THE PARLIAMENT OF THE COMMONWEALTH OF AUSTRALIA

SENATE

TREASURY LAWS AMENDMENT (MUTUAL REFORMS) BILL 2019

EXPLANATORY MEMORANDUM

(Circulated by authority of the Assistant Minister for Treasury and Finance, the Hon Zed Seselja)
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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

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<tr>
<td>ACNC Act</td>
<td>Australian Charities and Not-for-profits Commission Act 2012</td>
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<td>Bill</td>
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<td>Corporations Act</td>
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<td>Hammond Report</td>
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<td>ITAA 1936</td>
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General outline and financial impact

Overview

This Bill gives effect to recommendations 5, 8 and 9 of the Hammond Report to:

• introduce a definition of a mutual entity into the Corporations Act;
• remove the uncertainty for transferring financial institutions and friendly societies in respect of the demutualisation provisions in Part 5 of Schedule 4 of the Corporations Act; and
• expressly permit mutual entities registered under the Corporations Act to issue equity capital without risking their mutual structure or status.

Date of effect: The amendments in the Bill take effect from the day after Royal Assent.


Financial impact: This implements elements of the reforms announced in the 2017-18 MYEFO measure Debt-Equity rules – allowing debt tax treatment for Tier 2 capital issued by customer-owned banks, estimated to have an unquantifiable cost to revenue.


Compliance cost impact: Negligible.
Chapter 1
Reforms to the mutual sector

Outline of chapter

1.1 This Bill gives effect to recommendations 5, 8 and 9 of the Hammond Report to:

- introduce a definition of a mutual entity into the Corporations Act;
- remove the uncertainty for transferring financial institutions and friendly societies in respect of the demutualisation provisions in Part 5 of Schedule 4 of the Corporations Act; and
- expressly permit mutual entities registered under the Corporations Act to issue equity capital without risking their mutual structure or status.

Context of amendments

1.2 Cooperative and mutual entities operate in almost every sector of the Australian economy, including agriculture, banking and finance, housing, insurance and retail.

1.3 On 2 March 2015, the Senate Economics References Committee (Committee) was asked to review and report on the role, importance and the operations of these firms in the Australian economy. The Committee tabled their report on 17 March 2016.

1.4 On 24 March 2017, the then Treasurer appointed Mr Greg Hammond OAM to conduct further consultation on the recommendations of the Senate Report and assist in developing a Government Response. Mr Hammond provided his Report on Reforms for Cooperatives, Mutuals and Member-owned Firms on 31 July 2017.

1.5 On 8 November 2017, the Government tabled its response to the Senate Report and accepted all eleven recommendations in the Hammond Report. The recommendations in the Hammond Report are aimed at improving access to capital, removing uncertainties currently faced by the mutual sector, and reducing barriers to enable cooperatives and mutuals to invest, innovate, grow and compete.
1.6 The amendments in the Bill give effect to recommendations 5, 8 and 9 of the Hammond Report to:

- introduce a definition of a mutual entity into the Corporations Act;
- remove uncertainty for transferring financial institutions and friendly societies in respect of the demutualisation provisions in Part 5 of Schedule 4 of the Corporations Act; and
- provide for mutual entities registered under the Corporations Act to issue MCIs without affecting their mutual structure or status.

1.7 The new definition of a mutual entity addresses the lack of recognition and understanding of the mutual sector and the mutual form. The definition of a mutual entity also makes it simpler to determine when an entity demutualises.

1.8 Part 5 of Schedule 4 of the Corporations Act provides an enhanced disclosure regime which applies to building societies, credit unions, friendly societies and other State and Territory regulated financial institutions that transferred to Commonwealth regulation in 1999 (transferring financial institutions). This disclosure regime is intended to provide members with information that they would reasonably require and expect to be given to make an informed decision about a proposed constitutional modification or share issue that would have specified effects on members’ rights.

1.9 Entities affected by these demutualisation provisions submit that these provisions in their current form are too broad and give ASIC too wide a discretion which has resulted in uncertainty for the sector in being able to raise capital.

1.10 The amendments to Part 5 of Schedule 4 of the Corporations Act make it clear that these demutualisation provisions only apply if an entity no longer meets the new definition of a mutual entity.

