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TREASURY LAWS AMENDMENT (2018 MEASURES NO. 5) BILL 2018: AMIT  
TECHNICAL AMENDMENTS

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EXPOSURE DRAFT EXPLANATORY MATERIALS



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# Glossary

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The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
AMIT	attribution managed investment trust
AMMA statement	AMIT member annual statement
CGT	capital gains tax
DIR payment	dividends, interest or royalties payment
IT(TP)A 1997	<i>Income Tax (Transitional Provisions) Act 1997</i>
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
MIT	managed investment trust
PAYG	Pay As You Go
TAA 1953	<i>Taxation Administration Act 1953</i>
TLAA 2016	<i>Tax Laws Amendment (New Tax System for Managed Investment Trusts) Act 2016</i>



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# Chapter 1

## AMIT Technical Amendments

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### Outline of chapter

1.1 Schedule # to this Exposure Draft Bill amends the TAA 1953, ITAA 1997, ITAA 1936, TLAA 2016 and the IT(TP)A 1997 to make a number of technical refinements to the income tax law so that the new tax system for managed investment trusts operates as intended.

1.2 All legislative references in this Chapter are to the ITAA 1997 unless otherwise indicated.

### Context of amendments

1.3 In 2016, the new tax system for managed investment trusts (the AMIT regime) was enacted following recommendations made by the Board of Taxation in its Report on the *Review of the Tax Arrangements Applying to Managed Investment Trusts* (the Board's Report). The new tax system was designed to increase certainty, allow greater flexibility and reduce compliance costs for MITs and enhance the competitiveness of Australia's funds management industry.

1.4 The AMIT regime applies to certain MITs if the members of the MIT have clearly defined interests in relation to the income and capital of the trust and the trustee of the MIT makes a choice to apply the new tax system. MITs that choose to apply the new tax system are referred to as AMITs.

1.5 The AMIT regime has a number of benefits which include:

- fixed trust treatment for income tax purposes;
- an attribution regime which allows the trust to attribute amounts of assessable income, exempt income, non-assessable non-exempt income and tax offsets to members on a fair and reasonable basis for income tax purposes; and
- an 'unders and overs' regime which allows the trust to reconcile variances between the amounts actually attributed to members for an income year, and the amounts that should have been attributed, in the income year that it is discovered.

1.6 In addition, the AMIT regime:

- modified the CGT rules to allow for annual upward and downward adjustments to the cost bases of membership interests in an AMIT; and
- modified the withholding regime for DIR payments, and for fund payments, so that a withholding tax obligation arises when an AMIT attributes a relevant amount to a member who is a foreign resident (rather than when an amount is paid).

1.7 Since the enactment of the AMIT regime in 2016, some practical issues have been identified with the operation of the regime.

1.8 Consequently on 19 July 2017, the Minister for Revenue and Financial Services announced this package of technical amendments. Most of these changes have been sought by the funds management industry and are consistent with current industry practice.

## **Summary of new law**

1.9 Schedule # to this Exposure Draft Bill amends the TAA 1953, ITAA 1997, ITAA 1936, TLAA 2016 and the IT(TP)A 1997 to make a number of technical refinements to the income tax law so that the new tax system for managed investment trusts operates as intended.

1.10 These amendments clarify the operation of the income tax law applying to MITs and AMITs and make a number of modifications which are broadly in four parts.

1.11 Part 1 makes modifications to the primary AMIT rules. In particular, the amendments:

- clarify that a MIT with a single unitholder that is a widely-held entity can access the AMIT regime;
- ensure that, in calculating rounding adjustments and trustee shortfall tax under the AMIT regime, discount capital gains are treated consistently; and
- ensure that, in relation to a character that is a discount capital gain, the trustee is liable to pay income tax on the under-attributed component as though it were not a discount capital gain.

