

Tax insights

New Tax System for Managed Investment Trusts - Exposure Draft



Snapshot

On 9 April 2015 the government released *Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015* as an Exposure Draft (the AMIT Regime ED) for public consultation.

The proposed start date for the AMIT regime is 1 July 2015, however it is expected that this will be on an elective basis, with a compulsory start date of 1 July 2016.

While the compulsory start date is some way off, the AMIT Regime ED introduces a range of new issues and opportunities for fund managers which will require detailed consideration in the lead up to the application of the rules. In addition, the AMIT Regime ED proposes a number of other changes with a fixed 1 July 2015 application date or that will apply retrospectively.

The following provides a high level summary of the AMIT Regime ED to assist you in considering the impacts of the AMIT Regime ED on your current and future funds. It also details various proposed trustee taxation provisions which are part of the AMIT Regime, and outlines the proposed categories of income and offsets for which calculations will be required.

There are a number of substantial issues with the AMIT Regime ED which warrant further consideration throughout the consultation period. In addition, as with any legislation of this type, there will undoubtedly be further issues that are uncovered in practice or based on the administration or interpretation of the rules by the Australian Taxation Office (ATO) and, ultimately, the courts.

Summary of proposed amendments

Application dates	
Measure	Date
AMIT regime <ul style="list-style-type: none"> • Attribution • Arm's length rule¹ • Overs / unders² • Deemed fixed trust treatment • Unit cost adjustments (increases and decreases) • Classes of units³ • Debt-like units⁴ • MIT Withholding Tax and deemed payments 	1 July 2015 (expected to be elective with a 1 July 2016 compulsory application date)
New categories of deemed widely held investors <ul style="list-style-type: none"> • Foreign life companies • Wholly owned subsidiaries 	1 July 2014
Removal of the 20% tracing rule in Division 6C	1 July 2015
Repeal of Division 6B	1 July 2015
Tax deferred income deemed non-assessable	1 July 2011

¹ Transitional rules until 1 July 2017

² Retrospective (no "uplift" amounts for historical overs / unders)

³ Elective (irrevocable)

⁴ Applies to existing units

Features of the AMIT regimes

1. Qualification

A trust will be an AMIT if it is a MIT and satisfies the Clearly Defined Interests (CDI) test.

A registered managed investment scheme (MIS) will be treated as having CDI if the amount of each member's AMIT character components (refer below) can be worked out on a fair and reasonable basis and the rights of each member to the income and capital of the trust cannot be materially diminished through the exercise of a power or right.

An unregistered MIS will also need to be satisfied that its trust deed meets various criteria, based on certain Corporations Act 2001 requirements for registered MISs, safeguarding the interests of members.

The Commissioner also has discretion to treat a MIT as having CDI.

Deloitte perspective

Trustees will need to review constitutions and trust deeds to determine whether the CDI test is satisfied or whether amendments are required in order to qualify as an AMIT. Certain other amendments to accommodate the attribution of tax to investors (refer below) may also be required.

Trustee may also want to consider retaining /

including default present entitlement clauses to safe guard in the event that the CDI test is ultimately determined not to be met or the trust ceases to be an AMIT.

Careful consideration will be required to ensure that any amendments do not result in a resettlement of the trust.

2. Attribution

An AMIT must determine each component of income etc. based on the various "AMIT character" types. There are 15 AMIT character types in the ED (refer below), with the potential for more to be added by legislative instrument.

The rules categorise the AMIT character types into income, exempt, non-assessable non-exempt (NANE) and offset AMIT character types.

An AMIT will be permitted to attribute each AMIT character component to unitholders on a fair and reasonable basis.

AMITs will not be subject to the normal requirements that beneficiaries are "presently entitled" to the "income of the trust estate", thereby effectively de-linking the tax payable by unitholders from the cash distribution.

Members will be able to dispute the reasonableness of the attribution through the member's tax return, which may expose the

trustee to tax on any differences. Members must notify the trustee in these cases.

Deloitte perspective

While the current rules arguably allow trustees a similar degree of flexibility, the AMIT attribution rules potentially go further by permitting trustees to allocate tax differently to different unitholders in the same class, for example allocating capital gains released on the sale of assets to the redeeming unitholders to whom the proceeds are paid or allocating capital gains to unitholders that were on the register at the time that the relevant gains were distributed.

Trustees should consider how attribution may impact on future distributions and whether attribution policies should be communicated to investors to seek to reduce the risk that members will dispute the reasonableness of attribution.

3. Arm's length rule

The trustee of an AMIT will be subject to tax at 49% on any income derived from a non-AMIT to the extent it exceeds an arm's length amount.

For interest on loans there is a safe harbour of the greater of the "benchmark rate of return" or 3% above the Shortfall Interest Charge (SIC), being 5.36% for the June 2105 quarter.

