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TREASURY LAWS AMENDMENT (REDUCING PRESSURE ON HOUSING  
AFFORDABILITY NO. 2) BILL 2017  
INCOME TAX (MANAGED INVESTMENT TRUST WITHHOLDING)  
AMENDMENT BILL 2017

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EXPOSURE DRAFT EXPLANATORY MATERIAL



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## ***Table of contents***

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Glossary .....	1
Chapter 1      Additional capital gains discount for affordable housing .....	3
Chapter 2      Affordable housing through managed investment trusts .....	25



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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
CGT	capital gains tax
CIV	collective investment vehicle
Commissioner	Commissioner of Taxation
GST Act	<i>A New Tax System (Goods and Services Tax) Act 1999</i>
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
ITMITA 2008	<i>Income Tax (Managed Investment Trust Withholding Tax) Act 2008</i>
ITMIT Bill	<i>Income Tax (Managed Investment Trust Withholding Tax) Bill 2017</i>
MIT	managed investment trust
NRAS	National Rental Affordability Scheme
TAA 1953	<i>Taxation Administration Act 1953</i>



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# **Chapter 1**

## ***Additional capital gains discount for affordable housing***

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### **Outline of chapter**

1.1 Schedule 1 to Treasury Laws Amendment (Reducing Pressure on Housing Affordability No. 2) Bill 2017 (the Bill) amends the *Income Tax Assessment Act 1997* (ITAA 1997) and the *Taxation Administration Act 1953* (TAA 1953) to provide an additional affordable housing capital gains discount. The discount of up to 10 per cent applies if a capital gains tax (CGT) event occurs to an ownership interest in residential premises that has been used to provide affordable housing.

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

### **Context of amendments**

1.3 In the 2017-18 Budget, the Government announced a package of measures to improve outcomes across the housing sector, from Australians struggling to put a roof over their head to those in affordable housing, private renters and first home buyers.

1.4 Several of these measures specifically address housing affordability for members of the community earning low to moderate incomes by providing incentives for investors to increase the supply of affordable housing that is available. Having access to affordable housing on a long-term basis will help to support Australian households manage life's challenges and assist in relieving the pressure from rising cost of living.

1.5 The Government recognises that increased private investment is required to provide more Australians with access to affordable rental housing. Specific measures addressing this issue include:

- a CGT incentive for investment in affordable housing (this measure); and
- concessional withholding tax treatment for fund payments to certain managed investment trust (MIT) members relating to affordable housing investment through MITs (referred to as the MITs measure in this Chapter) (see Chapter 2).

1.6 These affordable housing measures provide an additional incentive to individual and institutional investors to increase the supply of affordable housing by allowing investors (including resident investors in MITs) to retain an increased amount of the capital gains they realise from their investments in affordable housing. Individual investors may invest by holding an ownership interest in affordable housing directly or through certain trusts.

1.7 Capital gains arising from CGT assets of individuals that they held for at least 12 months generally receive a 50 per cent capital gains discount. The individual's net capital gain (including a discounted capital gain) forms part of their assessable income. This amount, and the individual's other assessable income less allowable deductions forms their taxable income which is taxed at marginal tax rates.

1.8 In the 2016-17 Budget, the Government announced that it would establish a tax and regulatory framework for two new collective investment vehicles (CIVs):

- a corporate CIV; and
- a limited partnership CIV.

1.9 The Government intends that these CIVs will be able to invest in affordable housing in the same manner as MITs. It is intended that legislation to introduce the framework for the new types of CIVs will ensure members of CIVs have access to the additional affordable housing capital gains discount in the same manner as members of MITs.

## **Summary of new law**

1.10 Schedule 1 to the Bill encourages investment in affordable housing for members of the community earning low to moderate incomes. This is achieved by allowing investors to have an additional affordable housing capital gains discount of up to 10 percent at the time a CGT event occurs to an ownership interest in a dwelling that is residential premises that has been used to provide affordable housing. By reducing the CGT that is payable upon disposal of affordable housing, it ensures that a greater proportion of the gain realised at disposal is retained by the investor.