1.11 Cooperatives and mutuals have historically been constrained in their flexibility and speed of growth as they have only been able to raise capital through retained earnings rather than issuing securities to investors. The amendments in the Bill to allow mutuals to raise equity capital removes a significant barrier to investment, innovation, growth and competition in the sector and provides mutuals with access to a broader range of capital raising and investment options.

1.12 Together, the amendments in the Bill provide the mutual sector with greater certainty and confidence to be able to raise capital without the risk of demutualisation.
Summary of new law

1.13 There are 4 key components to the amendments in the Bill.

1.14 The first is to introduce a definition of a mutual entity into the Corporations Act. The new definition provides that a mutual entity is a company where each member has no more than one vote for each capacity in which the person is a member. The definition also determines which mutual entities are able to raise capital through the issuance of MCIs. Beyond this, the mutual entity definition does not create or alter any other rights for mutuals, including in relation to tax obligations or rights in relation to mutual receipts.

1.15 The definition also only applies in relation to mutuals registered under the Corporations Act and does not have any effect on other entities that may have similar governance arrangements. These entities would still be subject to the existing tax and governance treatment and concessions.

1.16 The second component of the amendments is to remove uncertainty for transferring financial institutions in respect of the demutualisation provisions in Part 5 of Schedule 4 of the Corporations Act.

1.17 The third is to provide for MCIs as a new bespoke capital instrument for mutual entities. MCIs can be issued by eligible mutual entities that are companies limited by shares, companies limited by guarantee and companies limited by shares and guarantee.

1.18 The fourth component of the amendments is to provide a standard process to allow eligible mutual entities to amend their constitutions to enable them to take advantage of these reforms.

Comparison of key features of new law and current law

<table>
<thead>
<tr>
<th>New law</th>
<th>Current law</th>
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<tbody>
<tr>
<td>A mutual entity is a company registered under the Corporations Act that provides its members with no more than one vote for each capacity in which the person is a member.</td>
<td>No equivalent.</td>
</tr>
<tr>
<td>The demutualisation provisions in Part 5 of Schedule 4 of the Corporations Act are triggered if the effect of a change to a mutual entity’s constitution is that it no longer meets the definition of a mutual entity.</td>
<td>The demutualisation provisions in Part 5 of Schedule 4 of the Corporations Act are triggered where proposed changes to the constitution or a proposed issue of shares would have one or more specified effects on existing membership rights.</td>
</tr>
<tr>
<td><strong>New law</strong></td>
<td><strong>Current law</strong></td>
</tr>
<tr>
<td>-------------</td>
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</tr>
<tr>
<td>MCIs are a new type of bespoke share for the mutual sector.</td>
<td>No equivalent.</td>
</tr>
<tr>
<td>Mutual entities that are companies limited by shares, companies limited by guarantee and companies limited by shares and guarantee can raise equity capital by issuing MCIs.</td>
<td>Mutual entities that are companies limited by shares and companies limited by shares and guarantee can raise capital by issuing shares but mutual entities that are companies limited by guarantee cannot.</td>
</tr>
<tr>
<td>For a three year period, eligible mutual entities can amend their constitutions by following a standardised process to enable mutual entities to take advantage of these reforms.</td>
<td>A mutual entity may only amend its constitution by following the process for amendment set out in its constitution.</td>
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**Detailed explanation of new law**

**Definition of a mutual entity**

1.19 A new definition of a mutual entity is provided for in Division 6B of Part 1.2 of the Corporations Act. The definition provides that a mutual entity is a company registered under the Act that has a constitution which provides that each member of the company has no more than one vote at a general meeting of the company for each capacity in which the person is a member. [Schedule 1, item 2, subsection 51M(1)]

1.20 To avoid doubt, the amendments make clear that a company registered under the Corporations Act is a mutual entity if its constitution provides for someone to have a separate vote in their capacity as:

- a joint member;
- holder of a proxy; or
- as a representative of another person or entity.

[Schedule 1, item 2, subsection 51M(2)]

**Example 1.1**

Hunt is a credit union that has a constitution which provides for two classes of members. The first class provides full membership which includes a single vote at the company’s general meeting. The second class is an associate membership which does not include a vote at the company’s general meeting. Hunt is a mutual entity under the new definition as all of its members have no more than one vote.

