution.

Power of members to requisition a meeting (section 252B) is not disapplied in respect of wholesale CCIVs

The same reasoning applies as for sections 1224T and 1224U mentioned above. If a right to requisition a meeting is given, it would be as a result of negotiation with wholesale/institutional investors. A requirement to offer these types of rights in all cases would lessen the attractiveness of CCIVs for wholesale use.

Section 1229A(2) should be limited to retail CCIVs, leaving wholesale CCIVs to provide their own arrangements and processes for meetings in the constitution. This would reflect current practice for wholesale funds. For example, requirements for notices, timeframes, proxies etc in the wholesale space are often more flexible, with an emphasis on speed, flexibility and avoiding administrative/technical requirements, rather than an emphasis on protections that are more suitable to retail investors.

Similarly, consideration should be given to excluding the prescriptive provisions in section 1229F (concerning voting entitlement) from wholesale CCIVs as well. Sometimes, votes are by reference to 'commitments', for example where investors commit $X up front and then face capital calls over time as funding is required for acquisitions, a fund may want the flexibility to give investors who have committed the ability to vote – and calculate their voting power based on how much they have committed. This may not always be proportional to current shareholdings (for example if investors commit at different times). Sometimes investors actually want to cap their voting power, for example 30% rule restrictions. In the wholesale landscape, statutory protections on voting rights are not as important and could lead to inflexibility.

Recommendations

40. Provide that if members of a wholesale CCIV are to have a right to requisition a meeting, it must be set out in the constitution. The right to obtain a copy of the register should be limited to retail funds.
41. The prescription of the number of votes a member has in section 1229F(2)(b) and (3)(b) should only apply to retail CCIVs, and for a wholesale CCIV should be as set out in the constitution.

Section 253E is applied to wholesale as well as retail

For the same reasons as set out above, we suggest that whether the corporate director is to have the right to vote any shares it or its associates may hold should be a matter for commercial negotiation.

Recommendation

42. Section 1229G should be modified in both subsections (1) and (2) so that section 253E applies only to retail CCIVs.

9.4. Public company requirement

Under the current MIS framework, there is no requirement for the trustee of a wholesale MIS to be a public company. Subject to satisfaction of applicable financial services licensing requirements, the trustee of a wholesale MIS can be a proprietary company. This flexibility should be maintained for the CCIV framework.

In a similar vein, it would be appropriate to extend access to the CCIV regime to Crown entities which cannot hold an AFS licence, to allow such entities to be a corporate director of a CCIV provided that other relevant requirements are met. This reflects the position under the current MIS framework.

Recommendation

43. Amend 1222D(1) so that the requirement for the corporate director to be a public company only applies to retail CCIVs. Consequential changes would also be required for other provisions referring to the corporate director as a ‘public’ company (for example 1224F).
44. Permit Crown entities that cannot hold AFSLs to be corporate directors of wholesale CCIVs.

9.5. Wholesale CCIV with indirect investment from retail investors

Paragraph 2.17 of the draft Explanatory Memorandum states the following (highlight added):

> A CCIV may be a retail CCIV or a wholesale CCIV. Retail CCIVs are subject to additional regulatory requirements that provide protections for retail clients. The new law sets out when a CCIV is a retail CCIV or a wholesale CCIV. A CCIV is a wholesale CCIV unless securities in the CCIV were issued to retail clients, or transferred to a retail client in circumstances that required that a PDS be given to that client. This will generally ensure that a CCIV with one or more retail clients (within the existing definitions in Chapter 7 of the Act) will be a retail CCIV. **This includes where a CCIV has one or more ‘indirect’ retail clients, who hold their interest in the CCIV under a custodial arrangement.**

This raises a concern that section 1222K(3) might be intended to mean that a wholesale CCIV which has only direct investors, including investor directed portfolio services (**IDPS**), may be considered to be a retail CCIV, because there are (in turn) retail client investors in the IDPS provider’s platform. While we note that the EM specifically refers to “custodial arrangements”, we would recommend that the EM be expanded upon so that it is clear that no other types of indirect investment would be captured.

We seek to ensure that the existing law around the distinction between retail and wholesale clients in the MIS framework remains for the CCIV regime. At the moment, if a retail client invests indirectly into a wholesale MIS through a platform such as an IDPS, the wholesale MIS retains its status as a “wholesale” scheme as it only recognises the IDPS as the investor in the scheme. We would expect that the existing regime will continue so that wholesale

CCIVs are not inadvertently affixed with obligations relating to retail CCIVs as a result of indirect retail investors that invest through an IDPS or such other custodial arrangements. We would suggest that other indirect retail investments are also expressly excluded.