1.11 The additional capital gains discount applies to investments by individuals directly in affordable housing or investments in affordable housing by individuals through trusts (other than public unit trusts and superannuation funds), including MITs to the extent the distribution or attribution is to the individual and includes such a capital gain.

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

<i>New law</i>	<i>Current law</i>
<b>Individuals — direct investment: additional 10 per cent capital gains discount</b>	
<p>Individuals are generally entitled to a 50 per cent discount on capital gains for assets held for at least 12 months.</p> <p>Individuals also are entitled to an additional capital gains discount of up to 10 per cent for capital gains on such assets to the extent they are attributable to capital gains on dwellings used to provide affordable housing for a period or periods totalling at least three years.</p>	<p>Individuals are generally entitled to a 50 per cent discount on capital gains for assets held for at least 12 months.</p>
<b>Individual — indirect investment through trusts and MITs: additional 10 per cent capital gains discount</b>	
<p>Individuals are generally entitled to a 50 per cent capital gains discount on capital gains that are distributed or attributed to them directly or through an interposed entity from a trust or MIT (if the trust or MIT is entitled to a discount capital gain).</p> <p>Individuals are also entitled to an additional capital gains discount of up to 10 per cent on capital gains:</p> <ul style="list-style-type: none"> <li>• that are distributed or attributed to them directly or through an interposed entity from a trust or MIT; and</li> <li>• to the extent they are attributable to capital gains on dwellings used to provide affordable housing.</li> </ul> <p>However, the trust or MIT must have used the dwelling to provide affordable housing for a period or periods totalling at least three years.</p> <p>The interposed entity or trust may be a trust or partnership (other than a public unit trust or superannuation fund).</p>	<p>Individuals are generally entitled to a 50 per cent capital gains discount on capital gains that are distributed or attributed to them directly or through an interposed entity from a trust or MIT (if the trust or MIT is entitled to a discount capital gain).</p>
<b>Providing affordable housing</b>	
A dwelling is used to provide affordable housing if the following	Not applicable.

<i>New law</i>	<i>Current law</i>
<p>conditions are satisfied:</p> <ul style="list-style-type: none"> <li>• residential premises condition — the dwelling is residential premises that is not commercial residential premises;</li> <li>• property management condition — the tenancy of the dwelling or its occupancy is exclusively managed by an eligible community housing provider;</li> <li>• providing affordable housing certification condition — the eligible community housing provider has given each entity that holds an ownership interest in the dwelling certification that the dwelling was used to provide affordable housing;</li> <li>• National Rental Affordability Scheme (NRAS) condition — no entity that has an ownership interest in the dwelling is entitled to receive an NRAS incentive for the NRAS year; and</li> <li>• MIT membership condition — if the ownership interest in the dwelling is owned by a MIT the tenant does not have an interest in the MIT that passes the non-portfolio test.</li> </ul>	

## Detailed explanation of new law

1.12 The additional affordable housing capital gains discount may apply to reduce an individual’s capital gain from a CGT event occurring to a dwelling that was either owned by the individual or a trustee of certain types of trusts in which the individual is a beneficiary (directly or through a partnership or a trust of any of those types). If the individual is eligible for an additional affordable housing capital gains discount it is applied to reduce the capital gain in working out their net capital gain for the income year.

## **Eligibility for an additional affordable housing capital gains discount**

1.13 The additional affordable housing capital gains discount applies separately to each capital gain from affordable housing made by an individual, or distributed or attributed to an individual by certain trusts, if eligibility conditions are met.

1.14 An individual is eligible for an additional affordable housing capital gains discount (direct investment) on a capital gain if they:

- make a discount capital gain from a CGT event happening in relation to a CGT asset that is their ownership interest in a dwelling; and
- used the dwelling to provide affordable housing for at least three years (1095 days) which may be aggregate usage over different periods.

