INFRASTRUCTURE
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AUSTRALIA
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SUBMISSION:

Implementation of a new tax system for managed investment trusts

November 2010

INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

BUILDING AUSTRALIA TOGETHER

Infrastructure Partnerships Australia is a national forum, comprising public and private sector CEO Members, advocating the public policy interests of Australia's infrastructure industry.

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1. ABOUT INFRASTRUCTURE PARTNERSHIPS AUSTRALIA

Infrastructure Partnerships Australia is the nation's peak infrastructure body. Our mission is to advocate the best solutions to Australia's infrastructure challenges, equipping the nation with the assets and services we need to secure enduring and strong economic growth and importantly, to meet national social objectives.

Infrastructure is about more than balance sheets and building sites. Infrastructure is the key to how Australia does business, how we meet the needs of a prosperous economy and growing population and how we sustain a cohesive and inclusive society.

Our Membership is comprised of the most senior industry leaders across the spectrum of the infrastructure sector, including financiers, constructors, operators and advisors. Importantly, a significant portion of our Membership is comprised of government agencies.

Infrastructure Partnerships Australia draws together the public and private sectors in a genuine partnership to debate the policies and priority projects that will build Australia for the challenges ahead.

1.1 INTRODUCTION

Infrastructure Partnerships Australia (IPA) is pleased to be able to provide this response to the discussion paper: *Implementation of a new tax system for managed investment Trusts (MITs)* and acknowledges the ongoing work of the Treasury in this area. The discussion paper released on 18 October represents the Government's response to the Board of Taxation's review of the tax arrangements applying to MITs and its commitment to a consultation process as to how the new tax system will be implemented.

Reform and modernisation of taxation arrangements for MITs has been long needed, including reducing complexity, increasing certainty and minimising compliance costs. Such reform would go a long way toward improving Australia's international competiveness in attracting funds under management.

In particular, IPA notes reforms already achieved as a result of the interim advice provided by the Board of Taxation while they were conducting the Government commissioned review of tax arrangements applying to managed funds. This includes legislation providing eligible MITs to make an irrevocable election to apply capital account treatment to gains and losses made on disposals of certain assets, primarily shares, units and real property, and a reduced rate of final withholding tax (of 7.5 per cent) for most foreign investors on fund payments from a MIT.

While IPA appreciates the Government's commitment to consultation on the proposed reforms, we consider there has been insufficient time allowed for this process to be undertaken thoroughly, particularly as the Government intends the new regime to commence on 1 July 2011. IPA has concerns that despite the intentions of the reforms, the discussion paper and consultation questions actually raise the possibility that the new regime will lead to increased complexity and compliance costs.

2. RESPONSE TO CONSULTATION QUESTIONS

2.1 Definition

Question 1

Whether any or all of the rules about trusts treated as MITs for the purposes of the capital account election (Division 275) should be incorporated in the concept of a MIT that applies generally to the treatment of MITs for income tax (but not withholding tax)?

We take this question as identifying what requirements should be treated as important in determining whether a trust is a MIT.

The answer to this question may be important considered in isolation but it is inextricably linked with a number of other issues which the Treasury Paper addresses. For example, the need and the shape of a MIT definition will depend on the way in which the 'clearly defined rights and entitlements' test is imposed.

The answer to the consultation question should be approached in a number of steps.

First, it seems clear that (with one exception) there should be a single definition of MIT which operates for all purposes of the Act – the CGT election, attribution regime, trust loss rules, 'unders-and-overs' rules, cost base adjustment rules and so on.

Secondly, the one divergence is that a MIT should be defined more narrowly for the purposes of the MIT withholding rules. This appears to be government policy and is currently reflected in s. 12-400(1)(c) of the *Taxation Administration Act 1953* in the requirement that, 'a substantial proportion of the investment management activities' of certain trust assets 'are carried out in Australia throughout the income year.'

The question posed envisages that the existing definition constructed in Div 275 ITAA 1997 will form the basis of the new MIT definition for the purposes of the attribution rules and other rules. We do not consider this as a good starting point.