Recommendation

45. Clarify paragraph 2.17 of EM in relation to a wholesale CCIV that has an IDPS (or other custodial arrangements) as an investor, to be clear that it would not be reclassified as a retail CCIV on the basis that the IDPS, in turn, has retail client investors.

10. Cross-investments

The FSC notes there are no regulatory restrictions on cross investment for registered MISs or in Singapore's VCC. As the CCIV regime is meant to be duplicating the regulatory settings applying to registered schemes, the starting point is that CCIV and registered schemes should be equivalent on this matter.

If the Government considers that there should be a restriction, we recommend that the only restriction should be a prohibition on circular investment, with no other cap or limit on cross investment.

10.1. Restrictions on circular investments

We submit the proposal to avoid circularity of capital (a sub-fund cannot invest back in a sub-fund that has invested in it) should, in principle, be acceptable. We note that it is to be implemented through Corporations Regulations and ask that the FSC have the opportunity be involved in consultations on the development of the Regulations.

10.2. Contracting ability

To make cross-investment viable, a provision should be added in the vicinity of section 1231PF that provides that contracts that the CCIV enters into with itself that are referable to two different sub-funds should be binding. Similarly, transfers of property such as the sale of an asset from one sub-fund to another should be legally valid. This is because the common law position is that a court will not generally enforce a contract where the only party is the same legal person, even if they are acting in different capacities.

By way of example, we refer to section 24 of the *Conveyancing Act 1919* (NSW) regarding the assurance of property, as a precedent for this. That section provides that a person may assure property to himself or herself, or to himself or herself and others. If such a provision is not included, transfer of property between sub-funds could be invalid. Although there is a provision in the Bill allowing cross investment, which could address the point for applications and redemptions, it would be helpful to put the point beyond doubt, for example in a buy-back in which another sub-fund participates.

In a similar vein, a CCIV should be able to take action against itself. By way of example, if there is a breach of contract referable to two sub-funds and one of the sub-funds suffers damage, then it should be permitted to take action against the other sub-fund to recover its losses to the extent the other sub-fund is liable for such loss.

Recommendation

46. Include a new provision that allows the corporate director in respect of one sub-fund to treat two sub-funds as separate legal persons for the purpose only of their entering into and discharging obligations that are referable to each of them separately.

10.3. CCIV as a 'wholesale client'

We submit a section is needed that provides that a CCIV is always a wholesale client for the purposes of section 761G of the Act.

A CCIV has a licensed corporate director, so it should have wholesale status in the same way as does a MIS with a licensed responsible entity. This will be important for cross investments in start-up wholesale structures that have not yet accumulated the $10 million to be wholesale under that test, and where any CCIV invests in an external fund that only admits wholesale client investors.

Recommendation

47. Amend s761G(7) in Schedule 2 or insert a new section 1244EA that defines a CCIV as a wholesale client.

10.4. Look-through voting

Section 1229G applies section 253E of the Corporations Act so that the corporate director and its associates are excluded from voting where any of them has an interest in the resolution other than as a member. This will work appropriately where a vote concerns only the sub-fund in which the corporate director or associate holds shares. The remaining investors could pass a special resolution. Where a vote concerns the whole CCIV however, the exclusionary rule will only work appropriately if cross-invested shares are disregarded in the vote to avoid double counting. This is because if they are not disregarded, a shareholder in sub-fund A that has invested in sub-fund B would have votes in respect of its holding in A and, indirectly, more votes in respect of A's investment in B.

If the shares in a sub-fund are 100% owned by another sub-fund, there should be an exception under which the corporate director can vote for that CCIV, strictly on the basis that the votes are cast in the best interests of the investor sub-fund.

In the consultation materials, Treasury proposes look-through voting where the CCIV holds cross-invested shares and the investor sub-fund has been excluded from voting. This seems to be an unnecessary complication.

"Look through" voting (that is, where the shareholders in the investor sub-fund that has cross invested vote instead of the corporate director itself) would be burdensome and does not seem likely to produce a consumer benefit.

If, say, sub-fund A invests 10% of its assets in sub-fund B, why would the A shareholders be interested enough to vote? It is only one of their investments, and they may simply find it puzzling to be asked their view. The time, complexity and cost of such an exercise cannot, on balance, be justified. The corporate directors' duty to act in the interests of sub-fund members as a group, considered separately should be sufficient protection for their interests. See 7.3 above.

