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Australia's property industry
Creating for Generations

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David Hawkins
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By email

Dear David

Submission on Corporate Collective Investment Vehicle regime – Tax Exposure Draft legislation

Thank you for the opportunity to provide our comments on the draft tax legislation for the Corporate Collective Investment Vehicle (CCIV) regime (the tax ED).

The Property Council is the peak body for owners and investors in Australia's $670 billion property investment industry. We represent owners, fund managers, developers and investors across all four quadrants of property investments: debt, equity, public and private.

The property industry now employs more people than any other sector. Creating more than 1.4 million jobs, property is the biggest direct contributor to employment in Australia by industry. The industry contributes some $87.9 billion annually in combined Australian, state, territory and local government tax revenues.

The introduction of the CCIV regime is intended to broaden the suite of passive investment vehicles available to Australian funds managers and be an internationally recognisable investment vehicle for marketing to foreign investors. The Property Council understands that the CCIV is intended to be an asset neutral passive investment vehicle, being available to investments in all types of passive assets equally. It is also critical that the CCIV is equally attractive to domestic investors, to ensure fund managers are not required to set up separate vehicles for domestic and international investors.

The introduction of the CCIV regime is a significant and complex policy development. Significant work was undertaken in the AMIT regime over a period of time to develop a coherent and attractive regime and we are still waiting on technical amendments to ensure the AMIT provisions operate as intended. The time period for consultation on CCIV has been significantly shorter than AMIT. We strongly encourage further consultation and testing be undertaken before introduction of the CCIV regime to ensure a coherent and attractive regime is introduced from the start.

While there are aspects of the broader regulatory framework that are still being developed, the CCIV framework as set out in the initial tax and regulatory exposure drafts is significantly more complex and costly to administer than the current Managed Investment Scheme (MIS)/Attribution Managed Investment Trust (AMIT) regime (e.g. due to introduction of a mandatory depository for all retail CCIVs).

This complexity, combined with the significant tax risks and penalties in the tax ED are likely to outweigh any potential benefits of the CCIV regime and discourage both existing AMITs from rolling over into the CCIV regime and new funds from setting up CCIVs. This is particularly the case given the potential impacts for domestic investors of a CCIV which includes the risk of double taxation if a CCIV fails the eligibility or trading business requirements and potential for taxation on the CGT discount portion of a capital gain made by a CCIV.

There are six main areas of concern with the operation of the tax ED:

1. Lack of alignment between regulatory framework and tax policy settings, particularly with regard to the segregated sub-fund structure;
2. Imposition of significant penalties for CCIVs who no longer satisfy the eligibility or trading business requirements;
3. Lack of alignment with CCIV tax settings and certain aspects of the AMIT regime, specifically the treatment of discount capital gains;
4. Impediments to transition existing vehicles to a CCIV, particularly with regard to a lack of rollover provisions for losses and other tax attributes and rollover relief for state stamp duty;
5. Consequential amendments required to ensure rules operate as intended; and
6. Uncertainty as to the interaction with other taxes, including application of Goods and Services Tax and State and Territory taxes.

Each of these issues is discussed further below.

1. Alignment of regulatory and tax policy settings.

The purpose of the sub-fund framework is to allow managed funds to offer a variety of investment options through multiple sub-funds under a single 'umbrella' CCIV. The regulatory framework will protect investors by quarantining activities of sub-funds, with assets and liabilities of one sub-fund being segregated from assets and liabilities of other sub-funds within the CCIV.

This policy intent of segregation of assets and liabilities is not reflected in the tax ED. Rather, the tax ED imposes eligibility criteria on each sub-fund and the overall CCIV such that one sub-fund's failure to meet the requirements to be a flow through sub-fund can result in all other sub-funds in a CCIV being taxed as a company and denial of franking credits. This creates a significant risk to investors as activities of a sub-fund they are not associated with, and have no knowledge of, could adversely impact their returns. This will require extensive due diligence cost and time by investors regarding the activities of all the sub-funds of the CCIV. Fund managers will likely be required to disclose this significant tax risk as part of product disclosure statements, reducing the attractiveness for investors for the CCIV.

Recommendation: It is critical that the tax policy settings for sub-funds are aligned with the regulatory settings such that where a sub-fund fails either the trading requirements or eligibility requirements, the loss of flow through status will be confined to that sub-fund, maintaining the policy of segregation of assets and liabilities as intended. An option to achieve this could be to treat each sub-fund as a separate taxpayer.

