FSC FINANCIAL SERVICES COUNCIL

24 April 2017

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The Treasury
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Via email to: ruth.gabbitas@treasury.gov.au

Dear Ruth

RE: AMIT Technical Amendments

The Financial Services Council (FSC) welcomes the opportunity to make a submission on issues with the Attribution Managed Investment Trust (AMIT) regime and other amendments that were introduced by the *Tax Laws Amendment (New Tax System for Managed Investment Trusts) Act 2016 (AMIT Act).*

Our comments are outlined in Appendix A and represent those issues that have been prioritised by FSC members as requiring legislative change either to enable responsible entities/trustees to elect for managed funds to become AMITs or because the identified legislative amendment is not operating to achieve the intended policy outcome.

FSC members have identified a number of other technical and/or interpretative issues with the AMIT Act. Those issues have not been included in Appendix A in recognition of the need to prioritise issues to achieve their urgent enactment. Of those issues which require an ATO interpretative view, the FSC will seek engagement with the ATO to achieve clarity. However, some of those issues may require further legislative amendments and the FSC urges Treasury to continue consulting on technical AMIT issues after it has actioned the matters listed in Appendix A.

Please don't hesitate to contact me should you wish to discuss further.

Yours sincerely

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Senior Policy Manager
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Appendix A

General comments

The FSC welcomes the opportunity to prioritise technical issues with the AMIT regime that require legislative amendments. In doing so, the FSC acknowledges the constructive approach adopted by Treasury and the ATO in developing the AMIT regime and other amendments within the AMIT Act. The positive engagement throughout that consultation resulted in a modern regime for taxing investment trusts that will bring greater certainty for all stakeholders. The matters listed below represent issues which have been identified as either inhibiting the adoption of the AMIT regime by some trusts or give rise to detriments for trust members that are not consistent with the apparent policy outcomes.

We have grouped the issues into five categories and outlined our proposed solutions below. We would welcome the opportunity to assist Treasury with these issues, including consulting on drafting legislative amendments that are required.

1 – Cost base of member interests – Differences to outcomes for non-AMITs

In evaluating whether the AMIT regime is in the best interests of members, responsible entities/trustees need to consider whether different outcomes may arise for the cost bases of member interests compared to if a trust remains subject to Division 6 of the *Income Tax Assessment Act 1936*.

The potential for cost base uplifts is a clear benefit for members. However, the cost base provisions for CGT and revenue account holders (in Sections 104-107A to 104-107H) adopt a very different mechanism to cost base adjustments under CGT event E4 for non-AMITs. This can result in significantly disadvantageous outcomes for members in the scenarios listed below. These differences to CGT event E4 do not appear to be intended and/or are inconsistent with our understanding of the policy intention that the changes to the cost base adjustment mechanism should not result in asymmetry between AMITs and non-AMIT cost base adjustments (other than for targeted changes such as cost base uplifts).

Issue 1(a) Capital gains sheltered by capital losses

Under current law, a non-assessable distribution to which s.104-71 applies does not reduce the cost base of the relevant units. Section 104-71 includes:

the CGT discount in respect of a capital gain made by the trust; and

certain other amounts, such as the amount of a capital gain that has been applied against capital losses.

These are usually referred to as CGT concession amounts.

This provision was replicated for AMITs in the August consultation draft in s.104-107E(5). Section 104-107E stated that a cost base increase amount included two amounts. The first amount was the amount of determined member components included in the unitholder's assessable income. The second amount was

*(5) … the amount by which the non-assessable part mentioned in section 104-70 is reduced by the operation of section 104-71, to the extent that the amount of the reduction is reasonably attributable to the *CGT asset.*

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Section 104-107E was amended in the final Bill to address the technical issue that capital gains of the AMIT may not be included in the assessable income of a unitholder (e.g., because the unitholder has capital losses). The section above was replaced with s.104-107E(4) which states:

*(4) The second amount is the total of each *determined member component of a character relating to *capital gains that:*

*(a) you have for the income year in respect of the *AMIT; and*

(b) is taken into account under section 276-80.