Although the Paper refers to the definition in Division 275, in reality there are multiple relevant definitions which are an amalgam of provisions found in Div 6C ITAA 1936, Div 12-H TAA 1953, Div 275 ITAA 1997 and s. 9 Corporations Act.

Paragraph 17 notes, 'because the definition of a MIT was enacted recently, it is not proposed to re-revisit the meaning of the term ...' This constraint is ill-advised because the current definition in Div 275 is not a good basis for achieving the kind of uniformity that is needed – that is, a single MIT definition, with per-regime elections, and only one set of modifications for the MIT withholding rules. It is hard to see the optimal outcome emerging from the current definitions of MIT for the CGT treatment regime which is inextricably linked to the MIT withholding regime and other tests. The Div 275 definition is built up from a number of discrete tests some of which accumulate and some of which are discarded or modified. The confusion that such a system now engenders seems obvious and it is likely to become worse. For instance, the following requirements seem dealt with differently.

Have you made an election: this test is applied for some portions of the CGT treatment regime, but not the MIT withholding rules. It will apparently be relevant for the attribution rules, but not for the treatment of unitholders holding on revenue account.

Testing time: the MIT test is applied if, and when, the trustee makes a fund payment in relation to the income year. This test has to be modified for the CGT election to deal with the problem that the trustee might not make a distribution in cash or property during a year of income.

Jurisdictional nexus: either the trustee is a resident or the central management and control of the trust is in Australia. This test is applied for both the CGT election and the MIT withholding rules.

MIS status: the trust must be a MIS.

Trust activities: the trust must not be a trading trust subject to Division 6C for that year of income. This requirement is constructed in a circuitous manner. First it is a requirement of the MIT withholding rules that the trust not be Div 6C trust for the income year in respect of which a fund payment is being made. This would make it a requirement for the CGT rules but the CGT rules switch it off. Instead, the CGT rules impose their own requirement to the same effect that trust not be a Div 6C trust at the relevant point in time – typically, the time at which a CGT event occurs.

Trustee activities: the investment management activities test is relevant for MIT withholding.

Ownership structure tests: the trust must pass a widely held test (which differs depending on whether the trust is a registered retail MIS, registered MIS but wholesale, or unregistered

MIS); and not trigger a closely held test (which also differs depending on the status of the trust). The discrepancies in the way the ownership structure tests are expressed are one of the most convoluted aspects of the MIT definitions.

Licensing test: the manager must hold an appropriate AFSL or be entitled to an exemption.

Relieving test: failures to satisfy some of the tests arising from temporary circumstances outside the control of the trustee can be ignored for CGT purposes but not MIT withholding. MIT withholding has relieving rules for failure to meet some of the timing requirements.

There are other reasons why building on Div 275 is likely to prove awkward. Some of the current regimes and the proposals in the Paper appear to be thought of as concessionary in nature (eg, attribution rules, CGT treatment) and so are made elective. Other regimes are apparently considered akin to integrity measures and so are made mandatory (eg, mandatory revenue account treatment [s. 275-120 ITAA 1997] or distributions of tax-preferred amounts to unitholders in MITs holding their interests on revenue account). These competing objectives will create obvious tensions.

We note also that the way the MIT definitions currently work (and because they invoke the MIS test in Corporations Law and Div 6C), they have to be met at different times – sometimes the test needs to be met once only on a fixed date, sometimes the test needs to be met once only on a variable date, sometimes several times during a year, sometimes throughout the whole of an income year.

In our view, rather than trying to build a single definition by further grafts, excisions or modifications to these elements, the goal of this project should be to create from scratch:

- a single non-elective definition which describes all relevant trusts;
- which needs to be met (or will be failed) at a single point of time;
- accompanied by a series of elections, on a regime-by-regime basis, for those measures which are optional.

Even if that approach is not taken, we consider that the project should at the very least recognise that the following trusts should qualify as MITs:

- retail trusts that are registered MIS's for Corporations Act purposes and are listed on an Australian exchange;

- trusts that are not themselves MIS's for Corporations Act purposes but are wholly or substantially owned by one or more collective investment vehicles (as currently listed in s. 12-402(3).