2. Imposition of significant penalties for CCIVs who fail to satisfy eligibility or trading business requirements.

We understand Government wishes to encourage a CCIV regime which will offer an internationally recognisable vehicle which can be readily marketed to global investors. However, there are currently 14.8 million Australians who are either directly or indirectly (through their superfund) investing in MITs. The CCIV should be able to be marketed to both domestic and global investors alike – it would be impractical, and give rise to unnecessary costs, if fund managers are required to set up different vehicles for their domestic and international investors.

If existing AMITs rollover and become CCIVs it is unlikely domestic investors will find the current CCIV regime an attractive vehicle. This is because, under the proposed regime, if a CCIV fails eligibility requirements under either the widely held test or the trading business test, tax is applied at the corporate rate to the whole CCIV similar to a company, however unlike other Australian companies (including listed investment companies and public trading trusts) franking credits for tax paid are unable to be attached to distributions. This creates double taxation of the income, at the corporate level and in the hands of the domestic investor upon receipt. We also understand that dividend withholding tax will apply to the CCIV distributions to non-resident investors in these circumstances (despite the current drafting of the tax ED).

Recommendation: Industry believes that it is sufficient penalty that tax is imposed on the CCIV at the corporate rate on the taxable income of the CCIV. There should not be an additional denial of franking credits and any dividend withholding tax should be limited to the unfranked component of a distribution. This will assist investors in understanding the risks of the CCIV as failure will align with the position for investment in an Australian company (including a listed investment company).

3. Alignment of CCIV and AMIT tax policy settings

Industry has worked closely with Treasury and ATO to develop a robust AMIT tax framework that was introduced in 2016. We understand that the CCIV tax regime is intended to align with the current AMIT regime to ensure investors and industry are agnostic as to which legal vehicle they use – whether that is an AMIT or a CCIV.

The tax ED includes a number of provisions which do not align with the AMIT regime resulting in a new regime which is more complex and less attractive than what is currently available.

While we have not had time to fully consider all of the potential interactions between the proposed CCIV tax regime and the existing tax law for companies, it seems that further consideration is required in relation to the flow on consequences that are likely to arise, as a CCIV is fundamentally a company for tax purposes with certain modifications to the tax rules that apply to companies. It is likely that some of the rules that apply to companies will inappropriately apply to CCIVs and will need to be modified or switched off.

Critically there are currently two issues with the treatment of CGT gains for the ACCIV which are required to be corrected to allow an comparable regime with AMIT, these being:

- The CCIV regime appears to have the effect that an ACCIV is never entitled to the CGT discount in respect of capital gains made by the CCIV itself (direct capital gains). A "discount capital gain" may only be made by an entity listed in s.115-10, which does not include an ACCIV. Paragraph 1.94 of the Explanatory Memorandum contemplates the CGT discount being relevant for a capital gain that "flows through the ACCIV" (i.e. a capital gain made by an underlying trust – indirect capital gains). We do not believe it was intended that there would be a policy distinction between capital gains which are made by the ACCIV directly, against those made through an underlying trust in which the CCIV holds an interest; and
- An ACCIV is currently unable to apply the CGT discount in calculating net income for distribution. This is a departure from how an AMIT calculates net income and results in tax payable for an Australian resident investor that would otherwise not be payable under the existing AMIT regime. We have provided a simple example below:

	AMIT	CCIV
Gross Capital gain	$100	$100
Application of 50% CGT discount	($50)	Not available
Revenue outgoings	($50)	($50)
Net income	$0	$50
Resident investor		
Distributed income	$0	$50
Less 50% CGT discount	$0	($25)
Net Assessable income	$0	$25

We understand that the exclusion of the discount at the ACCIV level is being driven by a concern that entities that would not normally be entitled to the CGT discount are indirectly obtaining the benefit of that CGT discount through its application at the vehicle level. We do not consider this to be a consistent policy since under the existing AMIT regime:

- non-residents do not obtain this benefit under the attribution regime due to the way that 'fund payment income' is calculated;
- Australian companies make up an insignificant portion of investors in collective investment vehicles; and

- for superannuation funds, any benefit is reversed through a cost base adjustment and results in the superannuation fund being worse off than for a direct investment.

Recommendation: We recommend the calculation of ACCIV net income be aligned with that of the current AMIT regime allowing the discount capital gain to be calculated at the vehicle level when calculating net income. We also recommend that s.115-10 be amended to include ACCIVs in the list of entities that can make discount capital gains so as to ensure alignment with the AMIT regime.