1.12 Part 2 makes modifications to the MIT and AMIT CGT rules. In particular, the amendments:

- clarify that the amount of the capital gain under CGT event E10 will be the cost base net amount where the cost base of the asset is nil at the start of the income year; and



- align the CGT outcomes for MITs with AMITs.

1.13 Part 3 makes modifications to the withholding tax rules for AMITs. In particular, the amendments:

- clarify that withholding tax liabilities arise on amounts of fund payments and DIR payments that are attributed to foreign members by an AMIT or custodian;
- ensure fund payments for AMITs includes capital losses from non-taxable Australian property that have been applied against capital gains from taxable Australian property;
- clarify that AMITs which only make deemed payments are withholding MITs; and
- clarify that the TFN withholding rules apply to AMITs that make deemed payments to members.

1.14 Part 4 makes modifications to the operation of the AMIT transitional rules. In particular, the amendments:

- ensure that former public trading trusts and corporate unit trusts can continue to use accumulated franking credits until 30 June 2018; and
- ensure early balancing trusts can elect into the AMIT regime for the 2016-17 and later income years, regardless of when those income years start.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
MITs with a single unitholder can satisfy the AMIT eligibility requirements if the only member is a specified widely-held entity.	MITs with a single unitholder can satisfy the AMIT eligibility requirements if the only member is itself a MIT.
In calculating rounding adjustments and trustee shortfall tax for the character of discount capital gains, the determined trust component and the determined member component will be calculated on the discounted amount.	In calculating rounding adjustments and trustee shortfall tax for the character of discount capital gains, <ul style="list-style-type: none"> <li>• the determined trust component is calculated on the discounted amount; and</li> <li>• the determined member component is calculated on the non-discounted amount.</li> </ul>
Where a member of an AMIT	Where a member of an AMIT

receives non-assessable distributions from the AMIT and the cost base of the membership interest cannot be reduced to nil (as it was already nil), the net amount of adjustments will give rise to a capital gain under CGT event E10.	receives non-assessable distributions from the AMIT, the cost base of the membership interest is reduced to nil by the net amount of adjustments and any remaining excess gives rise to a capital gain under CGT event E10.
Capital gains that have been applied against capital losses will not be excluded from the amount of non-assessable payments where the entity making the payment is a MIT.	The portion of the capital loss or net capital loss which has been used to reduce a capital gain reflected in the payment made by a trust is excluded from the amount of non-assessable payment.
In calculating a fund payment of a MIT or AMIT, capital losses from non-taxable Australian property which have been applied against capital gains from taxable Australian property will be added back.	In calculating a fund payment, capital losses from non-taxable Australian property are disregarded by a MIT or an AMIT.
In relation to AMITs, the TFN withholding rules will not apply to amounts which have already been subject to TFN withholding.	No equivalent.
Former public trading trusts and corporate unit trusts will be able to distribute franking credits until 30 June 2018, provided that the distribution is paid out of income derived before 1 July 2016.	Former public trading trusts and corporate unit trusts cannot distribute accumulated franking credits from 30 June 2016.
MITs with substituted accounting periods will be able to elect into the AMITs regime for the 2016-17 income year and later income years.	MITs can elect into the AMIT regime for income years commencing on or after 1 July 2016.

## Detailed explanation of new law

1.15 Schedule # to this Exposure Draft Bill makes a number of technical refinements to the income tax law affecting MITs and AMITs. The refinements are broadly categorised into the following parts:

- Part 1 makes modifications to the primary AMIT rules;
- Part 2 makes modifications to the MIT and AMIT CGT rules;
- Part 3 makes modifications to the withholding tax rules for AMITs; and

- Part 4 makes modifications to the operation of the AMIT transitional rules.

## **Part 1 – Modifications to the primary AMIT rules**

1.16 Amendments to the primary AMIT rules will:

- clarify that a MIT with a single unitholder that is a widely-held entity can access the AMIT regime;
- ensure that, in calculating rounding adjustments and trustee shortfall tax under the AMIT regime, discount capital gains are treated consistently; and
- ensure that, in relation to a character that is a discount capital gain, the trustee is liable to pay income tax on the under-attributed component as though it were not a discount capital gain.