Moreover, some of the current requirements in Div 12-H and Div 275 are largely redundant in light of other aspects of the Treasury Paper, especially the requirement for 'clearly defined rights and entitlements.' For example, the requirement that the trust be a MIS for the purposes of the Corporations Act and the licensing requirements are redundant and should be removed.

For the same reason, the convoluted widely-held and closely-held tests in Div 12-H should not be relevant to the MIT test. The attribution regime is about deciding who pays tax on the trust's income and gains. Insisting that the trust be widely held before these attribution rules can come into play misses the point. The integrity of the attribution system is assured by an appropriately expressed 'clearly defined rights and entitlements' test, not a test about how many owners the trust has.

The discrepancies in the various timing aspects of the definition should also be eliminated.

2.2 Clearly defined rights

Question 2

Should the core clearly defined rights rules be supplemented by tests which would allow some types of MITs (e.g. registered MISs) to automatically satisfy the requirement in situations where rules already operate to prohibit a MIT from acting in a manner inconsistent with the core rules? If yes, in which situations should these tests apply?

The core rules should be supplemented by tests which would allow nominated MITs to be treated as automatically satisfying the "clearly defined rights" test. MITs that operate under regulatory regimes should qualify for this automatic satisfaction test. Specifically MITs that are registered for the purposes of the *Corporations Act 2001* should not require any further investigation as to the qualification of rights, as sufficient regulation and scrutiny applies to these entities to ensure that the policy underlying the clearly defined rights would arise.

Chapter 5C of the *Corporations Act 2001* prescribes requirements for (among other things):

(a) the registration of a managed investment scheme;

(b) the role of a responsible entity of a managed investment scheme;

(c) the constitution of a managed investment scheme, including in relation to:

    (i) the withdrawal of members;

(ii) changing the constitution;

(iii) winding up and deregistration;

(d) the compliance plan of a managed investment scheme;

(e) the audit of a managed investment scheme;

(f) the membership of a managed investment scheme;

(g) the promotion of a managed investment scheme; and

(h) related schemes.

These rules tightly regulate Australian registered managed investment schemes. Where these rules to apply to a MIT, there should be no additional need to scrutinise the rights of members to satisfy any "clearly defined rights" test, or to qualify for the right to elect for the attribution method to apply.

Where similar rules and regimes exist in other countries, MITs registered in those countries (through stock exchanges or other prudential authorities) should similarly not be required to undertake a further scrutiny to ensure this test is satisfied. Relevant stock exchanges or authorities could be listed in regulations to ensure the comparable listing regimes are able to be updated with relative ease.

Question 3

Would it be possible for the clearly defined rights rules to accommodate trustee powers to accumulate income in the trust or issue units at a significant discount without impacting on the integrity of the rules?

The clearly defined rights rules should accommodate trustee powers to accumulate income in the trust or issue units in a manner that does not significantly affect the market value of other interests. As much flexibility for accumulation of income and issuing of units as the market place requires should be accommodated in the rules. In particular, if the constituent documents of the MIT contemplate these powers being exercised in a framework of disclosure to unitholders and, in the case of issuing units, equitable or arm's length pricing, based on the terms of the issue.

To the extent necessary, integrity measures that ensure there is no discretionary exercise of those powers, or exercise of the powers in a manner that would significantly adversely affect the rights of existing unitholders should be sufficient to ensure that these powers would not prejudice satisfaction of the clearly defined rights test.

MITs that qualify for an automatic satisfaction of the clearly defined rights rules (contemplated in the response to question 2, above), should automatically qualify without having to satisfy any further test. Powers of accumulation of income, or an ability to issue units at a discount within the regulatory frameworks required for automatic qualification of MITs for the attribution model should be expected to be appropriately contemplated and regulated within those frameworks without further inquiry.

Question 4

Is it appropriate to describe 'constituent documents' by way of a general principle, similar to the approach adopted by the Board in its Report, or should specific rules which list those documents that form part of a MIT's constituent documents be adopted?

The constituent documents are best described by a general reference, rather than a specific listing. To the extent to which MITs are registered managed investment schemes, the requirements of the *Corporations Act 2001* prescribe some requirements for constituent documents and scheme documents. However, there should be no requirement that those specific rules, or other rules, be introduced for the MIT regime.