Ly and Essam are both full members of Hunt and are therefore each entitled to a vote at the company’s general meeting. Ly plans to attend
and cast her vote but Essam is too busy to attend and wants to appoint Ly as his proxy. Ly is able to do this under the new definition. She may exercise her single vote on her own behalf. As the proxy for Essam, she may also exercise his single vote on his behalf.

Luke is also a full member of Hunt and is entitled to one vote at the company’s general meeting. He is also the representative of Hilfre, an unincorporated association which is also a full member of Hunt. At the general meeting, Luke is entitled to vote through his membership and also cast the vote on behalf of Hilfre. This is permitted under the new definition as Luke is will be exercising his vote as a member and exercising Hilfre’s vote as its representative.

**Example 1.2**

QLAD is a motoring mutual that has a constitution which provides for each member to have one vote at the company’s general meeting and allows for each joint membership to also have one vote at the general meeting.

Mel and Mark are best friends and have each been a member of QLAD for 15 years. They have also recently taken out a joint membership together.

Under QLAD’s constitution Mel and Mark will each be entitled to one vote at the company’s general meeting through their individual memberships. They will also each be entitled to an additional vote as a result of their joint membership (that may be exercised together).

QLAD is a mutual entity under the new definition as all of its members have no more than one vote for each capacity in which they are members.

**Example 1.3**

CPO is an insurance mutual. General members of the mutual are all only entitled to one vote at a general meeting. Directors are part of a separate class of members and are also entitled to one vote at a general meeting.

Laura, Julie and Tim are all directors of CPO and general members of CPO. Laura, Julie and Tim each have two votes at a general meeting: one in their capacity as director, and one in their capacity as a general member.

CPO is a mutual entity under the new definition as all of its members have no more than one vote for each capacity in which they are members.

**Example 1.4**

Thrice Mutual Insurance (TMI) is a mutual insurance provider. Under its constitution, each policy holder is a member but each member is only entitled to one vote at a general meeting regardless of the number of polices they hold.
Tony has two insurance policies with TMI. Each insurance policy would entitle him to membership with TMI under its constitution. TMI is a mutual entity under the new definition as Tony is still only entitled to one vote at a general meeting in his capacity as member.

Removing the uncertainty for transferring financial institutions and friendly societies in respect of the demutualisation provisions in Part 5 of Schedule 4 of the Corporations Act

1.21 The heading of Part 5 of Schedule 4 of the Corporations Act is clarified to make it clear that this part deals with disclosure requirements for a demutualisation. [Schedule 1, item 4, Part 5 of Schedule 4 (heading)]

1.22 The current trigger for the disclosure of a demutualisation in subclause 29(1) of Part 5 of Schedule 4 of the Corporations Act is repealed. Instead, the disclosure requirements for a demutualisation will be triggered when a transferring financial institution that meets the new mutual entity definition makes an amendment to its constitution that means it will no longer meet the mutual entity definition. [Schedule 1, item 5, subclause 29(1) of Part 5 of Schedule 4]

1.23 As the trigger for the disclosure of a demutualisation has been simplified, the existing ASIC exemption power has also been simplified so that it only applies to allow ASIC to exempt an entity from the operation of Part 5 of Schedule 4 where ASIC is satisfied that the entity is not a mutual entity. [Schedule 1, items 10 and 11, subclauses 30(1) to (5) and (7) of Part 5 of Schedule 4]

Example 1.5

Duck Credit Union is a transferring financial institution that meets the definition of a mutual entity because its constitution provides that all of its members are only entitled to one vote at a general meeting of the company.

Duck Credit Union proposes to amend its constitution so that it can issue shares with proportional voting. This proposal to change Duck Credit Union’s constitution would trigger Part 5 of Schedule 4 of the Corporations Act requiring appropriate disclosure to its members because the proposal if carried out would result in Duck Credit Union no longer meeting the mutual entity definition.

MCIs: A bespoke capital instrument for the mutual sector

1.24 The amendments in the Bill provide for eligible mutual entities to issue MCIs, a bespoke share that has been created for the mutual sector.

