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Mr David Hawkins
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By email: CIVreform@treasury.gov.au

Corporate Collective Investment Vehicle Tax Framework
EY Submission

Dear Mr Hawkins

Ernst & Young (EY) welcomes the opportunity to comment on the exposure draft (ED) law for the tax treatment of the proposed corporate collective investment vehicle (CCIV) regime, released for comment on 21 December 2017 (Treasury Laws Amendment (Corporate Collective Investment Vehicle) Bill 2017 (Tax Treatment)).

EY have long been active supporters of and participants in the reform of the asset and funds management industry. These reforms are important as they are intended 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.

We have limited the length of this submission on the ED for the following reasons:

(i) we would like to support the general approach taken and technical concerns raised in the PCA and FSC submissions

(ii) we wish to focus attention on the stated policy objectives of the CCIV regime which we consider are not met in the ED.

As such, we have summarised the technical issues we have identified in a table as an Appendix and a fuller analysis of the majority of these issues can be found in the PCA and FSC submissions.

The CCIV regime contained in the ED is significantly more complex, costly to administer and punitive in nature than both the current MIT and AMIT regimes. It also compares unfavorably against the tax arrangements for competing foreign collective investment vehicle regimes (such as UK OEICs). As such the CCIV framework will not achieve the Government's stated policy objectives without significant change.

This complexity, combined with significant tax risks, materially worse tax outcomes for CCIVs compared to AMITs, as well as the punitive nature of the penalties in the tax ED outweigh any potential benefits of the CCIV regime. These factors will both discourage existing AMITs from rolling over into the CCIV regime and new funds from being set up as CCIVs. This is particularly the case given the potential impacts for both foreign and domestic investors of a CCIV which includes the risk of double taxation if a CCIV fails the eligibility or trading business requirements.

From a foreign investor perspective, the proposed CCIV regime compares unfavourably with the tax rules applicable to competing international vehicles such as UK OEICs, Luxembourg SICAVs and ASEAN Collective Investment Schemes. This is due to the complexity of the widely held test requirements, the potential for tainting the tax treatment of one sub fund by other sub funds of the same CCIV, the complexity of the non-resident withholding tax ("NRWT") system compared to other

ARFP countries as well as the fact that Australia's rates of NRWT are noticeably higher than the equivalent tax rates in other Asian Passport countries.

We recommend that further consultation be undertaken and significant changes be made to the ED before finalisation of the CCIV regime, to ensure that an attractive and internationally competitive vehicle is introduced.

Policy Objectives

It is useful to highlight the Government's stated policy objectives of introducing the CCIV/Asian Regional Passport Regime. That policy intent as stated in the Assistant Treasurer's Press Release of 25 August 2017 and the 2016/17 Federal Budget papers is:

- "to enhance the marketability of Australian managed funds across our region"
- "These vehicles are internationally recognised and easy to use structures that will make managed funds based in Australia a more attractive place for foreigners to invest."
- "Investors in these new CIVs will generally be taxed as if they had invested directly."

We also 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.

Foreign Investor Focus

It is important to keep in mind that the CCIV regime is primarily intended to expand the opportunities to export Australia's funds management expertise particularly to the Asian Passport Countries.

This aim can only be achieved if CCIVs are at least as attractive of those of competing vehicles such as the UK OEICs, Luxembourg SICAVs and the new vehicles currently being established such as the ASEAN Collective Investment Schemes. The proposed CIV framework is clearly not as attractive as any of the foreign competing vehicles or AMITs for the following reasons:

- The imposition of significant penalties for CCIVs which fail to satisfy eligibility or trading business requirements and the risk of cross sub fund tainting such that events relating to one sub fund could taint every other sub fund in the same CCIV
- 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
- The proposed application of the AMIT widely held and closely held tests to foreign investors in CCIVs is of great concern because of both the complexity and uncertainty associated with these rules the difficulty in satisfying the rules in contexts such as in relation to new funds.

The dire consequences to domestic and foreign investors, if a CCIV fails eligibility requirements under either the widely held test or the trading business test are of great concern. On failure to satisfy those requirements, tax is applied at the corporate rate to the whole CCIV similar to a company, however franking credits for tax paid are unable to be attached to distributions. This results in double taxation of the income, at the corporate level and in the hands of the investor upon receipt. In this regard we also understand that dividend withholding tax will apply to the CCIV distributions to non-resident investors.