Recommendation

48. Do not impose look through voting, but provide for votes in respect of cross invested shares to be disregarded on a resolution that applies to the whole CCIV.

11. Transition from MIS to CCIV

11.1. Transition provisions

It is important to the success of the CCIV regime that a clear announcement is made that the Government is committed to enabling the transition of an existing MIS to a CCIV sub-fund. We appreciate that this may not be possible in the time available to include it in this Bill, but we emphasise its significance to the success of the regime.

To fully utilise the export benefits of the CCIV, an Australian fund manager needs to promote to foreign investors, particularly in a new market, funds that have significant scale and a good track record of at least 3 years. The only way to do this without waiting until July 2025 is to transition an existing MIS into the CCIV regime. A mechanism for the transition of existing MIS into the CCIV regime will be critical to the adoption of the new regime by managers. It is not limited to those managers seeking to export the benefits of the CCIV. The ability to transition existing funds into the CCIV structure will enable members of those funds to take advantage of additional attributes which are available through the new regime. It can provide the benefits associated with product rationalisation.

Transitional relief will also be important to allow sub-funds within a particular CCIV structure to move to another CCIV structure. This flexibility will be important to ensure that there is an effective means for members of a particular sub-fund to change the corporate director of their sub-fund.

The current exposure draft provides no broad tax relief where an AMIT is restructured into a CCIV entity. Drafts of any proposed replacement restructure relief rules should be released for consultation as soon as possible.

Without broad tax relief, including rollovers applicable to both CGT and revenue assets restructured into CCIVs, we would expect that fund managers would not be able to transition

existing AMITs into the CCIV regime, because the triggering of tax liabilities on transfer would not be consistent with trustees' duties to act in the best interests of existing investors.

The FSC's submissions on previous drafts of the CCIV regime discussed in some detail the issues relating to transition into the CCIV regime.

Recommendation
49. The Government make a clear commitment to implement comprehensive transition provisions for the CCIV regime, in line with previous FSC submissions on this issue.

11.2. Changing company type

Section 1222P prohibits changing company type, either to or from a CCIV, and this could stand in the way of flexible transition provisions. It would be useful to be able to change company type where (i) an existing company that holds assets, such as a company that holds real estate it has developed, wants to convert to a CCIV and offer interests in the asset; (ii) a company that is already a listed investment company wants to become a CCIV and (iii) a CCIV that for some reason ceases to meet the requirements for CCIV tax treatment could become a trading company and be taxed as such, rather than having to wind up. In all these cases, allowing change of company type would avoid having to dispose of assets and create unnecessary tax liabilities for shareholders. They could continue to hold their interest in the asset in that different form.

Recommendation
50. Delete section 1222P

12. Other important issues

12.1. ASIC's powers

ASIC can direct changes to CCIV constitution (section 1223C)

Product issuers would be very concerned about the lack of certainty in their products if this power to direct changes were available to ASIC. It is contrary to the principle of the rule of law that the terms on which investors have subscribed can be changed after the fact, gives disproportionate power to the regulator and does not support business confidence. The CCIV's arrangements at the outset should not be able to be changed except in accordance with the process set out in the constitution and offering document – a product's features will be developed and priced based on the terms that are offered. In particular, in wholesale funds the members will have agreed thresholds and processes to make any changes to those terms. Financiers often impose consent rights or other conditions on amendments to constituent documents as part of lending packages. A breach of such requirements could be to the detriment of investors. If ASIC has grave concerns about the terms of a fund offering and its effect on consumers, it can use its Product Intervention Power or powers under the

Design and Distribution Obligations. Otherwise, business should be able to proceed with confidence that the terms will not be amended.

Recommendation

51. Preference is to delete section 1223C. If this cannot be deleted, one approach could be to restrict the power to requiring changes to prevent actual harm to consumers, using comparable language to ASIC's product intervention power.

ASIC's exemption powers not broad enough for example 8B.5 in relation to custody, cross investment in 8B.4 (section 1246B)

We submit that there should be further consideration of whether ASIC's exemption powers are broad enough, for example, to cover modifications covering holding of fund assets, and cross investments. The exemption powers may need to be extended to allow for appropriate modifications in circumstances that are currently unforeseen.