1.25 The ability to issue MCIs provides mutual entities with access to a broader range of capital raising and investment options without risking their mutual structure or status.
**Who can issue MCIs?**

1.26 Mutual entities that are registered as companies limited by shares or companies limited by shares and guarantee already have the power to issue shares under the existing law. These mutual entities, may issue MCIs under this existing power.

1.27 Under section 124 of the existing law, companies limited by guarantee do not have power to issue shares. The new law ensures that a mutual entity that is a company limited by guarantee has power to issue an MCI. [Schedule 2, Part 1, item 3, subsection 124(4)]

**Requirements to be able to issue MCIs**

1.28 A mutual entity may issue an MCI provided it meets certain requirements. Some requirements relate to the mutual entity itself, while other requirements attach to the MCI.

1.29 The requirements that apply to the mutual entity itself provide that the entity:

- must be a public company;
- must not have voting shares (other than any MCIs) on a prescribed financial market;
- must not be a registered entity within the meaning of the of the *Australian Charities and Not-for-profits Commission Act 2012* (ACNC Act); and
- must have a constitution that states the entity is intended to be a MCI entity for the purposes of the Corporations Act.

[Schedule 2, Part 1, item 4, paragraphs 167AC(a) to (d), paragraph 167AD(1)(a)]

1.30 An entity is an MCI mutual entity if it meets the above requirements and has issued one or more MCIs. [Schedule 2, Part 1, item 2, subsection 167AC]

1.31 There are two sets of requirements for issuing an MCI that attach to the share itself. The first set involves a restriction on the mutual entity’s ability to vary or cancel class rights and the second set involves further rights and conditions on the share that must be stipulated in the entity’s constitution. These requirements are discussed further below in the context of the features of an MCI. [Schedule 2, Part 1, item 2, paragraph 167AD(1)(b)]

1.32 If any of the above requirements, including any of the requirements that attach to the mutual entity itself or the share itself, cease to be met, then the share ceases to be an MCI. It will continue to exist and operate as a type of share but will no longer meet the requirements for being an MCI. [Schedule 2, Part 1, item 2, paragraph 167AD(2)]
**Features of an MCI**

1.33 As a type of share, a MCI is a ‘security’ for the purposes of the Corporations Act. Accordingly, MCIs are subject to the Corporations Act regulatory regimes that would ordinarily apply to the issuance of a share issuing including fundraising and disclosure requirements.

1.34 MCIs are a new type of bespoke share for the mutual sector. While on their face there may be similarities between MCIs and preference shares (such as having non-cumulative dividends and the participation in surplus assets and profits), MCIs are distinctly different to preference shares.

1.35 In particular, as noted above, a share must meet certain requirements for it to be issued as an MCI and continue to be an MCI. These requirements involve:

- a restriction on the mutual entity’s ability to vary or cancel class rights; and
- further rights and conditions that attach to the share to be stipulated in the mutual entity’s constitution.

1.36 The rights attaching to an MCI can only be varied by a special resolution of the company and either:

- a special resolution of all members holding the same class of MCI; or
- obtaining written consent of 75 per cent of the holders of the class of MCI.

*Schedule 2, Part 1, item 4, section 167AE*

1.37 The mutual entity’s constitution must provide, in relation to the MCI, that:

- the share may only be issued as a fully paid share; and
- dividends in respect of the share are non-cumulative.

*Schedule 2, Part 1, item 4, paragraphs 167AF(1)(a) and (b)*

1.38 The constitution must also set out the rights attached to the share with respect to participation in surplus assets and profits (which includes any rights of an MCI holder to repayment of the face value ahead of other claims to surplus assets in a winding up). *Schedule 2, Part 1, item 2, paragraph 167AF(1)(c)*

1.39 The requirement to include these rights in the MCI mutual entity’s constitution is designed to be similar to the requirement for other companies to stipulate certain rights regarding preference shares in the company’s constitution (for example as in subsection 254A(2) of the existing law). This means that an MCI mutual entity can provide broad
parameters for the issuance of MCIs in its constitution that are consistent with the legislative requirements and allow the entity’s Board to set the specific details of each issuance of an MCI.