*[Schedule 1, item 2, subsection 115-125(2)]*

1.15 An individual will also be eligible for an additional affordable housing capital gains discount on a capital gain (trust investment) if:

- that capital gain was distributed or attributed to them:
  - directly from a trust; or
  - from a trust through a partnership or another trust;
- the capital gain was a discount capital gain for the trust that realised that gain;
- the dwelling was used to provide affordable housing for at least three years (1095 days) which may be aggregated use in different periods; and
- the trust which used the dwelling to provide affordable housing and any interposed entities (if any) through which the capital gain was distributed or attributed to the individual was one of the following specified entities:
  - a trust (other than a public unit trust or a superannuation fund);
  - a managed investment trust; or
  - a partnership.

*[Schedule 1, item 2, subsections 115-125(2) and (3)]*

1.16 This Chapter first explains the requirements to qualify for the capital gains discount for direct investment in affordable housing. Where these differ for trust investments in affordable housing, they are explained later in this Chapter.

***CGT event happening in relation to a CGT asset that is an ownership interest in a dwelling***

1.17 The CGT event that generally applies to ownership interests in dwellings is CGT event A1 disposals (see section 104-10). However other CGT events can also apply to an ownership interest in a dwelling.

1.18 For this measure dwelling takes its existing meaning as defined in section 118-115, that is a dwelling includes:

- a building (for example a house) or part of a building (for example an apartment or townhouse) that consists wholly or mainly of accommodation; and
- any land immediately under the unit of accommodation.

1.19 It also includes adjacent land that, together with the land under the dwelling, does not exceed two hectares, and adjacent structures (for example, a storeroom, shed or garage).

1.20 While caravans, houseboats and other mobile homes are included in the definition of dwelling for CGT purposes, only dwellings that are residential premises that are not commercial residential premises can be used to provide affordable housing. Therefore this measure does not apply to caravans, mobile homes and houseboats as they are not residential premises (see paragraph 1.32).

1.21 Section 118-130 provides that an ownership interest in a dwelling is:

- for land — a legal or equitable interest in it or a right to occupy it;
- for a dwelling that is not a flat or home unit — a legal or equitable interest in the land on which it is erected, or a licence or right to occupy it; or
- for a flat or home unit — a legal or equitable interest in a stratum unit in it, a licence or right to occupy it, or a share in a company that owns a legal or equitable interest in the land on which the flat or home is erected and provides a right to occupy it.

***Discount capital gain***

1.22 For the purposes of this measure a discount capital gain is a capital gain of an individual that:

- resulted from a CGT event happening to an ownership interest in a dwelling which the individual has owned for at least 12 months; and

- the cost base was worked out without the application of indexation.

1.23 A discount capital gain includes an amount that is treated as a capital gain of an individual under section 115-215 for the purposes of calculating their net capital gain where that individual is entitled to the capital gains discount. An individual's capital gains from the application of section 115-215 are those capital gains realised by trusts that have been distributed, either directly or through an interposed entity to that individual (see paragraphs 1.52 to 1.54 below).

1.24 Capital gains realised by trusts include capital gains that have been attributed to a resident individual by an attributed managed investment trust (AMIT) to which subsection 276-80(2) has applied. This provision treats the member as having derived, received or made the amount reflected in the determined member component in the same circumstance as the AMIT derived, received or made it.

#### ***Used the dwelling to provide affordable housing***

1.25 The additional affordable housing capital gains discount only applies to certain capital gains if the dwelling in which the ownership interest was held was used to provide affordable housing for a period or periods totalling three (1095 days) or more years after 1 January 2018. The capital gain must have been realised by an individual or be a capital gain that was distributed or attributed (directly or via a partnership or certain trusts) to an individual by certain trusts. The period that the dwelling was used to provide affordable housing may be a continuous period or an aggregation of periods totalling three or more years.

*[Schedule 1, item 2, subsection 115-125(2)]*

#### **Example 1.1 — Aggregated period of affordable housing use**

Lisa signs a contract to acquire a dwelling that is residential premises (but not commercial residential premises) on 15 August 2018.

