

19 October 2018

The Directors  
Specialised Investment and Lending Corporation Pty Ltd ATF  
Diversified Commercial Income Fund  
Level 9, 179 Queen Street, Melbourne, Victoria 3000  
For the attention of: Ms Michelle Tay

**By e-mail:** Michelle.Tay@silcgroup.com.au

Dear Michelle,

**Diversified Commercial Income Fund**  
**Tax comments**

As requested, we set out below our high-level tax advice for the Specialised Investments and Lending Corporation Pty Ltd as Trustee for the Diversified Commercial Income Fund (**the Fund**). This advice covers key immediate and future tax structuring matters for the Fund. Our comments arise from our review of the draft Trust Deed and Information Memorandum (**IM**).

**Issues Raised for Analysis**

Our analysis has been focused on the following issues from a tax perspective:

- Facilitation of flow through tax treatment which provides the ability of distribution of net interest income to be subject to 10% final interest withholding tax for foreign investors;
- Flexibility to evolve as the Fund grows over time; and
- Any other recommendation from a tax perspective to maximise value and certainty for the potential investors.

Refer to **Appendix A** for the basis of our opinion and other matters.

**Executive Summary**

We set out below an Executive Summary of our tax advice:

- Based on our review of the Fund Trust Deed, the Fund and each separate specified cash and loan units should be treated as 'flow through' for tax purposes. That is, the investors should be taxable on their respective shares of the net income and the Trustee should not be liable to any tax obligations in respect of the taxable income of the Fund.
- Broadly, for investors this means:
  - Australian investors: should recognise their share of the Net Income of the Fund which is in the form of interest income to be included in their marginal tax rates; and
  - Foreign investors: will be subject to 10% final interest withholding tax on the interest income which will be remitted by the Trustee to the Australian Taxation Office (**ATO**).
- The Fund should not have significant (if any) risk of being taxed as a company under 'Division 6C' as the nature of the underlying investments are loans which are eligible investments.

- As the Fund may not qualify as a Managed Investment Trust (**MIT**) for tax purposes in the short term (because of the need to have 25 investors), it is important that each class of cash and loan units is segregated and treated as a separate unit trust governed by the term of the Fund Trust Deed. We note Clause 4 of the Trust Deed provides the Trustee with the right to create different classes of units. Our observation is that this Clause is relatively generic in nature. Given the intention to have segregated sub classes for Cash Units, and discrete Loan Units, we recommend consideration whether the following 'type of working' may be inserted to Class 4.4 of the Trust Deed as well:

*d) Notwithstanding the generality of this Clause[x], the Trustee may issue Classes of Units on the following terms:*

- i. The Relevant Class Assets for each Class comprise a particular Asset or Assets and all proceeds and income received by the Trustee in respect of, or relating to, that particular Asset or Assets;*
  - ii. The Relevant Liabilities are attributed to a Class such that they can only be met from Relevant Class Assets;*
  - iii. Relevant Class Assets for a Class are not encumbered in relation to Relevant Liabilities of another Class;*
  - iv. the Trustee is not entitled to be indemnified out of the Relevant Class Assets of a Class in relation to the Relevant Liabilities of another Class;*
  - v. each Class that is constituted by a particular Asset or Assets will commence on the date determined by the Trustee and will expire on the maturity for the particular Asset or Assets or as otherwise determined by the Trustee;*
  - vi. for the avoidance of doubt, a Unit Holder of a particular Class has no beneficial interest or entitlement to the Relevant Class Assets of any other Class; and*
  - vii. each Class of Units represents a separate unit trust governed by the terms of this Trust Deed.*
- Practically, this means that although the Fund will be marketed as having different cash and loan units, from a tax perspective, each issue of different class of units will need to have a separate tax registration and tax return lodged. This treatment is consistent with the Full Federal Court decision in the recent case of *Aussiegolfa Pty Ltd (Trustee) v Commissioner of Taxation [2018]*. Accordingly, separate accounting and tax records should be maintained for each class of units.
  - We note that the Trust Deed provides flexibility for the Fund to evolve as an Attribution MIT with potential benefit that only one tax filing is required across all classes units. However we consider from a tax compliance perspective, this cost saving would not necessarily be significant as tax calculations would still need to be undertaken for each class of units as if each class of units was a separate trust.

### **Our Understanding of the Facts**

Our comments in this letter are based on our understanding of the below key facts:

- The Fund is an unlisted, unregistered Australian unit trust scheme;

- The Fund will invest predominantly in loans used in connection with development projects managed or developed by Capital Alliance Investment Group.
- The Fund is intended to provide Qualifying Investors with the opportunity to invest in different classes of units, namely the Cash Units and Loan Units.
- The Cash Units in the Fund are referable to a basic deposit product which include cash management accounts and term deposits. The Loan Units are referable to a portfolio of loans which may comprise of unsecured or secured loans with a mixture of either first mortgage, second mortgage (which may or may not be registered) or other security interests.
- We understand that the loans / funds will be made predominantly to special purpose vehicle companies (**SPVs**) each responsible for undertaking a single project.
- Loans will not be used for personal, domestic or household purposes.
- The Fund comprises of multiple classes of Units and the Trustee may, at its discretion, issue other classes of units.
- The Fund will be open to both local and offshore wholesale investors.

