Deloitte Tax Services Pty Ltd
ACN 092 223 240
Grosvenor Place
225 George Street
Sydney, NSW, 2000
Australia

Phone: +61 2 9322 7000
www.deloitte.com.au

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David Hawkins
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By e-mail: CIVreform@treasury.gov.au

Dear David

Corporate Collective Investment Vehicle - Tax Exposure Draft

Deloitte welcomes the opportunity to comment on the Exposure Draft Corporate Collective Investment Vehicle (**CCIV**) Bill and Explanatory Materials (Tax Framework) contained in the "*Treasury Laws Amendment (Corporate Collective Investment Vehicle) Bill 2017: TSY/45/032 (Tax Treatment)*" (the **draft CCIV tax rules**) released by the Federal Government on 20 December 2017.

Background

In the report, "*Australia as a Financial Centre – Seven years on; The Second Johnson Report*" dated June 2016, it was noted that the proposed introduction of two new collective investment vehicles was intended to "*put Australian fund managers on a level playing field with fund managers from other countries and allow them to make the most out of the new passport regime*." Deloitte supports the proposed introduction of two new collective investment vehicles, and Australia's commitment to the Asian Region Funds Passport.

Deloitte supports the Government's intention to implement a new tax and regulatory framework that will give effect to the CCIV, and supports the policy intent of the CCIV (namely, to establish a new form of passive investment vehicle to "*allow fund managers to offer investment products using corporate vehicles that are commonly in use overseas*", and providing broad alignment with the Attribution Managed Investment Trust (**AMIT**) tax rules). That said, Deloitte has various concerns with the draft CCIV rules, as summarised below.

Executive Summary

In summary, we respectfully submit that:

1. **Roll-over rules**: In order to ensure that an AMIT can transition to an Attribution Corporate Collective Investment Vehicle (**ACCIV**) regime, it is critical to implement much broader, and more comprehensive, tax rules than what is currently proposed by way of a narrow capital gains tax (**CGT**) rollover relief.
2. **No cross-contamination of sub-funds**: A key design principle of the proposed CCIV regime is that each sub-fund is segregated with the effect that legal and insolvency risks arising in respect of a sub-fund are quarantined to that sub-fund (and other sub-funds are not tainted). This design principle should also underpin the draft CCIV tax rules.
3. **Alignment with the AMIT rules**: A key design principle underpinning the taxation of an ACCIV is broad alignment with the AMIT tax rules. Our submission outlines various areas where significant departures from the AMIT rules should be removed.
4. **Implementation of other related tax rules**: A successful implementation of a new tax framework that will give effect to the CCIV, requires the implementation of other related rules (including stamp duty, Goods and Services Tax (**GST**), and the proposed reforms to the withholding tax rules). These related tax rules should be released for consultation as a matter of priority.

Our summary should be read in conjunction with our detailed comments in the Appendix.

* * * *

We welcome the opportunity to discuss these matters further with you. If you have any questions, please do not hesitate to contact me on (02) 9322 3823, or by email skchen@deloitte.com.au.

Yours faithfully

Siew-Kee Chen

Partner

Deloitte Tax Services Pty Ltd

Enclosures:

Appendix

APPENDIX

1 ROLL-OVER RELIEF

The intention of the roll-over relief in the draft CCIV tax rules is stated to be as follows:

> "*1.19 Eligible AMITs that choose to transition into an ACCIV will be provided roll-over relief on a 'like for like' basis to ensure that members of those entities are not disadvantaged by the restructure*."
>
> ...
>
> ***Roll-over relief for AMITs that transition to an ACCIV***
>
> *1.125 AMITs that choose to transition to an ACCIV will have access to roll-over relief at both the entity level (for assets) and the investor level (for members' units). This is achieved by adapting the existing CGT roll-over provisions for trust restructures under subdivision 124-N for the purposes of AMITs and ACCIVs. [Schedule #, items 251 to 253, sections 124-850 and paragraphs 124-855(1)(b) and (ba)]*
>
> *1.126 A CGT roll-over provides relief on certain capital gains events, to ensure that funds and investors do not incur an income tax liability at the time of transfer and defers tax consequences for members*."

The draft CCIV rules have limited operation as they only seek to adapt the existing CGT rollover provisions.