The s.276-80 amount is the gross amount of a discount capital gain. It therefore implicitly picks up the first type of CGT concession amount listed above. However, it does not pick up all of the CGT concession amounts listed in s.104-71. This means that, for example, an AMIT unitholder that receives a distribution of a capital gain that has been sheltered by a capital loss will suffer a net cost base reduction in circumstances where a unitholder in an ordinary unit trust would not.

Recommendation 1a: Insert a provision along the lines of former s.104-107E(5), which is an appropriate provision to prevent duplication by the current s.104-107E(4).

The FSC acknowledges that the treatment of capital gains sheltered by capital losses is addressed in Item 5 of Treasury's list of AMIT technical amendments for consideration in the CIV reform process. Where Treasury intends on following a different approach to the above recommendation, the FSC will seek to work closely with Treasury to understand the impacts on the managed fund industry. In this regard, it would be helpful if Treasury could provide examples demonstrating the principle stated in Item 5 that cost base adjustments will arise to reflect upward and downward movements in the value of a unit because of attribution and distribution amounts.

Further, to the extent that changes are initially made only to the AMIT cost base provisions, the FSC urges the Government to confirm:

- whether it will make any changes to CGT event E4, to allow trustees to appropriately evaluate each cost base regime in determining the impact on members of becoming an AMIT (i.e. the member best interest analysis); and
- that the application date of changes to the AMIT provisions will align with the application of any subsequent changes to CGT event E4.

These changes will affect both the choice to adopt the AMIT regime, which FSC members are considering for income years commencing as early as 1 June 2017, and potential consequences for non-AMIT trusts under CGT E4 if that is amended. We urge the Government to announce any intended changes, including to CGT event E4, by 31 May 2017 to provide clarity for trustees in respect of income years that are about to end. Alternately, if an announcement is not possible before 31 May 2017, any changes should only apply from the 2017-18 income year.

1(b) AMIT cost base increase where discount capital gain amounts are less than CGT concession components

There is an issue with the AMIT cost base provisions where a discounted capital gain is reduced by a revenue deduction (or carried forward loss revenue loss) because the AMIT cost base increase amount in Section 104-107E only includes double the discounted capital gain. Where the discounted capital gain (after other deductions) is less than the CGT concession component, this effectively

results in the excess of the CGT concession above the discounted capital gain being converted into a deferred capital gain or a current year capital gain if there is insufficient cost base (see example below). This is also a problem for chains of trusts, where discount gain components distributed from subsidiary trusts are less than CGT concession components.

Example

Assume AMIT 1 makes a capital gain of $140, has no other income and $40 of deductible expenses. Its assessable trust component for discount capital gains would be calculated as follows:

Gross capital gain	$140
Discount capital gain (50%)	$70
Less: Deductible expenses	($40)
Trust component attributed to members	$30

AMIT 1 distributes cash of $100 to its only member, AMIT 2. The outcomes for AMIT 2 are:

- AMIT 2 is assessed on $60 capital gain (after grossing-up under subsection 276-85(4)). AMIT 2 then applies the CGT discount in its own trust component calculation. Thus, AMIT 2 includes the appropriate capital gain in its trust component calculation.
- There is a $40 decrease in cost base in AMIT 1 units held by AMIT 2 calculated as the difference between cash received ($100) and twice the attributed capital gain ($60). If no cost base existed in the units, a capital gain of $40 would arise under CGT event E10 to AMIT 2.
- After applying its own 50% CGT discount, AMIT 2 has a net capital gain of $50 ($30 discount capital gain from AMIT 1 plus $20 discounted gain from E10).

The outcome does not appear to be appropriate from a policy perspective as the benefit of the CGT concession in excess of the discounted gain is lost through the AMIT cost base reduction amount (or E10 capital gain). By comparison, if AMIT 2 did not invest via AMIT 1 but instead derived the same discount capital gain on directly held assets and incurred the same expenses, it would only be assessed on a net capital gain of $30 after applying its own 50% CGT discount.

This would not occur outside of the AMIT rules, as Section 115-215 would ensure that AMIT 2 is assessed on a $60 capital gain amount and there would be no cost base reduction pursuant to Item 1 in the table to subsection 104-71(4) (for completeness, the outcome would have been the same whether applying Section 115-215 in its CGT streaming form (as amended in 2011) or the pre-CGT streaming version that existed prior to 2011).

