CORPORATE CIVS: INDIRECT TAX CONSIDERATIONS

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On 25 August 2017, the Government released exposure draft legislation for both the Asia Region Funds Passport (**Passport**) and the proposed Corporate Collective Investment Vehicle (**CCIV**) – reported at 2017 WTB 36 [1262]. These are important initiatives for the Australian funds management industry. CCIVs may, over time, replace alternative collective investment structures such as AMITs in Australia.

This article discusses the indirect tax issues that will need to be considered if the proposed CCIV laws are enacted. Comments on the draft legislation are due by 21 September 2017.

CONTEXT

The Passport is intended to support the creation of an Asia-wide funds management industry. This is achieved through greater market access and increased harmonisation of regulations across member countries. Once the Passport is fully established, eligible funds can be marketed across member countries, with only limited additional regulatory requirements in each country.

At the same time, the Government proposes introducing CCIVs as a new form of collective investment vehicle to achieve three aims, being:

- to provide a corporate based investment vehicle that is more internationally recognised than Australia's existing managed investment schemes (which are trust based)
- to provide "flow-through" tax treatment
- maintain investor protection.

The establishment of a CCIV regime also supports the introduction of the Passport, as it provides a new investment vehicle that is compliant with the Passport requirements. The CCIV is modelled on European-style corporate investment vehicles which are already popular in some parts of Asia.

In respect of taxation, the Explanatory Memorandum for the exposure draft bill states (paragraph 1.21):

"The taxation arrangements applying to Attribution Managed Investment Trusts (AMITs) will be extended to CCIVs, subject to meeting certain eligibility criteria. Exposure draft legislation addressing the taxation treatment of CCIVs will be released at a later date.

While there is currently no further publicly available guidance on how the income tax rules will apply to CCIVs in practice, it is clear that the policy intention is for CCIVs to be flow-through tax vehicles consistent with AMITs.

There is presently no publicly available information on how indirect tax laws may apply to CCIVs, but such issues will also need to be considered and worked through.

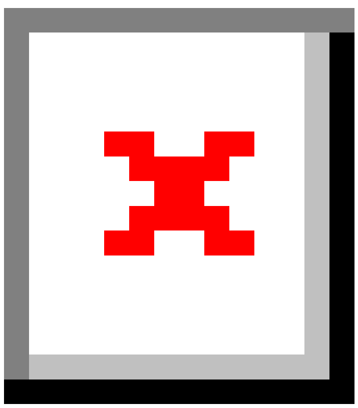
WHAT ARE THE FEATURES OF A CCIV?

In high level terms, based on the exposure draft legislation, a CCIV will have the following features:

- A CCIV will be a new form of company under the Corporations Act. It will be a legal entity (unlike a partnership or trust).
- Each new CCIV must be registered with ASIC.
- A CCIV must have a "Corporate Director" which is a public company. A CCIV cannot have any officers or employees. This is intended to ensure that a CCIV cannot operate a business and only undertakes passive investment activities.
- All CCIVs must have a constitution. For retail CCIVs, the constitution must include certain provisions aimed at protecting investors. Wholesale CCIVs will not mandatorily need to include those same provisions in their constitutions.
- A retail CCIV must appoint an independent third party to the role of "Depositary". The role of the Depositary has three aspects, being:
  - To hold the assets of the CCIV on trust.
  - To deal with the assets held on trust on instructions and as directed by the Corporate Director.
  - To supervise the conduct of certain functions of the Corporate Director for the protection of investors (including in relation to dealings in shares of the CCIV, valuation of CCIV shares, allocation of assets and liabilities to sub-funds and allocation of income of the CCIV).
- The Depositary may delegate the holding of the assets to an agent or custodian. However, the supervisory responsibilities cannot be delegated.
- A wholesale CCIV is not required to appoint a Depositary, but may choose to do so. If a wholesale CCIV appoints a traditional "custodian" to hold assets, that entity will not be a Depositary.
- Retail CCIVs are also required to have a compliance plan which must be periodically reviewed and audited annually. This is not a mandatory requirement for a wholesale CCIV.
- Each CCIV must have at least one sub-fund. All CCIV activities must be conducted via a sub-fund.
- The shares in the CCIV must relate solely to one sub-fund. However, for each sub-fund, there may be multiple classes of shares. For example, a CCIV may issue both Class A and Class B shares that relate to "Sub-Fund A". Neither the Class A or Class B shares can relate to any other Sub-Fund.
- The sub-funds are not separate legal entities. The sub-funds are similar to "statutory funds" maintained by life insurance companies. ASIC must be informed when a sub-fund is established, but the sub-fund will not be registered.
- All assets and liabilities of the CCIV must be allocated to a sub-fund. There cannot be any unallocated assets or liabilities.

