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By email: CIVreform@treasury.gov.au

Corporate Collective Investment Vehicles Framework
EY Submission

Dear Sir/Madam

Ernst & Young (EY) welcomes the opportunity to comment on the August 2021 draft law to implement the tax and regulatory components of the proposed corporate collective investment vehicle (CCIV) regime.

We have also been involved in the process for submissions made by the various industry bodies (FSC, AIMA) and support their additional comments.

Tax Components

We welcome various changes in the drafting approach from the previous January 2019 tax proposals which address some issues raised in previous submissions including:

- Elimination of sub-fund eligibility restrictions
  - Rule which disqualified ineligible sub fund all other sub-funds from applying the alternative widely and closely held tests in para 276-20(20)(b)(i)
  - Rule which prevented a sub fund that becomes ineligible to be resurrected as an eligible sub-fund in a future year in paras 276-20(1)(d) and 276-20(3)(c)
- Removal of proposals to remove CGT discount at the CCIV level, although we note this may still be introduced in proposed but still unlegislated AMIT changes
- Removal of the new penalty for attribution ‘unders and overs’ that result from a lack of reasonable care.

The resetting of the drafting approach to more directly utilise the current attribution managed investment trust (AMIT) tax rules by applying modifications in proposed subdivision 195-C ITAA 1997 to the existing AMIT subdivisions, rather than to introduce new law as previously proposed, will also improve the understanding of and application of the tax law to CCIVs and their members. We recommend that notes should be added to the relevant Division 275 and Division 276 ITAA 1997 provisions to cross reference to the subdivision 195-C modifications for CCIVs.

We note the removal of taxation at the corporate rate without franking penalty for CCIVs which fail to satisfy eligibility or trading business requirements, however that has been replaced with a potentially more punitive outcome under Division 6 ITAA where a CCIV fails to satisfy the widely held eligibility requirements, as discussed below.

The resetting of the approach of the tax law to deem CCIV sub funds to be treated as trusts for all purposes also raises new issues for access to Australia's network of double tax treaties, as discussed below.

However, fundamental issues still remain with the design of the CCIV which will make it difficult to utilise the regime to attract further foreign investment into Australia.

The key aim of the CCIV proposal was to help Australia develop as a regional financial services hub with internationally competitive tax laws, in order to drive further opportunities and growth from foreign investment using the services of Australian managers.

An underlying focus of the proposed CCIV tax law appears to be to protect the Australian tax base by applying the same restrictive qualification rules as for AMITs and to impose the same complex and relatively high rates of non-resident withholding tax (NRWT) on investors in CCIVs as are imposed on investors in AMITS.

The successful expansion of Australia's fund management industry to service CCIV funds would increase Australia's tax revenue from taxing the profits of the expanded Australian businesses and from taxation of additional Australian employees.

To the extent that restrictive eligibility rules and uncompetitive non-resident rates of tax dampen or fail to produce new foreign investment then little to no increased revenue will be generated from the maintenance of current withholding tax rates.

The proposed CCIV rules as drafted continue to compare unfavourably against the tax arrangements for competing foreign collective investment vehicle regimes such as UK OEICs, Luxembourg SICAVs, Singapore Variable Capital Companies (VCC), Hong Kong open-ended fund company (OFC) and ASEAN Collective Investment Schemes.

This approach will likely see little take up by Australian funds managers to introduce CCIVs as there will be little incentive for foreign investors to choose a CCIV structure – if these foreign investors are not comfortable investing through AMITs then notwithstanding the badging of CCIVs as a corporate collective investment vehicle they will also not be interested in investing through a CCIV.

Our previous submissions remain that there are still core tax issues with the CCIV regime:

► Concerns with the proposed application of the AMIT widely held tests (including closely held limitation to 10% of a CCIV) to foreign investors in CCIVs with complexity, uncertainty and also difficulty in satisfying the rules. We are unable to discern any policy reasons why foreign investors should be subject to widely held test rules. Our suggestion in this respect is that provision be made for some CCIV sub funds to be restricted to foreign investors and that these foreign only sub funds not be subject to any widely held tests.

  When comparing the Australian CCIV regime proposals to competing foreign collective investment regimes it is the only regime which requires the satisfaction of complex widely held tests.

The requirement for CCIVs to satisfy widely held (including not to fail closely held) tests at the level of each CCIV sub-fund is inconsistent with the current widely held/closely held tests which apply to multi-class AMITs at the overall fund level

- We recommend an alternative approach should be considered taking into account previous EY and industry submissions

- Australia's NRWT regime is not globally competitive nor consistent with intent to facilitate the export fund management services to Asia. In particular Australia's NRWT rules are complex with multiple higher rates than applicable to competing vehicles
  - We recommend that reform of Australia's withholding tax rules should be explored including simplification and lowering rates. As a first step, for CCIVs that are marketed under the Asia Region Funds Passport (ARFP) regime a low single rate of non-resident withholding tax should be applied.

We also note that the 2019 proposals for broad tax relief where an AMIT is restructured into a CCIV entity is not included in this draft law. The policy position whether it is now intended that CCIVs should only be established for new funds should be made clear as soon as possible. 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 confidently expect no fund managers would transition existing AMITs into the CCIV regime, because the triggering of tax liabilities on transfer would not be consistent with the managers' duties to act in the best interests of existing investors.