Transitional rules apply for payments before 1 July 2017 for arrangements entered into before the date on which the AMIT Bill is introduced into the House of Representatives.

Deloitte perspective

The arm's length rule is stated as not requiring trustees to consider the interest income assuming an arm's length quantum of debt.

Trustees should consider the safe harbours, including the relevant benchmark rate of return (which generally requires an analysis of the rate on a comparable loan in the market) or substantiation of the arm's length nature of current cross-stapled arrangements (e.g. loans or leases) and, if necessary, restructuring of existing arrangements prior to 1 July 2017.

4. Overs / unders

The AMIT rules codify the treatment of over/under distributions (e.g. situations where the actual taxable income of the trust is over or under the taxable income notified to unitholders at the time

of distribution) by allowing the AMIT to carry an over / under forward to the year in which it is discovered.

Overs / unders are calculated separately for each AMIT character type.

Members will be required to include "uplift" amounts where an AMIT has a "big" under of an income, exempt or NANE AMIT character. The uplift reflects the SIC calculated from the 4 months following the "base year" to 4 months following the "discovery year".

An under is "big" if total net unders for income AMIT character types for an income year exceed the greater of 0.4% of net assets and 5% of the taxable income of the AMIT for the base year.

Trustees can be subject to penalty tax if the AMIT has a "big" under / over as a result of "recklessness" or intentional disregard of the law.

Overs / unders for income years before a trust became an AMIT will be included in over / under calculations once the trust becomes an AMIT, but will not be subject to the SIC "uplift" rules.

Where a trust ceases to be an AMIT the over / under rules continue to apply for "base years" during which the trust was an AMIT.

Deloitte perspective

While the carry forward of overs / unders is in line with current industry practice, it has strictly never been accommodated by the tax rules.

A number of issues arise for trustees, including systems changes that will be required to accommodate the determination of overs / unders by AMIT character type and consideration of new processes to seek to reduce the risks of overs / unders and "uplift" amounts arising to unitholders.

In an acquisition scenario, the codification of overs / unders may shift the risk of historical errors to the unitholders and trustee of the acquirer, therefore more detailed due diligence may be required where the target or acquirer is, or will become, an AMIT. In some situations consideration could be given to including an ability to re-issue statements to pre-acquisition unitholders under the sale and purchase agreement to avoid overs / unders arising post acquisition.

5. Deemed fixed trust treatment

AMITs will be deemed to be fixed trusts. Fixed trust treatment makes it easier for AMITs to satisfy the carry forward loss rules, provides access to concessional tracing rules for flowing through franking credits and certain Capital Gains Tax (CGT) roll-overs (e.g. CGT relief for scrip for scrip takeovers).

Deloitte perspective

This addresses concerns that, under the current rules, it is difficult (if not impossible) for a trust to satisfy the fixed trust definition, such that the favourable exercise of the Commissioner's discretion would be required in order to qualify as a fixed trust.

6. Tax deferred income not assessable

As previously announced, distributions of tax deferred income (e.g. distributions sheltered from tax by depreciation deductions) from an MIT will be deemed to be non-assessable, with effect from 1 July 2011 (retrospective amendments are yet to be released).

Deloitte perspective

This deals with the concern that such amounts could be assessable to "revenue account" unitholders (e.g. life companies). It is expected that the tax deferred distribution will reduce the cost of the membership interest (i.e. increase any gain / reduce any loss on disposal).

7. Cost adjustments

Where the taxable distribution from an AMIT exceeds the cash distribution unitholders will be permitted to increase the cost base of their units. The rules will also specifically provide for adjustments to the cost of units held on revenue account.

Cost adjustments will need to be shown on the AMIT member annual statement (AMMA).

Deloitte perspective

This adjustment prevents the double taxation that may otherwise arise where unitholders have previously suffered reductions in the cost base of their units through the receipt of tax deferred distributions.

8. Classes of units

AMITs with multiple classes of units will be permitted to make an irrevocable election to treat

each class of unit as a separate AMIT. Making the election quarantines taxable income and losses to the unitholders of the relevant class.

Deloitte perspective

This change provides managers with substantial flexibility in the structuring of funds (e.g. allowing the issue of separate classes of units for individual assets). Managers should consider the opportunity to establish new types of funds and whether existing units should be split into classes.

9. Debt-like units

AMITs will be able to claim deductions for distributions on debt-like units. Distributions on debt-like units will fall outside the attribution rules.

A unit will be debt-like if the distribution is fixed by reference to the amount subscribed, it ranks above other classes of units and the trust deed prohibits distributions on other units or stapled securities ahead of distributions on the debt-like units.