- Two or more sub-funds cannot jointly own a single asset (for example, jointly own a parcel of land). However, multiple sub-funds can separately invest into a trust or other investment structure that owns a single asset (for example, through each sub-fund separately acquiring units in a trust that holds a parcel of land).
- Some or all of the shares issued by the CCIV may be redeemable in accordance with the terms of issue.

The following diagram is extracted from the exposure draft Explanatory Memorandum. It shows the regulatory framework for a retail CCIV (note the reduced regulatory requirements for wholesale CCIVs as outlined above).



GST CONSIDERATIONS

At a Federal level, the main indirect tax considerations will relate to GST.

"Entity" definition

The concept of an "entity" is important in a GST context, as it is an entity that must pay any applicable GST and which is entitled to any available input tax credits (GST credits). The concept extends beyond legal entities and applies to partnerships, trusts and government agencies (amongst others).

The GST Act already defines an "entity" to include a "body corporate" - s 184-1(1)(c). As a CCIV will be a new form of company, a CCIV should qualify as an "entity" as that term is currently defined.
However, there is an issue as to whether each sub-fund within the CCIV (rather than the CCIV) should be treated as a separate entity for GST purposes, noting the sub-funds form a part of the CCIV and are not separate legal

entities. This would require an amendment to the "entity" definition in the GST Act to both recognise each sub-fund as an entity for GST purposes, while also excluding a CCIV from being an "entity" for GST purposes.

In a life insurance context, a "statutory fund" is not treated as a separate entity from the life insurance company for GST purposes. A difference in a CCIV context is that investors will have direct investment exposure to the assets and liabilities of a particular sub-fund based on holding shares referable to that particular sub-fund only. Treating each sub-fund as a separate entity may assist in quarantining GST liabilities and provide more options for GST grouping as discussed further below.

In the United Kingdom, a similar vehicle to the proposed CCIV is known as a "Protected Cell Company" (**PCC**). Each sub-fund of the PCC is a "protected cell", which is not a separate legal entity. Protected cells are also not treated as a separate entity for UK VAT (GST) purposes. However, a key difference between the Australian GST regime and the UK VAT regime is that in Australia, all services supplied to a CCIV by a GST registered business will be taxable and subject to GST, giving rise to input tax credit recovery issues as discussed below. In contrast, management services supplied to collective investment vehicles are exempt and not subject to VAT in the UK.

Can A CCIV Register for GST Purposes?

A CCIV (or sub-fund, if a separate entity) will need to be registered for GST purposes if it intends to claim input tax credits for GST incurred on costs. This will be important given that the CCIV will not have officers or staff and all functions will be outsourced to third parties, including the Corporate Director and Depositary, for a fee.

To be eligible to register for GST purposes, the GST Act requires that an entity must first "carry on an enterprise" - s 23-10(1).

Generally the Commissioner's view is that passive holding entities, including both companies and trusts, do not carry on an enterprise and hence cannot register (refer Miscellaneous Tax Ruling MT 2006/1 and GST Determination GSTD 2006/6). This is an issue given CCIVs are only intended to make passive investments.

However, if an entity must comply with regulatory requirements, the Commissioner may accept that those regulatory obligations involve sufficient "business-like" activities to satisfy the enterprise tests. The Commissioner's views on these issues in an MIS context are set out in an interpretative decision, ATO ID 2007/7. The decision confirms that a public unit trust which is a MIS carries on an "enterprise" for GST purposes, albeit the MIS may only make passive investments.

It would seem reasonable to expect that the same position would be adopted in respect of CCIVs which will be established in a business-like manner and which must also comply with regulatory requirements, albeit CCIVs will be limited to passive investments.

Nonetheless, to provide certainty from the outset, and avoid the need for the Commissioner to rule on this issue, the "enterprise" provisions in the GST Act could be amended to specifically include any activities undertaken by a CCIV or sub-fund (as the case may be). This would be consistent with the way in which the "enterprise" definition currently applies to any activity of a charity or government agency.

It should be noted that if sub-funds are treated as a separate entity for GST purposes, any "enterprise" will be carried on via those sub-funds. This is because all investment activities must occur via a sub-fund. While it may be the case that it is the CCIV which needs to satisfy all regulatory requirements, the costs of complying with those requirements will be allocated across each of the sub-funds. This would be another reason to exclude a CCIV from being an "entity" for GST purposes if each sub-fund is recognised as an "entity".

