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# ***Corporate Collective Investment Vehicle - exposure draft law***

*18 January 2018*

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## ***In brief***

Late last year, the Government released exposure draft legislation for comment in relation to the tax treatment proposed for the new Corporate Collective Investment Vehicle (CCIV). This follows the earlier release of draft legislation dealing with the regulatory framework proposed to apply to CCIVs.

The package of legislation governing CCIVs was first foreshadowed in the 2016-2017 Budget, where the Government announced proposals for two new Corporate Investment Vehicles (CIVs), the CCIV and a limited partnership CIV. The new CIVs were designed to be internationally recognised vehicles to attract foreign investors including under the Asia Region Funds Passport. Broadly, the proposed tax treatment of CIVs aligns with the current tax arrangements for Attribution Managed Investment Trusts (AMITs), but there are some important differences to be noted.

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## ***In detail***

The new rules, released in exposure draft form on 21 December 2017, propose a new group of attribution entities referred to as an Attribution Investment Vehicle (AIV) which is defined to include both an AMIT and an Attribution CCIV (ACCIV). When introduced, the legislation will presumably also cover attribution limited partnerships. Amendments will be made to the AMIT provisions to incorporate the new terminology, which will effectively replicate most of the current AMIT features into the new ACCIV.

## ***Observations***

### *Equivalence with domestic vehicles*

The new CIVs that are proposed seek to provide Australian fund managers with vehicles that will be more readily capable of being marketed in Asia. This presents a challenge for Australia, as local industry will now also need to take into account domestic investors seeking to invest in domestic assets. Consequently, these new CIVs also need to strike a point of equivalence with existing domestic vehicles, in particular, the Managed Investment trust (MIT)/AMIT regime. The table below summarises some of the points of equivalence.

Under the proposed rules, there are two main areas where it is anticipated equivalence with other domestic vehicles will require attention. The first area is the regulatory requirement for a depository, and the second is the application of company taxation where a CCIV fails to qualify as an ACCIV.

### *Equivalence with international vehicles*

The need for flow through taxation treatment and retention of the character of tax components, which are essential for Australian investors to obtain the benefit of franking and foreign income tax offsets as well as discount capital gains treatment, may be seen as a point of competitive advantage over foreign corporate vehicles that do not feature character flow through treatment i.e. where distributions are dividends for income tax purposes. It remains to be seen how foreign markets will respond to this difference in competitive advantage.

### *Withholding taxes and non-Australian investors*

There has been some conjecture as to whether an ACCIV regime would feature reduced withholding taxes for foreign investors. The reality is that many ACCIVs will make distributions that largely do not attract any Australian withholding taxes. For example, franked dividends, widely held interest bearing debentures and non-taxable Australian property capital gains do not attract withholding tax.

### **Key features of an ACCIV**

| <b><i>Proposed feature</i></b>  | <b><i>Observations</i></b>   |
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| <p><b><i>Qualification requirements of an ACCIV</i></b></p> <p>A CCIV (being a registered company under the Corporations Act that satisfies certain regulatory requirements) will be an ACCIV and have access to 'flow-through' tax treatment if:</p> <ul style="list-style-type: none"><li>• At all times during the income year it is a CCIV.</li><li>• Each sub-fund of the CCIV satisfies the widely held and closely held requirements.</li><li>• The CCIV does not breach the trading restrictions.</li><li>• Either the corporate director has elected into the ACCIV regime or the entity was an ACCIV from an earlier income year.</li></ul> | <p>In substance, for tax purposes, an ACCIV will replicate most of the features of an AMIT, except that it is in corporate form (and subject to the Corporations Act). The intent is that foreign investors will be more familiar with a corporate vehicle rather than a unit trust.</p> <p>The requirement that each sub-fund of the CCIV must satisfy the widely held and closely held test in order for the CCIV to qualify as an ACCIV may be a reason to have multiple CCIVs rather than a single CCIV with multiple sub-funds.</p>             |
| <p><b><i>Like for like</i></b></p> <p>Each sub-fund of a CCIV can be referenced to an AMIT.</p>   | <p>An AMIT may be constituted as a multiclass entity where each class of an AMIT may be elected for treatment as a separate AMIT. Likewise, a sub-fund of a CCIV may be constituted as a multiclass sub-fund, where each class may be elected for treatment as a separate ACCIV.</p>   |
| <p><b><i>Attribution of amounts</i></b></p> <p>An ACCIV will be able to attribute amounts of assessable income, exempt income, non-assessable non-exempt income and tax offsets to members on a fair and reasonable basis.</p> <p>Amounts attributed by the ACCIV to members retain their character and, therefore, will not be treated as a normal dividend from a company.</p>  | <p>An ACCIV will be required to issue an AIV member annual statement, setting out the amounts attributed within three months after year end. Although these procedures for ACCIVs are the same for AMITs, it is worth questioning whether operationally, ACCIVs will want to adopt the same tight year-end timelines for the issue of annual statements to investors as AMITs. For these new vehicles, it is worth considering whether there is an opportunity to set market expectations regarding distributions and mitigate operational risk.</p> |