In addition, we note there are outstanding technical issues with the AMIT law which should be addressed by Treasury including for example to ensure AMITs and CCIVs can access CGT rollovers for business reorganisations as is allowed for companies, MITs and unit trusts.

Taxation of a CCIV which fails widely held rules as a Division 6 trust

The proposed modified application of the Division 6 ITAA 1936 trust taxation rules to CCIVs that do not meet the widely held tests to qualify for CCIV tax treatment in a year will likely result in a final CCIV tax on some or all of its income at the top individual marginal tax rate, currently 45%, in that year.

This is because it will be extremely difficult to satisfy the requirements for there to be beneficiaries that are presently entitled to the entire income of the CCIV sub-fund prior to year-end based on current drafting. Where the CCIV is taxed on the income no credit is recognised when the year's income is subsequently distributed to investors (rather that subsequent payment is taken to be a distribution of capital).

The potential for resulting significant taxation to the CCIV without credit to the investor where the CCIV does not meet the widely held tests creates significant uncertainty for investors and will be a disincentive to invest in these funds.

Treasury should consider options for a more equitable approach to deal with CCIV sub-funds that are no longer eligible for AMIT taxation treatment.

Proposed section 195-125 provides that a beneficiary of a CCIV sub-fund will only be presently entitled to the income of the trust to the extent that the CCIV has paid a dividend to the beneficiary that represents that income (with modifications for exempt and non-assessable non-exempt income). The draft explanatory materials (paragraph 1.83) confirms that dividends (equal to the total of the sub-fund's net income) must therefore be paid by the end of the income year to establish present entitlement for that year. However, the payment of all of the CCIV sub-fund's income as a dividend before the end of the year will not be practically possible other than in rare cases.

The proposed mechanism to provide for a beneficiary to be taken to be presently entitled to a share of the income of the CCIV sub-fund trust must be modified to operate so that it is possible to create a present entitlement to the income without an actual dividend or distribution before year end else the default position will be 45% taxation.

One way that this issue could be dealt with is by allowing dividends paid by the CCIV within a period (say 3 months) after the end of the year to be added to dividends (if any) paid prior to year-end to establish PE for the year, to extent the dividends align with the amounts which would be the attributed income for that year as per a notional AMMA statement.

Treaty interaction

Treatment of a CCIV as a trust rather than a corporate vehicle will prevent them from being eligible in their own right for treaty relief under Australia's international tax treaties. This is a significant difference to competing foreign collective investment regimes.

We note that the importance of establishing a corporate collective investment vehicle for access to double tax treaty relief for withholding tax was set out in the Board of Taxation's 2011 CCIV report (see for example chapter 5).

We recommend that Treasury review how CCIVs interact with treaties and consider how this issue might be addressed.

Regulatory Components

We have been actively involved in the process for submissions made by the various industry bodies (FSC, AIMA) which include comments on the proposed CCIV regulatory law elements which we support.

In particular, for the CCIV to be an effective vehicle and compared to other similar vehicles, we are concerned about:

- Treatment of CCIV wholesale funds – we consider the requirements applicable to registered schemes but not unregistered wholesale schemes should not apply to wholesale CCIVs. For example, a corporate director of wholesale CCIV should not have to be a public company (section 1224F)

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- Prescribed process for the corporate director to amend the constitution of a retail CCIV (s1223D) – the corporate director should be allowed to make changes that will not materially adversely affect members' rights, and where members are given 30 days' notice of the proposed change to enable voluntary redemptions
- ASIC's power to amend the constitution of a retail CCIV (s1223C) – this may be problematic where investors have already invested into the CCIV on the basis of the original constitution
- PDS exemptions - certain exemptions available to managed investment schemes from the requirement to provide a PDS should be equally applied to CCIVs
- Listed CCIVs (buy-back prohibition) (s1231T and s1231Z) – on-market buy backs and internal market making should be allowed and carved out of the buy-back prohibition
- Listed CCIVs (insider trading exception) (s1244ZA) – insider trading exception should also be allowed for members' withdrawals calculated by reference to market price of shares on redemption
- Sub-fund design (s1236E) – the Court's power to "make any order it considers appropriate" does not provide sufficient certainty
- Maintenance of capital rules – the extensive provisions regarding capital reductions, buy-backs, self-acquisition and redemption compares unfavourably with the existing framework for managed investment schemes and other jurisdictions. These provisions also appear inconsistent to the intention for sub-funds to be able to act as open-ended investment funds.

We agree with the FSC and AIMA submissions on these points and have not seek to replicate the detailed analysis and comments on these points in this submission.

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If you would like to discuss this submission in more detail, would you please contact in the first instance either Antoinette Elias ((02) 8295 6251) or Scott Kilner ((02) 9248 4596) in our Wealth and Asset Management tax practice, Nikki Bentley ((02) 9276 9544) in our Wealth and Asset Management law practice (for regulatory issues) or in our Tax Policy Centre Alf Capito on (02) 8295 6473 or Brian Lane on (03) 8650 7250.

Yours sincerely

Ernst & Young