

FEBRUARY 2019

TECHNICAL UPDATE



AUSTRALIA TO ALLOW FLOW-THROUGH TAXATION FOR CORPORATE COLLECTIVE INVESTMENT VEHICLES

THE AUSTRALIAN GOVERNMENT HAS RELEASED DRAFT LAW THAT WILL INTRODUCE A NEW CORPORATE STRUCTURE CALLED CORPORATE COLLECTIVE INVESTMENT VEHICLES (CCIV). IT WILL ALSO PROVIDE FOR TAX TREATMENT OF CCIVS THAT BROADLY ALIGNS WITH THE EXISTING TREATMENT OF ATTRIBUTION MANAGED INVESTMENT TRUSTS (AMIT). IT AIMS TO PROVIDE INVESTORS WITH THE BENEFITS OF FLOW-THROUGH TAXATION AND ESTABLISH THE CCIV TO BECOME AUSTRALIA'S MODERN GLOBALLY COMPETITIVE INVESTMENT VEHICLE FOR DOMESTIC AND FOREIGN INVESTORS.

NEW DRAFT LAW

On 17 January 2019 the Australian Government released for public consultation two [bills](#) (draft law) that implement the tax and regulatory components of the CCIV regime. The draft law proposes a 'character flow-through' basis so investors benefit from flow-through taxation. Amounts of assessable income, exempt income, non-assessable non-exempt income and tax offsets received by the CCIV, and having a particular character, are to be attributed to members and generally not taxed to the CCIV. Those amounts will retain that character and be taxed in the hands of each member.