1.40 The MCI mutual entity may also specify further terms, conditions or rights that attach to the MCI beyond those required above.

1.41 To avoid doubt, a mutual entity that issues an MCI is not required to treat the holders of an MCI in the same way that it treats its members who do not hold MCIs. [*Schedule 2, Part 1, item 4, subsection 167AD(3)]

**Example 1.6**

Unity One is a mutual entity that provides its members with insurance products. Jennifer, Linley and Daniel have insurance products from and are members of Unity One.

Unity One has MCIs on issue and some of the MCIs are owned by Michael, Nayanisha and Greg.

Unity One decides to reward its members by providing them with exclusive pre-sale access to tickets to the ‘RG147’ concert by hit band ‘Peter and the Mutuos’.

Jennifer, Linley and Daniel receive the pre-sale access as they are members of Unity One. Michael, Nayanisha and Greg are not given access as their membership to Unity One is only through their ownership of its MCIs.

Michael finds out about the pre-sale access through his good friend Jennifer and complains to Unity One.

Unity One explains to Michael that the pre-sale access is only for its members who have insurance policies and that they are not required to treat an MCI holder like Michael in the same way that they treat non-MCI members.

1.42 As MCIs are limited to one vote per member regardless of the number of MCIs the holder owns (other than in relation a proposed change in class rights), MCIs will not be taken into account when determining whether an entity is a subsidiary of another entity or an entity has control over another entity for the purposes of the Corporations Act. [*Schedule 2, Part 1, item 2, subsection 48(6); Schedule 2, Part 1, item 11, section 910A (paragraph (b) of the definition of control)]

**Consequences of issuing an MCI**

1.43 As discussed above, once an eligible mutual entity issues an MCI it becomes an MCI mutual entity. [*Schedule 2, Part 1, item 4, section 167AC]*

1.44 MCI mutual entities that are companies limited by guarantee are be able to pay dividends in respect of MCIs. [*Schedule 2, Part 1, item 6, subsection 254WA(1)]
1.45 MCI mutual entities must not pay dividends in respect of an MCI unless the payment of the dividend is fair and reasonable to its members as a whole (as opposed to only its shareholders). [Schedule 2, Part 1, item 6, subsection 254WA(2)]

1.46 Once a mutual entity becomes an MCI mutual entity, a resolution that would result in the entity ceasing to be an MCI mutual entity does not have any effect unless there are no MCIs in the entity or the resolution provides for all MCIs on issue to be cancelled (before or at the time the entity ceases to be an MCI mutual entity). [Schedule 2, Part 1, item 4, section 167AG]

1.47 This ensures that a mutual entity that issues MCIs is not able to demutualise without first dealing with any MCIs on issue. This could be done by first extinguishing the MCIs on issue or by addressing the MCIs as part of the relevant resolution. Cancelling the MCIs could involve buying them back to extinguish them or providing for them to be cancelled prior to the demutualisation with MCI holders to be given replacement shares following the demutualisation. Cancellation of the MCIs requires approval from the class of holders of the MCIs.

1.48 The restriction does not prevent a court from making an order under section 233 of the Corporations Act that would result in the demutualisation of a mutual entity or a mutual entity ceasing to be an MCI mutual entity. It is however anticipated that a court would consider the existence of any MCIs and make appropriate consequential orders to address them.

Modernisation without corporatisation

1.49 The mutual sector is very diverse with mutual entities operating in almost every sector of the Australian economy. Mutual entities have historically included strict demutualisation provisions in their constitutions. These provisions were based on historic legislative settings and may prevent some mutual entities from making use of the reforms to be delivered through the amendments in this Bill.

1.50 As such, the amendments provide for a special standardised procedure to allow mutual entities to make the necessary amendments to their constitutions to allow them to issue MCIs. These provisions are included in Division 3 of the new ‘Part 2B.8 – Mutual capital instruments (MCIs)’ which has been created at the end of Chapter 2B of the Corporations Act. The special procedure is available to mutual entities that:

- are public companies;
- do not have voting shares quoted on a prescribed financial market; and
Reforms to the mutual sector

• are not a registered entity within the meaning of the ACNC Act.