We understand that no such punitive penalties apply to investors in any of the competing foreign vehicles and the even the remote possibility of such penalties applying would render CCIV unmarketable to foreign investors who require tax and regulatory certainty when investing.

The NRWT issues raised above are not discussed further in detail in this submission but we support the position taken in Attachment 1 to the FSC CCIV submission.

Widely Held Tests

We accept that historically MITs and AMITs have been subject to widely held and closely held tests and are not seeking to change this in relation to domestic investors in CCIVs or AMITs.

However, the need for such tests in relation to foreign investors in CCIVs has not been established.

The nature of these tests is highly complex, subject to uncertainty and they discriminate against foreign investors. Again we note that foreign investors require tax and regulatory certainty when investing and will not invest in a vehicle such as the proposed CCIV which does not clearly offer this certainty, particularly where significant penalties apply for failure to satisfy eligibility tests.

In this regard, we also note that paragraph 1.60 of the ED EM indicates that no foreign investor can hold more than 10% of a CCIV. Given the fact that CCIVs are targeted at foreign retail investors who typically invest via foreign platforms (similar to wrap accounts in Australia) and the platform entity is likely to be treated as a single entity it is expected that the proposed 10% limit will significantly limit the amount of foreign investment into CCIVs.

Given the policy intent for CCIVs to be taxed as if they had invested directly in the underlying assets we do not understand the justification for the proposed CCIV widely and closely held tests as they apply to foreign investors and request that they be reconsidered.

Alternatively, a possible solution to the Government's integrity concerns may be to adopt a very clear principles based approach to widely held tests along the lines of that which currently applies to UK OEICs. The terms of the UK OEIC test require that three conditions be met by funds at all times. These relate to the fund being marketed and made available to sufficiently widely to the intended categories of investor and that the fund documents state the intended categories of investor and that the fund interests will be made widely available and that the fund documents do not have a limiting effect on the type of investor whom may wish to invest in the fund.

The terms of the UK test can be found at
http://www.legislation.gov.uk/uksi/2009/2036/regulation/6/made

We have set out in the Appendix a table of the main technical issues we have identified in the ED.

If you would like to discuss this submission in more detail, would you please contact in the first instance either Antoinette Elias on (02) 8295 6251 or Scott Kilner on (02) 9248 4596.

Yours sincerely

Ernst & Young

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APPENDIX – Technical issues

ISSUE	SUMMARY
CGT rollover relief provisions (s124-855)	Rollover relief is only available for rollovers into new CCIVs not existing CCIVs · Rollover to new entities only is too restrictive and limits use of CCIVs as umbrella funds. Should allow rollovers to existing CCIVs into new sub funds. Scope of relief is too narrow · Does not cover substantial range of other tax characteristics that should also be rolled into the CCIV. Rollover relief should be expanded to include the transfer of AMIT attributes to the CCIV such as: · Capital losses · Gains/losses on non-CGT assets · Tax elections · AMIT unders/overs. State/territory taxes cost is a barrier to use · Federal Government should encourage State/Territory rollover relief to be provided for state stamp duty which otherwise would arise on the transfer of assets.
Eligibility of AMITs who convert to CCIV during the year	Consequential amendments are required to ensure that AMITs transitioning to a CCIV only need to satisfy the AMIT eligibility requirements for the part of the year up to the start of the trust restructuring period. Otherwise it appears that ownership changes to the AMIT on the exchange of interests as part of the rollover itself may result in AMIT status being lost for the year, with adverse impacts on the fund and investors and the rollover then technically not being available (ie if no longer an AMIT).
CGT discount gains (EM para 1.93-1.94)	An ACCIV is not entitled to discount capital gains. The EM proposes that tax character flow through will result in a member who is entitled to discount capital gains being able to apply the discount to the capital gain when working out their taxable income however this outcome appears to be restricted to indirect capital gains of the ACCIV received as part of a distribution from another entity. This approach will not result in the correct tax outcome to a member including where capital gains of the ACCIV are reduced by allowable deductions and carried forward losses (gross capital gain reduced rather than discount amount). The divergence from AMIT treatment will also increase complexity for investors and their administrators and custodians in dealing with a mix of investments in AMITs and CCIVs. The treatment of discount capital gains in an ACCIV should align to that of an AMIT and include discount capital gains at the ACCIV level.
CGT event M1 cost base adjustments (Subdivision 104-M)	Denial of CGT discount treatment at the CCIV level creates inconsistency between AMITs and ACCIVs in CGT cost base adjustment rules. The rules should be aligned.

