Law Council
OF AUSTRALIA

Business Law Section

22 December 2023

Mr Christopher Magee
Office of the Chief Tax Counsel
Australian Taxation Office

By email: Chris.Magee@ato.gov.au

Dear Mr Magee

LAW COMPANION RULING LCR 2023/D1

1. The Taxation Committee of the Business Law Section of the Law Council of Australia (the **Committee**) welcomes the opportunity to provide a submission to the Australian Taxation Office (**ATO**) in response to its Draft Law Companion Ruling LCR 2023/D1 concerning the tax treatment for Corporate Collective Investment Vehicles (**CCIVs**).

2. The effort which has gone into the preparation of the Draft Law Companion Ruling, and the accompanying documents relating to CCIVs, is greatly appreciated and is important for the regime to be a success. These are a significant step in promoting the development of the regime and the funds management industry in Australia, although there is still work to be done.

3. The Committee would encourage the ATO to continue to provide guidance on key issues.

Potential for the adoption of the CCIV regime in Australia

4. There continues to be real potential for CCIVs to become significant vehicles in the Australian managed fund industry.

5. To date, the take up of the CCIV has been limited. The reasons for this are complex. The Committee are pleased to provide an explanation of some factors that have limited the take up of CCIVs below.

Key aspects to focus on to accelerate the take up of the CCIV regime

6. There are several matters that would assist in accelerating the take up of the CCIV regime, which are dealt with in the Draft Law Companion Ruling.

Removal of anomalies, which create tax ambiguity or uncertainty compared to the existing structure

7. There are several aspects of the regime that do not compare favourably when clients are considering the use of a CCIV, rather than a traditional managed investment scheme operating through a trust. It is important that these matters are dealt with.

8. These matters are not limited to the tax treatment.

9. It is important that ATO guidance insofar as possible limits the impact of these aspects of the regime.

10. It is for that reason that it is critical that the ATO continue to support the development of the vehicle by providing appropriate guidance in relation to the use and operation of CCIVs.

Observations in relation to the Draft Law Companion Ruling

11. The Committee has some concerns in relation to a number of matters dealt with in the Draft Law Companion Ruling. For present purposes, the Committee is focusing on the primary issues.

12. It is important to recognise that in the event that there are small differences which create disadvantages for a CCIV, they themselves will be sufficient to prevent and restrict the take up of the regime.

13. As a general observation, the Committee is concerned that the Draft Law Companion Ruling may be regarded as taking a strict view of the application of various aspects of the regime which is likely to impede the adoption of the vehicle in Australia. The Committee would strongly advocate for a more purposive approach to the application of the rules to facilitate the adoption of the vehicle in Australia.

14. If the ATO is reluctant to take a more purposive approach to the application of the rules to facilitate the adoption of the vehicle in Australia, the Committee would suggest that these are matters that should be the subject of legislative change.

Key matters for consideration under the Draft Law Companion Ruling

Importance of the concept of dividends for tax purposes.

15. The Committee agrees with the observation in paragraph 46 of the Draft Law Companion Ruling that the concept of a dividend should have no relevance to the operation of the relevant tax laws.

16. The Committee considers that it would be appropriate to provide greater clarity as to the operation of the default tax rules which make a reference to a dividend.

17. It will be helpful for the guidance to make clear that, in determining whether a relevant distribution creates a present entitlement, there does not need to be strict adherence to the dividend rules.

18. This is similarly important in paragraph 47 of the Draft Law Companion Ruling, which deals with the concept of a fixed entitlement.

19. The emphasis on the corporations law entitlements in paragraph 47 of LCR 2023/D1 again reinforces the concept of the relevance of a dividend for tax purposes.

20. This reinforces the need, despite the lack of relevance of the tax law definition of a dividend, to have regard to distributions that are made by way of dividend in a tax sense to determine whether there is an appropriate fixed entitlement.

21. The guidance should emphasise the relevant entitlements to distributions, rather than a focus on the gateway of the relevant amount, being a dividend or a capital return.

Treatment of the default tax position

22. The default tax position, which is created by the terms of the legislation, results in there being a significant disincentive to a client to adopt a CCIV rather than a traditional managed investment trust.

23. The default tax position is dealt with in paragraphs 57 to 66 of the Draft Law Companion Ruling. The disincentive arises because there is not a level playing field in the event that the widely held precondition necessary for the trust to be treated as a CCIV is not satisfied. These are not related to business activities of the sub-fund of the CCIV.

24. It has been suggested that these provisions are not material because they only apply to a small number of funds that did not satisfy these requirements. This is not correct.

25. In assessing the risks that may arise when creating a fund, the consequences of failing to satisfy the widely held test is a matter which will be taken into account.

