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By email: [csef@treasury.gov.au](mailto:csef@treasury.gov.au)

Dear Sir / Madam

**SUBMISSION: CROWD SOURCED EQUITY FUNDING ("CSEF")**

We welcome the opportunity to be able to provide comments and a submission on the Treasury Discussion Paper titled "Crowd sourced equity funding" ("the Discussion Paper").

Pitcher Partners is an accounting firm that specialises in servicing the middle market. We refer to the middle market as consisting of smaller public companies, large family businesses and small to medium enterprises.

One of the most significant issues for the middle market is obtaining access to debt and equity funding as compared to big business. These impediments have largely been acknowledged through Government inquiries and various reports in recent years. We therefore welcome the possibility of the creation of new platforms and a new regulatory regime that will help to improve access to funding in the middle market.

In order to ensure that the regime can be as effective and cost efficient as possible, we raise a number of items for consideration in this submission, including the possible extension of the intermediary platform to MIS arrangements and a number of taxation issues that we believe should (at the very least) be considered in formalising final recommendations.

We would be more than happy to meet with you to discuss any of these recommendations contained in this submission. Please contact me at any time on (03) 8610 5170 or alternatively by email on [alexis.kokkinos@pitcher.com.au](mailto:alexis.kokkinos@pitcher.com.au).

Yours sincerely

A M KOKKINOS  
Executive Director

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## DETAILED COMMENTS

### 1.1 Background

We are pleased that the Government and Treasury have acknowledged the difficulties for small business and the middle market to obtain access to finance. These difficulties have long been acknowledged and highlighted in reports such as the Senate's report of 2010 titled "Access of Small Business to Finance" report of 2010, the RBA's submission of 2011 titled "Submission to the Inquiry into Access for Small and Medium Business to Finance" and the Parliamentary Joint Committee's report of 2011 titled "Access for Small and Medium Business to Finance".

We therefore are pleased that the Government and Treasury are considering alternative regulatory frameworks that will assist in providing access to funding for the middle market. In particular, the CSEF platforms for the provision of equity and P2P platforms for the provision of debt.

We believe that if these regulatory regimes are implemented correctly, they could go a long way in assisting the middle market with addressing some of their concerns with their ability to access finance and capital from alternative sources.

However, we understand the risks associated with relaxing the regulatory requirements. Accordingly, our submission is not intended to provide comments on the "regulatory" framework (per se) and investor protection. Instead, we have limited our comments to some suggestions around platform options and taxation issues that we believe should be considered in developing the relevant platforms.

### 1.2 Types of platforms

The Discussion Paper predominantly focuses on two types of platforms that are currently being considered by Treasury, being the CAMAC model and the New Zealand model. We do not intend to comment on these models, other than in relation to some minor observations. We do, however, believe that it is important to offer alternative platforms that can be used for the intermediary entity.

We note that the report appears to predominantly focus on an intermediary being an online broking type business. However, we highlight that the Financial Services Inquiry raised the possibility of using a Managed Investment Scheme ("MIS") as the potential intermediary vehicle for facilitating the P2P platforms. That is, at page 180, the report stated:

For peer-to-peer lending, the current MIS regime may be able to accommodate different types of platforms — including pooled investment mechanisms and 'bulletin board' models — where investors choose to lend to specific ventures. Consideration should be given to graduating the MIS regime, but also to facilitating other mechanisms for direct lending, with policy settings consistent with securities-based crowdfunding.

We highlight that the MIS regime could potentially facilitate both a CSEF platform as well as a P2P platform, using various MIS type platforms. A Master Trust or Wrap Account is a MIS where the investor has the sole responsibility for all the investment decisions. Typically these are referred to as IDPS or IDPS-like platforms. Alternatively, a unit trust structure can replicate features of this platform using a multi-class unitised structure.

### Investor Directed Portfolio Services (“IDPS”)

In the case of an IDPS (or wrap platform), the investor would effectively have a beneficial interest in the underlying equity instrument or loan note, however they would be managed and held by the trustee / custodian of the MIS. The CSEF and P2P platform would operate in the same way (i.e. by investors choosing their investment), however investors would not take an interest in the equities or debt legally, but would instead hold a beneficial through the MIS.