10. Taxable distribution exceeding cash payment-deemed payments

In situations where a taxable distribution to a non-resident exceeds the cash distributed, the current rules are unclear as to the amount on which MIT WHT is to be applied

For AMITs, WHT will clearly apply to the whole taxable distribution. For intermediaries (e.g. custodians), where the cash distribution is insufficient to satisfy the WHT obligation, the intermediary must notify the trustee of the AMIT which must then pay the shortfall directly to the ATO. If the intermediary fails to notify the trustee with 30 days, the WHT obligations must be satisfied by the intermediary.

AMIT benefits and risks

Trustees will need to evaluate the benefits and risks associated with entering the AMIT regime, and the timing of entry.

A summary of potential benefits and risks is set out below. While codification of industry practice may be seen as maintaining the status quo, there is risk involved in continuing to rely on such practices and the way in which the rules are currently administered.

Benefits	<ul style="list-style-type: none"> • Unit cost increasing adjustments • Classes of units • Debt-like units • Attribution de-linked from present entitlement
Codification of industry practice	<ul style="list-style-type: none"> • Attribution linked to present entitlement • Overs / unders • Deemed fixed trust treatment • MIT Withholding Tax and deemed payments • Unit cost decreasing adjustments for revenue assets
Risks	<ul style="list-style-type: none"> • Arm's length rule penalties • Overs / unders uplifts and penalties • Attribution penalties • Trust resettlement

Deloitte perspective

This change will open up the MIT rules to a number of common offshore investment structures that previously would not have qualified, for example limited partnerships used as a pooling vehicle for deemed widely held investors and structures with corporate blockers. An issue has been identified in relation to the membership interest held by a general partner in a limited partnership which it is hoped will be addressed through consultation.

Other changes

1. Removal of 20% rule tracing rule in Division 6C

A trust will no longer be a public unit trust by virtue of 20% or more of its investors being superannuation funds.

Where a trust is not a public unit trust it will not be a public trading trust and therefore not taxed in a similar way to a company (i.e. it will be a flow through trust) despite carrying on a trading business.

MIT qualifications – New categories of deemed widely held investors

Trustees should review existing structures and consider whether the changes allow an existing trust to satisfy the widely held test. Given the retrospective nature of the change, trustees which become MITs due to the amendments may be faced with withholding obligations on distributions that have already been paid.

The extended list will also be relevant in establishing new funds. The uncertainty existing prior to the enactment of the measures will need to be factored into any tax forecast for acquisitions or divestments.

1. Foreign life companies

Foreign life companies regulated under a foreign law will now qualify as deemed widely held investors

Deloitte perspective

This change provides an enormous pool of investment funds with access to the MIT rules.

2. Wholly owned subsidiaries

Wholly owned subsidiaries of one or more deemed widely held entities will also be deemed to be widely held.

Deloitte perspective

This opens up the opportunity for superannuation funds to invest in operating businesses and categories of real estate which would not have been available via a flow through trust in the past, for example hotel operations, retirement villages, student accommodation, property development and residential.

Transitional rules for existing trusts which cease to be taxed as companies have not been included in the ED. Such rules may be required, for example, in order to release franking credits.

2. Repeal of Division 6B

Division 6B is an old integrity rule that operated to cause a trust to be taxed in a similar way to a company if it offered units in return for the acquisition of assets.

Deloitte perspective

The repeal of Division 6B will increase certainty in restructuring transactions.