By contrast, the explicit ability in this section for ASIC to make new law, by adding sections of the Corporations Act by way of legislative instrument applicable to all or a class of persons is concerning. There should be an accountability process for making new laws that are not simply a delegation of power to add detail within the existing scope of the legislation. The circumstances in which ASIC has created new obligations in the past without legislative oversight is through the imposition of conditions on holders of Australian financial services licences in the Class Orders relating to custody and licensee financial requirements as referred to in ASIC Regulatory Guides 133 and 166. To the extent section 1246B of the Bill expands ASIC's ability to make new law in that way, appropriate constraints should be considered for that power.

12.2. Important technical amendments

The constitution must state that the CCIV has power to borrow or raise money (section 1223G(c))

This should be re-expressed to say that if a CCIV is to have the power to borrow, it must be stated in its constitution. That will align the requirement with MISs, and allow for the existence of funds that specifically wish to prohibit borrowing.

Agents of the CCIV or corporate director are related parties (for example custodian or registrar) (section 1228E)

Under the new drafting, agents of the CCIV and the corporate director are considered to be related parties. The section should be modified so that it is clear that the definition of related party does not capture an external fund manager, share registry, administrator, custodian or distributor – all of whom would (if they are not related companies) be genuine third party service providers to the CCIV or the corporate director acting at arm's length.

Recommendation

52. Delete paragraphs 2(c) to (e) of section 1228E

The definition of Liabilities as including contingent risks applies too broadly; confine to this Part (section 1233A)

This provision should not refer to the definition applying to the whole of the Corporations Act. For example, accounting standards and not this expanded definition should be the reference point for reporting under Chapter 2M. In operating a CCIV, the liabilities of each sub-fund will need to be determined under accounting standards for calculation of application and redemption prices, and in that context liabilities will not include contingent liabilities.

Recommendation

53. The definition of liabilities of a CCIV in Part 8B.5 should only apply within that Part.

It should be clear that the sub-fund of a CCIV is not a MIS (section 1244N)

The express application of the PDS regime under section 1244N suggests that without this provision, the shares in a CCIV sub-fund would be considered to be securities for which the disclosure would otherwise be regulated under Chapter 6D. However, this is not clearly stated and it would be helpful to put the point beyond doubt in the EM, if that is the Government's view.

A share in a company is, in concept, an interest (issued by the company) in the capital of the company.[4] An interest in a managed investment scheme is an interest (issued by a company, the responsible entity) in a pool of assets held by the responsible entity for the investors. It is arguable that each sub-fund is a pool of assets held for the investors, and that the interest issued is not in the overarching capital of the company but in that pool. Unless a share in a CCIV falls squarely within the exemption in the definition of MIS for an interest in a body corporate, it will be an interest in a MIS as well as a share, and a provision expressly disapplying the MIS regime would be needed. Clarification of this point by way of legislative amendment to section 9 of the Act, or failing which at least in the EM, would be helpful.

Recommendation

54. Amend the definition of managed investment scheme in section 9 to state that a sub-fund of a CCIV is expressly excluded.

PDS exemptions that have not been addressed include those for additional investments, continuous disclosure and secondary sale (section 1244Q)

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[4] Section 761A defines a security to include a share IN a body, including a body corporate (not a share issued by a body corporate).

Some of the necessary categories of exemption from providing a PDS are not covered in the Bill. They include the exemption that applies to MISs in section 1012D(2) where the client already has all the required information (this is used for subsequent applications by existing investors), section 1013F where the information is already available to investors, for example through continuous disclosure, and section 1012D(7) re takeovers, now that listing is possible. The equivalent of section 1012DA is also needed now that listing will be possible.

Recommendation
55. Provisions to expressly cover PDS exemptions be added in the Bill.

Insider trading redemption exception for buy-backs limited to purchasing by reference to NAV (section 1244ZA)

A change is needed to accommodate both a listed CCIV, and AQUA or Chi-X products where there can be buy-backs and market making by reference to the market traded price, not based on underlying asset prices. ASIC has published policy on how insider trading risks must be managed for market making. See also Section 4.1 above.

Recommendation
56. The price for buy-backs and market making should just be in accordance with the constitution, without a legislative requirement to refer to NAV as the basis for calculation of the price.