### Managed Investment Trust (“MIT”)

The second is through a Managed Investment Trust (“MIT”), whereby investors would acquire units in the MIS unit trust, which would give the investor rights to returns referable to the underlying debt or equity. Again, the CSEF and P2P platform would operate in a very similar manner to that proposed in the Discussion Paper (i.e. by investors choosing their investment via the unit class issue). However, investors would instead take an interest in a unit trust rather than taking a direct interest in the underlying securities.

### Potential benefits of using a MIS

There are a number of benefits of using an MIS as a collective investment vehicle for a CSEF or P2P platform.

The MIS regime is heavily regulated and thus would assist in providing some degree of protection to investors that invest in the relevant MIS arrangement. This may remove some of the uncertainties or risks identified in the Financial Services Inquiry report (e.g. associated with “fraudulent” websites).

These platforms can also help to provide for a “scaled” collective investment. Accordingly, the MIS could carry or hold surplus cash of investors at any particular time (prior to deployment), which in turn could be deployed into investments more promptly as and when the underlying Issuers require funding. This would be as opposed to matching investors and issuer in real time (all the time).

Simplified reporting to investors can also be provided through an MIS. That is, the responsible entity will typically provide one single report, covering investments and distributions. Typically these records are provided in a format that is compliant with the ATO requirements and serves as a tax statement, making it easier for investors to comply with the taxation regime.

Furthermore, an MIS platform may facilitate flexibility for investors wanting a “pooled” approach to their investment, in order to reduce the risk of investing in a single Issue under a CSEF platform. For example, investors in the MIS could obtain a pro-rata investment interest in the underlying equities or securities (e.g. 5% of all assets), which in turn could be easily increased or decreased by issuing units in the Fund (collectively) or redeeming units in the Fund (collectively). While the investor would still have risks with respect to the Issuers, the portfolio approach may assist in reducing the risk of defaulting entities.

Finally, due to the larger scale of the MIS holdings and the potential to reduce the proportionate size of administrative work of the intermediary, it is possible that an MIS arrangement can offer a lower fee structure as compared to other intermediary platforms.

Accordingly, we recommend that the Treasury consider ensuring that any proposed rules for CSEF or P2P platforms provide for or allow for MIS intermediaries to be able to invest in the relevant CSEF or P2P equity or debt securities. We highlight that a number of the P2P funds that are currently being established have been through an MIS platform. Accordingly, we believe that this is an important consideration for Treasury when considering the CSEF platforms and the proposed regulatory regime.

### **1.3 Interaction considerations for MIS arrangements**

If the Treasury accepts our proposal at Section 1.2, we highlight that a number of interaction issues may need to be taken into account with some of the proposals under the CAMAC or New Zealand model.

For example, the CAMAC model may seek to impose “investment caps per investor”. Where the legal investor is the responsible entity on behalf of other investors, this test would not be relevant to the investor. Furthermore, it would also not be relevant where the investor has a “collective” interest in the MIS.

To demonstrate, assume that investor A invests \$10,000 in AMIT (being a unit trust MIS), which in turn invests \$2000 in Aco to Eco. Assume that the AMIT holds a collective interest in Aco to Eco of \$50,000 in each entity. If these investments were held directly by the investor, they would satisfy the CAMAC investor caps. However, query how this would be tested under the CAMAC. It would seem that the AMIT would not qualify for an investment in Aco to Eco under CAMAC.

Alternatively, if the New Zealand regime were implemented, the Investor caps would be voluntary and thus it may more readily facilitate interaction with a MIS platform.

Another example is the fee structure and proposed prohibitions for intermediaries under a CAMAC. It is noted that the New Zealand model does not place restrictions on fees, but requires disclosure. Similarly, the CAMAC proposes to prohibit the platform from having an interest in an issuer (which would be impossible to satisfy via a MIS arrangement). However, the New Zealand model does not have such a restriction.

Based on the above, we highlight that the New Zealand model appears to provide for rules that are more supportive of using a MIS intermediary platform as compared to the CAMAC model.

However, no matter which model is ultimately chosen, we request that Treasury consider ensuring that MIS platforms (albeit registered or unregistered funds) are appropriately catered for under the proposals.