Providing a structure around documentation would not benefit the regime and would be subject to constant change and updating, as industry standards, and community, governmental and regulator expectations shifted with global, domestic, or industry-specific trends. Prescriptive rules around constituent documents should not be preferred to general principles, which preserve some flexibility.

2.3 Attribution principles

Question 5

Are specific rules required to ensure that amounts of tax income are appropriately attributed where a unit in a MIT is sold or redeemed during an income year? If so, what rules would be appropriate?

Specific rules are not required, and would prove impractical and cumbersome to implement. Specific rules would add an unnecessary new layer of compliance and red tape, without adding any practical advantage.

Tracking the sale of units in MITs would be impractical and add unnecessary administrative expense to MITs. Currently, any economic impact of transferring (either selling or buying) units in a MIT are managed by investors, with expectations about taxable income (and any trust income) flowing through to investors in accordance with the terms of the MIT constituent documents and the ordinary operation of the tax laws. It would be expected that investors should similarly be able to manage those economic impacts within the new MIT regime.

MITs currently manage the redemption of units within their own processes. Flexibility is critical to ensuring the appropriate treatment of redemptions within:

(a) the context of the redemption;
(b) global and domestic economic conditions at the time of redemption;
(c) the proportionate number of units being redeemed as to the number of units on offer;
(d) the economic and financial status of the MIT at the time of the redemption; and
(e) the impact of any redemption on the economic and financial status of the MIT.

No prescriptive rules relating to the taxation treatment, or impact, of redemptions for either the MIT or the investor should be required. As now, decisions should be able to be made by the MIT (or more specifically, the trustee or responsible entity of the MIT) within the context of all relevant considerations for the MIT at the time of the redemption.

Question 6

Would compliance issues be raised by a requirement under the attribution method that tax losses in respect of one class of unit holders cannot be used to reduce the tax income of another class of unit holders?

Yes, compliance issues would be raised if tax losses were quarantined within a particular class of unit holders. Maintaining flexibility in the MIT and not distorting the preparation of accounts and distributions in years where losses arise is important to ensure the practical operation of the regime. However, there should be no prohibition on quarantining income and losses within units, if the MIT clearly states that would be the case. In each case, investors would be expected to price the terms of the units (both in terms of expected income, income class, investment class, loss position or transferability, and terms of redemption or termination) in acquiring units.

Question 7

Are any modifications to the proposed attribution rules needed for trustees of trusts where units may be traded on a more regular basis (compared to unlisted trusts), such as listed property trusts or exchange traded funds?

No. If there is a rule that applies to MITs, they should all be treated the same. Regular trading should not have any impact on the attribution model.

2.4 Integrity rules

Question 8

What would be an appropriate principle for the proposed anti-streaming provision?

IPA has no comment.

Question 9

If certain types of MITs (e.g. registered MISs) were to be treated as automatically eligible for the attribution method, would it be necessary to consider whether the anti-streaming and/or value shifting rules might need to apply beyond changes to a MIT's constituent documents?

IPA has no comment.

Question 10

Is it practically feasible to have an alternative test for a de minimis amount based on a prescribed dollar value per unit?

IPA had no comment.

Question 11

If so, what would be an appropriate way for the Government to determine a prescribed dollar value per unit?

IPA has no comment.

Question 12

In addition to the proposed rules for overs and unders in relation to the tax income of a trust, should there also be statutory rules for overs and unders relating to tax offsets? If so, what would be an appropriate de minimis threshold?

IPA has no comment.

Question 13

For the income year in which an under or over arises that is less than the de minimis threshold, what would be a suitable operative mechanism to ensure that the trustee does not need to *issue revised distribution statements and that assessments made in accordance with distribution statements do not need to be amended?*

IPA has no comment.

Question 14

In applying the carry forward of an under or over not exceeding the de minimis amount in a later income year:

a) *should constituent amounts (e.g. capital gains; franking credits) be applied specifically against an amount of the same type?*

b) *if so, for what categories of amount should a separate under or over figure be calculated; and*

c) *if not, what would be a suitable rule in applying the amount carried forward?*

IPA has no comment.