We respectfully submit that broader, more comprehensive rules are required in order to ensure that an AMIT will be able to transition to an ACCIV regime, including:

- AMITs will need access to roll-over relief at both the entity level (for revenue assets) and the investor level (for members' units held on revenue account). A key example are bond funds, which are an important part of the Asian Region Funds Passport. If the rollover is merely limited to a CGT rollover, many funds will not be able to transition to an ACCIV.
- AMITs will need a legislative mechanism to allow their tax attributes (e.g. tax losses), and their tax history (including elections) to transition into an ACCIV.
- Appropriate stamp duty relief / exemption (in all Australian jurisdictions) will be required in order to allow AMITs to restructure / transition to an ACCIV. In particular, the stamp duty rules in each jurisdiction should treat the transfer of assets from an AMIT to an ACCIV as a dutiable transaction, and the acquisition of interests in the ACCIV by the members as a separate dutiable transaction.

2 SEGREGATION OF SUB-FUNDS

2.1 Cross-contamination of sub-funds

A key design principle of the proposed CCIV regime is that each sub-fund is segregated. This is intended to ensure that legal and insolvency risks arising in respect of a sub-fund are 'ring-fenced' to that sub-fund (and other sub-funds are not tainted). We respectfully submit that this design principle should also underpin the draft CCIV tax rules.

In order for a CCIV to qualify as an ACCIV, the draft CCIV tax rules require that each sub-fund must satisfy the widely-held requirements, and the closely held restrictions (refer to proposed section 276-20 and 276-30 of the *Income Tax Assessment Act 1997*). Where a CCIV has multiple sub-funds, this requirement has the effect that if one sub-fund fails the test, the CCIV will not satisfy the general test (with severe consequences as noted in the *"Consequences of failure to meet the ACCIV criteria"* section below*)*. The drafting of this negative limb appears to be premised on integrity concerns, and perceived tax planning opportunities, arising from the ability to create sub-funds in a CCIV.

In the context of AMITs, integrity concerns were raised in relation to the ability to create a multi-class AMIT (with each class treated as a separate AMIT) in circumstances where a particular class would otherwise not qualify as an AMIT (because that particular class would otherwise fail the widely held requirements and / or the closely held restrictions).

This integrity concern was outlined in *Law Companion Guideline LCG 2015/5 (***LCG 2015/5***).* Relevantly, the Australian Taxation Office (**ATO**) considered that such integrity concerns could be adequately addressed under existing provisions of the tax law (rather than requiring additional legislative amendments in the AMIT tax rules).

The ATO expressed the view in LCG 2015/5 that:

- They would closely monitor arrangements which sought to obtain tax benefits by creating separate classes (that would not otherwise qualify as an AMIT).
- They would apply the anti-avoidance provisions in Part IVA of the *Income Tax Assessment Act 1936* (the **1936 Tax Act**) to any such contrived arrangements.

Having regard to the approach adopted in the context of the AMIT rules, we submit that:

- Similar integrity concerns in relation to arrangements to create sub-funds of a CCIV should be addressed via Part IVA, where its conditions are met.
- The negative limb (that if one sub-fund fails the test, the CCIV will not satisfy the general test) should therefore be removed.
- If a sub-fund fails the widely held / closely held tests, that sub-fund should be subject to separate company tax rules (without tainting the entire CCIV structure). The CCIV tax rules could be drafted using similar principles which govern the tax regime for a life insurance company. The CCIV could perform two tax calculations (one in respect of a flow-through sub-fund, and another which applies the company tax rules to a sub-fund which fails the widely held/closely held rules). An alternative framework could be for a 'tainted' sub-fund to exit the CCIV (and for that 'tainted' sub-fund to lodge a stand-alone, company tax return).

We note that the draft CCIV tax rules contemplate a 'savings rule' (modelled on the managed investment trust rules) which applies in the temporary circumstances noted in the draft Explanatory Memorandum as follows:

> "*1.16 However, if, due to temporary circumstances that are outside the control of the corporate director, the CCIV fails the ACCIV requirements, the CCIV can continue to be treated as an ACCIV in relation to the income year if it is fair and reasonable to do so*."

In our view, the range of circumstances where a sub-fund could inadvertently fail the widely held / closely held tests are much wider than the narrow temporary circumstances test outlined above. We therefore consider that the temporary circumstances test will not adequately deal with our concerns in relation to the drafting of the negative limb.