We have provided below a summary of other technical changes that have been identified to date to align the tax outcomes for a CCIV with the AMIT regime:

Section reference	Issue
Existing s.275-50: Extended definition of managed investment trust where no fund payment made.	An equivalent section to s.275-50 is not included in the current ED. This is a technical section allowing satisfaction of AMIT requirements in a year where no fund payments are made. **Recommendation:** An equivalent provision should be included for CCIV.
Proposed s.276-35(2)(b): 2% excluded income concession	The current drafting of s.276-35(2)(b) does not make it clear that the 2% excluded amount is a concession for minor trading business activities that applies where the CCIV would otherwise carry on a trading business – along the lines of s.102MC. The inclusion of the note to s.276-35 introduces this as an additional requirement to satisfy the trading business restrictions by deeming an entity a trading business if it exceeds the 2% non-eligible investment business. **Recommendation:** If this provision is intended to replicate the safe harbor in s.102MC, then s.102MC should be amended to refer to an "entity" rather than a unit trust. This would make the proposed s276-35(2) unnecessary. We note that the other safe harbor in s.102MB already applies to ACCIVs because s.102MB refers to "entities". Alternatively, the section could be worded along the lines of s.102MC – "an entity / sub-fund that would otherwise be carrying on a trading business is not taken to carry on a trading business…"
Proposed s.276-443: parties to the scheme - non-arm's length income	Under the current law (s.275-615), for the non-arm's length income rules to apply there must be a scheme where at least one of the parties to the scheme is not an MIT. Under the proposed law the non-arm's length income rules can apply where one of the parties is not an AIV (being either an AMIT or CCIV) however passive MITs are not included in this definition. **Recommendation:** An amendment is required to the tax ED to extend the section to MITs as a passive investment vehicle. We suggest this should also apply to the current s.275-615(1)(c) also. The amendments should be as follows: Amend s.276-443(1)(c) to state: (c) at least one of the parties to that scheme is *not* an AIV **<u>or a MIT</u>** in relation to the income year. Amend s.275-615(1)(c) to state the following: (c) at least one of the parties to that scheme is *not* a MIT **<u>or an AIV</u>** in relation to the income year.

Inappropriate changes to the penalties regime

It is vital that Australia has a stable investment environment for domestic and global capital to promote Australia as a secure market to invest funds. Inclusion of a new "lack of reasonable care penalty" on unders and overs calculations, for both CCIVs and AMITs so soon after enactment of the AMIT regime does not promote a stable investment market.

The exclusion of a penalty for lack of reasonable care was a deliberate and considered policy choice in the development of the AMIT rules. This position was reached having regard to many factors including the initially proposed (but not adopted) 5% de minimis threshold for unders and overs. It was also noted that:

- it would be highly impractical for AMITs and the ATO to have to issue or reissue significant amounts of statements to investors which be in the tens of thousands and can be compounded if investments are held through layers of AMITs/CCIVs; and
- it is extremely difficult to distinguish between small and large unders and overs (and to impose penalties only on large unders and overs), this was acknowledged to be unworkable in practice.

It is acknowledged common practice in the fund management industry to use estimates due to requirements to distribute and calculate tax components shortly after year end (typically within two weeks) and the obligation on trustees to act in the best interests of members. In this regard we note that due to the short time between a period end and distributions being made not all information is available and that AMITs/CCIVs will have to make estimates.

If penalties for non-reckless unders and overs are introduced, there will be overwhelming pressure on AMITs and CCIVs to re-issue statements from prior years rather than carry forward the under or over. Re-issuing statements will impose significant administrative costs and complexity on the AMIT or CCIV and require the ATO to assess the position of every investor individually before issuing a penalty notice.

Recommendation: Given the unique nature of unders and overs calculations, the "lack of reasonable care penalty" should be removed.

4. Impediments to transitioning existing AMITs

The Property Council understands that government wishes to encourage existing AMITs to transition to the CCIV regime to promote the CCIV as an attractive investment vehicle in Australia. The tax ED provides CGT rollover for existing AMITs entering CCIV.

However, the tax ED does not currently have comprehensive rollover relief provisions to ensure that investors are in the same position as they were prior to entering into the regime regarding tax history including elections made by the AMIT and carried forward losses.