### ***Single unit holder MITs can elect into the AMIT regime***

1.17 The AMIT regime provides special rules (sections 276-10 and 275-45) for MITs to satisfy the AMIT eligibility requirements if all members of that MIT are specified widely-held entities (such as a MIT).

1.18 Paragraph 276-10(1)(c) allows a MIT to qualify as an AMIT if the only member of the MIT is another MIT. As this is unnecessarily restrictive, paragraph 276-10(1)(c) will be removed so that eligible MITs which satisfy the requirements under section 275-45 in relation to the income year can elect into the AMIT regime, provided that other requirements are satisfied. *[Schedule #, item 7]*

1.19 This ensures that eligible MITs which only have a single unitholder that is a specified widely-held entity, as required by section 275-45, (such as life insurance companies and complying superannuation funds) can access the AMIT regime.

### ***Discount capital gains treated consistently***

#### ***Rounding adjustments***

1.20 Under the AMIT ‘unders’ and ‘overs’ regime, the trust component of a particular character is decreased by the amount of a rounding adjustment surplus where the sum of all the determined member components exceeds the determined trust components of that character for the income year (section 276-315).

1.21 Currently, where the relevant character is a discount capital gain, the amounts are doubled for the purposes of the determined member component (subsections 276-315(4) and (5)), but are not doubled for the purposes of the determined trust component.

1.22 The amendments ensure that, where the relevant character is a discount capital gain, the amount of the determined member component will not be doubled and remain as the discounted amount.

1.23 This provides a ‘like for like’ comparison under subsection 276-315(3) to ensure equal treatment of discount capital gain amounts in relation to the determined member component and determined trust component under the rounding adjustment rules. *[Schedule #, item 8]*

#### *Trustee shortfall tax*

1.24 Under the AMIT regime, the trustee of an AMIT is subject to trustee shortfall taxation if, broadly, there is an under-attribution of income. This occurs because the sum of the determined member component of a particular character falls short of the determined trust component of that character (section 276-415).

1.25 Currently, where the relevant character is a discount capital gain, the amounts are doubled for the purposes of the determined member component (subsections 276-415(3) and (4)), but are not doubled for the purposes of the determined trust component.

1.26 The amendments ensure that, where the relevant character is a discount capital gain, the amount of the determined member component will not be doubled and remain the discounted amount. *[Schedule #, item 9, subsection 276-415(4)]*

1.27 This provides a ‘like for like’ comparison under subsection 276-415(1) and ensures equal treatment of discount capital gain amounts in relation to both the determined member component and determined trust component when working out whether a shortfall has occurred.

1.28 In addition, the amendments ensure that where the relevant character is a discount capital gain, the trustee will be liable to pay income tax on double the amount of the shortfall. *[Schedule #, item 9, subsection 276-415(4)]*

1.29 This ensures that the trustee is liable to pay income tax on the under-attributed component as though it were not a discount capital gain.

## **Part 2 – Modifications to the MIT and AMIT CGT rules**

1.30 Amendments to the MIT and AMIT CGT rules will:

- clarify that the amount of the capital gain under CGT event E10 will be the cost base net amount where the cost base of the asset is nil at the start of the income year; and
- align the CGT outcomes for MITs with AMITs.

***CGT event E10 can occur where the cost base is nil***

1.31 Broadly, where a member of an AMIT (who holds a CGT asset that is their membership interest in the AMIT) receives non-assessable distributions from the AMIT, adjustments are made to the cost base and reduced cost base of the membership interest. Where the net amount of those adjustments are greater than the asset's cost base, the asset's cost base is reduced to nil, and any remaining excess gives rise to a capital gain under CGT event E10 (section 104-107A).