2.2 Consequences of failure to meet the ACCIV criteria

The Explanatory Memorandum states that a failure to meet the ACCIV criteria has the following consequences:

> "*1.120 A CCIV that does not satisfy the ACCIV criteria is subject to taxation at the corporate rate and is not able to distribute franking credits to its members as it is not a franking entity. The distributions to non-resident investors will be non-assessable non-exempt income.*
> *[Schedule #, item 427, paragraph 202-15(ba)]*
>
> *1.121 This approach is consistent with the policy intent of the ACCIV regime, which is to introduce a tax framework for a more internationally recognisable primarily passive investment vehicle that provides flow-through taxation treatment and delivers tax neutral outcomes for investors in CIVs.*
>
> *1.122 To the extent a CCIV fails to meet the ACCIV eligibility (i.e. it is not a flow-through vehicle), it is not appropriate to have a corporate entity (i.e. the CCIV) being taxed like a trust.*
>
> *1.123 In this circumstance, the CCIV will be subject to taxation at the corporate tax rate. Denying the entity the ability to distribute franked dividends is intended to be a disincentive for funds registering as a CCIV, without ever having the intention of electing into the ACCIV tax regime. This aligns with the purpose of the regime to provide a framework for ACCIVs.*
>
> *1.124 A CCIV must deregister from being a CCIV if it ultimately does not elect into the regime or fails to meet the eligibility requirements*."

The draft CCIV tax rules impose a severe penalty where a CCIV fails to meet the ACCIV criteria (effectively a double taxation of income, given that the income is taxed at the corporate tax rate, and there is no ability to distribute franking credits).

We respectfully submit that:

- Such a punitive penalty is unnecessary, and will be a significant disincentive for fund managers to transition to the CCIV regime.
- A more appropriate design principle can be drawn from the existing tax rules which govern a situation where Division 6C is triggered. In broad terms, the company tax rules should be switched on (with the effect that the CCIV is taxed, in all respects, like a company). Importantly, the draft CCIV tax rules should allow a CCIV to distribute franking credits.

3 ALIGNMENT WITH THE AMIT RULES

The Explanatory Memorandum (extracted below) articulates a clear policy intention underpinning the taxation of a CCIV:

> "*1.11 On 19 July 2017, the Minister for Revenue and Financial Services issued a media release outlining a number of clarifications to the AMIT tax framework to ensure that it operates as intended. … These amendments will be progressed in parallel with the finalisation of the CCIV tax framework.*
>
> *…*
>
> *1.13 Schedule # to this exposure draft Bill amends the ITAA 1997 and the TAA 1953 to specify the tax treatment for a company that is a CCIV. This tax treatment broadly aligns with the way AMITs are currently taxed*."

The policy intention is that a CCIV is intended to be a flow-through vehicle for tax purposes. A key design principle is that the tax treatment of a CCIV should broadly align with the taxation of an AMIT. That various technical amendments to the AMIT rules are proposed to be finalised in conjunction with the finalisation of the CCIV rules re-affirm the legislative recognition of the dependency of the proposed CCIV regime with the AMIT tax regime.

The above observation underpins a key aspect of our submission.

In our view, the draft CCIV tax rules significantly depart from the AMIT tax regime in a number of critical areas. We respectfully submit that these significant departures from the AMIT tax regime should be removed for various reasons, including the following:

- If the CCIV is subject to additional tax requirements (beyond what it is currently required of AMITs), this will place an additional barrier in relation to a decision to adopt the CCIV regime.
- If the tax consequences of investing via a CCIV are different from investing via an AMIT, this will result in an uneven playing field. For example, the off-market share buyback rules in Division 16K of Part III of the 1936 Tax Act could apply to treat part of the redemption of shares in CCIVs as a dividend. Such a tax consequence is not logical given the taxable income of the CCIV would be attributed to investors each year and tax would be paid at the investor level (even if it is not distributed). Division 16K potentially results in double taxation where a CCIV structure is used, which does not arise where an AMIT structure is used.
- In a number of cases, various integrity issues were previously canvassed in the context of the introduction of the AMIT rules and the Government ultimately adopted a different solution to address integrity concerns. We submit that it is important to have regard to the outcome of these consultations, and the solutions ultimately adopted by the Government.
- In any case, any proposed material changes to the tax regime should apply equally to AMITs and CCIVs. Rather than introduce them solely in the context of CCIVs, the next step should be to remove them from the CCIV tax rules, and include them for broader industry consultation to consider whether the proposed legislative changes are appropriate, and whether an alternative solution is more appropriate.