13. List of recommendations

1. In section 1231G(2)(b) change drafting to: A retail CCIV must not redeem shares if … the redemption price is not calculated in accordance with the CCIV's constitution.
2. A new paragraph 1223H(2)(d) be added [The provision must] …(d) state the price, or formula for calculating the price, at which shares referable to a sub-fund may be redeemed.
3. change drafting of 1223H(2)(a) so that [The provision must] specify a period within which a redemption will ordinarily be satisfied …[while the sub-fund is liquid]
4. The provision section 1231F is vague and we submit it should at the least be clarified in the legislation or deleted.
5. The corporate director of a CCIV should, subject to the CCIV's constitution, be able to decide to adopt a new name for a sub-fund of the CCIV.
6. An equivalent to Part 5C.5 of Chapter 5C of the Corporations Act be made available under the CCIV legislation.
7. Unless there is a particular reason for using different language (which should be explained) it is suggested that the same language used in section 601HA(1) of the Act concerning the content of an MIS compliance plan be used in relation to a CCIV.
8. Section 1227B be amended to allow the compliance plan of a retail CCIV to incorporate by reference the compliance plan of a registered MIS where the corporate director of the retail CCIV and the responsible entity of the MIS is the same entity.
9. Provide the exceptions from holding property on trust where it is held in jurisdictions that do not recognise trusts or holding on trust is not practical, and provide for the standard industry practice of mixing assets in omnibus accounts for cash, securities and similar assets by way of amendment to the Bill or by way of regulation.
10. Do not include provisions that require independent valuation of assets.
11. Section 1227H be redrafted in line with the existing section 601HG allowing at least 28 days for a compliance plan auditor to notify ASIC of prescribed contraventions.
12. Section 1233H be amended such that the definition of assets of a sub-fund is consistent with the definition of scheme property of a registered MIS in section 9.
13. The best approach would be to disapply the whole of the capital reduction and self-acquisition rules for CCIVs, as they are not appropriate for open-ended investment funds.
14. If the provisions are not removed, we suggest at least that section 1231T be amended to remove the limitations on buy-backs and simply state that the CCIV may do so.
15. Regarding the ability to buy back shares, we suggest adding a provision such as s601FG which provides that a responsible entity can only buy units in a managed fund at the price another person would pay.

16. To the same end, we suggest that section 1231Z should state that section 259A (the self-acquisition rules) does not apply to a CCIV.
17. Amend section 1233T to refer to investments and expenses, in the EM confirm that all types of capital distribution are permitted, and ensure there are no other sections in the Bill that prohibit this.
18. Amend section 1232F so that the reporting requirement only applies to sub-funds that are disclosing entities under section 111F, and do not apply to the CCIV as a whole.
19. Amend section 1232C so that the requirement to prepare a financial report only applies to sub-funds, and not to the CCIV as a whole.
20. Add a new sub-section 1223D(2)(a)(iii) "by special resolution of the members holding shares referable to a sub-fund if the modification only affects the terms of the constitution that are applicable solely to that sub-fund"
21. The duty should be to "act in the best interests of the members of each sub-fund of the CCIV considered as a separate group"
22. Add to 1244N(1) "applies separately to securities in each sub-fund of a CCIV"
23. The ability of a sub-fund to make a distribution should not be dependent or have a distinction as to whether it is at law a dividend or from capital. There should be no differential test or penalty. The critical criteria should simply be that the distribution may not be made at a time when the relevant fund is not solvent.
24. The specific allocation mechanism in proposed sections 195-120 and 195-125 to create fixed entitlements to income and capital are unnecessary and should be removed.
25. The deemed present entitlement concept, if it is to be retained, should only operate for periods when the sub-fund is assessed under Division 6.
26. The proposed sections dealing with fixed entitlements should simply deem that there are fixed entitlements to income and capital and allocation should be determined by reference to a sub-fund's constitution.
27. The concept of default tax system should not be dependent upon Division 6 concepts.
28. If considered necessary, a specific addition should be made to section 195-125 to allow for the creation of a present entitlement to income for a particular period if the relevant income is distributed within a prescribed period following the end of the relevant year. The time for this payment should be equivalent to the existing period in relation to which an attribution managed investment trust member annual statement is required to be issued by an AMIT.
29. A sub-fund be able to create a specific entitlement to either franked dividends or capital gains for the purposes of applying Division 6.
30. A specific deeming provision should be added which facilitates the retention of character of net income when allocated to beneficiaries.
31. The rules dealing with the taxation of a sub-fund in a CCIV should not be based on trust concepts – it should be sufficient that the relevant sub-fund is deemed to be an AMIT,

and there should not be the deeming of particular tax attributes as a means of achieving that outcome.

