A NEW TAX SYSTEM FOR MANAGED INVESTMENT TRUSTS

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Tax and Investment Management Alert

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INTRODUCTION

The Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015 (Bill) was tabled in Parliament on 3 December 2015, along with three supporting bills.

If passed in its present form, the Bill will introduce a new tax system for certain managed investment vehicles (to be known as Attribution Managed Investment Trusts or AMITs) which elect into the regime. The new regime will apply from 1 July 2016, although in certain circumstances a trustee of a managed investment trust (MIT) can choose to apply the rules prior to this date.

Importantly, the new regime aims to increase operating flexibility and reduce compliance costs for trusts and investors. We expect that most trust constitutions will need to be amended in order to take advantage of the new regime, which means trustees and fund managers will need to consider:

- the features of the new AMIT regime
- implementing a review process for trust constitutions
- timing in relation to any unitholder meetings or communications that may be required for the necessary constitution amendments (this will depend on what relief may be made available by the Australian Securities and Investments Commission (ASIC))
- updating offer documentation in order to reflect the constitution amendments and the timing in relation to these updates.

BACKGROUND

The underlying reason for introducing the AMIT regime is to provide greater certainty for investors and fund managers as to the operation of the tax rules which apply to MITs. The current regime has been considered inherently unsuitable for wholesale and retail funds, as it was historically for closely held investments.

The new regime will remove AMITs from the operation of Division 6 of the *Income Tax Assessment Act 1936*, and instead AMITs will be subject to tax under new Division 276 of the *Income Tax Assessment 1997*.

EXISTING MIT CONCESSIONS

Australia currently has an MIT regime, which is targeted at foreign investors looking to make passive investments in Australian assets, particularly real property and infrastructure assets.

This regime allows trust assets to be treated as being on capital account, so that any gains on realisation of those assets (other than direct and indirect interests in Australian real property) are generally exempt from tax in the hands of an offshore investor.

The current MIT regime also imposes a final and concessional tax on such gains, generally at the rate of 15%.

AMITs, as a type of MIT, will be entitled to these concessions.

WHAT IS AN AMIT?

In order to qualify for AMIT treatment and be taxed under the new Division 276, a trust must:

1. be a MIT under current law (which in broad terms means a widely held, Australian-based, regulated, passive investment vehicle)
2. be one in which investors have clearly defined interests in income and capital of the trust
3. have made an election that the AMIT regime applies.

OUTLINE OF THE AMIT REGIME

Under the new Division 276, income of the trust is divided into a number of categories (income, non-assessable, non-exempt income, capital gains, tax offsets and so forth), and allocated ('attributed') to investors.

Attribution of each income type must be done on a fair and reasonable basis in accordance with the Trust's constituent documents. Streaming income on the basis of the tax profile of a particular investor is prohibited. Members are notified of the amounts allocated to them via an annual statement.

Trust income retains its character when distributed and investors are treated as if they had received the item of income directly. The result is that an AMIT is treated in many respects as a fiscally transparent vehicle. Losses however, continue to be retained within the trust - although because AMITS are deemed to be fixed trusts, certain rules that limit the ability to carry forward trust losses do not apply as onerously.

In light of the proposed changes in relation to attribution of income, we expect that trustees and fund managers will need to review the distribution provisions in their trust constitutions. In particular, we expect trustees and fund managers will need to consider what amendments may be required in order to take advantage of the new regime as typically the distribution provisions in a trust constitution state that unitholders are entitled to a pro rata share of all distributable income, rather than apportioning entitlement by class or type of income.

The new Division 276 also proposes a regime to carry forward 'overs and unders'. Where a trustee is unable to accurately calculate investor entitlements at year end, and a variance to the true number is later discovered an 'overs and unders' regime allows the variance to be reconciled by adjusting members' entitlements to trust income in the year of discovery, rather than requiring investor statements to be re-issued and investors potentially needing to seek amendments to tax returns lodged, which is the current case. The 'overs and unders' regime may also require trust constitutional amendments.

The trustee of an AMIT will be liable to tax where there has been an error in attributing income to investors such that tax is not payable on some trust income. The trustee will also be taxed in respect of certain income attributed to offshore investors, unless the payments are subject to the MIT withholding provisions.

If investors sell units in a trust before a distribution is received, but are allocated the distribution for tax purposes, double taxation may result. This is now relieved, as the AMIT regime allows an upwards adjustment to the cost base of units in an AMIT in this (and other) circumstances. Downwards adjustments are also required in certain circumstances, including where a tax deferred or tax exempt distribution is received.

OTHER DEVELOPMENTS

The Australian Tax Office (ATO) has published draft guidelines on its administration of the AMIT regime. The guidelines will be finalised once the Bill is passed.

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