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Corporate Collective Investment Vehicles – Regulatory and Tax Frameworks

Dear Sir/Madam

As the industry association for private capital in Australia, the Australian Investment Council is pleased to present its submission to the Treasury on the *Corporate Collective Investment Vehicles - Regulatory and Tax Frameworks consultation (the Consultation)*, following the release of the Consultation Paper on 27 August 2021 together, with exposure draft legislation and materials.

Private capital investment has played a central role in the innovation, growth and expansion of thousands of businesses and represents a multi-billion-dollar contribution to the Australian economy. Our members are the standard-bearers of professional investment and include private equity (**PE**), venture capital (**VC**) and private credit (**PC**) funds (collectively **Private Capital Funds**), alongside institutional investors such as superannuation funds, sovereign wealth funds and family offices as well as leading financial, legal and operational advisers. Our members include both Australian domestic and offshore-based firms who in turn invest capital on behalf of millions of Australian families and attract capital from passive overseas investors.

Private Capital Funds invest billions of dollars into Australian companies every year. Australian-based funds under management reached \$37 billion in 2020, which represents a growth in available capital to support investment into businesses across every industry sector of the economy. The industry now has a combined total of around \$13 billion in equity capital available to be invested in the short-term.

Investments made by private capital firms into Australian businesses directly result in the creation of new jobs and support growth in economic output across all sectors of the market. These investments represent 2.6 per cent of Australia's GDP output each year and are responsible for creating around 1 in 9 new Australian jobs according to independent analysis by Deloitte Access Economics.

Given the impact of the COVID pandemic and the uncertain times that lay ahead, and as a net importer of capital, Australia's economy relies on a dependable and steady flow of foreign capital to drive economic growth and job creation. At this critical juncture, it is vitally important for our economic recovery, and Australian jobs, that businesses are able to quickly and efficiently access capital from domestic as well as offshore investors.

As you may be aware, the Council has been a long-term advocate for the introduction of globally competitive collective investment vehicles in Australia. In principle, the Council welcomes the introduction of the new Corporate Collective Investment Vehicle (**CCIV**) regime, subject to the comments and observations that we make below on the design and structure of the provisions, in particular the deeming of the sub-funds of CCIV to be trusts for tax law purposes.



Based on discussions with our members, it is unlikely that many private capital funds will use CCIVs because the vehicle is generally seen to have a “closed” tax status for many foreign investors, in the absence of counterpart offshore “entity classification” regimes. Additionally, the operation of many legacy tax treaties, even though the vehicle may be fiscally transparent in Australia under domestic law, is also likely to mean that most private capital funds will not seek to access the CCIV regime. It is worth noting also that most private capital funds are not listed on financial markets.

Given the reflections set out above in respect of CCIVs, the Council has for many years urged the government and Treasury to prioritise the development of the Limited Partnership Collective Investment Vehicle (**LP CIV**) regime. As you will recall, in the May 2016 Federal Budget the then Federal Treasurer, the Hon Scott Morrison MP, committed the government to the introduction of a new LP CIV from July 2018. Despite that clear commitment, the most recent announcements in the 2018-19 and 2021-22 Federal Budgets did not include any specific references to the introduction of the LP CIV regime. Based on our understanding of the current status of this work within Treasury, it is unclear when the LP CIV will be developed and introduced.

The Council has previously identified the proposed new LP CIV regime as an area of policy focus for our industry. A globally competitive LP CIV would have a significant and profound impact on the capacity of our industry to invest billions of dollars into great Australian businesses spanning all corners of the economy, and at all stages of development – small, medium and large scale – to help them realise their growth and expansion plans, and create new employment for the future.

We also observe, that unlike the CCIV regime, the LP CIV regime does not require any extensive changes to the *Corporations Act 2002* as it is governed by state-based legislation which has already been successfully legislated for this type of structure for nearly 20 years.

We set out below our submission for consideration by the Treasury and look forward to participating in future discussions about reforms to Australia’s collective investment vehicle regimes. The Council is ready and able to play a constructive role in the development of the new CIV regimes to help make Australia a more globally competitive centre for financial services.

We have set out below our previously shared briefing note on the design features of a globally competitive LP CIV fund vehicle. We trust that this information will be instructive to Treasury through the development of the CCIV regime, followed by the development of the LP CIV regime.

If you have any questions about specific points made in our submission, please do not hesitate to contact me or our policy team on policy@aic.co.

Yours sincerely

Yasser El-Ansary
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Australian Investment Council



1. The need for Limited Partnership Collective Investment Vehicle (LP CIV)

The Council welcomed the Treasurer's re-commitment in the May 2021 Federal Budget to introduce a new Corporate Collective Investment Vehicle (CCIV) by 1 July 2022.