1.32 The amendments clarify that where the cost base of an asset cannot be reduced for an income year (because the cost base of that asset was nil at the start of the income year), the amount of the capital gain under CGT event E10 will be the asset's AMIT cost base net amount. *[Schedule #, items 3 and 4, paragraphs 104-107A(1)(b) and (c) and subsection 104-107A(3)]*

1.33 Further, where the asset's cost base is nil at the start of the income year, the CGT event occurs at the time at which the cost base would have been reduced under subsection 104-107B(2) during the income year if the cost base had been greater than nil at the start of the income year. *[Schedule #, item 4, subsection 104-107A(2)]*

***Aligning the CGT outcomes of MITs with AMITs***

1.34 Broadly, a capital gain arises under CGT event E4 for MITs (subsection 104-70(4)), and under CGT event E10 for AMITs (subsection 104-107A), if the sum of the amounts of non-assessable payments is more than the cost base of the units in the MIT or AMIT.

1.35 Under CGT event E4, certain amounts (such as a capital gain that has been applied against capital losses) can be excluded from the amount of non-assessable payments. Therefore, those amounts do not reduce the cost base of the units in the MIT. However, those same amounts cannot be excluded from the amount of non-assessable payments under CGT event E10 and therefore do not reduce the cost base of the units in an AMIT (section 104-107D).

1.36 The amendments align the CGT outcomes of members of MITs with members of AMITs by removing the ability to disregard amounts in item 7 of the table in subsection 104-71(4) from the non-assessable part if

the trust making the payment is a MIT. [Schedule #, item 2, subsection 104-71(6)]

1.37 This ensures that the outcomes under CGT events E4 and E10 are consistent for the members of MITs and AMITs.

### Example 1.1

Ian holds units in a MIT. The total cost base of the units is \$300. During the income year the trustee of the MIT makes a capital gain of \$200 and a capital loss of \$200 (attributable to Ian's units). As a result, the value of Ian's investment in the MIT (\$300) does not change.

Before the end of the year, the trustee makes a payment of \$200 and advises Ian that it relates to the capital gain which has been reduced to nil for income tax purposes through application of the capital loss in the MIT.

At the year-end, the trustee of the MIT would need to classify this as a non-assessable amount as it cannot be disregarded under item 7 of the table in subsection 104-71(4).

Ian must reduce the cost base of the units to \$100. Ian would make no capital gain or loss if he then sold the units for their market value of \$100.

#### Treatment of the distribution if the MIT were an AMIT

If the trust were an AMIT, Ian would have a cost base net amount of \$200 as an excess under section 104-107C and would need to reduce the cost base of his units to \$100 under 104-107A (CGT event E10).

If Ian then sold his units for their market value of \$100 he would make no capital gain or loss.

## Part 3 – Modifications to the withholding tax rules for AMITs

1.38 Amendments to the withholding tax rules for AMITs will:

- clarify that withholding tax liabilities arise on amounts of fund payments and DIR payments that are attributed to foreign members by an AMIT or custodian;
- ensure fund payments for AMITs includes capital losses from non-taxable Australian property that have been applied against capital gains from taxable Australian property;
- clarify that AMITs which only make deemed payments are withholding MITs; and
- clarify that the TFN withholding rules apply to AMITs that make deemed payments to members.

***MIT withholding provisions apply to attributed amounts***

*Fund payments*

1.39 Under the AMIT regime, when an AMIT (or a MIT) makes a fund payment to a foreign resident member, the foreign resident has a liability to withholding tax in relation to the fund payment (Subdivision 840-M).

1.40 Notes have been inserted into subsections 840-805(2) and (3) to clarify that deemed payments made by an AMIT may be treated as having been paid to the member by a withholding MIT or a custodian for the purposes of determining the withholding tax liability on the fund payment. *[Schedule #, items 10 to 13, notes to subsections 840-805(2) and (3)]*

1.41 This clarifies that the withholding tax rules apply to the amounts of the fund payment that is attributed to foreign resident members by an AMIT, in addition to amounts which are actually paid.