Lisa used the dwelling as follows when she owned it:

- undertook repairs at the property from when she acquired it on 15 August 2018 (the acquisition date for CGT purposes) until 1 December 2018 (109 days);
- rented it out by providing affordable housing from 2 December 2018 until 20 August 2020 (628 days);
- rented it out through a real estate property manager at market rates (that is not providing affordable housing) from 21 August 2020 until 31 August 2021 (376 days);
- rented it out by providing affordable housing from 1 September 2021 until 15 January 2023 (502 days); and

- vacated the property and prepared it for sale on and after 16 January 2023 (57 days).

On 13 March 2023 Lisa signed a contract to sell the dwelling with settlement occurring on 11 April 2023.

Lisa has held the dwelling for a total of 1,672 days of which it was used to provide affordable housing for 1,130 days. As the dwelling was used to provide affordable housing for more than 1,095 days, Lisa is eligible for the additional affordable housing capital gains discount (assuming the dwelling meets the other requirements).

1.26 A dwelling is used to provide affordable housing if the following conditions are satisfied:

- residential premises condition — the dwelling is residential premises that is not commercial residential premises;
- property management condition — the tenancy of the dwelling or its occupancy is exclusively managed by an eligible community housing provider;
- providing affordable housing certification condition — the eligible community housing provider has given each entity that holds an ownership interest in the dwelling certification that the dwelling was used to provide affordable housing;
- NRAS condition — no entity that has an ownership interest in the dwelling is entitled to receive an NRAS incentive for the NRAS year; and
- MIT membership condition — if the ownership interest in the dwelling is owned by a MIT the tenant does not have an interest in the MIT that passes the non-portfolio test.

*[Schedule 1, items 3 and 4, section 980-5 and definition of provide affordable housing in subsection 995-1(1)]*

1.27 In addition affordable housing use must have been from on or after:

- this measure — 1 January 2018 (the day this measure applies from); or
- for the MITs measure in Chapter 2 — 1 July 2017 (the day that measure applies from).

*Residential premises condition*

1.28 The residential premises condition is satisfied if the dwelling is residential premises that are not commercial residential premises.

*Schedule 1, item 3, paragraph 980-5(a)]*

1.29 The term ‘residential premises’ is defined in subsection 995-1(1) of the ITAA 1997 as having the same meaning as in the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act). The GST Act provides that the term ‘residential premises’ means land or a building that:

- is occupied as a residence or for residential accommodation; or
- is intended to be occupied, and is capable of being occupied, as a residence or for residential accommodation.

1.30 The definition specifies that land or a building that meets these requirements is residential premises regardless of the term of the occupation or intended occupation. It also specifies that the term residential premises includes a floating home.

1.31 Due to its use in the GST law, this defined term is already the subject of considerable judicial scrutiny and interpretative guidance. Broadly, land or a building will be residential premises if it provides, at minimum, shelter and basic living facilities and is either occupied by a person or designed for occupation. This is to be ascertained by an objective consideration of the character of the property — the purpose for which an entity may hold the property is not relevant.

1.32 Residential premises need only be suitable for occupation, rather than long-term occupation — they include, for example, a hotel room that may only be suitable for short term accommodation. However, it does not include things that people may occupy that are not land or a building, such as a caravan.

1.33 The term ‘commercial residential premises’ takes its meaning from the GST Act. Section 195-1 of the GST Act defines commercial residential premises as:

- a hotel, motel, inn, hostel or boarding house;
- premises used to provide accommodation in connection with a school;
- a ship that is mainly let out on hire in the ordinary course of a business of letting ships out on hire;
- a ship that is mainly used for entertainment or transport in the ordinary course of a business of providing ships for entertainment or transport;
- a marina at which one or more of the berths are occupied, or are to be occupied, by ships used as residences;
- a caravan park or a camping ground; or

- anything similar to residential premises described in the preceding dot points.