Australia's capacity to attract inbound investment through the introduction of a CIV that is competitive with other jurisdictions is an important policy announcement. World-class competitive collective investment vehicles are essential for building and expanding the pool of capital that can be attracted into the Australian economy.

Currently, Australia's existing suite of collective investment vehicles (CIVs) is out of step with international practice, necessitating complex structures and constraining foreign investment. Having a simple, internationally competitive CIV regime able to invest in a broad category of investments with a deemed capital gains tax treatment, is critical to Australia's ambition to be a regional financial services hub which will, in turn, drive significant local employment opportunities.

In particular, Australia's use of trusts (e.g. managed investment trusts (MITs)) is uncommon internationally and deters foreign investors. Noting that over the last five years, around 64% of commitments to Australian PE came from offshore investors, it is critical that Australia's CIVs are well-understood overseas. In particular, there is still significant misunderstanding of Australia's trust structures, including Managed Investment Trusts (MITs) and Attribution Managed Investment Trusts (AMITs).

Accordingly, it is important that a flow-through, internationally best practice LP – the globally accepted private capital vehicle of choice – be introduced as soon as possible, keeping in mind that the original introduction date of 1 July 2018 has not been met. Such a vehicle could transform the flow of capital into high growth Australian businesses, helping to facilitate Australia's transition to a knowledge-driven economy.

It is important that the structure of the LP CIV recognises the nature of the private capital industry and the ability of funds in this sector to hold an active trading business. It is also worth emphasising that if certain legacy and redundant features of Australia's MIT regime are imported into a new LP structure, especially the 'no control' test, then the new vehicle's utility will be compromised, severely limiting its ability to act as a catalyst for greater investment into promising businesses.

A 'control test' or similar investment restriction is not a feature of comparable overseas LP vehicles as investors often expect private capital managers to have control over their investments to maximise the success of the companies. LP design features consistent with the recommendation of the Johnson Report ("Australia as a Financial Centre") would ensure that foreign investors in Australian-managed private capital funds are, for tax purposes, treated the same as if the investments were made directly by the non-resident without the use of any Australian intermediary. It is also important that the LP CIV factors in the commercial aspects of holding an active trading business.

In particular, we note that the historical tax features in Australian taxation law which necessitated the need for a "no control test" no longer exist because Australia has long adopted an imputation system of taxation, whereas, the "no control" test was aimed at preventing a specific type of business structure which existed under Australia's "classical" system of taxation (ie taxation at multiple corporate levels).

2. Observations on the proposed CCIV design features

Whilst we appreciate that there was a desire to keep the design of the CCIV as close to possible to AMIT regime from a familiarity and compliance perspective, the Council believes that there was a missed opportunity to consider the essential design features of a globally competitive fund vehicle. In particular, deeming a legal form company to be a tax form trust is at odds with the many tax reform attempts associated with the taxation of trusts. We also note, that the position around the taxation of trusts, is still governed by the "interim" rules which were legislated in 2011 following the High Court decision in *Federal Commissioner of Taxation v Bamford* [2010] HCA 10). However, these rules now appear to be "permanent".



We also note that most foreign investors do not understand the uncommon use of trusts in an Australian context which is unique even for other common law jurisdictions. Accordingly, basing the tax rules on trusts is not only at odds with international practice but is also the source of most of the complexity from a tax and compliance perspective. Therefore, it appears that the key benefit of opting into the CCIV regime is the provision of a corporate form to a trust. Whilst we appreciate the need for certainty in practice to funds who are likely to adopt this regime, an optional ability to “elect” into partnership taxation rules in Division 5 of the *Income Tax Assessment Act 1936* would address some of concerns around the complexity of the regime.

We also have significant concerns as to the need for the retention of a “no control” test in the CCIV regime given the observations set out above and in Appendix A.