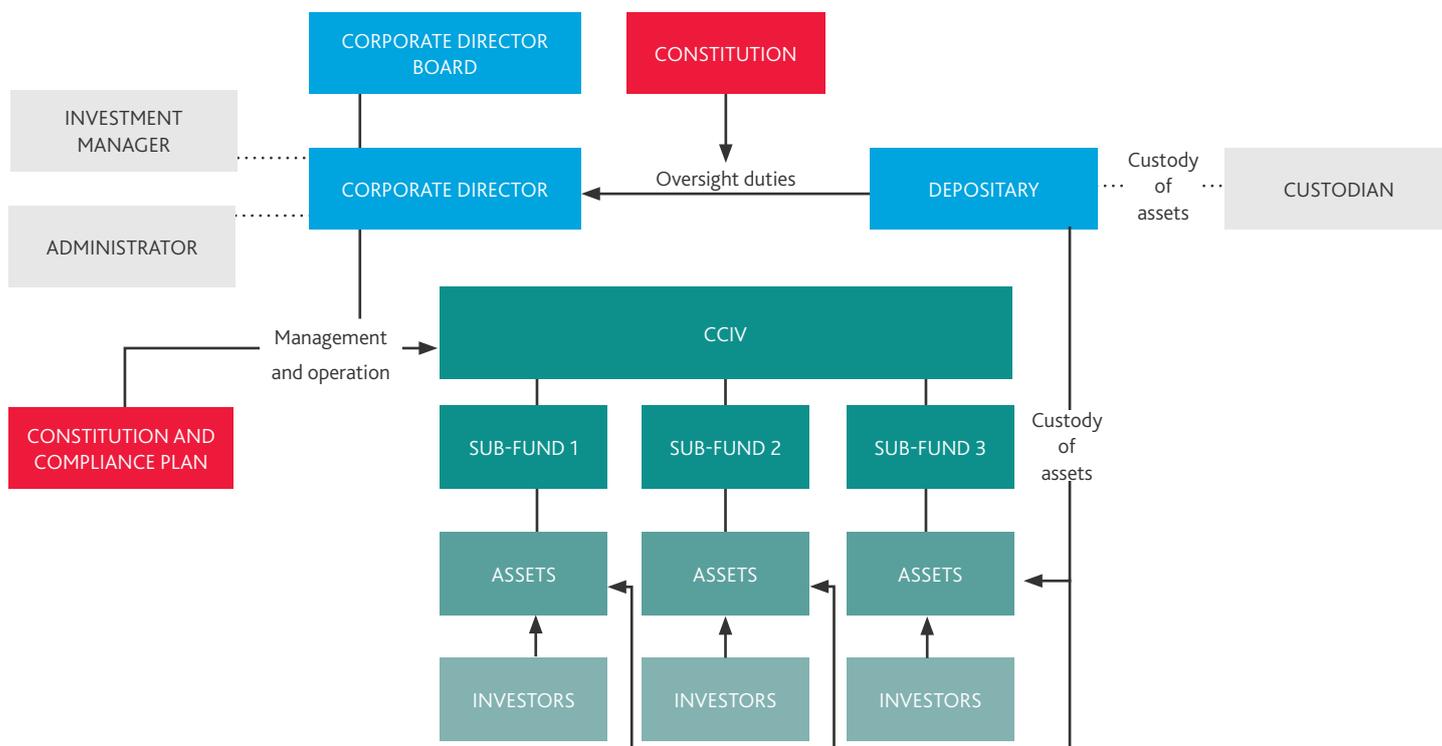
CORPORATE COLLECTIVE INVESTMENT VEHICLES

The CCIV is a new form of passive investment vehicle, intended to broaden the suite of investment vehicles available to Australian fund managers and be an internationally recognisable investment vehicle that can be marketed to foreign investors. A CCIV has a corporate structure, with the additional consumer protection of an independent depository for retail funds, that is responsible for the oversight of certain administrative functions undertaken by the fund which offers multiple products and investment strategies within the one corporate vehicle. The CCIV tax regime is based on an attribution system of tax and complements the existing Attribution Managed Investment Trust (AMIT) tax regime with CCIVs subject to similar eligibility criteria as AMITs, such as being widely-held and not closely-held, limited to passive income activities and being an Australian resident.

A CCIV can break up its assets between sub funds with different investors having differing entitlements to one or more of the sub funds. Each sub fund will be treated as a separate entity for tax purposes. The sub funds that satisfy the eligibility requirements for attribution will generally not be taxed on the income or gains of the sub fund. However, a sub-fund that does not satisfy the eligibility requirements for attribution will be subject to tax at the top corporate tax rate.

The CCIV investment vehicle is intended to increase the competitiveness of Australia's export funds management industry and attract foreign investment, but without refinement may receive unfavourable tax treatment as compared to MITs, resulting in an underutilisation of the regime.

PROPOSED REGULATORY MODEL



Source: Asia Region Funds Passport and Corporate Collective Investment Vehicle Exposure Draft Law (25 August 2017).

CHANGES IN DETAIL

Attribution sub-fund requirements

A sub-fund of a CCIV that satisfies the attribution requirements will be referred to as an attribution sub fund (ASF) and will have access to an attribution or 'character flow-through' model of taxation. A sub-fund will be an ASF if:

- ▶ The sub-fund satisfies the widely held requirements and closely held restrictions in relation to the income year (or the alternative test);
- ▶ The sub-fund satisfies the trading business restrictions;
- ▶ The CCIV is an Australian resident during the whole of the income year; and
- ▶ The sub-fund is not an excluded sub-fund (i.e. a sub-fund that did not become a ASF within its first year of existence or a sub-fund that has previously ceased to be an ASF).

However, if a sub-fund fails the ASF requirements due to temporary circumstances outside the control of the CCIV, the sub-fund can continue to be treated as an ASF in relation to the income year if it is fair and reasonable to do so.

Under the attribution model, an ASF of a CCIV has the following features:

- ▶ For income tax purposes, the CCIV is able to attribute amounts of assessable income, exempt income, non-assessable non-exempt income and tax offsets to members of the ASF on a fair and reasonable basis;
- ▶ If the CCIV discovers a variance between the amounts actually attributed to members of an ASF for an income year, and the amounts that should have been attributed, the CCIV can reconcile the variance in the year that it is discovered by using the 'unders' and 'overs' regime; and
- ▶ Where an ASF has separate classes of membership interests and certain criteria are met, the CCIV may elect to treat those classes as separate ASFs for the purposes of applying the attribution rules.

Withholding tax treatment

The Australian withholding tax provisions will apply to CCIVs and their members in the same way that they apply to AMITs and their beneficiaries. Withholding tax will generally apply to Australian source income and capital gains on Taxable Australian Property that are attributed to non-Australian resident members of the CCIV. The withholding tax rate will depend on the types of income attributed to the sub-fund members and the relevant double tax treaty (if applicable).