Recommendation 1b: Insert a provision along the lines of former s.104-107E(5), which is an appropriate provision to prevent duplication by the current s.104-107E(4).

1(c) Timing of AMIT cost base decrease amount where a disposal of units occurs before a right to receive a payment arises

An AMIT cost base reduction amount for an income year arises under Section 104-107D when a member "…starts to have a right to receive…" money or property from the trustee in the income year.

As the concept of present entitlement is no longer relevant to the attribution of taxable amounts (determined member components), some trust constitutions may be amended so that a member of an AMIT is not automatically presently entitled to receive a distribution (of money or property) on the last day of the trust's income year. This could give rise to circumstances where an AMIT cost base reduction amount does not arise until after a member disposes of their units in the AMIT and it is not clear that the AMIT cost base net amount (Section 104-107C) would include that cost base reduction for the purposes of adjusting the unit's cost base just before the CGT event occurs (under paragraph 104-107B(4)(b).

For example, assume a trust constitution does not contain a present entitlement clause (or it is deactivated where the trust is an AMIT) and allows a trustee of an AMIT to determine after 30 June 2017 that it will distribute cash to members of the trust on a pro-rata basis according to their period of membership during the year ended 30 June 2017. For a member that held units during the year ended 30 June 2017 but sold their units during May 2017, this would appear to give rise to the following consequences:

- The AMIT cost base reduction amount for the 30 June 2017 income year would not include the payment made after year-end as no right to receive the money existed until the trustee determined that it would pay a distribution (during July 2017).
- An AMIT cost base increase amount would arise under Section 104-107E for any assessable or NANE income attributed to the member for the 30 June 2017 income year.
- The AMIT cost base net amount (104-107C) is calculated "for the income year" and would only include the cost base increase amount.
- The cost base of the member's units would be adjusted immediately before their disposal in May 2017 (104-107B(4)(b)) but only reflecting the cost base increase amount.
- It is appears an AMIT cost base reduction amount cannot arise under subsection 104-107D(1) for the 30 June 2018 income year as this provision relies upon a CGT asset existing. Subsection 104-107B(1) only applies to a member of an AMIT in respect of an income year because they have a CGT asset that is their unit or interest in the AMIT. As the former member would no longer hold any units in the AMIT for the 30 June 2018 income year, it appears that subsection 104-107B cannot apply and neither can Section 104-107D. Further, an AMIT cost base net amount cannot subsequently arise (in July 2018) for the 30 June 2017 year as Section 104-107C clearly states that this is calculated on an income year by year basis ("…for the income year…").

Recommendation 1c: The application of the AMIT cost base adjustment provisions in Sections 104-107D, 104-107C and 104-107B should be clarified for situations where members do not automatically have an indefeasible right to a distribution at the end of an income year and the trustee of an AMIT subsequently determines to distribute money or property to former members in respect of the prior income year.

A similar issue exists for interests in an AMIT held on revenue account (Section 104-107G).

2 - Single Unitholder issue – legislative interpretation issue

In summary, the issue is that trusts which are not managed investment schemes under the *Corporations Act 2001* can be MITs provided they are wholly-owned by qualifying widely held entities (as listed in subsection 275-20(4), being complying superannuation funds, other MITs, etc). However, it appears that the legislative drafting in paragraph 276-10(1)(c) restricts such MITs from being AMITs unless they are wholly-owned by MITs.

This may depend on an interpretation of what the words "*the only members of the trust are managed investment trusts in relation to the income year*;" in 276-10(1)(c) are meant to be doing. There may be two readings – either they are a badly worded reference to s275-10(1)(b), or they have their own meaning.

If they have their own meaning, this interpretation precludes such MITs from being AMITs if they are wholly-owned by other qualifying widely held investors, resulting in inconsistent treatment to MITs that are wholly-owned by other MITs. It is problematic for unregistered wholesale funds, e.g. a MIT wholly-owned by a superannuation fund, and it is common for unregistered wholesale trusts to be used as intermediate holding vehicles in a chain of trusts to achieve different investment exposures by investing in a range of subsidiary asset holding trusts. Typically, such wholesale trusts have not been registered as managed investment schemes as it saves registration fees and compliance costs under the *Corporations Act 2001* where registration is not otherwise needed. This has become an issue for large fund managers given it appears to prevent some MITs from entering into the AMIT regime. Indications to date from large fund management groups are that it could affect a large number of wholesale unregistered MITs (hundreds).

