SUPERCENTRAL

Mutual funds – they're on their way

As indicated in the recent May Budget, the Government has decided to re-commence the project to introduce mutual funds (technical name – "Corporate Collective Investment Vehicles" abbreviated to "CCIVs" or event more succinctly "204s"). The Government intends that the legislative regime permitting mutual funds will have a start date of 1 July 2022.

Two significant bills have been released in the form of exposure drafts for public comment – one dealing with the regulatory issues arising from the introduction of mutual funds and the other dealing with the taxation issues which will arise. What has not been released so far is a bill dealing with consequential and transitional issues which will arise from the introduction of mutual funds in the Australian investment landscape.

This brief note will provide an overview of mutual funds.

What are mutual funds?

A mutual funds is a term used to describe an investment vehicle which has the legal form of a company. The investors buy into the investment vehicle by acquiring shares (or, more correctly, a particular class of shares) and they cash out their investment by selling the shares. In many countries (such as America) investment vehicles are structured as companies while in Australia, New Zealand the United Kingdom, investment vehicles are structured as unit trusts.

Why introduce mutual funds?

By introducing mutual funds into Australia, the Government hopes to encourage overseas investors to invest locally in Australian investment vehicles or, to use Australian based investment vehicles to invest in Southeast Asian economies by allowing those investments to be made by means of mutual funds (with which they are familiar) rather than by unit trusts (with which they are far less familiar).

In short, the Government hopes to expand the Australian funds management industry by encouraging overseas investors to use the services of the local funds management industry whether to invest locally or to invest in Southeast Asia.

What will be the impact on SMSFs?

Once the mutual funds regime is established, SMSFs will have the opportunity to invest by means of mutual funds in addition to or as an alternative to investing in unit trusts.

How are mutual funds different from unit trusts?

The main difference is that mutual funds will be structured as companies whilst unit trusts are based upon a trust structure.

Mutual funds will issue shares which must belong to a particular class of shares whilst unit trusts issue units.

For a mutual fund each class of shares must correspond to a particular sub-fund (i.e. portfolio of identified assets) and the total value of the shares of the sub-class is constituted by the value of the sub-fund. Shares of one class have no rights to and are not supported by the assets of another sub-fund.

How are mutual funds and unit trusts similar?

Like unit trusts – which can be retail unit trusts or wholesale unit trusts, mutual funds must be either retail mutual funds or wholesale mutual funds

What are the advantages of mutual funds over unit trusts?

The intention of the Government is not to confer any regulatory or taxation advantage on mutual funds as against unit trusts other than an advantage which arises from the simpler regulatory structure of mutual funds.

Both mutual funds and retail and wholesale unit trusts will be taxed on a flow-through tax basis. Consequently, both will be taxed as attribution managed investment trusts.

Is there a difference in the tax treatment between mutual funds and unit trusts?

Most unit trusts which operate either as retail investment trusts or wholesale investment trusts have elected to be taxed as attribution managed investment trusts. Consequently, they use the attribution method of tax (instead of the existing present entitlement to income method).

The attribution method of taxation allows the unit trust or mutual fund, amongst other things, to

- carry forward under and over estimates of tax amounts into the financial year in which the under or over estimate is identified without adverse tax consequences
- be treated as fixed entitlement entities – this is important as the investors are treated as having a fixed entitlement to income and capital and the trust or mutual fund has to satisfy less onerous conditions to carry forward and deduct tax losses and enables imputation credits to flow to investors
- allow investors (in certain circumstances) both upward and downward adjustments to the cost base of their holdings to eliminate double taxation that may otherwise arise.

Thus mutual funds will have a materially similar taxation treatment as applies to unit trusts which have elected to be subject to the attribution method of taxation.

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