Applicable Rate For Reduced Input Tax Credits (RITCs)

RITCs are available to entities that make "financial supplies" for GST purposes and which are not otherwise entitled to full credits on associated costs.

For a "recognised trust scheme", the RITC rate is generally 55% (and up to 75% for some costs). Recognised trust schemes can claim RITCs on a broad range of costs including, for example, legal services.

In contrast, corporate entities are eligible for RITCs at the higher rate of 75%. However, the range of costs that qualify for RITCs is much narrower and does not typically include legal services, for example.

Assuming a CCIV (or sub-fund) is eligible to register for GST purposes and claim credits, consideration will need to be given to whether the rules relating to "recognised trust schemes" should be extended and apply to CCIVs or sub-funds on the same basis.

In practice, the importance of this issue may turn on whether costs are incurred directly by the CCIV, or whether costs may instead initially be incurred by the Corporate Director and are then recharged to the CCIV as a component of the fees for services provided. If it is expected that all costs will be "bundled" into the Corporate Director fees, and a RITC is available for Corporate Director services, then the availability of RITCs for other acquisitions may become less relevant.

Extending RITC provisions to cover Corporate Director and Depositary services

In a funds management context, the existing RITC provisions expressly apply to trustee, responsible entity and custodian services (amongst other investment management and fund administration services).

To ensure that RITCs are available for all services that must be acquired by a CCIV, it may be necessary to amend the RITC provisions to expressly cover services supplied by a Corporate Director, Depositary and compliance plan auditor (noting that only a retail CCIV will need to acquire all of these services).

GST grouping

Related entities may be able to establish a GST group, which is viewed as a single entity for GST purposes. Intra-GST group supplies between group members are ignored for GST purposes.

The GST grouping rules contain specific provisions relating to the inclusion of a company within a group. If a CCIV is treated as an entity for GST purposes (and the sub-funds are not recognised as entities), those existing company rules may potentially apply where a CCIV (via an investment through a sub-fund) is considered to be a holding company that has at least a 90% stake in a subsidiary company or holds the units in a subsidiary trust.

However, there will be a number of GST grouping related issues to consider if a CCIV is treated as an entity, including:

- The allocation of the joint and several GST liabilities that will arise for the CCIV as a consequence of being grouped for GST purposes.
- The ability of a CCIV to establish a GST group that includes subsidiary entities of different sub-funds.

For example, assume that a CCIV has Sub-Fund A and Sub-Fund B. Sub-Fund A owns 100% of the shares in A Ltd and Sub-Fund B owns 100% of the shares in B Ltd. Can the CCIV establish a GST group that includes the CCIV, A Ltd and B Ltd? This would create joint and several liabilities for the three entities (although an indirect tax sharing agreement could assist with this).

If alternatively each sub-fund is treated as a separate entity for GST purposes, and the CCIV is ignored, this may simplify GST grouping considerations. Each sub-fund could be separately grouped (or not) with its own subsidiaries as appropriate, with any joint and several liability being quarantined to the specific sub-fund. This would likely mean that different subsidiary entities of the CCIV, held in different sub-funds, could not be grouped.

Continuing the same example above, this would mean that Sub-Fund A could form a GST group with A Ltd. Any joint and several liability is quarantined to Sub-Fund A. B Ltd would not be able to join that GST group.

It is noted that AMITs can currently be GST grouped with qualifying subsidiary entities. Usually the only reason for doing so is that the GST group is viewed as a single entity for credit recovery purposes, which may increase the level of credits available to the AMIT (if the AMIT otherwise exceeds the financial acquisitions threshold). This is generally only relevant where the subsidiary entity carries on an enterprise that predominantly makes taxable or GST-free supplies. These same considerations may arise for CCIVs or sub-funds.

What exposure does a Corporate Director have for GST liabilities of the CCIV / sub-fund?

A trustee is personally liable for the liabilities of a trust (with a right of indemnity from the assets of the trust in most circumstances). It will be important to clarify what exposure a Corporate Director may have for GST and tax related liabilities of a CCIV (or sub-fund, if recognised as a separate entity).

This will be particularly relevant if a CCIV changes Corporate Director and a GST shortfall arises during a tax period for which a former Corporate Director was in place.

State Tax Considerations

In addition to GST, State taxes will also need to be considered.

Landholder Duty

All States and Territories impose "landholder" duty which may apply to certain transfers or other dealings in shares in a company that holds land in a particular jurisdiction.
As a CCIV will be a company, the landholder provisions could potentially apply where a CCIV holds land (directly or indirectly).