When this issue was raised during the AMIT consultation process, we recall that Treasury thought that AMIT treatment was not necessary for unregistered wholesale MITs with single (widely-held) investors because unders/overs would flow through to the same investor. However, AMIT treatment is important for a number of other reasons, including obtaining certainty on fixed trust status, confirmation of character flow-through and clarity on cost base adjustments whether held on capital or revenue account (e.g. life insurer members).

As the unregistered wholesale MIT would be wholly-owned by an investor that is considered widely-held for MIT purposes, these types of MITs should not be precluded from AMIT status and certainty on the abovementioned issues, which will impact the wide group of stakeholders that benefit from the trust investment (superannuation fund members, life insurance policyholders, etc). From a policy perspective this will allow the ATO to administer them in a consistent way with other MITs.

We understand the ATO is concerned that some trusts with single foreign investors should not qualify as MITs because they are not managed investment schemes (we refer to page 112 of the draft ATO Infrastructure Tax Framework released in January 2017). If the single unitholder issue outlined above relates to this concern, we urge Treasury to consider a targeted measure, as a trust that has a single member of a type covered by paragraph 275-45(1)(c)(i) will be widely held due to the nature of that member and where that member is an Australian resident (e.g. superannuation fund or life insurance company) the ATO's concerns would not apply but to deny AMIT treatment would cause potentially widespread detriment to a large number of Australian managed funds and their investors.

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Recommendation 2: Amend subsection 276-10(1)(c) to delete the words "the only members of the trust are managed investment trusts in relation to the income year" and replacing that with the same words in existing paragraph 275-45(1)(c) (this would align with the existing qualifying requirements for becoming a MIT where a trust is not a managed investment scheme).

For completeness, we note that this was raised in an FSC submission on 24 April 2015 (copy attached, see pages 8-10 entitled "Unregistered Wholesale Schemes") but the legislation only picked up on the changes to 275-45(1)(c) to refer to members and entities (plural) but did not amend 276-10(1)(c) as requested in the table on page 10 of the submission (i.e. delete the only member(s) are MIT(s) requirement).

3 - Public trading trusts - Loss of franking credits

Public trading trusts that have a balance of undistributed franking credits and cease to be public trading trusts from 1 July 2016 on commencement of Schedule 5 of Tax Laws Amendment (New Tax System for Managed Investment Trusts) Act 2016, will cease to be a "franking entity" under Section 202-15, also resulting in a franking debit equal to the amount of the franking surplus under Item 4 of the table in subsection 205-30(1). This will result in the automatic loss of all franking credits in their franking account.

The transitional rules in Item 75, Part 4 of Schedule 5 do not stop this automatic loss of franking credits from arising. Those transitional rules allow the subsequent use of any franking credits and recognition of franking credits from subsequent payments of tax but because the events in Item 75(2)(c) do not include the franking debit under Item 4 in 205-30(1), the transitional rules will not prevent the loss of those franking credits.

Recommendation 3: Where a trust ceases to be subject to Division 6C on or after 1 July 2016 because of the amendments to Section 102MD, deem the trust to be a "franking entity" for the purposes of Item 4 of the table in subsection 205-30(1).

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4 - CFC attribution and AMITs

Where a CFC is held via an Australian trust, the CFC attribution provisions rely on amounts arising under Division 6 and will not operate where a CFC is held by an AMIT.

Where a controlled foreign company ("CFC") is held by a Division 6 trust, section 23AI operates to treat amounts that were previously assessed under the CFC provisions as non-assessable non-exempt income of the unitholder.

Section 23AI will only apply to a unitholder where there has been an attribution account payment and an attribution debit arises (refer subsection 23AI(1)). The definition of an attribution account payment in subsection 365(1)(c) is based on the concept of present entitlement and by reference to net income for section 95 purposes. The mechanism by which an attribution debit arises under Section 372 links to the definition of "tax detriment" in subsection 371(6). "Tax detriment" is defined in subsection 330(2) by reference to amounts under Sections 97, 98A or 100 (with subsection 330(3) referencing Sections 99 and 99A).