26. There are two difficulties with the default tax rules that apply when the widely held preconditions are not satisfied:

    (a) The trust income is determined under law by reference to the accounting profits rather than the terms of the sub-fund

        (i) It may not be possible or practical for the accounting profits to be distributed. Moreover, the accounting profit may be significantly different to the profit calculated according to the terms of the sub-fund.

        (ii) The problem with the proposed assessment provision arises because of the deemed status of determining the trust law income for the purposes of the application of section 97 Income Tax Assessment Act 1936 (Cth) (**ITAA36**) to the deemed trust which is created under the CCIV tax rules.

        (iii) The concept is based on the relevant trust income being deemed to be based on the accounting income. This is contained in section 195-123 Income Tax Assessment Act 1997 (Cth) (**ITAA97**). It defines the net income of the sub-fund, which is deemed to be a trust for tax purposes, as the profit as stated in the financial statements for the sub-fund. This trust income is relevant to the application of section 97 ITAA36 in relation to the deemed trust.

        (iv) The condition in section 195-123 ITAA97 is unnecessary and causes real problems with the operation of the default tax provisions.

(b) The relevant elements of the distribution of the trust income for the application of section 97 depend on the distribution being a tax law dividend

(i) The expression dividend has a particular meaning for tax purposes. It depends on a series of complex inclusions and exclusions. It is not appropriate for this narrow tax law construct to be used when determining whether an appropriate distribution of the net income of the sub-fund has been made.

(ii) This reference to a dividend is again unnecessary.

(iii) It introduces, into the default tax position, a concept of differentiating between distributions of the relevant tax laws between a conventional trust and a sub-fund of a CCIV. This is not appropriate. The concept of a dividend is used for the purposes of the assessment of company's dividends under the ITAA36. This is not a concept that should have relevance in the default treatment in Division 6 of the ITAA36.

27. The Draft Law Companion Ruling does not provide any relief in relation to these issues.

Income of the trust fund.

28. The Draft Law Companion Ruling takes a strict view of what may constitute income in the event that the attribution rules do not apply. (See paragraph 60 of the Draft Law Companion Ruling).

29. This is a significant issue in relation to the administration of the regime.

30. It would be desirable for the ATO to provide guidance that this aspect of the regime is not proposed to be strictly applied.

Present entitlement.

31. There are certain deeming provisions associated with payments of a dividend within three months of the end of an income year. This is discussed in paragraphs 62 to 66 of the Draft Law Companion Ruling.

32. Again, the strict reliance on the dividend concept is unhelpful.

33. The reliance on the notification made by the CCIV to the beneficiaries of the beneficiary's present entitlement in paragraph 66 of the Draft Law Companion Ruling is helpful.

34. The Committee would suggest that the other material dealing with corporate actions should be deleted as it creates uncertainty in relation to the outcome of the precondition.

General Approach to default tax rules

35. It would be preferable if the Draft Law Companion Ruling indicated that, in applying the administration of the regime, the ATO would not apply the requirement of the income being determined by reference to the accounting income of the funds strictly. Rather, the income may be adjusted to reflect the particular circumstances of the funds.

36. In the event that this is not possible within the administration of the regime by the ATO, the Committee submits that it is an important issue on which there should be a review of the legislation to improve take up.

37. Again, our request is that clarity should be provided that the administration of the provisions dealing with dividends would not be strictly construed by the ATO in, and by reference to, the specific and detailed provisions of what constitutes a dividend for the purposes of the ITAA36.

38. Our suggestion is that the relevant concept should simply be that a distribution of the relevant amount is made within the prescribed period.

39. It should not and need not have a particular status as a dividend for tax purposes.

If the tax law is not capable of administration to deal with these unnecessary requirements the law should be amended

40. If the tax law is not capable of administration in this way to deal with these unnecessary requirements, then it should be amended:

(a) Determination of net income

(i) The alteration to the legislation should be to allow the CCIV sub-funds to determine what is the net income, in exactly the same manner as is the case with a managed investment scheme that operates through a unit trust.

(ii) This approach could be adopted very simply by a small change to the legislation. It would simply provide that, unless otherwise determined under the Constitution for the sub-fund, net income will be determined under section 195-135 ITAA97. It should operate as a default measure.

(iii) Moreover, the change to the legislation does not in our view involve any integrity risks in relation to the system. Indeed, it reflects the existing arrangements that apply in relation to the taxation of a unit trust under Division 6 ITAA36.

(b) Determination of appropriate distribution to create a present entitlement after the relevant year end

(i) The relevant distributions of the trust income for this purpose should not need to be a tax law dividend.

Specific entitlement to capital gains and franked dividends and character retention.

41. The Committee believes it would be appropriate to provide confirmation that it is possible in the default tax position to create a specific entitlement to both capital gains and franked dividends.

