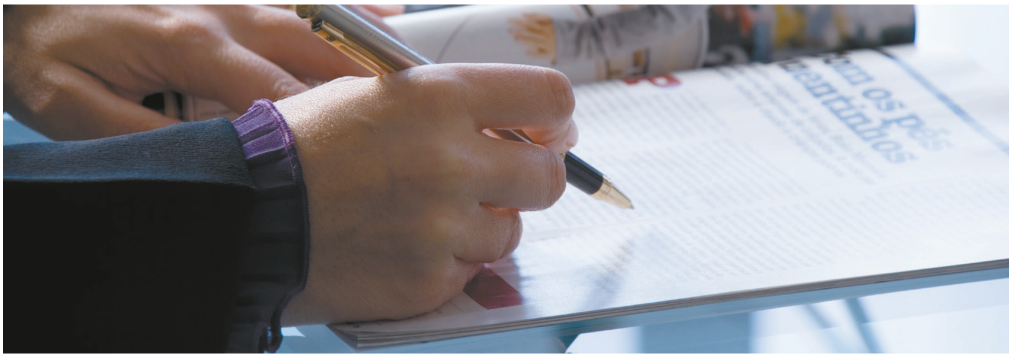

TECHNICAL UPDATE

FEDERAL TREASURY RELEASES LONG AWAITED EXPOSURE DRAFT LEGISLATION IN RESPECT OF THE TAXATION TREATMENT OF MANAGED INVESTMENT TRUSTS (MITs)

THE EXPOSURE DRAFT LEGISLATION AND EXPLANATORY MATERIALS ADDRESS THE TAXATION TREATMENT OF AN ATTRIBUTION MANAGED INVESTMENT TRUST (AMIT).

The proposed changes to the taxation treatment of trusts and trust distributions from trusts that qualify as an AMIT include:

- Members of an AMIT will be assessed on the amount of income or gains attributed to them on a fair and reasonable basis by the trustee of the AMIT – the current Division 6 rules for taxing trust distributions will no longer apply to the AMIT or its members
- The attributed income amounts retain their character in the hands of the members
- The AMIT will be deemed to be a 'fixed trust' for income tax purposes (important for various issues including trust losses and distributions of franked dividends)
- The trustee will have the choice of including unders and overs variances in the distribution for the year the variance is discovered, instead of reissuing the AMIT member annual statements for the year of distribution
- New rules on when Trustees will be assessed on trust income including:
  - Where there are errors in determining the attribution of character of income
  - Errors in the unders and overs calculations, or
  - Where the AMIT has derived non-arm's length income
- CGT cost base of units will be increased where the member's entitlements from the AMIT are less than the assessable amounts attributed from the AMIT (the reverse of a CGT event E4).

A trust will be an AMIT, broadly where:

- The trust is a MIT as currently defined for MIT withholding tax purposes, and
- The members of the MIT have clearly defined interests.

Clearly defined interests

Members of the MIT will have clearly defined interests if:

- The amount of each member component for the income year of each member of the trust can be worked out on a fair and reasonable basis in accordance with the constituent documents of the trust

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- The right of each member of the trust to the income and capital of the trust cannot be materially diminished through the exercise of a power or right
- Where the MIT is not a registered managed investment scheme under the *Corporations Act 2001*, the following further requirements must also be met:
  - The trustee has an obligation to treat members who hold interests in the same class equally and members who hold interests of different classes fairly
  - The constituent documents can be changed only:
    - By the trustee, if the trustee reasonably considers that the change will not adversely affect the rights of members
    - By a resolution that has been passed by at least 75 per cent of the votes cast by members entitled to vote on a special resolution within the meaning of the Corporations Act 2001, or
    - By a resolution that has been passed by at least 50 per cent of the total votes that may be cast by members entitled to vote on a resolution that meets the requirements of an extraordinary resolution within the meaning of the Corporations Act 2001.

Tax treatment of AMITs and investors

Where a MIT is an AMIT, the following income tax consequences will arise.