| <b><i>Proposed feature</i></b>   | <b><i>Observations</i></b>   |
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| <p><b><i>'Unders' and 'overs'</i></b></p> <p>ACCIVs are able to apply the 'unders' and 'overs' provisions to reconcile variances (i.e. difference between component amounts actually attributed to members and component amounts based upon the latest available information rather than having to amend member annual statements).</p>  | <p>The distribution process for ACCIVs, as noted above, should be considered in order to mitigate 'unders' and 'overs'. Refer comments below for the penalty regime related to 'unders' and 'overs'</p>  |
| <p><b><i>Transfers between sub-funds</i></b></p> <p>Transfer of assets between sub-funds of an ACCIV will be recognised as a realisation for certain tax purposes. That is, the ACCIV is taken to have sold the asset for an amount equal to its market value immediately before the transfer, and taken to have re-acquired the asset at the time of the transfer for an amount of consideration equal to the market value.</p> | <p>These rules are analogous to the segregation rules for life companies. Therefore, if asset transfers are contemplated, from an administration perspective and depending on custodian systems, it may be preferable to transfer cash rather than track 'disposed' assets in different sub-funds.</p> |
| <p><b><i>Multi-class election</i></b></p> <p>The corporate director can elect that each sub-fund of an ACCIV be treated as a separate ACCIV if certain criteria are met.</p> <p>Each sub-fund must meet the widely held and closely held tests. If one sub-fund does not meet the requirements, the CCIV will not satisfy the ACCIV general test.</p>  | <p>The ability to make a multi-class election mirrors the rules for AMITs. Importantly, in order to maintain the ACCIV status of the entire entity, each sub-fund must satisfy the relevant requirements.</p>  |
| <p><b><i>Deemed capital account treatment</i></b></p> <p>An ACCIV can elect to apply the capital gains tax (CGT) provision to gains and losses on the disposal of certain assets. The election must be made in the first year the CCIV qualifies as an ACCIV and is irrevocable. If the ACCIV does not make an election, revenue account treatment applies.</p>  | <p>These rules replicate the existing election available for MITs</p>  |
| <p><b><i>Discount capital gains not applicable</i></b></p> <p>An ACCIV is not entitled to discount capital gains consistent with the treatment for companies. However, under the character flow through treatment, if an ACCIV receives an amount which qualifies as a discount capital gain, the benefit of the discount can be passed on to investors.</p>   | <p>The ability to flow through discount capital gains is equivalent to the treatment for AMITs.</p>  |
| <p><b><i>New CGT event M1</i></b></p> <p>The proposed amendments introduce a new event, CGT event M1 for both ACCIVs and AMITs, replacing CGT event E10 (which currently applies to AMITs). This reflects the principle that adjustments to the cost base (either upwards or downwards) where broadly,</p>   | <p>The requirement to track cost base adjustments may be a challenge operationally for ACCIVs and AMITs alike. CGT event M1 which covers AIVs is essentially the same as the current CGT event E10.</p>  |