These provisions are based on concepts in Division 6 and specific references to Division 6 provisions. However, section 95AAD states that Division 6 does not apply in relation to an AMIT. As such, the mechanics of the section 23AI exemption will not apply to distributions of CFC attributed income. This could potentially result in double taxation (on attribution and on payment of a dividend in respect of the same income).

Recommendation 4: Redrafting of the CFC rules in Part X to deal with the AMIT provisions. To allow AMITs to operate with confidence prior to legislative amendments, we urge the government to publicly announce that these changes will apply with effect from the date a trust becomes an AMIT (even if the legislative amendments are enacted after that time)

5 - Withholding tax – NTAP losses

As currently drafted, the non-TAP capital loss adjustment in the fund payment calculation could result in MIT withholding tax being payable on an amount in excess of the actual Australian income of the AMIT. This appears to be a technical error, rather than the policy intention of the provision.

Section 12A-110(3) states that the amount of the fund payment is the sum of:

- *12A-110(3)(a)* - the determined member components for the AMIT for the income year of a character relating to assessable income, disregarding determined member components of particular characters (e.g., non-TAP capital gains); and
- *12A-110(3)(b)* - the total of each capital loss of the AMIT from a CGT event that happened in the income year to a CGT asset that is not taxable Australian property.

Section 12-110(3)(b) appears to be intended to replicate s.12-405(1)(d) and exclude the effect of non-TAP capital losses in calculating "fund payment income". However, the exclusion of non-TAP capital losses is only intended to the extent that:

- the loss was taken into account in calculating a determined member component; and

- that determined member component has not already been excluded from fund payment income by s.12-110(3)(a).

That is, to the extent that a non-TAP capital loss is applied against a non-TAP capital gain (or not applied against any capital gain) no adjustment to fund payment income is intended or required.

Issue 1 – adding back non-TAP capital losses

Section 12A-110(3)(b) currently requires a non-TAP capital loss in a year of income to be added to the assessable determined member components for that year of income.

This is required regardless of whether the non-TAP capital loss is applied against a TAP capital gain or carried forward. This will produce inappropriate outcomes, as described below:

	Scenario 1	*Scenario 2*	*Scenario 3*
Australian source ordinary income	100	100	100
TAP capital gain	100	0	0
Non-TAP capital gain	0	100	0
Non-TAP capital loss	-100	-100	-100
Determined member components			
Australian source ordinary income	100	100	100
TAP capital gain	0	0	0
Non-TAP capital gain	0	0	0
Non-TAP capital loss	100	100	100
Fund payment income	200	200	200
Intended result?	Yes	No	No

In Scenario 2 (where loss is applied against a capital gain, to produce net nil capital gain), MIT withholding tax will apply to $200 despite the fact that there is only $100 of "Australian" income.

In Scenario 3 (where there is no capital gain and capital loss is carried forward), MIT withholding tax will apply to $200 despite the fact that there are no capital gains at all.

Recommendation 5: To correct this outcome, s.12A-110(3)(b) needs to be amended to read:

> *the total of each *capital loss of the AMIT from a *CGT event that happened in the income year to a CGT asset that is not taxable Australian property to the extent that the capital loss has been applied against a *capital gain of the AMIT from a *CGT event that happened in the income year to a CGT asset that is taxable Australian property.*

Issue 2 – carried forward losses

The second potential flaw in s.12A-110(3)(b) is that it is limited to a non-TAP capital loss that arises in the current year of income. It does not apply to a carried forward net capital loss that was

created by a non-TAP capital loss. It is possible that this is intended, as s.12-405(1)(d) also does not refer to net capital losses (although it is not explicitly limited to capital losses arising in the current income year).