AMIT taken to be fixed trust

The AMIT will be taken to be a fixed trust for income tax purposes. That is, for the purposes of the income tax law, a member of the AMIT for an income year will be taken to have a vested and indefeasible interest in a share of the income and capital of the AMIT throughout the income year. This is particularly important for the trust loss rules and for the distribution of franked dividends.

Amounts attributed to investors to retain AMIT attribution character

Amounts (including tax offsets) derived or received by an AMIT that are attributed to members of the AMIT on a fair and reasonable basis will retain their character in the hands of the members. As a result, for income tax purposes, members of the AMIT will recognise the amounts attributed to them in the same way that the amounts were recognised by the AMIT.

AMIT characters are divided in to four categories:

- Income AMIT characters - such as discount capital gains, non-discount capital gains, amounts that are subject to dividend, interest or royalty withholding tax, and ordinary or statutory income from a foreign source
- Exempt income AMIT characters
- Non-assessable non-exempt AMIT characters
- Tax offset AMIT characters - such as franking credits received and foreign income tax paid by the AMIT.

'Unders and overs' – reconciling variances between the amounts actually attributed to members for an income year, and the amounts that should have been attributed

Under the new tax system, AMITs will be able to reconcile a variance in calculating trust components of particular AMIT characters attributed to members for an income tax year in the income year that the variance is discovered. This unders and overs system is stated by the Explanatory Materials to be consistent with the current approach used by MITs to reconcile variances in reporting amounts to their members.

Circumstances where the trustee of an AMIT will be assessable to income tax

The trustee of an AMIT will be liable to pay income tax where:

- The amount of the determined member component of a particular AMIT character attributed to a member is different to what it should have been
- The sum of the determined member components of a particular AMIT character attributed to members is less than the determined trust component of that character

- Unders of an income character are not properly carried forward, or
- Overs of an offset character are not properly carried forward.

The trustee of an AMIT will also be liable to pay income tax on:

- A taxable member component that has been attributed to a foreign resident member in some circumstances, and
- Non-arm's length income derived by the AMIT.

MITs withholding tax in respect of dividends, interest or royalties funding attributions to non-residents

Amendments modify the existing dividend, interest and royalty withholding provisions, and the MIT withholding provisions to ensure that the withholding provisions apply appropriately to taxable member components of an AMIT that are, directly or indirectly, attributed to a non-resident. These, amongst other things, address the treatment of a deemed payment that is a fund payment that is made to a foreign resident.

Cost base of investors' interest in an AMIT can be adjusted upwards in some circumstances

The cost base and reduced cost base of membership interests held by the member in an AMIT are adjusted downwards if the member's entitlements from the AMIT exceed the assessable amounts received from the AMIT. This can result in:

- A capital gain arising for a member of a trust under proposed CGT event E10 in certain circumstances, or
- A greater capital gain, or reduced capital loss, on the disposal of the membership interests.

This is in line with the current treatment of beneficiaries of a non-MIT under CGT event E4.

Unlike CGT event E4, however, the cost base and reduced cost base of membership interests are adjusted upwards if the member's entitlements from the AMIT are less than the assessable amounts received from the AMIT. This can result in a reduced capital gain, or greater capital loss, on the disposal of the membership interests.

BDO comment

On the whole, the contents of the exposure draft and explanatory materials represent a considered and sensible attempt to address the shortcomings of the existing trust taxation provisions when applied to MITs and the holders of interests in such MITs. It might be observed that some of these shortcomings remain apparent when applying such trust taxation provisions to non-MIT trusts and their beneficiaries.

The Technical Update represents an extremely abbreviated summary of some of the main points raised in some 106 pages of exposure draft legislation and 127 pages of Explanatory Materials. If you require additional information on these measures please contact your BDO tax adviser.

The closing date for submissions in respect of the exposure draft is 23 April 2015. We suggest that you contact your BDO tax adviser if you wish to contribute to a BDO submission on these measures.

National expertise
The BDO Tax team is one of the largest and most dynamic tax practices in Australia, with 30 partners and more than 150 specialists located in each major city across the country.

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