| <b><i>Proposed feature</i></b>   | <b><i>Observations</i></b>  |
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| distributions differ from attributed amounts in respect of an income year.   |   |
| <p><b><i>Liability to pay tax</i></b></p> <p>The ACCIV is generally not subject to tax unless certain circumstances arise such as where assessable income is not attributed to members, or where the ACCIV is not a withholding ACCIV and an amount is attributed to a foreign resident.</p>   | Unlike the AMIT rules, it is the ACCIV which is potentially liable to tax in such circumstances rather than the trustee of the AMIT.  |
| <p><b><i>Withholding tax</i></b></p> <p>The proposed amendments ensure that withholding tax replicates the AMIT attribution model. In order to be a 'withholding ACCIV' and therefore qualify for the concessional withholding rate of 15 per cent paid to members located in Information Exchange Countries, the 'investment management activities requirement applies to each sub-fund of the ACCIV.</p>   | Operators of ACCIV should be aware that if a substantial portion of investment management activity relating to certain Australian assets for each sub-fund is not conducted in Australia, the concessional withholding ACCIV status is compromised.   |
| <p><b><i>Administrative penalties</i></b></p> <p>Administrative penalties have also been introduced for ACCIVs which apply to the corporate director for 'unders' and 'overs' resulting from intentional disregard of a taxation law, recklessness and failure to take reasonable care.</p>  | Similar to AMITs, ACCIVs will need to ensure there are robust processes and procedures in place around the management of 'unders' and 'overs'.  |
| <p><b><i>CGT rollover relief on transition</i></b></p> <p>CGT rollover relief has been provided to allow AMITs to transition into an ACCIV provided certain requirements are met. The relief applies at both the AMIT level and member level such that any capital gain or loss is disregarded and the original cost base of the asset is preserved. There is also an ability for CGT relief to apply to multiple AMITs restructuring into an ACCIV with multiple sub-funds.</p> | Managers may find it more attractive to use these rollover provisions to transition an established AMIT into an ACCIV in order to market their fund offshore under the Asia Region Funds Passport, rather than establishing a new product, knowing that the widely held and closely held tests are already met. However, this will also mean that the manager will need to ensure that the relevant infrastructure is in place to support the CCIV under the regulatory requirements (i.e. corporate director and independent depositary), which was not required whilst the product was an AMIT. |
| <p><b><i>Failure to qualify as an ACCIV</i></b></p> <p>A CCIV which does not qualify as an ACCIV is subject to tax at the corporate rate and is not able to distribute franked dividends to its members.</p>   | This rule is designed to discourage operators from setting up CCIVs without the intention of being an ACCIV. The draft Explanatory Memorandum also states that a CCIV must deregister from being a CCIV if it does not elect into the regime or fails to meet the eligibility requirements of being an ACCIV. This could have catastrophic implications where the CCIV or a sub-fund subsequently does not meet the relevant criteria such as the widely held and closely held tests.   |
| <p><b><i>Tax consolidation</i></b></p> <p>An ACCIV cannot be part of a tax consolidated group.</p>   | This is consistent with AMITs being excluded from a tax consolidated group.   |

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## ***The takeaway***

The success of the ACCIV will depend on how the industry embraces the new CCIV structure (and in particular, some of the new regulatory requirements), and the acceptance of a new corporate vehicle by foreign investors under the Asia Region Funds Passport regime. Foreign investors will still need to understand the various attributed components in the new AIV member annual statement, and the corresponding withholding tax that could apply to certain Australian sourced income. A lot will depend on how the CCIV is marketed and promoted in the region by fund operators, industry bodies and the Australian Government.

On 5 January 2018, the Asia Region Funds Passport Joint Committee called for expressions of interest for participation in a Pilot Program for the Passport. This Program will be a litmus test as to the acceptability of the CCIV in the region and whether there are any barriers to entry.

## ***Let's talk***

For a deeper discussion of how these issues might affect your business, please contact:

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