Trustee taxation provisions, penalties and rates

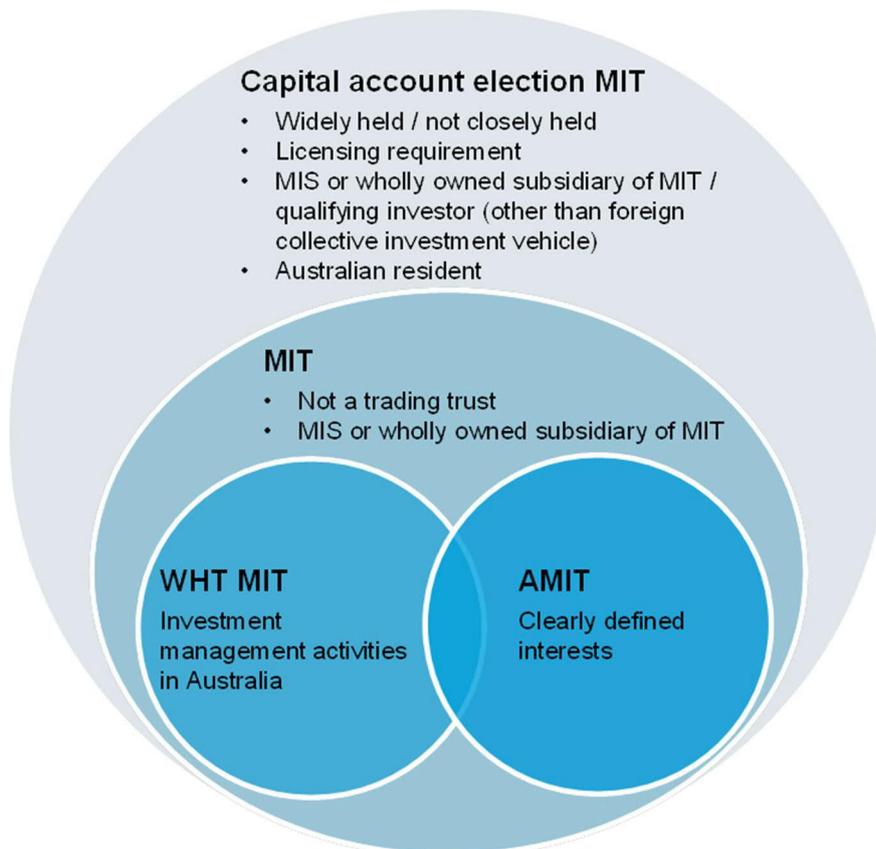
Outline of change		Rate of tax / penalty
1. Amounts attributed to foreign resident members	Where the cash payment of an AMIT is insufficient to cover the MIT WHT payable by an intermediary.	MIT WHT shortfall
2. Trust component deficit for offset characters	Where an AMIT has a negative offset AMIT character amount (due to offset AMIT character overs and/or uplifts), other than foreign income tax offsets.	The amount of the trust component deficit
3. Shortfall in single determined member component (income, exempt, NANE)	Where a member disputes the reasonableness of the attribution of an income, exempt or NANE AMIT character type resulting in a shortfall.	49% ¹
4. Excess in single determined member component (offset)	Where a member disputes the reasonableness of attribution of an offset AMIT character type resulting in an excess.	49% ¹
5. Amounts of determined trust component that cannot be reflected in member components	Where a trustee fails to fully attribute all of an income AMIT character component to members.	49% ¹
6. Amounts of under of income character not properly carried forward	Where a trustee fails to fully recognise an under of an income AMIT character in the discovery year (e.g. uncovered through ATO audit).	49% ¹
7. Amounts of over of offset character not properly carried forward	Where a trustee includes an excessive over of an offset AMIT character in the discovery year (e.g. uncovered through ATO audit).	49% ¹
8. Amount of non-arm's length income of AMIT		49% ¹
9. Penalty for substantial net variance (i.e. "big" over / under)		<p>Intentional disregard 49%¹ x 75% of shortfall Greater of 60 penalty units / 49%¹ x 30% of excess</p> <p>Recklessness 49%¹ x 50% of shortfall Greater of 40 penalty units / 49%¹ x 20% of excess</p>

¹ Including 2% Medicare levy and 2% temporary budget repair levy

AMIT character types

Character types	
Income AMIT character type	<ol style="list-style-type: none"> 1. Interest 2. Dividends: unfranked 3. Franking credit gross up 4. Royalties 5. Other Australian income 6. Other capital gains: Taxable Australian Property (TAP) 7. Other capital gains: Non-Taxable Australian Property (NTAP) 8. Discounted capital gains: Taxable Australian Property (TAP) 9. Discounted capital gains: Non-Taxable Australian Property (NTAP) 10. Other net foreign source income
Exempt AMIT character type	<ol style="list-style-type: none"> 11. Net Exempt income 12. Net Exempt income for foreign residents
NANE AMIT character type	<ol style="list-style-type: none"> 13. Non-assessable, non-exempt (NANE)
Offset AMIT character types	<ol style="list-style-type: none"> 14. Franking credits 15. Foreign Income Tax Offsets

Types of MIT



Contacts

For more information, please contact



Joe Galea
Partner
+61 2 9322 7591
jgalea@deloitte.com.au



Max Persson
Partner
+61 2 9322 7538
mpersson@deloitte.com.au



Mark Ekkel
Partner
+61 3 9671 7436
mekkel@deloitte.com.au



Ryan English
Partner
+61 3 9671 6774
renglish@deloitte.com.au

For further information, visit our website at www.deloitte.com

This publication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively the "Deloitte Network") is, by means of this publication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this publication.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/au/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte's approximately 195,000 professionals are committed to becoming the standard of excellence.

About Deloitte Australia

In Australia, the member firm is the Australian partnership of Deloitte Touche Tohmatsu. As one of Australia's leading professional services firms, Deloitte Touche Tohmatsu and its affiliates provide audit, tax, consulting, and financial advisory services through approximately 6,000 people across the country. Focused on the creation of value and growth, and known as an employer of choice for innovative human resources programs, we are dedicated to helping our clients and our people excel. For more information, please visit our web site at www.deloitte.com.au.

Liability limited by a scheme approved under Professional Standards Legislation.

Member of Deloitte Touche Tohmatsu Limited

© 2015 Deloitte Tax Services Pty Ltd.