Question 15

What should be the specified period allowed for the trustee to reissue distribution statements to beneficiaries after becoming aware that there is an under exceeding the de minimis amount?

IPA has no comment.

Question 16

What would be appropriate sanctions for a trustee intentionally (or recklessly) misstating the tax income of the trust?

IPA has no comment.

Question 17

Are there any significant compliance costs associated with requiring a MIT to track cost base movements on each event?

IPA supports the proposed inclusion of upwards cost base adjustments outlined in the Treasury discussion paper as it advances policy principle no. 1 and, if implemented appropriately, can be achieved without too onerous a burden being placed on MIT trustees.

IPA submits there would be significant compliance costs if the trustee of a MIT were required to track cost base movements in respect of each adjustment event and, as anticipated in question 18 below, advise unitholders of those movements on a regular basis.

IPA acknowledges this may allow unitholders to more accurately calculate capital gains and losses that may arise from disposals of units or CGT Event E4 capital gains before the end of an income year.

However, IPA submits that the compliance costs that would be incurred by MIT trustees in compiling and notifying investors of this information would substantially outweigh any potential benefit to unitholders.

Most MIT trustees currently provide an annual statement to unitholders which provides sufficient information to allow the calculation of CGT Event E4 reductions in cost base. In order to implement the proposed reforms, IPA recommends that trustees be required to include sufficient information in an annual taxation statement provided to unitholders that would allow for the calculation of the gross upward and downward adjustments to a unitholders cost base for the income year.

This is consistent with the alternative approach suggested in both the Board of Tax discussion paper and Treasury discussion paper.

Question 18

Should the requirement for MITs to notify unit holders of cost base adjustments be an annual requirement, or should MITs be required to notify unit holders more frequently.

For the reasons outlined above, the requirement to notify unitholders of cost base adjustments should be an annual requirement.

Question 19

Are any modifications to the proposals warranted for MITs that are Exchange Traded Funds?

IPA has no comment.

Question 20

Is the proposed approach workable in practice?

IPA submits that character and source retention is to some extent embodied in existing legislation in respect of matters critical to the taxation of both resident and non resident unitholders.

In respect of the allocation of expenses against trust income, IPA submits that industry practices have evolved over time that are generally accepted as providing a reasonable basis for allocating expenses to trust income. As such, IPA submits that existing industry practice provides sufficient certainty while retaining sufficient discretion on the part of trustees to determine a reasonable allocation of expenses based on the particular circumstances investment activity being undertaken by the MIT.

IPA is concerned that if a particular approach were to be legislated, the approach adopted may be inflexible or overly complicated leading to both unintended and inequitable results and substantially increased compliance costs. In this regard, any approach which simply requires the proportional allocation of expenses against trust income will result in inequitable results and would run counter to policy principle no. 1.

IPA submits that further consultation is required on this point once further details of the attribution method are determined.

Question 21

Are there any alternative approaches that should be considered?

IPA submits that further consultation is required on this point once further details of the attribution method are determined.

Question 22

Under the proposed rule about non arm's length transactions in Division 6C:

a) *Should the market value treatment apply to transactions where a MIT does not deal at arm's length with another entity, transactions between an entity and its associates or both?*

b) *Should the market value treatment also apply to the other party to the transaction?*

c) *Are any exemptions from the rule appropriate?*

Initial comments

As an initial comment, IPA gives its strong endorsement to the repeal of Division 6B of the ITAA 1936, as set out in section 7.1. IPA would also strongly endorse the amendments to restrict the Public Unit Trust definition as set out in section 7.3.

It is very difficult to answer Question 22 as it is currently put, because the precise amendments to Division 6C which are contemplated in the Discussion Paper are unclear. IPA's view is that the introduction of an arm's length rule in Division 6C is inappropriate and an extensive set of integrity measures to counter perceived abuses already exist.

Our interpretation of the three propositions that we have extracted from the Discussion Paper are set out below.