*[Schedule 1, item 4, definition of commercial residential premises in subsection 995-1(1)]*

1.34 The definition of commercial residential premises also expressly excludes premises to the extent that they are used to provide accommodation to students in connection with an educational institution that is not a school. For further information about commercial residential premises refer to Goods and Services Tax Taxation Ruling GSTR 2012/6 — Goods and services tax: commercial residential premises.

*Property management condition*

1.35 The property management condition requires the tenancy of the dwelling or its availability for rent to be exclusively managed by an eligible community housing provider. *[Schedule 1, item 3, paragraph 980-5(b)]*

1.36 Community housing providers provide rental housing to tenants who are members of the community earning low to moderate incomes. Community housing providers may own some of the dwellings, however they also manage dwellings on behalf of investors, institutions and state and territory governments. Many community housing providers specialise in providing accommodation to particular client groups which may include disability housing, aged tenants and youth housing.

1.37 Community housing providers are regulated by the states and territories. For the purposes of this measure an eligible community housing provider is an entity that is registered as a community housing provider to provide community housing services under a law of the Commonwealth, state or territory or is registered by an Australian government or government entity. *[Schedule 1, items 3 and 4, subsection 980-10(1) and definition of eligible community housing provider in subsection 995-1(1)]*

1.38 An organisation that was a community housing provider will continue to be recognised as an eligible community housing provider for a period of 90 days from when its registration as a community housing provider is cancelled by a state or territory registrar. This ensures that investors do not immediately lose access to the additional capital gains discount for the dwelling by giving them a transition period to find a new community housing provider. *[Schedule 1, item 3, subsection 980-25(2)]*

1.39 The management of a tenancy generally includes being the point of contact for the property for tenants, collecting rent from the tenants, conducting property inspections, scheduling and managing the carrying out of repairs and maintenance for the dwelling, keeping of records, giving of notices to tenants on behalf of the owner (if required) and, if the

dwelling is vacant, advertising it as being available for rent and arranging tenancy agreements. A dwelling is available for rent if it is advertised so it has broad exposure to potential eligible tenants and having regard to all of the circumstances, tenants are reasonably likely to rent it.

1.40 The part of the condition that the dwelling is ‘exclusively managed by a community housing provider’ requires the community housing provider to have exclusive responsibility and oversight of the management of the dwelling. However the community housing provider does not have to perform all aspects of the management of the dwelling themselves and could subcontract out any or all of the responsibilities provided they retain oversight of decisions. For example they may contract out the scheduling and carrying out of repairs and maintenance or advertising of vacant properties for rent.

### **Example 1.2 — Property management — direct management**

ACF Community Housing is a community housing provider registered under a state law that manages the tenancy and occupancy of dwellings on behalf of owners to eligible tenants.

Eligible tenants are tenants that ACF Community Housing assesses as being eligible to live in affordable housing properties.

ACF Community Housing undertakes the assessment. It applies guidelines and criteria in operation in the applicable state or territory in making eligibility decisions.

In managing the tenancy or occupancy of dwellings ACF Community Housing manages the tenancy and occupation of dwellings, deals with tenants and property owners, collects rent, undertakes property inspections, organises repairs and maintenance of properties, keeps records, gives notices to tenants for owners and advertises vacant properties for rent.

As such ACF Community Housing is exclusively managing the tenancy and occupancy of the dwellings.

### **Example 1.3 — Property management — outsourcing**

BDG Community Housing is a community housing provider registered under a state law that manages the tenancy and occupancy of dwellings on behalf of owners to eligible tenants.

Eligible tenants are tenants that BDG Community Housing assesses as being eligible to live in affordable housing properties.

BDG Community Housing undertakes the assessment applying guidelines and criteria in operation in the applicable state or territory in making eligibility decisions.