Please advise us if any of the background facts above are incorrect as it may materially impact the findings in this paper.

## **Detailed Tax Analysis**

We set out below a summary of our key comments.

### ***Implications for the Fund***

#### ***Flow through tax treatment of the Fund***

In Australia, Trusts are generally treated as flow through vehicles from a tax perspective. This means that the 'Net Income' of the Fund retains its character (for example, interest, dividends, capital gains etc) depending on the underlying income earned by the Fund.

The Fund should be able to be treated as flow through vehicles from an Australian tax perspective provided the investors are made 'presently entitled' to the Net Income of the Fund by 30 June each year (please note we are assuming that the Fund will not qualify as a MIT immediately as discussed further below).

In this regard, based on our review of the Trust Deed, Clause 17.3 provides that a unitholder is presently entitled to its distribution entitlement that has been calculated for that distribution period, and has a vested and indefeasible interest in that entitlement.

Distribution entitlement is calculated with reference to Distributable Amount which is further defined by reference to the Income of the Fund and any additional amount (including capital) that the Trustee has determined to be distributed.

Therefore, it is unlikely that there would be any distributable amount to which the Trustee may be liable as at the end of a financial year to pay tax at the marginal rate of 47% (i.e. where no beneficiary was presently entitled to the distributable amount of the Fund as at the end of the year).

For completeness, we also note that given the nature of the intended underlying investments in the Fund, it would be unlikely that the Fund would be considered as a 'public trading trust' (which can mean that a Trust is treated and taxed as a company). However, based on our review of the Trust Deed, Clause 17.12 covers such circumstances in the unlikely event this is to occur.

*Each class of units may if necessary be treated as a separate entity for tax purposes*

With reference to clause 4.4 of the Trust Deed, we understand that the different classes of units (referred to as cash and loan units in the IM) can facilitate each class of units to segregate interests held by the Fund in different assets (including liabilities associated with those assets).

We further understand as per Section 8.1 of the IM that it is intended that:

*Each class of Unit gives you an equal and undivided interest in the assets of that class only. Subject to the Trust Deed, as an Investor in a class of Units you have the following rights relating to that class of Units:*

- *The right to share in any distributions.*
- *The right to attend and vote at meetings of Investors.*
- *The right to participate in the proceeds of winding up of the Fund.*
- *The Trust Deed contains provisions about convening and conducting meetings of Investors.*

As the Fund is not expected to qualify as a Managed Investment Trust for tax purposes in the short term, it is important that each class of Units is segregated and treated as a separate unit trust governed by the term of the Fund Trust Deed. In particular, in the recent case of *Aussiegolfa Pty Ltd (Trustee) v Commissioner of Taxation [2018]*, the Full Federal Court decision held that in respect of the DomaCom Fund, each specific class of units in a unit trust with respect to a certain asset was to be treated as a separate trust for tax purposes. This was in light of how the IM articulated that each specific class of units was in respect of specific assets only.

*Tax filing requirements*

Practically, this means that although the Fund will be marketed as having different Specified Loan Units, from a tax perspective, each issue of different class of units will need to have a separate tax registration and tax return lodged. This means that separate accounting and tax records should be maintained for each class of units.

***Implications for Investors***

*Flow through nature of interest income*

Given the nature of the underlying investments, it means that the Net Income of the Fund is likely to constitute majority returns of interest income (however we **recommend** that the advice should be sought on this aspect before each underlying investment is made), this means that for Unitholders that are:

- Australian investors: should recognise their share of the Net Income of the Fund which is in the form of interest income to be included in their marginal tax rates; and
- Foreign investors: will be subject to 10% final interest withholding tax on the interest income which will be remitted by the Trustee to the ATO. As this is a final withholding tax the foreign investors will not have any Australian tax filing obligation in respect of receipt of such income.

*Tax treatment of non-interest income*

If the Fund receives non-interest income (although less likely), this means:

- Australian investors: their share of the non-interest income will be included in their marginal tax rates; and

- Foreign investors: the Trustee is required to withhold / prepay tax at 45% on behalf of the non-resident unitholders for their shares of the income. Foreign investors are then technically required to file a tax return in Australia to claim back any overpayment of tax.

#### *Disposals / redemptions*

We note that in our experience with credit / mortgage funds, given the nature of the underlying investments, generally the unit price will remain the same as the issue price (i.e. \$1 per unit).