3.1 Trading Business – 2% excluded income rule

3.1.1 Board of Taxation

From the outset, one of the broad principles underpinning the design of a tax flow-through CIV is that it should be taxed consistent with the eligible investment rules in Division 6C of the 1936 Tax Act. Relevantly, the Board of Taxation expressed the view in its Discussion Paper, *Review of Tax Arrangements Applying to Collective Investment Vehicles*, dated December 2010 (at pages 2 and 3) as follows:

> "*1.8 Against this background, the Board of Taxation was asked to examine and report on the tax treatment of CIVs, having regard to the MIT tax framework and including whether a broader range of tax flow-through CIVs (such as corporate CIVs) should be permitted.*
>
> *1.9 The review is to have regard to the following broad principles:*
>
> - *CIVs in this context are widely held investment vehicles (with typically long term portfolio investors) that undertake primarily passive investment activities,* ***consistent with the eligible investment rules in Division 6C of the ITAA 1936****.*
> - *The tax treatment of a CIV should be determined by the nature of its investment activities rather than the structure of the entity through which the funds are pooled.*
> - *The tax outcomes for investors in a CIV should be broadly consistent with the tax outcomes of direct investment, other than flow through of losses (subject to limited special rules for their utilisation).*
>
> *...*
>
> *1.13 The recommendations should seek to enhance Australia's status as a leading regional financial centre and support growth and employment in the Australian managed funds industry while maintaining the integrity of the tax system and revenue neutral or near revenue neutral outcomes*." [***Our emphasis***]

3.1.2 Division 6C

Section 102MC of the 1936 Act provides as follows:

> "***102MC When trading business not carried on***
>
> *102MC A trustee of a unit trust that would, apart from this section, carry on a trading business at a time during a year of income is taken for the purposes of this Division not to carry on a trading business at a time during that year if, for that year, not more than 2% of the gross revenue of the trustee (as trustee of the unit trust) was income from things other than eligible investment business (except from the carrying on of a business that is not incidental and relevant to the eligible investment business)*."

The 2% test in section 102MC is a statutory safe harbour rule which ameliorates, to some degree, the adverse impact of Division 6C.

Even if a unit trust carries on a trading business, section 102MC will nonetheless deem the unit trust not to do so, if, for the year, **not more** than 2% of its gross revenue was income from things other than an "eligible investment business" (except from the carrying on of a business that is not incidental and relevant to the eligible investment business).

Relevantly, the existing tax legislation (including section 102MC) does not deem a unit trust to carry on a trading business if **more** than 2% of its gross revenue was income from things other than an "eligible investment business".

3.1.3 Draft CCIV tax rules

The draft CCIV tax rules introduce a new rule which is not consistent with Division 6C. The proposed 2% excluded income rule in draft Section 276-35 includes a note as follows:

> "*If any of the entity's sub-funds exceeds the 2% ceiling on excluded income under paragraph (b), the entity will be taken to carry on a trading business, even if the entity as a whole does not exceed the 2% ceiling on excluded income under paragraph (a)*."

The Explanatory Memorandum states that:

> "*1.66 However, an entity will not be taken to carry on a trading business during the income year if for that year:*
>
> - *no more than two per cent of the entity's gross revenue was from excluded income; and*
> - *no more than two per cent of the entity's gross revenue attributable to each sub-fund was income that was excluded income.*
>
> *[Schedule #, item 1, subsection 276-35(2)]*
>
> *1.67 This means that, for example, an entity (with multiple sub-funds) which derives two per cent of its gross revenue from excluded income through investment activities attributable to a single sub-fund will be taken to carry on a trading business through that sub-fund.*
>
> *1.68 The trading business restrictions for CCIVs broadly align with the AMIT trading business restrictions (see paragraph 275-10(3)(b), subsections 275-10(4), (4A) and (5)) to ensure that the ACCIV vehicle is a passive investment vehicle*."

We submit that:

- The new 2% excluded income rule in proposed Section 276-35 is inconsistent, and goes well beyond, what is currently prescribed in the 2% safe harbour rule in Division 6C. A CCIV is deemed to carry on a trading business if it exceeds the 2% excluded income requirement.
- A clear policy rationale has not been articulated to justify imposing an additional 2% excluded income requirement in the context of the proposed CCIV tax regime.
- Any proposed changes to the trading business rules should not be implemented in isolation, in a piecemeal basis, with sole application to CCIVs only.
- Any proposed changes should be considered holistically as part of a broader, industry consultation process in relation to Division 6C. This would also ensure that there are no distortions in the trading business rules which apply as between AMITs and CCIVs.