> **Recommendation 6:** If this outcome is not intended s.12A-110(3)(b) needs to be amended to read:
>
> _the total of each *capital loss of the AMIT from a *CGT event that happened ~~in the income year~~ to a CGT asset that is not taxable Australian property to the extent that the capital loss has been applied against a *capital gain of the AMIT from a *CGT event that happened in the income year to a CGT asset that is taxable Australian property (or forms part of a *net capital loss that has been applied against such a gain)_

Issue 3 – deemed AMMA payment

At present, the adjustment made by s.12A-110(3)(b) does not appear to flow through to the "deemed AMMA payment". Section 12A-205 limits the amount of the deemed AMMA payment to the "_determined member components of all the *members of the AMIT of a character relating to assessable income for the income year_". This will not include the amount of a capital loss in any circumstances.

> **Recommendation 7:** If an AMIT in Scenario 1, above, made no actual payment it would seem that its deemed AMMA payment would be limited to $100 (since its net capital gain is nil). No tax would be imposed in respect of the TAP capital gain that has been sheltered by the non-TAP capital loss. If this outcome is not intended s.12A-205(2)(b)(i) needs to be amended to read either:
>
> _first, work out the sum of the total of all the *determined member components of all the *members of the AMIT of a character relating to assessable income for the income year and the total of each *capital loss of the AMIT from a *CGT event that happened in the income year to a CGT asset that is not taxable Australian property to the extent that the capital loss has been applied against a *capital gain of the AMIT from a *CGT event that happened in the income year to a CGT asset that is taxable Australian property_
>
> OR:
>
> _first, work out the sum of the total of all the *determined member components of all the *members of the AMIT of a character relating to assessable income for the income year and the total of each *capital loss of the AMIT from a *CGT event that happened to a CGT asset that is not taxable Australian property to the extent that the capital loss has been applied against a *capital gain of the AMIT from a *CGT event that happened in the income year to a CGT asset that is taxable Australian property (or forms part of a *net capital loss that has been applied against such a gain)_
>
> The wording depends upon the intended outcome for the second issue.

AMIT technical amendments for consideration in the Government's Corporate Collective Investment Vehicle reform process

Response to Policy Issue 4 – Foreign income tax offset rules in Treasury Document

If an individual invests directly in an offshore asset they may derive foreign income. Foreign taxes may be paid on that income. In broad terms, the investor is entitled to claim a foreign income tax offset against the Australian tax payable on the foreign income. As a matter of policy, the AMIT rules prescribe deeming rules, so that an individual investing indirectly in the same foreign asset through an AMIT should have the same tax outcome as where investing directly. Positive clarification of this 'same tax outcome' is required to provide baseline certainty.

Subsection 770-10(1) requires that for an amount of foreign income tax to count towards the tax offset for the year *you paid it* in respect of an amount *included in your assessable income* for the year. Paragraph 7.4 of the EM notes that a member who invests in an AMIT is taxed on the income and other amounts that are derived or received by the trust in broadly the same way that they would have been taxed if they had held the assets of the AMIT directly.

In line with this objective, subsection 276-80(5) provides, for the purpose of working out if a member is entitled to a tax offset, that the member is treated as having paid or received the amount reflected in the determined member component of a tax offset in the member's own right and in the same circumstances as the AMIT paid or received that amount. Subsection 276-80(5) applies if a member of an AMIT has a determined member component of a character relating to a tax offset (i.e. a tax offset has been attributed).

Accordingly, foreign tax offsets of an AMIT should flow to members, even where (in technical terms) there is no determined member component of foreign income attributed after the allocation of deductions, or even if there are no characters relating to assessable income to be attributed e.g. because allowable deductions have reduced the trust components relating to assessable income to nil. Relevantly, the rules for calculating trust components in sections 276-265 and 265-270 prescribe that deductions be allocated against trust components of a character relating to assessable income. They are not allocated against tax offsets.

Further, because the member is treated as having paid the amount of foreign income tax in the same circumstances as the AMIT, for the purposes of determining entitlement to a foreign income tax offset, the member should be treated as if they have included the relevant amount in their assessable income (because the AMIT has done so).

Confirmation of the flow through and utilisation of foreign tax offsets in these circumstances is important, as the uncertainty and risk of overstatement of offsets is a potentially material consequence given the collective outcomes for members and potential penalties that may be applied to trustees of AMITs.

Similarly we also seek clarification and certainty as to whether in line with this objective, franking credits (as a tax offset) should also flow to members irrespective of whether the AMIT has any taxable income, particularly given they refundable in nature.