[Schedule 2, Part 1, item 4, section 167AH]

1.51 The special procedure will allow an eligible mutual entity to amend its constitution to:

• include a statement that it intends to be an MCI mutual entity;
• provide for it to issue MCIs;
• specify the rights and obligations attaching to any MCIs it issues; and
• make other incidental or ancillary changes that are required.

[Schedule 2, Part 1, item 4, subsection 167A(1)]

1.52 The special procedure allows a mutual entity to amend its constitution to include rights and obligations attached to MCIs that are not specified in new section 167AE to 167AG. For example, a mutual entity’s obligations could include the right to receive dividends and how the amount of dividends to be paid will be determined.

1.53 The special procedure cannot result in a change to a mutual entity’s constitution that would result in it ceasing to be a mutual entity.

[Schedule 2, Part 1, item 4, subsection 167A(2)]

1.54 A mutual entity relying on the special procedure must provide notice of the proposed resolutions in accordance with the existing requirements provided for in paragraph 249L(1)(c) of the Corporations Act. The resolution cannot deal with any other matters.

[Schedule 2, Part 1, item 4, subsections 167A(1) and 167A(1)]

1.55 The special procedure provides for mutual entities to make the changes outlined above if the resolution is passed by 75 per cent of the votes cast by members who are present (including via proxy) at the meeting and entitled to vote on the resolution.

[Schedule 2, Part 1, item 4, subsection 167A(2)]

1.56 The special procedure applies regardless of anything else provided for in a mutual entity’s constitution in relation to process or quorum requirements.

[Schedule 2, Part 1, item 2, subsections 167A(2) and 3)]

1.57 The special procedure is only available for a fixed period of 36 months from the time this Bill receives Royal Assent. Further, a mutual entity can only try to make use of the process a total of three times. The ability to use the process up to three times has been included to provide for circumstances where a mutual entity comes close to but does not get enough votes to make the required constitutional changes.

[Schedule 2, Part 1, item 2, subsection 167AJ(1)]
However, if the 36 month period has expired, a mutual entity may alter its constitution in accordance with the terms of the entity’s constitution.

Consequential amendments

Amendments to the Corporations Act

The definition in section 9 of the Act is updated to insert new definitions of MCI, MCI amendment resolution, MCI mutual entity and mutual entity. [Schedule 1, item 1, section 9; Schedule 2, Part 1, item 1, section 9]

The amendments relating to MCIs have been included in a new ‘Part 2B.8 – Mutual capital instruments (MCIs)’ which has been created at the end of Chapter 2B of the Corporations Act. [Schedule 2, Part 1, item 4, Part 2B.8 – Mutual capital instruments (MCIs)]

A simplified outline of new Part 2B.8 is provided for in new section 167AB. The simplified outline will assist readers of the Bill to understand the substantive provisions of the Bill, but is not otherwise operational. For a detailed understanding, readers of the Bill will need to refer to the substantive provisions and explanation in this Explanatory Memorandum. [Schedule 2, Part 1, item 4, section 167AB]

Provisions relating to class rights in Part 2F.2 currently operate differently depending on whether a company has a share capital or not. A MCI mutual entity (a mutual entity that has MCIs on issues) would have share capital and therefore Part 2F.2 would only apply in relation to the entity’s MCI holders. To preserve the Part’s application to the mutual entity’s other non-shareholder members, a consequential amendment is included to provide that the provisions in the Part should:

- apply to a person who holds an MCI as if the entity is a company with share capital; and
- apply to a person who is member of the entity otherwise than as a MCI holder as if the entity is a company without a share capital.

Provisions relating to share capital reductions and share buy backs in Part 2J.1 of the Corporations Act refer only to shareholders. However, as MCI mutual entities that are companies limited by guarantee can also issue MCIs, the references to shareholder in the Part are taken to include other non-shareholder mutual members. The change only applies once a mutual entity has an MCI on issue and therefore becomes an MCI mutual entity. The change ensures that all mutual members of MCI mutual entities that are companies limited by guarantee will be able to vote on
changes affecting share capital reductions and share buy backs. [Schedule 2, Part 1, item 7, subsection 258G(1)]