3.2 Overs and unders – penalty for failure to take reasonable care

Subsection 288-115(3) of the *Taxation Administration Act 1953* is proposed to be extended to include a penalty where there is an over, or under, that results from the failure to take reasonable care by both a CCIV and extended also to apply to AMITs.

This extension of the penalty regime is at odds with what was agreed as part of the AMIT tax regime negotiations. One of the incentives for electing into the AMIT regime was the higher threshold of recklessness before the penalty regime would apply provided operators and investors with greater certainty. This higher threshold, combined with the ATO's release of *Law Companion Guideline LCG 2015/10* (**LCG 2015/10**), ensured that AMITs would not be exposed to penalties where practical administrative solutions are applied in order to generate the high volume of calculations required by the industry (within a very short period after year end).

By introducing a penalty for failure to take reasonable care, the industry will need assurance that the industry examples set out in LCG 2015/10 would also not result in the failure to take reasonable care. We note that this assurance would also effectively provide certainty to managed investment trusts which have not elected to be AMITs where the same practices are applied.

4 GST

We understand that a second round of consultation is planned during April 2018 which will focus on other tax amendments (including GST amendments) required in relation to the ACCIV initiative. Deloitte would welcome the opportunity to provide more specific comments in relation to the GST consequences of ACCIV arrangements once we see further details of the proposed amendments.

Based on our current understanding of the ACCIV initiative, we consider that the key objectives of any GST amendments should be to:

- Clarify the application of the GST law to ACCIVs.
- Achieve parity of GST outcomes as between AMITs and ACCIVs.
- Promote the stated intention of the ACCIV initiative.

In order to achieve these objectives, we respectfully submit that the following key issues should be taken into account as part of the drafting process:

- Input tax credit recovery under the 'reduced input tax credit' (**RITC**) provisions and in particular, whether the rules relating to Recognised Trust Schemes should be extended to ACCIVs and/or sub-funds.
- Whether the RITC provisions should be extended to cover services supplied by a Corporate Director and Depository.
- Whether the definition of "entity" and/or "carrying on an enterprise" should be amended to specifically include activities undertaken by an ACCIV and/or sub-fund.
- Whether the sub-funds should be able to separately register for GST in order to:
    - enable each sub-fund to recover GST on its costs;
    - ring-fence GST liabilities and exposures incurred by investment activity undertaken within each sub-fund of the ACCIV;
    - enable sub-funds to form a GST group (and allow for ring-fencing of GST exposures and liabilities via an Indirect Tax Sharing Agreement).
- The capacity in which the Corporate Director does various things under the proposed amendments to the *Corporations Act 2001*. In particular, whether this is in the capacity as the ACCIV itself, or in a personal capacity. This will be important for determining the extent of the Corporate Director's exposure for GST liabilities.

5 STAMP DUTY

Each Australian jurisdiction will need to separately consider how the ACCIV rules interact with their stamp duty provisions. In particular, we respectfully submit that:

- The availability of corporate reconstruction relief should be extended to groups that are headed by an ACCIV (to allow the transfer of assets between entities held by the ACCIV).
- To preclude a member that only has a membership interest in one sub-fund from being deemed to hold or have acquired an interest in assets held by other sub-funds.
- To facilitate the roll-over of assets from an existing AMIT to an ACCIV.
- The Commonwealth should seek to encourage a harmonised stamp duty approach.

6 WITHHOLDING TAX

We refer to the Government's consultation regarding non-resident withholding taxes on collective investment vehicles, including the Government's "*Collective investment vehicle non-resident withholding taxes Consultation Paper November 2016*".

The Government's intention to reform the withholding tax regime, together with the proposed introduction of a new internationally recognised collective investment vehicle and the Asia Region Funds Passport, are important steps in ensuring the international competitiveness of the Australian funds management industry.

In order to ensure that Australian fund managers can compete in Asia, we respectfully submit that it is important to continue to progress reforms to the withholding tax regime (in particular, to ensure that the current Australian withholding tax regime is more competitive in Asia), in parallel with the proposed CCIV tax regime.