The issue will be whether it is appropriate for landholder duty to be applied and assessed by reference to all of the landholdings of a CCIV, or whether the provisions should apply separately to each sub-fund.

For example, assume a CCIV has Sub-Fund A and Sub-Fund B. Sub-Fund A indirectly owns land in New South Wales valued above the $2 million landholder duty threshold in that State. Sub-Fund B owns no land assets.

If an investor acquires a large parcel of shares relating to Sub-Fund B only, which equates to more than 50% of the total shares in the CCIV, will the investor be liable for landholder duty in New South Wales (notwithstanding the investor has no interest in the land through the shares relating to Sub-Fund B only)?

These issues might be addressed by treating each sub-fund as a separate company for landholder duty purposes (and potentially broader State Tax purposes). This approach is already adopted for statutory funds of life insurance companies for landholder duty purposes in New South Wales (s 149(5), Duties Act 1997). Each statutory fund is treated as a separate "person" for landholder duty purposes.

In the above example, adopting this same approach for CCIV sub-funds should mean that any changes to the shareholdings of Sub-Fund B do not give rise to landholder duty issues based on the land holdings of Sub-Fund A.

OTHER STATE TAX ISSUES

Other State tax considerations may include:

- Potential duty implications (if any) from changing the Corporate Director or Depositary.
- Foreign investor surcharges (for both duty and land tax). Surcharges may arise where land is owned in relevant jurisdictions and CCIV shares have been issued to non-resident investors.
- Payroll tax. While a CCIV may not carry on a business itself, the sub-funds may invest into subsidiaries which do carry on a business. It is conceivable that the CCIV could then be grouped with the relevant subsidiary entities for payroll tax purposes (giving rise to joint and several liabilities).

Again, it may be desirable to treat sub-funds as a separate company for all State tax purposes. This could assist from a payroll tax grouping perspective (so that it is the relevant sub-fund, not the CCIV as a whole which is grouped). It would also assist in quarantining any State tax liabilities to the relevant sub-fund.

IMPACT OF ALLOCATION OF TAX-RELATED LIABILITIES BETWEEN SUB-FUNDS

All assets and liabilities of a CCIV must be allocated to a sub-fund and no assets or liabilities can remain unallocated.

Where there are multiple sub-funds, a key consideration will be the extent to which revenue authorities, at both a Federal and State level, are bound by tax-related liability allocations made by the Corporate Director.

For example, assume a CCIV has Sub-Fund A and Sub-Fund B. A revenue authority audit has determined that the CCIV failed to correctly pay landholder duty on shares that were purchased via Sub-Fund A in a land owning company. Those shares have since been sold and all proceeds distributed out of Sub-Fund A. The only remaining assets of the CCIV are those allocated to Sub-Fund B. The Corporate Director has allocated the land-holder duty liability to Sub-Fund A, as that was the Sub-Fund which owned and dealt with the shares.

Can the revenue authority pursue the CCIV to recover the unpaid landholder duty from the assets of Sub-Fund B?

The Explanatory Memorandum currently states:

4.5 The purpose of a sub-fund framework is to allow managed funds to offer a variety of investment options through multiple sub-funds under a single "umbrella" CCIV, and to protect investors in respect of a particular sub-fund of a CCIV by quarantining them from the consequences of activities in respect of other sub-funds of the CCIV. This is achieved by segregating assets and liabilities allocated to a sub-fund of a CCIV from the assets and liabilities of other sub-funds of the CCIV.

4.6 This segregation, or protection, of sub-funds is intended to extend to the rights of creditors, legal proceedings and external administration of or in relation to a CCIV. The external administration process for CCIVs (and sub-funds) is still under development and will be included in the next exposure draft of the Bill.

It will be important to ensure that any "quarantining" between sub-funds does extend to tax related liabilities.

Treating each sub-fund as a separate entity for GST purposes, and potentially also for State taxes, would further assist this quarantining.

CONCLUDING REMARKS

The indirect tax issues raised in this article are not exhaustive and the issues will undoubtedly evolve further as the new regime takes form.

While none of the issues raised are insurmountable, it is important that indirect tax issues are considered from the outset to provide all participants with certainty and to also ensure that there are no roadblocks to the take up of CCIVs as the preferred form of collective investment vehicle.

It is also important that State tax issues are not overlooked. Ideally, all of the States and Territories will approach the issues relating to CCIVs in a consistent and harmonised manner, to the extent this is possible. It would be unfortunate if all the work that has been done to introduce CCIVs and harmonise fund regulations across Passport member countries was to be undone through a lack of indirect tax harmonisation across Australia.

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