To assist it in managing the tenancy or occupancy of the dwellings BDG Community Housing contracts JKL property management agency to undertake some tenancy and occupancy related tasks, that is the managing of property repairs and maintenance and engagement

with tenants and owners and advertising properties that are vacant on its behalf (with BDG Community Housing having oversight).

As BDG Community Housing has full oversight of the property management services that JKL property management agency provides, BDG Community Housing is accepted as exclusively managing the dwellings itself. Therefore BDG Community Housing satisfies the property management condition.

*Providing affordable housing certification condition*

1.41 A dwelling can only be taken to be used for providing affordable housing use for a day if the community housing provider has provided an affordable housing certificate stating that it declares that the residential premises and property management conditions have been satisfied on that day. [Schedule 1, item 3, paragraphs 980-5(c) and 980-15(a)]

1.42 The affordable housing certificate must be provided in the approved form. This will allow the Commissioner to specify the information that is required to be included in affordable housing certificates and to review and update it as required. The certificate will need to state the number of days the dwelling was used to provide affordable housing in the income year. [Schedule 1, item 3, paragraph 980-15(b)]

1.43 The community housing provider must provide the affordable housing certificate to the individuals or trusts that hold an ownership interest in the property on or before the 31<sup>st</sup> day after the end of the individuals' or trusts' income year (31 July for most community housing providers). [Schedule 1, item 3, paragraph 980-15(b)]

*NRAS condition*

1.44 A dwelling can only be taken to provide affordable housing for a day if no entity that has an ownership interest in the dwelling is entitled to an NRAS incentive for the NRAS year (that includes that day). [Schedule 1, item 3, paragraph 980-5(d)]

1.45 The *National Rental Affordability Scheme Regulations 2008* set out the benefits that can be provided to an entity under the NRAS for making a dwelling available to be used as part of the scheme. They are:

- a tax offset — as set out in the tax offset certificate provided to the approved participant in relation to the dwelling by the Secretary of the Department of Social Services; or
- a payment or other non-cash benefit — a payment made by the Secretary of the Department of Social Services to an entity in relation to the use of that dwelling under the NRAS.

1.46 For this condition the NRAS year is the year that begins on 1 May in which the day under consideration occurs.

*MIT membership condition*

1.47 The MIT membership condition applies if the ownership interest in the dwelling is owned by a MIT. It is satisfied if the tenant does not have an interest in the MIT that passes the non-portfolio test (that is broadly with associates has a less than 10 per cent interest in the MIT).  
*[Schedule 1, item 3, paragraph 980-5(e)]*

1.48 Section 960-195 provides that an interest passes the non-portfolio test if the holding entity (in this case the tenant) holds in another entity (in this case the MIT) and the sum of the direct participation interests held by the holding entity and its associates in that other entity at that time is 10 per cent or more.

***Capital gain that was distributed or attributed to them directly or through an interposed entity by a trust***

1.49 A capital gain is distributed or attributed by a trust directly to an individual if the trust:

- realises that capital gain itself, that is the CGT event occurs to a CGT asset of the trust (the ownership interest in the dwelling); and
- the gain is distributed or attributed by the trust directly to the individual (with there being no intervening entity).

1.50 A capital gain is distributed or attributed by a trust through an interposed entity to an individual if a trust (the first trust):

- realises that capital gain, that is the CGT event occurs to a CGT asset of the first trust (the ownership interest in the dwelling);
- the gain is distributed or attributed by the first trust (or a subsequent trust) to another entity that is another trust or a partnership; and
- the other trust or partnership then distributes the capital gain to the individual.

1.51 A capital gain of an individual that resulted from a CGT event occurring to units in a unit trust (including a MIT) that holds affordable housing will not qualify for an additional discount capital gain for affordable housing. The capital gain may have been realised by the individual or by another entity and be distributed or attributed to the individual. However as this capital gain arose from the sale of units in a unit trust, and not from a holding by an entity in an ownership interest in a dwelling, it will not qualify as it does not satisfy this requirement.