1.62 Division 1 of Part 2J.1 of the Corporations Act provides for equal and selective reductions of share capital. The amendments provide that reductions of share capital that relate to MCI mutual entities are taken to be selective reductions because a reduction can only be an equal reduction if it relates to ordinary shares. [Schedule 2, Part 1, item 7, subsection 258G(2)]

1.63 Division 2 of Part 2J.1 of the Corporations Act provides for equal and selective share buyback schemes. The amendments provide that buybacks that relate to MCI mutual entities are not taken to be an equal access scheme as equal access schemes can only relate to ordinary shares. [Schedule 2, Part 1, item 7, paragraph 258G(3)(a)]

1.64 To ensure the 10/12 limit for share buybacks works in relation to MCI mutual entities, subsections 257B(4) and (5) will have effect in relation to an MCI as if each MCI were a voting share with one vote attached to it. [Schedule 2, Part 1, item 7, paragraph 258G(3)(b)]

1.65 For MCI mutual entities, references to a shareholder in Part 2J.3 are taken to include the mutual entity’s non-shareholder members. [Schedule 2, Part 1, item 8, subsection 260DA(1)]

1.66 The existing requirements for entities to get shareholder approval for share capital reductions, share buybacks and the provision of financial assistance relating to the acquisition of the entity’s shares are modified for MCI mutual entities so that approval is required from all members of the entity. [Schedule 2, Part 1, items 7 and 8, subsections 258G(2) to (3) and 260DA(1)]

1.67 To avoid doubt, the modification to the operation of Parts 2J.1 and 2J.3 do not have the effect of requiring an MCI mutual entity to treat a non-shareholder member’s membership as a share. [Schedule 2, Part 1, items 7 and 8, subsections 258G(4) and 260DA(2)]

1.68 The provisions in the Corporations Act for takeovers, compulsory acquisitions and buy-outs do not apply to MCIs as each MCI is limited to no more than one vote per member (other than in relation to variations to class rights). [Schedule 2, Part 1, Items 9 and 10, sections 605A and 660C]

Amendments to Part 5 of Schedule 4 to the Corporations Act

1.69 The disclosure provisions under Part 5 of Schedule 4 to the Corporations Act require the disclosure statement to include an estimate of the financial benefits members will be offered if the demutualisation occurs as a result of a constitutional amendment. The provision is amended to always require the estimate to be provided because the new
simplified test is based on a mutual entity amending its constitution. [Schedule 1, item 7, paragraph 29(4)(b) of Part 5 of Schedule 4]

1.70 A number of redundant references to demutualisation though the issuance of shares are removed. [Schedule 1, items 6, 8, 9 and 12 to 20, subclauses 29(2), (5), (6) and (7) of Part 5 of Schedule 4; subparagraphs 29(4)(c)(i) and 35(1)(c)(ii) of Part 5 of Schedule 4; clause 31 of Part 5 of Schedule 4; paragraphs 32(1)(c), (g), (h), (i), (k) and (l), 32(3)(b), 34(1)(d) and (e) of Part 5 of Schedule 4]


1.71 The Financial Sector (Shareholdings) Act 1998 and the Insurance Acquisitions and Takeovers Act 1991 are amended to ensure that an MCI mutual entity’s non-shareholder mutual member’s voting rights are taken into account in assessing voting power for the purposes of the two acts. [Schedule 2, Part 2, items 12 and 23, subsection 9(4) of Schedule 1 to the Financial Sector (Shareholdings) Act 1998, subsection 13(4) of the Insurance Acquisitions and Takeovers Act 1991]

Amendments to the ITAA 1936 and the ITAA 1997

1.72 The ITAA 1936 and the ITAA 1997 are amended to clarify that the issue of MCIs by a mutual entity does not cause it to demutualise for income tax purposes. Consequently, for the purpose of determining whether an entity is mutual insurance company, a mutual affiliate company or a mutual entity under the demutualisation provisions in the income tax law, the following factors are disregarded:

- the issue of MCIs by the entity;
- the payment of dividends or profits in respect of MCIs issued by the entity; and
- having members who are members of the entity by virtue of holding an MCI.