Appendix A

Briefing note on key considerations for proposed new Limited Partnership Collective Investment Vehicle (LP CIV)

Key points

- In the 2016 Federal Budget, the Government announced that – consistent with the recommendations of the 2009 Johnson Review into Australia as a Financial Centre – it would introduce two new collective investment vehicles (CIVs) to grow Australia's capacity to attract inbound investment into our economy (see attached).
- The two new vehicles are known as a corporate collective investment vehicle, and a limited partnership collective investment vehicle.
- The announcement was significant, because it is widely acknowledged that Australia's current suite of CIVs is out of step with international practice, necessitating complex and costly structures, while also deterring foreign investment because the existing vehicles we have in-place are not widely understood or common amongst international institutional investors. Modernising our CIV regime with two new vehicles would deliver tangible long-term gains for Australia by:
 - Having a simple, internationally competitive CIV regime which will promote Australia's ambition to be a regional financial services hub. That, in turn, will drive significant local employment opportunities right across the economy
 - Australia's use of trusts (e.g. managed investment trusts (MITs)) is unusual or not well understood internationally, having the direct effect of deterring foreign investors
 - Over the last five years, the vast majority of commitments to Australian private equity funds came from offshore investors, underlining the importance of having a CIV which is well-understood and competitive with other developed markets globally.
- If Australia wishes to grow the funds available for investment into unlisted assets such as high-growth Australian businesses, a new limited partnership (LP) CIV should be created as soon as possible:
 - LPs are the globally accepted private equity (PE) and venture capital (VC) vehicle of choice, and will transform and grow the pipeline of capital moving into Australian businesses.
- A new LP CIV could be relatively quickly introduced given there are only a limited number of key issues to address.
- The new LP CIV will assist the Australian managed funds industry by encouraging PE funds to set-up Australian investment structures, thereby generating an even greater level of highly-skilled investment professional roles in Australia.
- A new LP CIV will cut red-tape by creating a more equal and competitive landscape with competing foreign funds management hubs such as Singapore, the US and the UK.



Summary of key features of commonly used international CIVs

Jurisdiction	Tax transparent in relation to income & losses	Ability to prevent permanent establishment for foreign investors	Carried interest is on capital account/capital incentive regime	No undue investment restrictions/no control test
Germany (<i>Kommanditgesellschaft</i>)	Yes ¹	Yes	Yes	Yes
Ireland (Limited Partnership)	Yes	Yes	Yes	Yes
Luxembourg (SICAR)	Yes ²	Yes	Yes	Yes
New Zealand (Limited Partnership)	Yes	Yes ³	n/a ⁴	Yes
Switzerland (Limited Partnership)	Yes	Yes ⁵	Yes	Yes
UK (English & Scottish Limited Partnerships)	Yes	Yes ⁶	Yes	Yes
USA (Limited Partnership)	Yes	Yes	Yes	Yes

Recommended design features of an Australian LP CIV

1. Flow-through tax treatment and consistent tax treatment of PE and VC gains:
 - a. Consistent with the Managed Investment Trust (MIT) regime and consistent with the Board of Taxation's recommendation, the LP CIV should have a deemed CGT treatment for its eligible investments.
 - b. A partnership "flow-through" treatment should be adopted, consistent with the Early-Stage Venture Capital Limited Partnership (ESVCLP), Venture Capital Limited Partnership (VCLP), and AFOF rules.
2. There should be no prohibition relating to "control" of a trading company in order to retain tax transparent status:
 - a. The current MIT control test is inconsistent with Australia's funds management competitor jurisdictions like the US, UK and New Zealand:
 - i. In such jurisdictions, their respective LP CIVs are not prohibited from controlling a trading company in order to maintain their tax transparent status.
 - ii. A new Australian LP CIV that retains a 'control test' restriction will fail to achieve the broader objectives of a more globally competitive CIV regime.

¹ Where the limited partnership is structured as a non-entrepreneurial limited partnership.

² Where the SICAR is established as a fiscally transparent entity – an elective regime.

³ Although no specific deeming exists, this is the generally adopted position.

⁴ Note New Zealand does not have a capital gains tax regime.

⁵ This is the general position under Swiss tax law in respect of non-residents.

⁶ This is the general position under UK tax law except where the limited partnership conducts trade in the UK (this will generally not cover private equity funds holding shares in investee companies)



- b. The current MIT control test rules are out-dated, and premised on policy concerns that have been progressively addressed by tax reforms over the last 30 years, such as the introduction of refundable imputation credits and a stronger Part IVA general anti-avoidance regime:
 - i. Controlled companies are taxed at the corporate tax rate
 - ii. CIVs are widely-held and typically closed-end funds which are not being used to avoid corporate taxation
 - iii. The control test is particularly difficult for the PE industry as it prevents the fund vehicle from taking a majority interest in an underlying company
 - iv. The new MIT arm's length rule now addresses any integrity concerns associated with transactions with investees, thereby removing the risk of converting taxable income at the corporate level into pre-tax income at the fund level.
- c. ESVCLPs and VCLPs do not have a 'control test'
 - i. If there are still remaining corporate tax integrity concerns, consideration should be given to a "safe harbour" exception to ensure that the control test is not breached if the only assets which the CIV has are shares in an investee company and the making of loans to investees.