**Example 1.4 — Trust distributing capital gain to an individual through an interposed entity**

BDF Unit Trust signs a contract on 5 September 2022 to sell a dwelling. The settlement of the sale of the dwelling is on 3 October 2022. It had acquired the dwelling on 1 March 2018.

The BDF Unit Trust used the dwelling to provide affordable housing for more than 1095 days (3 years) during its ownership period.

The BDF Unit Trust realised a capital gain of \$200,000 from the sale of the dwelling, which was reduced to \$100,000 following application of the discount capital gain of 50 per cent. The trust did not realise any other capital gains or losses during the income year.

The BDF Unit Trust distributed this capital gain in equal proportion to its unit holders, including the HLJ Trust (a discretionary trust) which received a distribution of \$50,000. The HLJ Trust distributes the whole of this capital gain of \$50,000 to Martin. (In doing so the HLJ Trust grossed up the distribution and re-applied the capital gains discount.)

Martin's capital gain has been distributed to him by a trust (BDF Unit Trust) through an interposed entity (the HLJ Trust). Martin therefore satisfies this requirement for claiming the additional 10 per cent capital gains discount for affordable housing.

***Capital gains distributed by or attributed by a trust covered by the specified entities***

1.52 The incentive to invest in affordable housing provided by this measure is directed at individuals, who either invest directly in affordable housing (that is they directly have an ownership interest in the property used to provide affordable housing) or through trusts, but only closely held trusts or managed investment trusts.

1.53 For investments by individuals made through other entities, the entity that realises the capital gain from a CGT event occurring to an ownership interest in the property used to provide the affordable housing and any entity through which the capital gain is distributed or attributed to the individual must be either a certain type of trust or a partnership. For this purpose these trusts must not be:

- a public unit trust (other than a MIT); or
- a superannuation fund.

*[Schedule 1, item 2, subsection 115-225(3)]*

1.54 Public unit trust is defined in section 102P of the *Income Tax Assessment Act 1936* (ITAA 1936). Broadly, a unit trust will be a public unit trust if the units in the trust are listed for quotation in the official list of a stock exchange, offered to the public in a public offer, held by more than 50 people or where a tax-exempt investment vehicle, such as a

foreign superannuation fund, is a substantial unitholder (see subsections 102P(1) and (2) of the ITAA 1936). However, a trust will not be a public unit trust if 20 or fewer people hold a beneficial interest in 75 per cent or more of the income or property of the trust, or if other integrity rules are not satisfied (see section 102P of the ITAA 1936).

### **Working out the net capital gain where additional affordable housing capital gains discount applies**

1.55 The additional affordable housing capital gains discount is taken into account in working out an individual's capital gain:

- from a CGT event occurring to an ownership interest in residential premises that has been used to provide affordable housing they held, or
- that was distributed or attributed to them directly or through an interposed entity by a trust.

1.56 Section 102-5 sets out five steps to work out the net capital gain for an income year. They are:

- Step 1 — reduce the capital gains made during the income year by the capital losses (if any) made during the income year;
- Step 2 — reduce the capital gains remaining at the end of Step 1 by any previously unapplied net capital losses from earlier income years;
- Step 3 — reduce by the discount percentage each amount of a discount capital gain remaining after Step 2;
- Step 4 — apply the small business concession to any capital gain to which they apply;
- Step 5 — Add up the amounts of any capital gains (if any) remaining after step 4. The sum is the net capital gain for the income year.

1.57 Following the amendments made by this measure, at Step 3, the capital gain is reduced by the discount percentage. The discount percentage is taken to be the discount percentage that would ordinarily apply plus the additional affordable housing discount percentage.

*[Schedule 1, item 2, subsection 115-125(4)]*

1.58 The affordable housing discount percentage is equal to:

$$= \frac{\text{Subdiv 115-B discount percentage}}{5} \times \frac{\text{Affordable housing days}}{\text{Total ownership days}}$$

where:

Subdivision 115-B discount percentage is the discount percentage that applies under Subdivision 115-B

Affordable housing days are the number of days the dwelling was used to provide affordable housing during its ownership period less the number of days when the individual receiving the affordable housing capital gains discount was a foreign or temporary resident.