32. Eligibility for treaty relief based on conditions being satisfied by the CCIV /sub fund, as a corporation/investment entity.
33. There should be at least parity of treatment with Australian MIS from a Double Tax Treaty perspective.
34. Remove fund payment withholding to encourage use of CCIVs by foreign investors.
35. The changes in section 1224D(1) other than paragraphs (a) and (g) should be reversed.
36. Drafting should be made more consistent so that here (and elsewhere in the Bill) references are to the "corporate director" where this is the case, so that it is clear this section applies to the corporate director. Natural person director duties are in section 1225
37. Some flexibility should be given to allow statutory provisions concerning certain corporate director duties for wholesale CCIVs to be disapplied by agreement among the members.
38. Section 1224T(1) "If the corporate director of a retail CCIV wants to retire … And add: "The corporate director of a wholesale CCIV may retire and be replaced in accordance with the CCIV's constitution."
39. If the members of a wholesale CCIV are to have any right in relation to the replacement of the corporate director of the CCIV, the right must be specified in the CCIV's constitution.
40. Provide that if members of a wholesale CCIV are to have a right to requisition a meeting, it must be set out in the constitution. The right to obtain a copy of the register should be limited to retail funds.
41. The prescription of the number of votes a member has in section 1229F(2)(b) and (3)(b) should only apply to retail CCIVs, and for a wholesale CCIV should be as set out in the constitution.
42. Section 1229G should be modified in both subsections (1) and (2) so that section 253E applies only to retail CCIVs.
43. Amend 1222D(1) so that the requirement for the corporate director to be a public company only applies to retail CCIVs. Consequential changes would also be required for other provisions referring to the corporate director as a 'public' company (for example 1224F).
44. Permit Crown entities that cannot hold AFSLs to be corporate directors of wholesale CCIVs.
45. Clarify paragraph 2.17 of EM in relation to a wholesale CCIV that has an IDPS (or other custodial arrangements) as an investor, to be clear that it would not be reclassified as a retail CCIV on the basis that the IDPS, in turn, has retail client investors.

46. Include a new provision that allows the corporate director in respect of one sub-fund to treat two sub-funds as separate legal persons for the purpose only of their entering into and discharging obligations that are referable to each of them separately.
47. Amend s761G(7) in Schedule 2 or insert a new section 1244EA that defines a CCIV as a wholesale client.
48. Do not impose look through voting, but provide for votes in respect of cross invested shares to be disregarded on a resolution that applies to the whole CCIV.
49. The Government make a clear commitment to implement comprehensive transition provisions for the CCIV regime, in line with previous FSC submissions on this issue.
50. Delete section 1222P
51. Preference is to delete section 1223C. If this cannot be deleted, one approach could be to restrict the power to requiring changes to prevent actual harm to consumers, using comparable language to ASIC's product intervention power.
52. Delete paragraphs 2(c) to (e) of section 1228E
53. The definition of liabilities of a CCIV in Part 8B.5 should only apply within that Part.
54. Ideally, amend the definition of managed investment scheme in section 9 to state that a sub-fund of a CCIV is expressly excluded.
55. Provisions to expressly cover PDS exemptions be added in the Bill.
56. The price for buy-backs and market making should just be in accordance with the constitution, without a legislative requirement to refer to NAV as the basis for calculation of the price.

14. Attachment – Targeted extension of Managed Investment Trust (MIT) start up concession

Issue with current MIT start up concession

It is important to retail investors for a managed fund to have MIT or Attribution MIT (**AMIT**) status. The benefits most notably include the certainty provided by deemed capital account treatment for covered assets, ability to adjust 'unders and overs' in subsequent years (rather than amending unitholder tax statements) and deemed fixed trust status.

To qualify as a MIT a fund needs to meet widely held/not closely held tests within 1-2 years of set up under the current start up concession rules (and to elect to be an AMIT, a fund must first qualify as a MIT).

However, in practice, funds generally need a 2 to 3-year track record before starting to gain any sales traction and up to 6 years to become properly established. Many new funds are 'seeded' by the fund manager, in order to demonstrate the viability of the strategy over an initial period and so attract further investors required to meet the widely held or not closely held requirements. If the fund fails the widely held/not closely held tests at the end of the relatively short start-up concession period, the loss of MIT/AMIT status then makes the fund unattractive to many retail investors.

Policy Intent

The introduction of the deemed capital account election for managed investment trusts was announced by the Assistant Treasurer and Minister for Competition Policy and Consumer Affairs on 12 May 2009.[5] It was said that allowing for deemed capital account treatment for MITs will provide more certainty and ensure Australia's tax regime is competitive in attracting foreign funds.