Proposition 1

A provision is proposed to be inserted into Division 6C (hereafter referred to as the MIT Integrity Rule). If the MIT Integrity Rule is breached then the sanction is:

- treatment of the trust as a trading trust such that the trustee of the trust is likely subjected to corporate taxation by being treated as a public trading trust;
- denial of all MIT benefits (including withholding tax, deemed capital gains treatment and regime MIT benefits).

Comment

Infrastructure transactions undertaken by unit trusts can often involve complex arrangements in relation to real property. The arrangements seldom fit neatly within the definition of eligible investment business, and are more readily structured using stapled vehicles or related party arrangements to comply with the Division 6C requirements. This is by quarantining the activities of the unit trust to eligible investment activities. These types of arrangements have existed for a number of years, are well known to Treasury and in the market and have received numerous private rulings from the Australian Taxation Office over the years.

Division 6C contains very strict tests as to those activities which are permitted so that a unit trust will not be treated as a trading trust. For infrastructure projects the relevant permitted activities are typically in relation to investment in financial arrangements and investments in land primarily for the purpose of deriving rent. Any amendments limiting the current definition of eligible investment activities or any new restriction on activities could have a significant impact on existing and future infrastructure projects.

Proposition 2

It would appear that the MIT Integrity Rule would only apply to unit trusts that are MITs, and not more broadly to all unit trusts. This assumption is based on the wording of paragraph 119, the question proposed as Question 22 and on the basis that the discussion paper generally applies only to MITs.

Comment

In the event that proposition 2 is correct, IPA believes that it would be inappropriate to have an integrity rule that is relevant to perceived issues with transactions undertaken by unit trusts generally, but restrict the application of that rule only to MITs. Generally, MITs have a stronger compliance framework and are more likely to be widely held than other types of unit trusts. Having an integrity rule or a tougher integrity rule for MITs does not therefore seem logical.

If Proposition 2 is incorrect (i.e. that the MIT Integrity Rule applies to all unit trusts) then this measure is a much broader measure, best dealt with separately from the rest of the package that is specifically directed at MITs. The consultation and consideration of this rule is better suited to the broader Board of Taxation review of unit trusts generally.

Proposition 3

It would appear that the trigger for the MIT Integrity Rule could be either:

(a) any transactions entered into by a MIT with a party that they do not deal with at arm's length (i.e. both to transactions in certain circumstances at market value and transactions other than at market value);

(b) any transaction entered into by a MIT with an arm's length party, but where the consideration provided in respect of that transaction is not a market value consideration.

Comment

IPA has a strong view that the introduction of the MIT Integrity Rule as a Division 6C measure will lead to anomalous results and administrative complexity and cost.

There is no justification for introducing a rule into Division 6C, where transactions take place between a MIT and a non-arm's length party but are at market value. Even the international transfer pricing provisions are not framed to strike at transactions which are entered into at market value.

Secondly, IPA believes that having such a punitive sanction as tainting a unit trust so that it turns from a tax flow-through vehicle to a vehicle taxed like a company, on a judgement call as to whether a transaction is at market value is inappropriate. This gives the ATO wide subjective powers.

To highlight the point, whether an interest rate, rental rate or financial transaction is transacted at market value is a matter that is often subject to a diversity of opinion and views. Is the test to be performed when the transaction is undertaken, on a year by year basis, or otherwise? To give an example of the difficulties proposed by this concept, consider this situation. If a market value interest rate on a loan made by a MIT is determined to be 10%, should the MIT be deemed to be a trading trust if it entered into a loan with a third party where the interest rate has been set at 9.5%? If this were the case, then the unit trust would be taxed as a company and lose any benefits of being classified as a MIT, including access to the MIT regime, as the transaction will be deemed to be one that is not a permitted eligible investment activity.

Given the significant change of policy proposed in this section, and its potential impact on entities involved in infrastructure development, IPA would like further clarification of the proposal and the opportunity to be involved in further consultation prior to final drafting.

2.5 Resettlements

Question 23

What are the possible types of amendments to deeds that may be required to be made (in particular, to satisfy the clearly defined rights requirement) and would they likely result in a resettlement?