[Schedule 2, Part 2, items 13 to 16 and 22, subsections 121AB(1), 121AC(1), 121AC(2) of the ITAA 1936; subsection 326-10(1A) to Schedule 2H of the ITAA 1936; the definition of ‘demutualise’ in subsection 995-1(1) of the ITAA 1997]

1.73 The ITAA 1997 is also amended to ensure that the power of a mutual entity to issue MCIs does not disturb the operation of the mutuality principle in the income tax law to the mutual entity’s mutual receipts.

1.74 In this regard, mutuality is a legal principle based on the proposition that a taxpayer cannot derive income from itself. For income tax purposes, the mutuality principle operates so that any surplus arising from the member contributions and receipts from member dealings are not taxable income if:
Reforms to the mutual sector

- members contribute to a common fund created and controlled by them for a common purpose; and
- those contributing members are essentially the same as those who participate in the fund.

1.75 Mutual receipts are those receipts arising out of mutual dealings and do not include income derived from outside sources or income derived from dealings with members which go beyond mutual arrangements and are in the nature of trade.

1.76 Section 59-35 of the ITAA 1997 ensures that not-for-profit mutual entities are not subject to income tax on amounts of ordinary income from their members where those amounts would be mutual receipts but for the entity’s constituent documents prohibiting them from distributing funds to members. This is done by treating those amounts as non-assessable non-exempt income. The section was introduced in response to the Federal Court decision in Coleambally Irrigation Mutual Co-Operative Ltd v Commissioner of Taxation [2004] FCAFC 250.

1.77 The issue of MCIs, or the power to issue MCIs, by a mutual entity is not intended to affect the application of the mutuality principle to the entity. Therefore, section 59-35 of the ITAA 1997 is extended to cover amounts of ordinary income derived by a mutual entity that are prevented from being mutual receipts because:

- the entity's constituent document prevents the entity from making any distribution (whether in property, money or otherwise) to its members;
- the entity's constituent document provides for the entity to issue MCIs or to pay dividends in respect of MCIs; or
- the entity has issued one or more MCIs or has paid dividends in respect of one or more MCIs.

[Schedule 2, Part 2, items 17, 19 and 20, section 11-55 and paragraph 59-35(a) of the ITAA 1997]

1.78 If there are any other circumstances associated with MCIs that a mutual entity has or proposes to issue, those circumstances will need to be considered in determining whether the mutuality principle continues to apply to the relevant mutual entity.

1.79 Where section 59-35 of the ITAA 1997 applies to amounts produced by a mutual entity:

- the mutual entity may be entitled to a full or partial deduction for rates and land tax paid for premises used by the mutual entity (section 25-75); and
• the capital gains tax exemption rules are modified so that
  not-for-profit mutual entities are treated in the same way as
  other mutual entities (subparagraph 118-12(2)(ia)).

1.80 Consequential amendments ensure that, where section 59-35
  applies because a mutual entity has issued MCIs, section 25-75 and
  subparagraph 118-12(2)(ia) will apply appropriately. [Schedule 2, Part 2,
  items 18 and 21, paragraph 25-75(1)(e) and subparagraph 118-12(2)(ia) of the
  ITAA 1997]

Application and transitional provisions

1.81 The amendments take effect from the day after Royal Assent.

1.82 The amendments to Part 5 of Schedule 4 of the Corporations Act
  apply on and after commencement of the bill. [Schedule 1, item 3, section 1662]
Chapter 2
Statement of Compatibility with Human Rights

Prepared in accordance with Part 3 of the Human Rights (Parliamentary Scrutiny) Act 2011

Treasury Laws Amendment (Mutual Reforms) Bill 2019

2.1 This Bill is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the Human Rights (Parliamentary Scrutiny) Act 2011.

Overview

2.2 This Bill gives effect to recommendations 5, 8 and 9 of the Hammond Report to:

• introduce a definition of a mutual entity into the Corporations Act;
• remove the uncertainty for transferring financial institutions and friendly societies in respect of the demutualisation provisions in Part 5 of Schedule 4 of the Corporations Act; and
• expressly permit mutual entities registered under the Corporations Act to issue equity capital without risking their mutual structure or status.

Human rights implications

2.3 This Bill does not engage any of the applicable rights or freedoms.

Conclusion

2.4 This Bill is compatible with human rights as it does not raise any human rights issues.