Restructure roll-over relief

A key aspect of the CCIV regime is the ability for existing AMITs to 'convert' into CCIVs, so that fund managers can simplify their existing structures through the conversion of existing funds into a CCIV. The tax rollover provisions to facilitate conversion apply not only for the purposes of capital gains tax (CGT) consequences, but also revenue assets and tax losses. The rollover relief requires a rollover from a single AMIT into a single CCIV sub-fund with each investor holding membership interests (shares) in the CCIV referable to the ASF *in the same proportion* as it owned membership interests in the AMIT. The rollover also does not allow for rollover from other entities such as listed investment companies.

Failure of ASF requirements

Where a sub-fund fails to satisfy the ASF requirements that does not fit into the temporary circumstances mentioned above, it will be taxed under the default tax rules at the top corporate tax rate and not permitted to frank distributions to members as it is not a franking entity (franked dividends provide a tax credit for Australian resident shareholders and tax exemption for non-resident shareholders). This could be a disastrous result as the investors could also be taxed on distributions received without credit for the tax paid by the sub-fund. However, there is CGT roll-over relief available to facilitate an excluded sub-fund to restructure into a new company that is not a CCIV and therefore become entitled to frank its distributions.

Character flow-through' model

The 'character flow-through' CCIV model ensures that amounts derived or received by the CCIV that are attributed to members, retain the character they had in the hands of the CCIV for income tax purposes. Therefore, amounts derived or received by the CCIV referable to an ASF that are attributed to members will retain their original character and will not be treated as a dividend unless the amount had the character of a dividend when it was derived by the CCIV. The distributions will also not be treated as dividends for Australia's Double Tax Treaties with other countries (unless they have the underlying character of a dividend).

SOME ISSUES RESOLVED WHILST OTHERS REMAIN

Sub-fund 'contagion'

One of the key concerns raised in consultation on previous draft law was the risk of 'sub-fund contagion' due to the conduct in one sub-fund effecting the tax status of another sub-fund. This has been addressed in the latest draft law which deals with these concerns by treating each sub-fund as a separate taxpayer. For example, a sub-fund undertaking a trading business and accordingly being taxed under the default tax rules will not alter the tax status of other sub-funds. However, this means that the preconditions which must be satisfied in order to be a qualifying sub-fund (such as widely held and closely held tests) must be satisfied independently for each sub-fund.

Unders and overs

The draft law has retained the contentious administrative penalty imposed on trustees of an AMIT if there is an 'under' or an 'over' for the base year which resulted from intentional disregard or recklessness of the law by the trustee (which applies to attribution in both CCIVs and AMITs). BDO anticipate that this issue will continue to be raised during consultation, particularly in relation to its application to existing AMITs.

BDO COMMENT

Legislation on CCIVs was first foreshadowed more than a decade ago in the 2009 Johnson Report and the Board of Taxation's report on tax arrangements applying to CIVs, which recognised that foreign investors are dissuaded from investing in Australian funds because they do not understand unit trusts, and that access to a broader range of CIVs would help Australian fund managers to compete for capital with their offshore counterparts. The introduction of CCIVs will finally deal with these issues.

CCIVs also underpin the Asia Region Funds Passport legislation, which passed both houses of Federal Parliament in June 2018 and aim to enhance the competitiveness of Australia's funds management industry, expanding the range of options for Australian investors and attracting foreign investors by enabling Australia to export its management products to countries participating in the Asia Region Funds Passport Regime, which include Japan, Korea, New Zealand and Thailand.

BDO note that whilst attractive from a commercial aspect, there are still concerns associated with the proposed CCIV regime including the stricter treatment of sub funds as compared to MITs. If a sub fund fails the ASF rules, which include certain 'passive tests' similar to the public trading trust rules, it will permanently be treated as a company for income tax purposes as well as deprived of franking credits, resulting in double taxation to investors unless it can utilise the CGT rollover to be a normal company and then be able to frank dividends. While this CGT rollover is welcome there may be a number of practical, commercial and stamp duty issue associated with the rollover of property into the new company. Consultation is currently underway in Australia on the draft law, with submissions due on 28 February 2019 although with Australian Parliament having only resumed on 12 February 2019 and with an Australian Federal Election due by mid-May 2019, there could be delays with the introduction of the CCIV legislation into Parliament.



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