Generally, to date, trust deeds for the majority of trusts (if not all trusts) have been drafted in the following manner:

- calculation of the distributable income of the trust and the distribution of this income to unitholders based on present entitlement concepts; and

- broadly to ensure that trustees had sufficient powers at the time the trust was established to carry out all necessary activities/investments that the trust proposed to carry out/make in the future.

  We would expect that trusts that propose to elect the attribution method of taxation will need to amend their trust deeds in respect of the following:

- to amend the clauses dealing with the calculation of the distributable income of the trust and the distribution of this income to unitholders from a present entitlement basis to an attribution basis; and
- to remove clauses containing powers of the trustee to carry out a number of broad ranging activities/investments similar to those listed in paragraph 33 of the Discussion Paper.

Certain trust deeds have been amended recently in the context of the Bamford decision and related developments (e.g. AIFRS) impacting trusts.

The High Court in *Commissioner of Taxation v. Commercial Nominees of Australia Ltd* [2001] HCA 33 (*Commercial Nominee's case*) considered the resettlement issue and stated that the three main indicia of continuity of a superannuation entity (a trust) for the purposes of the income tax superannuation rules are:

- the constitution of the trust under which the fund operates;
- the trust property; and
- membership.

In the Commercial Nominee's case, a number of amendments were made to the trust deed including introducing a new category of beneficiaries and introducing an administration fee structure. The High Court held that the amendments did not amount to a resettlement as "[t]he trusts under which the fund operated in 1994-1995 were constituted by the original trust deed in 1988 as varied by the exercise in 1993, of a power of amendment. The property the subject of the trusts did not alter at the time the amendments took effect. Persons who were members of the fund before the amendments remained members of the fund after the amendments. The fund, both before and after the amendments, was administrated as a single fund, and treated in that way by the regulatory authority".

We submit that the general principles in respect of resettlements espoused by the High Court in the Commercial Nominee's case apply equally to MITs although this case was in respect of a superannuation fund. On this basis, we submit that any changes proposed to a trust deed by a trust proposing to elect the attribution method of taxation by altering the calculation of distributable income and/or a unitholder's entitlement to distributable income should not of itself give rise to a resettlement although this will depend on the facts and circumstances and the impact of other amendments to each trust's deed / constitution. We would expect that the trusts that propose to elect the attribution method of taxation would vary their original trust deeds via a Deed of Variation. The property that is the subject of the trusts would not alter at the time the amendments take place and the unitholders of the trust before the amendments would generally remain the unitholders after the amendments.

In respect of resettlements, the Commissioner of Taxation provides in his paper (Creation of a new trust - Statement of Principles August 2001 at page 9) that "although inserting or varying an income definition may materially change the rights of beneficiaries, it may not in itself alter the essential nature and character of the trust relationship so as to result in a new trust estate. The ATO has indicated it will accept that no new trust estate arises where, in the absence of other factors:

- it can be reasonably concluded that the purpose and effect of the new definition is to clarify rather than significantly redefine entitlements to income and capital; or

- where there is a significant change in respective entitlements, it is between the rights of a single beneficiary or class of beneficiary, rather than between different beneficiaries or classes of beneficiaries."

Further, the Commissioner of Taxation in his paper (Trust resettlements - AIFRS related amendments to trust deeds at page 4) provides that trust deed amendments to provide the trustee with a discretion in calculating the amount of the distributable income of the trust due to the introduction of Australian equivalents to the International Financial Reporting Standards (AIFRS) should not constitute a resettlement in light of comments made above in his earlier paper.

On this basis, we would submit that generally the amendments to the trust deeds by trusts proposing to elect the attribution method of taxation should not give rise to a resettlement in the light of the comments made by the High Court in the Commercial Nominee's case and the recent publicly available statements of the Commissioner. However, we submit that in some particular cases there may be a resettlement of the trust depending on the amendments that are required to the trust deeds. This would depend on the extent of amendments required to the trust deed.

Question 24

Are many MITs likely to wish to amend trust deeds?

As discussed in question 23 above, we submit that most trusts (if not all trusts) will need to amend their trust deeds in order to elect the attribution method of taxation.

Question 25

What would be appropriate roll-over relief where a resettlement of a trust occurs as a result of a MIT amending its constituent documents so as to be eligible for the attribution method of taxation?