*DIR payments*

1.42 Generally, if an Australian resident makes a DIR payment to a foreign resident, the foreign resident is liable to withholding tax on the amount paid (section 128B of the ITAA 1936).

1.43 A note has been inserted into subsection 128B(1A) of the ITAA 1936 to clarify that deemed payments made by an AMIT are treated as having been paid to the member by a withholding MIT or a custodian for the purposes of determining the withholding tax liability on the DIR payments. *[Schedule #, item 1, note to subsection 128B(1A) of the ITAA 1936]*

1.44 This clarifies that the withholding tax rules apply to the amounts of the DIR payments that are attributed to foreign resident members by an AMIT, in addition to amounts which are actually paid.

***AMIT and MIT fund payments calculated only on taxable Australian property gains***

1.45 Broadly, fund payments are amounts of assessable income derived by a MIT or an AMIT that are paid or attributed to members.

1.46 For a MIT, the total of the fund payments in relation to an income year equals, as nearly as practicable, the net income of the trust for the income year disregarding excluded components (section 12-405 in Schedule 1 to the TAA 1953).

1.47 For an AMIT, the total of the fund payments in relation to an income year equals, as nearly as practicable, the total of the determined member components for the income year that are of an assessable income

character disregarding excluded components (section 12A-110 in Schedule 1 to the TAA 1953).

1.48 For a MIT, the method statement for working out the amount of a fund payment has been modified (subsection 12-405(2)) to ensure that capital losses from non-taxable Australian property (including carry-forward capital losses) which have been applied against capital gains from taxable Australian property in the income year are added back to the total of the fund payments, except to the extent that the capital gain is included in the actual payment made in relation to the income year.

*[Schedule #, items 20 to 22, subsections 12-405(2) and (2A) in Schedule 1 to the TAA 1953]*

1.49 For an AMIT, a similar modification has been made to the total of the fund payments (subsection 12A-110(3)) to achieve a consistent result. *[Schedule #, item 23, paragraph 12A-110(3)(b) in Schedule 1 to the TAA 1953]*

1.50 This ensures that, where a fund payment is made to a foreign resident member, the amount of withholding tax payable by the MIT or AMIT is calculated on taxable Australian property net capital gains.

#### ***Withholding MIT provisions apply to deemed payments***

1.51 Generally, where a deemed payment arises, a trustee of an AMIT may have an obligation to pay an amount to the Commissioner if, among other things, it is a withholding MIT (subsection 12-383 in Schedule 1 to the TAA 1953). The obligation applies to a trust that is a withholding MIT that makes a fund payment to foreign members.

1.52 The amendment clarifies that an AMIT which makes a deemed payment to a foreign resident is a withholding MIT. *[Schedule #, item 19, section 12-383 in Schedule 1 to the TAA 1953]*

1.53 This ensures that trusts which only make deemed payments for an income year (and do not make actual cash distributions) will be a withholding MIT, provided that other requirements are satisfied.

#### ***TFN withholding provisions apply appropriately to AMITs***

##### ***Deemed payments to be treated as amounts paid***

1.54 The TFN withholding rules (Subdivision 12E in Schedule 1 to the TAA 1953) ensure that amounts are withheld from payments made by certain entities (such as trust) to an investor who has not quoted their TFN. Generally, the rules apply where, among other things, there is an actual payment or an investor becomes presently entitled to income of a unit trust (section 12-145 in Schedule 1 to the TAA 1953).

1.55 The amendments clarify that deemed payments made by an AMIT are treated as having been paid to the investor for the purposes of



determining whether amounts are required to be withheld from a payment made by the AMIT. *[Schedule #, item 15 and 16, notes to subsections 12-140(1) and 12-145(1) in Schedule 1 to the TAA 1953]*

*Ensuring amounts are subject to appropriate TFN withholding*

1.56 The amendments also limit the application of the TFN withholding rules under section 12-140 in Schedule 1 to the TAA 1953 to ensure that they do not apply to amounts in certain payments which have already been subject to TFN withholding.