Therefore, this means that where there is a redemption or transfer of units, unless the principal value of any underlying investments changes, investors should not make any significant capital gains / losses (if any) depending on incidental costs that have been incurred to acquire and dispose of their units.

#### *Managed Investment Trust (MIT) vs Non-MIT status*

From a tax perspective, there is a separate type of trust called MIT that can offer concessional tax treatment for foreign investors that derive Australian source income from a MIT (e.g. 15% final withholding tax on **non** dividend, interest and royalty income if the investor is in an eligible country).

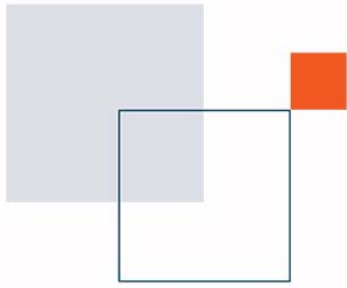
However, in the current circumstances, as the Fund will likely distribute Net Income in the form of interest income to foreign investors, as previously discussed, foreign investors will benefit from a final 10% interest withholding tax which is lower than the 15% MIT tax rate for other sources of income. On this basis, we consider there is little (if any) value to qualify as a MIT in the short term. In addition, we consider it will be difficult to qualify as a MIT as one of the requirements is that a MIT is widely held, which in the case of a wholesale trust requires at least 25 investors (and requires that no one foreign individual investor can have 10% or more interest in the Fund).

Notwithstanding the above, we note that one potential benefit of being an MIT, is that from 1 July 2016, a MIT can elect to be treated as an Attribution MIT (**AMIT**). Whilst an AMIT does not reduce the after-tax return to investors, one benefit of electing to be an AMIT if all conditions are satisfied is the possibility to apply a 'clearly defined rights' test to multi class AMITs. This means for example, that although there may be separate classes of units, only one tax filing is required for the AMIT which may potentially be of value if for example a contributory mortgage fund is contemplated in the future.

The ability to qualify for this concession is very detailed and guidance is provided in *Law Companion Guide 2015/5 Attribution Managed Investment Trusts: Choice to treat separate classes as separate MITs*.

Whilst outside the scope of the current needs for the Fund, we note that inclusion of Clause 3 of the Trust Deed provides the flexibility for the Fund to be qualified for benefits as an Attribution MIT in the future.

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Should you have any questions in relation to this matter please contact me on (03) 9606 3888.

Yours sincerely

**Josh Chye**  
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## Appendix A

### Basis for Our Opinion

Our opinion is based on taxation legislation and Australian Taxation Office or other relevant revenue authority (collectively "ATO") pronouncements in effect at the date of this advice. We are not responsible for updating our advice to consider any prospective or retrospectively applied changes in taxation legislation, new or amended ATO pronouncements, nor the outcome of case law subsequently decided by a court or tribunal.

Nevertheless, we would be pleased to update this advice for any subsequent changes to taxation legislation at a later date, as part of a separate engagement, if you so require.

### Accuracy and Retention of Records and Information

Our opinion is reliant on our understanding of the information that you have provided to us and the assumptions we have made. If these are in any way incorrect or incomplete please let us know immediately as this will require us to review the opinion provided in our taxation advice and may require our opinion to be amended.

Responsibility for providing accurate and complete information rests with you. Under the taxation legislation, you are required to retain full and proper records that adequately support the nature of each transaction undertaken.

Under the taxation legislation, you should retain records for at least five years from the later of the date of their creation or the completion of each transaction to which they relate. If the period for amendment of a tax assessment is extended then the period for which retention of those records must be kept is correspondingly extended. Under Australian corporations law, you should retain company records for seven years.

### ATO Challenge to Our Opinion

You should be aware that any taxation position adopted by you as a result of our advice may be challenged by the ATO at a later date. Where an original or amended assessment is issued, you are formally required to pay any unpaid taxation liability. The ATO will apply a 'general interest charge' and may apply significant penalties to any unpaid taxation liability.

Where the ATO forms a view contrary to our opinion and issues a decision, taxation assessment or determination, the taxpayer has certain statutory rights to object to such decisions within certain specified time limits.

Where the taxpayer exercises their statutory rights to object to a decision, a Court or Tribunal may form a view that is contrary to our opinion and uphold the decision of the ATO, in part, or in full.

We would be pleased to assist you with such matters as described above, should it prove necessary to object to a decision of the ATO.

### Private Binding Ruling

If you wish to have greater certainty concerning the matter(s) covered in this letter, we can assist you to apply for a private binding ruling from the ATO. Alternatively, we can seek an opinion from a revenue law barrister.

### Limitation of Our Responsibility

The advice in this letter is given specifically for Specialised Investments and Lending Corporation Pty Ltd. No other party may rely upon the information contained within this letter. Accordingly, to the extent permitted by law, we do not accept liability for any loss or damage which any other person may suffer arising from any negligence on our part in giving this advice.