We submit that roll-over relief may be introduced into Sub-division 124 of the *Income Tax Assessment Act 1997* to provide relief where there has been a resettlement of a trust as a result of a MIT amending its constituent documents to be eligible for the attribution method of taxation. This roll-over relief may be drafted in a similar manner to section 124-520 (subdivision 124-I) (Conversion of a body to an incorporated company).

Alternatively, an exemption may be included in Sub-division 118-A which provides to the effect that any capital gains resulting from a MIT amending its constituent documents to be eligible for the attribution method of taxation will be disregarded. This exemption may be drafted in a similar manner to section 118-42 (Transfer of stratum units). We note the exemption / amendments should also specifically provide that the cost base of the assets of the MIT will be the cost base of the assets just prior to the resettlement.

However, has Treasury raised / discussed with each State/Territory Office of State Revenue the need for relief from stamp duty if these amendments to a trust's constituent documents / deeds result in a resettlement for stamp duty purposes?

2.6 Reporting

Question 26

Should the trustees of MITs be required to notify unit holders of the amount of unders and overs identified and to be carried forward? If so, what would be the best way for the notification to occur?

IPA has no comment.

2.7 Application

Question 27

Do some MITs need time before the commencement of the new attribution rules to amend trust deeds and, if so, what would be a reasonable amount of time to allow?

We submit that MITS should be provided with a reasonable amount of time before the commencement of the new attribution rules to amend their trust deeds. The time required will vary depending on a number of variable factors such as the number of MITS comprising a particular group, complexity of changes required to the trust deed and the process involved in implementing the changes (eg unit holder / shareholder approvals etc).

We note that entities were provided with two tax periods to comply with their obligations pursuant to Division 230 (Taxation of financial arrangements) as these provisions were very complex and required substantial changes to an organisation's recording and reporting systems. In light of the current proposed amendments, we submit that the beginning of two successive tax years should be allowed as a reasonable time required particularly by the larger MIT groups to make the necessary amendments to their trust deeds and their recording/reporting systems. However, the time provided should specifically take into consideration trusts that may have substituted accounting periods. Similar arrangements (including transitional rules) that applied for the introduction of the new tax consolidation regime in 2003 and 2004 might be appropriate.

Question 28

By what date would industry need to implement changes to its systems and how much time would it be likely to take industry to make those changes?

As noted in question 27 above, we submit that two successive tax years should be sufficient time to implement the necessary changes to systems required by MITs.

2.8 Interactions

Question 29

What specific interaction issues should be addressed in the legislation and what are possible solutions to those issues?

We are unable to provide a response to this question at this date. We propose to provide our comments in respect of these issues once we review the draft provisions implementing the attribution method of taxation.

Question 30

What amendments should be made to the withholding tax (and associated PAYG withholding) provisions to ensure that they mesh appropriately?

As per our response to question 29 above, we will provide our comments once we review the draft provisions implementing the attribution method of taxation.

3 Fixed Trusts

Section 6 of the Paper discusses fixed trusts, and although there are no specific consultation questions, it is a significant issue for the infrastructure sector and one which requires increased certainty.

IPA strongly agrees that the current concept of a 'fixed trust' set out in section 272-65 of Schedule 2F of the Income Tax Assessment Act 1936 does not reflect the commercial or legal environment in which managed investment trusts operate.

IPA acknowledges the proposition that most if not all MITs would not satisfy the strict requirements of the 'fixed trust' definition contained in that provision. IPA submits that reliance on the exercise of the Commissioner's discretion to treat beneficiaries as having fixed entitlement to the income and capital of the trust in order to obtain fixed trust status is completely inappropriate given the fundamental taxation implications that turn on whether a trust can be considered a fixed trust (many of which are noted in the Treasury discussion paper).

IPA agrees that where all unit holders in the MIT have clearly defined rights or a MIT is treated as having clearly defined rights the MIT should automatically qualify as a fixed trust for these purposes.

In addition, subject to obtaining further clarity around these concepts IPA submits that it is likely that additional safe harbours will be required to provide requisite certainty as to the circumstances in which a MIT will be considered a fixed trust.

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