### **1.4 Extending the CSEF platforms to debt**

It would be important for Treasury to consider the proposals in the Discussion Paper and whether they can be extended to debt interests. We believe that a CSEF direct platform for debt interests (in addition to an MIS P2P platform) would provide ultimate flexibility for the market in structuring these types of arrangements.

However, as the issue of debt interests (direct to investors) may involve a number of regulatory regimes and licencing requirements (such as the National Consumer Credit Protection Act 2009), we highlight that these requirements may create legal impediments for the operation of such platforms. We therefore believe that there is real merit in

considering this issue, which in turn would require appropriate consideration of the regulatory requirements that apply to lending and borrowing arrangements currently. This would help to ensure a CSEF could work where the underlying security is a debt security.

### 1.5 Taxation issues associated with CSEF and P2P platforms

We note that the CSEF and P2P platforms may bring with them a number of taxation issues and risks. Accordingly, if these risks proved to be significant, this may create an impediment to the use of these platforms if the regime does not appropriately address those concerns. While a number of proposed amendments to the MIT taxation regime may address some of these issues, it will not address a number of issues (in particular those that arise outside of the use of a MIS platform). Accordingly, we highlight some of these issues for consideration by Treasury.

We believe that it is important for the Treasury to review or (at the very least) acknowledge the possible taxation risks that may occur on implanting these regimes. Where appropriate, Treasury should seek to see whether it is possible to address these issues so that they do not inadvertently become an impediment to using the system. While some may say that (practically) this may not be the case for CSEF, we highlight that such an issue occurred in relation to the Listed Investment Company regime, which has now become partially redundant due to the ATO ruling [TR 2005/23](#). Accordingly, it would be a shame if this were to occur for CSEF due to the significant benefits this regime could have for the middle market.

Item	Issue	Resolution
The Issuers may issue a new class of shares to facilitate the CSEF raising.	A number of taxation issues can occur on a new issue of shares. For example, it may trigger a capital gain under the direct value shifting provisions (if not done at market value). It may also result in a number of integrity provisions applying that may deny franking credits. We believe that it would defeat the purpose of the regime if an entity were required to approach the ATO for a ruling each and every time it wished to raise capital via a CSEF platform.	The introduction of the CSEF regime could provide a number of “exceptions” throughout the taxation provisions to turn off these taxation rules.

Item	Issue	Resolution
<p>The Issuers may issue a new class of shares to facilitate the CSEF raising.</p>	<p>Currently an entity will be denied the ability to carry forward tax losses (under the current ATO view) where a private company is owned through multiple classes of shares.</p>	<p>Treasury are currently drafting legislation to deal with carrying forward tax losses where a private company has multiple classes of shares. However, the status of these new rules is unknown. We would recommend that these rules be introduced to compliment a CSEF regime and that special provisions be considered if they do not appropriate support the ability for such an entity to carry forward losses.</p>
<p>The Issuers pay franked dividends to a MIS fund, which in turn is passed to an investor.</p>	<p>A MIS fund needs to be a fixed trust in order to allow franking credits to pass through.</p>	<p>The Government agreed to treat MITs as fixed trusts. This may be fixed from 1 July 2015 or 2016.</p>
<p>The investor acquires units in the trust referable to a particular investment.</p>	<p>Division 6 allocates taxable income on a pro-rata basis. This means an investor may be taxable on the returns referable to another investor under the platform.</p>	<p>The Government has proposed an ability to allocate income to investors on an attribution basis. However, there is some uncertainty as to whether the new MIT regime will deal with multi-class trusts, especially where the make losses. Should Treasury introduce a multi-class rules in the new MIT taxation regime (with loss quarantining), we believe that this could address this concern.</p>
<p>An IDPS Wrap Platform is treated as a look-through for income tax purposes and a MIS trust for GST purposes.</p>	<p>The two regimes use the same definition of a “trust”, yet they provide for different classifications. This creates a risk that under an IDPS, losses on debt or equity under a CSEF or P2P platform will not flow through to the ultimate investor.</p>	<p>There is currently no Government proposal to legislate the treatment of a bare trust arrangement for income tax and GST purposes. While the ATO may provide administrative guidance on this issue in the short term, we would recommend that Treasury consider more formal recommendations in this space.</p>