The purpose of the start-up concession is to provide trusts in the start-up phase to have certainty of tax treatment in respect of its assets, even though the trust may not otherwise have the numbers of unitholders required to satisfy the MIT widely held/closely held tests.

This policy intent is better achieved if the start-up concession could be extended to a longer period as it generally takes 5 to 6 years for a fund to become properly established. The current start-up concession in subsection 275-10(6) of the *Income Tax Assessment Act 1997* allows a fund a period of up to 24 months to obtain the necessary unitholders to satisfy the widely held and not closely held requirements in subsection 275-10. This may not always be possible within that short timeframe.

[5] See: https://ministers.treasury.gov.au/ministers/chris-bowen-2007/media-releases/next-major-steps-promote-australia-regional-financial-hub

The start-up concession provides certainty for investors who have invested in the fund in good faith. Investors prefer to invest into an equity fund on the basis that gains on equities would benefit from the CGT discount, to mirror the tax treatment that investors would obtain if they had invested directly into the underlying equities.

Further, foreign investors in the MIT would generally not be taxed on the MIT distribution referable to a CGT gain unless the gain relates to taxable Australian property. As stated in the Explanatory Memorandum to *Tax Laws Amendment (2010 Measures No. 1) Bill 2010*, which introduced the deemed capital account treatment at paragraph 3.6:

> *"In the 2009-10 Budget the Government announced that it would allow eligible Australian MITs that are not taxed like companies to make an irrevocable election to treat gains and losses on the disposal of certain assets (primarily shares, units and real property) on capital account for taxation purposes, subject to appropriate integrity rules.* ***This measure is an important part of the Government's reforms to provide a more certain and competitive Australian tax regime for attracting foreign funds under management****." [emphasis added]*

If the fund fails to have enough investors by the end of the start-up period (despite best efforts from the manager in marketing the fund to investors), then the fund either reverts to revenue account or is forced to close due to the uncertainty arising from the capital vs revenue classification. In these cases, it is the investors who are punished due to the fund being unable to rely on the deemed capital account election available to MITs. This would be contrary to the stated policy intent of the MIT regime.

Typical process on commencement of a new fund

Most investors in retail funds invest through platforms, and there is generally a long lag time involved in getting investors allocated to products. For example, most platforms require sufficient ratings on a fund before it would consider placing the fund on its platform. However, in order for a fund to get a rating, the fund first needs to be established before it can be presented to a ratings agency. Most ratings agencies operate on a 12 month cycle in reviewing different products (rotating between different product types). Therefore, it may sometimes take up to 12 months for a particular fund to get a rating. The starting rating would generally be a 'neutral' rating. There is then an additional period of 12 to 24 months before a fund may achieve a 'favourable' rating. Many platforms would only consider products which have a favourable rating. Given the competitive landscape, there is no guarantee that a platform would take the fund onto its platform even with a favourable rating. Platforms would typically undertake its own research, having regard to the ratings, and most would expect to see a proven demand for a product before they will consider offering it on their platform. Based on our experience, most funds have a 3-5 year window to get any traction.

Self-fulfilling disqualification if start-up period too short

The limited timeframe for MIT qualification can be a self-fulfilling exclusion from attaining MIT status. Many investors will not invest unless MIT status can be confirmed and in the start-up phase, this can limit the ability of the fund manager to attract clients, because the timeframes may be considered too tight. While the full 5 year period may not be utilised, it provides sufficient 'buffer' that provides confidence to potential investors that the fund will qualify as a

MIT. Given the implications of not qualifying are material, potential investors will assess the risk as high even if it is probable that MIT status may be achieved in a shorter time frame.

Integrity concerns

Treasury and the ATO may have integrity concerns as MIT status affords concessional withholding tax treatment on distributions to non-resident investors. These might be addressed by measures which minimises WHT impact to the revenue but at the same time provides the required certainty to funds and their investors.

Treasury and the ATO may also be concerned about funds which would otherwise be holding assets on revenue account being able to access the deemed capital account election. However, even if the fund can pass on the benefit of the CGT discount, this may not necessarily be reflected as a discount in the hands of the unitholders if, for example, they are a corporate unitholder. For other types of unitholders (such as superannuation funds and trusts), it is arguably the correct outcome that the assets be treated on capital account regardless of the status of the investment fund as they would likely be on capital account if held directly by the unitholder. Therefore, it is submitted that there should not be any integrity concerns relating to the ability for a fund to make the deemed capital account election.