ISSUE	SUMMARY
	The drafting also retains current AMIT E10 issues · We note that changes announced in July 2017 are still to be developed and they will incorporated in a final M1 · However other issues will remain for AMITs and CCIVs including in relation to the non-recognition of deductions against net capital gains (because proposed s104-620 retains s104-107E approach which includes only double the discount capital gain amount).
Closely held ownership test restrictions (para 276-30(1)(c))	Rules that no foreign investor can hold more than 10% in any sub-fund is inconsistent with AMIT policy and creates risks to the use of CCIVs as umbrella funds. An ACCIV should be tested on a sub-fund by sub-fund basis with the failure of the test in one sub-fund not impacting other sub-funds.
Eligibility – ownership test tracing	The ownership tests should allow tracing of interests through platforms (eg WRAP accounts), specifically the widely-held test with no wholesale membership.
At all times when in existence rule (p267-20(1)(a))	Practically it will be difficult to meet the requirement in ss276-20(1)(a) to be a corporate collective investment at all times when the entity is in existence during the year the CCIV is established, as there will likely to be a period of time between the incorporation of the company and its registration as a CCIV. A modified first year test is needed.
Non-resident withholding tax (NRWT)	Single withholding rate needed · Current complexity of NRWT means possible tax consequences to foreign investors cannot be explained in a simple manner. As a result the NRWT is not globally competitive, and will become less so as other countries reduce their NRWT over time. · A single flat rate of withholding should apply to distributions of all taxable income from an AIV. Treaty interactions · Treasury should address how CCIV entities are treated and qualify for relief under Australia's double tax treaties
Unders/overs failure to take reasonable care penalties (TAA ss288-115(3) table)	Introduces penalty for attribution 'unders and overs' that results from lack of reasonable care. This is inconsistent with AMIT policy. It is inappropriate to change the policy as no evidence has been provided that there is substantial issue with 'unders and overs' to support this change. Introduces new uncertainty especially until ATO guidance is released and increases risks from adopting CCIV. The penalty should not be introduced.
Trading business restrictions – 2% safe harbour (ss276-35(2))	While the 2% rules appear to be a safe harbour to mirror s102MC ITAA1936, the note to the section states that any single sub fund breach of this safe harbour rule will result in the ACCIV failing the test.

ISSUE	SUMMARY
	This outcome is inconsistent with AMIT policy and creates uncertainty and increases risks from adopting CCIV. Separate sub fund taxation approach is needed so that a failure in one fund does not impact other sub funds. Alternatively, s102MC could be amended to refer to "entities" in order to extend that safe harbour to CCIVs on an entity basis. We also note that Div 6c reforms are still required to deliver a complete package of attractive investment vehicles with reduced complexity.
Non-arm's length income (subdivision 276-GA)	Proposed new non-arm's length rule should only apply if at least one of the parties to the scheme is neither an AIV (AMIT/ACCIV) nor a MIT. This discourages transactions between MITs and AIVs. MITs should be treated as an equivalent passive investment vehicle for this rule and the arm's length rules should be amended to apply this rule equally to AIVs and MITs.
ACCIV loss recoupment	It is inconsistent that the company loss recoupment rules apply to an ACCIV while AMITs have no recoupment rules for deducting capital losses applying Schedule 2F of the ITAA 1936. Further the implications from the range of company loss recoupment integrity rules prima facie applying to ACCIVs should be examined. CCIV loss recoupment rules should mirror those applicable to AMITs and not incorporate additional company loss recoupment rules.
AMITs impact from introduction of AIV drafting	We note the various law updates to introduce the new AIV terminology may require: · AMITs to update various documents including potentially product disclosure statements and marketing material · The ATO to update its guidance material issued in respect of AMITs. Treasury should review whether the AIV terminology is a necessary abbreviation compared to merely including that particular provisions apply to both AMITs and ACCIVs.
CCIV tax administration	Clarification is needed on how income tax returns, GST calculations, BAS returns and third party reports will be completed – ie at CCIV level or sub-fund level? Consistency of approach is preferred.