Recommendation: The rollover relief provisions should be expanded to provide that tax attributes including all elections and loses which applied to the AMIT will apply to the CCIV at the time of rollover. It is also essential that state and territory governments introduce equivalent rollover relief from stamp duty (see further discussion below regarding state taxes).

5. Consequential amendments required to ensure existing rules operate as intended

The introduction of new regimes result in requirements to amend other sections of the existing tax law to ensure they interact appropriately with the new law.

As noted above, we have not had the tine to have a comprehensive review of all the tax act provisions. However, we aware there are a number of CGT rollover provisions (such as subdivision 124-N – where a unit trust converts to a company, Division 125 – Demerger relief and subdivision 126-G – Transfers of CGT assets between certain trusts) that apply to trusts only if CGT event E4 is capable of applying to all of the units and interests in the trust. Under the tax ED, CGT event M1 replaces E4 and E10 for all AMITs and CCIVs – as such, without a consequential amendment to the CGT rollover provisions to reflect this change, AMITs will be technically ineligible for these rollovers.

Recommendation: References in the various CGT rollovers for trusts that reference CGT event E4 should be amended to include references to CGT event E10 and M1 as well where appropriate to ensure the rules operate as intended and that CGT rollovers are available for AMITs.

Certain other technical CGT issues in respect of AMIT will also need to be addressed to ensure the correct operation for CCIV. These technical aspects are described below:

Issue	Issue
CGT event E4 and accumulated CGT concession amounts	Under the current law, a trust can distribute the CGT concession amount of a capital gain (and other amounts described in s.104-71) without an adjustment to the cost base of interests in the trust. In private rulings, the ATO has accepted that CGT concession amounts can be retained and distributed in later years without a cost base adjustment. For capital gains arising after an entity becomes an AMIT where there is no change in unitholders, this treatment will be preserved. A capital gain by a trust will result in a cost base increase equal to 100% of the capital gain. However, an Australian resident individual may only be taxed on 50% of the capital gain. The distribution of the capital gain will result in a reduction of the cost base in the interests in the trust. The Australian resident individual will have no net change in cost base and will have received 100% of the capital gain, of which 50% may be untaxed. The existing treatment will not be preserved where: • the capital gain arose before the trust became an AMIT; or • the unitholder was not a member of the trust for the year in which the capital gain arose. In these circumstances, the distribution of the capital gain causes a reduction in the cost base of the units and there is no offsetting increase. The same principle for AMIT should apply to entities that transition to a CCIV. **Recommendation:** The Property Council suggests insertion of a provision along the lines of the former s.104-107E(5). i.e. to include the sum of the discount capital gain and CGT concession components in the AMIT cost base increase amount.
AMIT cost base increase where discount capital gain amounts are less than CGT concession components.	There is an issue with the AMIT cost base provisions where a discounted capital gain is reduced by a revenue deduction (or carried forward loss revenue loss) because the AMIT cost base increase amount in s.104-107E only includes double the discounted capital gain. Where the discounted capital gain (after other deductions) is less than the CGT concession component, this effectively results in the excess of the CGT concession above the discounted capital gain being converted into a deferred capital gain or a current year capital gain if there is insufficient cost base. This is also a problem for chains of trusts, where discount gain components distributed from subsidiary trusts are less than CGT concession components. **Recommendation:** s.104-107E should be amended to insert a provision along the lines of former s.104-107E(5), i.e. to include the sum of the discount capital gain and CGT concession components in the AMIT cost base increase amount.

6. The application of other taxes.

As stated previously in our submission, the introduction of the CCIV regime is intended to broaden the suite of passive investment vehicles available to Australian funds managers and be an internationally recognisable investment vehicle for marketing to foreign investors. Currently however there is insufficient information as to how the Goods and Services Taxes (GST) legislation may apply to CCIVs and sub-funds and how States and Territories intend to apply stamp duty provisions and land taxes in light of the new regime. In particular, without certainty around the ability to access rollover relief existing property funds will not elect to become CCIVs as this would trigger state-based liabilities that otherwise would not exist.

It is critical that Treasury facilitates a coordinated approach to the application of stamp duty and land taxes to support the new regime.

We look forward to working closely with Treasury and ATO to ensure the new regime is an attractive investment vehicle for all types of passive assets, and for both domestic and international investors.

Please contact Eli Braggins (02 9033 1998) or me (02 9033 1929) if you have any queries on our submission.

Yours sincerely

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