Comparison to IMR start up concession

We note that a start-up concession is available in respect of the widely held requirements of the Investment Management Regime (**IMR**) rules. Section 842(2)(b) provides that an entity will be a widely held entity for the purposes of the IMR rules if the entity has never satisfied the widely held requirements in subsection 842(2)(a) "but the investment in the entity is being actively marketed with the intention that the entity satisfies the requirements of that paragraph". This would allow a reasonable start up period which is appropriate to the fund's circumstances, depending on the type of fund, market conditions etc.

In the Revised Explanatory Memorandum to the *Tax and Superannuation Laws Amendment (2015 Measures No 1) Bill 2015* which introduced subsection 842-230(2)(b), paragraph 7.58 states that "It will be a question of fact whether an IMR entity is being actively marketed and this requires evidence of ongoing genuine attempts to obtain third party investment to meet the total participation interests test". Paragraphs 7.59 and 7.60 also notes as follows:

> "7.59 Although there is no express time limit on how long an IMR entity can be actively marketed with such an intention before it is taken to fail this test, an IMR entity that has not satisfied the total participation interest tests within a reasonable period of time (such as 18 months) of receiving its first investor may need to provide compelling evidence about its genuine attempts to obtain third party investment to rebut any presumption that it is not being actively marketed with such an intention.
>
> 7.60 Depending on the circumstances, there may be other forms of evidence indicating that an IMR entity is not being actively marketed with the intention of satisfying the total participation interest tests."

A benefit of not specifying a fixed number of years for the start-up concession is that a start-up period could be applied which is reasonable and appropriate in the particular

circumstances to enable the MIT to achieve the stated policy intent of the regime. In order to provide more certainty to taxpayers and to not overload the ATO with ruling requests from taxpayers seeking to confirm what would be considered to be a reasonable timeframe, it is submitted that some guidance should be provided in the legislation for the MIT start up concession with a discretion for the Commissioner to extend the period in appropriate circumstances.

Proposed extension

The proposed solution is to extend the MIT start-up concession to a longer time frame but include additional requirements such that only funds which are intended to be widely held and not closely held would benefit from the extended start-up concession:

On that basis, we would propose a targeted extension of the MIT start up concession for funds intended for retail distribution:

- Extension of start-up period to 5 years
- Election to be made by the fund in year 1 to elect into the extended start up concession (with a commitment that the additional requirements below will be satisfied)
- To be eligible for the extended start up concession, the investment in the entity must be actively marketed with the intention that the widely held (and not closely held) requirements be satisfied once fund established. The ATO may provide guidance material on what would evidence bona fide marketing efforts to attract investors – this may include (but is not limited to) roadshows to promote the fund, advertising the fund online or with advisors, seeking consultants rating on the product etc. Further examples are provided below.
- ATO discretion to extend the start-up period beyond 5 years.

Transitional arrangement – for funds which already exist at the time the targeted extension of the MIT start up concession becomes law; these funds should be able to elect into the new rules and benefit from the extended start up period provided:

- The election is made in the first year the new rules become law; and
- The 3rd bullet point above must be able to be satisfied.

We note that the original MIT start-up/wind down concession did not allow a trust to qualify as a managed investment trust for two successive income years by utilising the start-up phase in the first year and wind-up phase in the following year. This was because each exception to the widely held requirement is specifically targeted and not intended to be used in conjunction. To allow otherwise would be inconsistent with the broad aim of the new rules, which was to encourage long-term investment by foreign residents.

We recommend that a similar integrity rule be re-instated to alleviate any concerns the Treasury has about starting and then winding up the fund within the concession period.

In circumstances where the widely held/not closely held requirements are not met by the end of 5 years, an integrity rule could be introduced whereby the fund will be deemed not to have been an MIT for the relevant years and the trustee would be required to reissue tax statements on that basis.

Examples of evidence to demonstrate active marketing

- Roadshows to promote the fund
- Advertising the fund - online or with advisors
- Seeking consultants rating on the product
- Marketing materials and go-to-market strategy
- Diary of meetings with investors/advisers/platforms
- Budget of marketing costs and promotional events including conference exhibitions and sponsorships
- Identification of target market segments e.g. SMSFs or retail platforms, retirees, high net-worth individuals
- Feasibility studies of focus groups and market research to demonstrate that the fund would get traction within a certain time period
- Recruitment of marketing people and advertising or promotional campaign with external parties