42. The current guidance only provides emphasis in relation to the primary present entitlement to income.

43. Given the deeming provisions, the relevant specific entitlement to capital gains and franked dividends should be capable of being created.

44. This should be dealt with and confirmed as part of the guidance.

45. More generally, it would be very helpful in relation to the default tax position to include guidance that there is appropriate character retention of the amounts when distributed by the trust to beneficiaries.

46. This may be particularly important in the application of the relevant withholding tax rules.

Narrow view in relation to the limits on deeming.

47. The Committee is particularly concerned as to the narrow construction of the relevant amounts for the purposes of capital returns.

48. This is dealt with in paragraph 82 of the Draft Law Companion Ruling. The Committee considers that the emphasis on regulatory contributed capital should not rely on the company law rules. This is particularly important in the context of returns of capital and the application of CGT event E4, together with the potential application of section 99B ITAA36.

Dealings between sub-funds

49. There are particular provisions in the Draft Law Companion Ruling, which deal with the tax consequences associated with matters relating to dealings between a sub-fund and another sub-fund in the same CCIV. This is dealt with in paragraphs 79 to 81 of the Draft Law Companion Ruling.

50. A weakness in the structure of the current CCIV regime is that it does not clearly address dealings between sub-funds.

51. This is in direct contrast to the Singapore variable capital regime which includes specific provisions relating to the ability of sub-funds to deal between themselves. The Singapore SVACC legislation specifically contemplates the variable capital company may sue and be sued as if it were a legal person.[1]

52. The ability to deal between sub-funds is complex under the Australian legalisation. This is because it does not facilitate the dealings between sub-funds in the manner prescribed in Singapore.

53. As a result, the matter needs to be resolved more generally by the application of the relevant state and territories legislation, which deals with the capacity of parties to enter into arrangements and dealings.[2] These are complex issues. It is important the Ruling does not increase this complexity.

54. The Committee submit that the approach adopted in the Ruling inappropriately oversimplifies the issue of the treatment of dealings between sub-funds. This approach is likely to further impede the take up of the CCIV.

[1] Section 32(1) of the *Variable Capital Companies Act 2018* (Singapore). This need to be read in conjunction with the portions of the *Conveyancing and Law of Property Act 1886* (Singapore). See section 50.
[2] These include by way of example the provisions in the New South Wales *Conveyancing Act 1919* (NSW). See section 72. It provides personal property may be conveyed by a person to himself jointly with another person by the like means by which it might be conveyed by him to another person. There are broadly equality provisions in other States and Territories.

55. It would be desirable to recognise the power of sub-funds to deal between each other.

56. The current explanation is not appropriate as it does not recognise the operation and scope of the relevant provisions in the state and territory conveyancing acts.

57. The Committee submits that it too narrowly states the ability of sub-funds to deal between each other and this construction has the potential to further impede the take up of the CCIV.

58. Preferably, the material in the Draft Law Companion Ruling should recognise the scope in operation of the relevant provisions in the state and territory conveyancing provisions, and the potential impact on dealings between sub-funds.

59. More generally, it is inconsistent with the approach that was adopted in relation to managed investment schemes, which qualified as an attribution managed investment trust with different categories of units which are treated as different taxpayers.[3]

60. In that case, the Ruling has recognised that there may be dealings between the relevant taxpayers, which have tax consequences. In particular:

> *2.37 In this regard, to the extent that assets and expenditure relate solely to a particular class of membership interests, the assessable income and deductions and other trust attributes relating to that class will need to be identified by reference to the assets supporting that class. In addition, transactions and events involving those assets (including intra-entity dealings within the actual attribution MIT involving the deemed separate attribution MITs) will need to be recognised for tax purposes as though the class was in fact a separate entity.*

61. The same consequences should apply in relation to a CCIV. Indeed, it is more appropriate in the context of a CCIV where the substance has a particular legal form.

62. The Ruling should recognise in the same way the ability of sub-funds to deal with each other. In any event the current commentary on the power to contract should be deleted.

GST treatment.

63. The Committee notes the approach in relation to the scope of the relevant exemptions, which are dependent upon relevant services being provided by the trustee. This is discussed in paragraphs 113 to 116 of the Draft Law Companion Ruling.

64. The Committee suggests that a more general approach and purposive construction of the relevant rules should be adopted to allow the recognition of the services provided by the corporate director to be akin to that of the trustee.

65. The strict interpretation of the scope of the relevant exemptions is another limiting factor on the adoption of the CCIV structure.

3 Law companion guide LCR 2015/5. See paragraph 2.37.

Conclusion and further contact

66. The Committee would be pleased to discuss any aspect of this submission.

67. Please do not hesitate to contact Mr Justin Byrne, Chair of the Taxation Committee, at (justin.byrne@qldbar.asn.au).

Yours sincerely



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