1.57 These payment amounts include:

- the pre-AMMA actual payment portion of a deemed payment, to the extent that TFN withholding has already been applied to the pre-AMMA actual payment amount; and
- the pre-AMMA actual payment or deemed payment portion of a post-AMMA actual payment, to the extent that TFN withholding has already been applied to the pre-AMMA actual payment or deemed payment amounts.

*[Schedule #, item 17, subsection 12-152 in Schedule 1 to the TAA 1953]*

#### **Part 4 – Modifications to the operation of the AMIT transitional rules**

1.58 Amendments to the AMIT transitional rules will:

- ensure that former public trading trusts or corporate unit trusts can continue to use accumulated franking credits until 30 June 2018; and
- ensure early balancing trusts can elect into the AMIT regime for the 2016-17 and later income years, regardless of when those income years start.

##### ***Transitional rules regarding franked distributions***

1.59 As part of the AMIT reforms, transitional rules (item 75 of Schedule 5 to the TLAA 2016) applied so that trusts which ceased to be corporate unit trusts or public trading trusts (and therefore were no longer a corporate tax entity) could continue to treat distributions as frankable distributions and distribute accumulated franking credits until 30 June 2018.

1.60 The amendments improve the operation of the transitional rules by ensuring that:

- franking credits of former corporate unit trusts and public trading trusts are retained by varying the application of the

franking debit rules (section 205-30) from the time the trust ceased to be a franking entity to 1 July 2018; and

- distributions made by these trusts to beneficiaries retain the character of a dividend, paid from a corporate tax entity, during the transitional period (that is on or after the cessation time but before 1 July 2018).

*[Schedule #, items 25 and 28, subitems 75(3A) and (6) of Schedule 5 to the TLAA 2016]*

1.61 Further, for the purposes of determining whether the trust can frank a distribution, the amendments ensure that the distribution must be paid out of income derived before 1 July 2016. This ensures that distributions cannot be franked if they are made out of post 30 June 2016 income. *[Schedule #, item 27, paragraph 75(4)(c) of Schedule 5 to the TLAA 2016]*

1.62 Therefore, trusts that ceased to be corporate unit trusts or public trading trusts under the AMIT reforms will be able to pass on franking credits to members provided that the other requirements of the transitional rules are satisfied.

### ***MITs with substituted accounting periods can elect into the AMIT regime for the 2016-17 and later income years***

1.63 Under the application provisions of the AMIT regime (paragraph 1(1)(a) of Schedule 8 to the TLAA 2016), a trust can elect into the AMIT regime for income years starting on or after 1 July 2016.

1.64 The amendments provide additional flexibility to the application provisions by allowing trusts to elect into the AMIT regime for the 2016-17 and later income years, regardless of when those income years start. This ensures that eligible MITs with substituted accounting periods (for example, starting before 1 July) can elect into the AMIT regime for the 2016-17 and later income years. *[Schedule #, items 14, 29, 30 and 31, subitem 1(1) of Schedule 8 of the TLAA 2016 and the definition of ‘starting income year’ in section 276-25 of the IT(TP)A 1997]*

#### **Example 1.2**

RGV is an early balancing trust with a substituted accounting period commencing on 1 April 2016 each year. RGV will be able to elect into the AMIT regime for the 2016-17 income year.

## **Minor and consequential amendments**

1.65 Schedule # to this Bill also makes a number of minor consequential amendments to a number of Commonwealth Acts to update various provisions to take into account the AMIT technical amendments

and repeal provisions that are no longer necessary. *[Schedule #, items 5, 6, 18, 24 and 26]*

## **Application and transitional provisions**

1.66 The amendments to the ITAA 1936, ITAA 1997 and the TAA 1953 apply in relation to the 2017-18 income year and later income years. *[Schedule #, item 32]*