Total ownership days are the number of days the dwelling was held from the time it was acquired until a CGT event occurred to it.

*[Schedule 1, item 2, subsection 115-125(5)]*

1.59 The Subdivision 115-B discount percentage is used as the basis for determining the affordable housing discount percentage as:

- the affordable housing discount percentage (before adjustment) of 10 per cent is one-fifth of the discount capital gain percentage of 50 per cent that applies to individuals (noting that only individuals are entitled to an affordable housing capital gains discount); and
- it reduces the amount of the discount to take into account the time the individual was either a foreign resident or temporary resident for taxation purposes — this ensures consistency with the discount capital gain, removes the need to apportion separately and also takes into account the transitional arrangements that applied to this apportionment (that is not reducing the discount for foreign or temporary residence days occurring before 9 May 2012).

*[Schedule 1, item 1, paragraph 115-100(e)]*

1.60 The affordable housing discount percentage must also be adjusted to ensure that a capital gains discount is only available to the extent that the property was used for affordable housing use on and after 1 January 2018. This is achieved by applying an adjustment factor calculated by dividing the affordable housing days by total days in the ownership period. However, both the denominator and numerator in this calculation exclude the number of days the individual was a foreign or temporary resident after 8 May 2012. This exclusion to the number of days applies as the period that an individual was a foreign or temporary resident is already accounted for through the use of the Subdivision 115-B discount percentage.

1.61 As with the existing discount capital gain, the additional 10 per cent capital gains discount for affordable housing will not apply if

there is a net capital loss for the income year, that is the sum of the capital losses for the income year exceeds the sum of the capital gains.

### **Example 1.5 —Affordable housing capital gain**

Erica signed a contract to purchase a dwelling that was residential premises (but not commercial residential premises) on 15 May 2018 for \$600,000.

On 15 September 2024 Erica signs a contract to sell the property. She makes a gross capital gain (before any capital gains discount applies) of \$140,000.

Erica was an Australian resident for taxation purposes for the whole of the ownership period for the dwelling.

Erica also realises a capital loss of \$30,000 in the 2024-25 income year and has a \$10,000 carry forward capital loss from a prior income year.

Erica used the dwelling as follows during the period of time for which she owned it:

- undertook repairs at the property from when she acquired it on 15 May 2018 (the acquisition date for CGT purposes) until 9 September 2018 (118 days);
- rented it out by providing affordable housing to eligible tenants through an eligible community housing provider from 10 September 2018 until 17 May 2022 (1346 days);
- rented it for rent at market value (that is not providing affordable housing) from 18 May 2022 until 1 February 2023 (260 days);
- rented it out by providing affordable housing to eligible tenants through an eligible community housing provider from 2 February 2023 until 1 August 2024 (547 days);
- vacated the property and prepared it for sale on and after 2 August 2024 through until 15 September 2024 (45 days).

Therefore Erica owned the dwelling for a total of 2,316 days of which she used it to provide affordable housing for 1,893 days.

Erica's net capital gain for the 2024-25 income year is calculated as follows:

Step 1 — reduce the capital gains made during the income year by the capital losses (if any) made during the income year

Erica's capital gain from Step 1 is \$110,000, being the \$140,000 capital gain less the capital loss of \$30,000 she realised during the current income year.

Step 2 — reduce the capital gains remaining at the end of Step 1 by any previously unapplied net capital losses from earlier income years

Erica's capital gain from Step 2 is \$100,000, being the \$110,000 capital gain at the end of Step 1 less the prior year capital loss of \$10,000.

Step 3 — reduce by the discount percentage each amount of a discount capital gain remaining after Step 2

For the purpose of Step 3 the discount percentage is equal to the sum of the Subdivision 115-B discount capital gain percentage plus the affordable housing capital gains discount percentage.

Erica's Subdivision 115-B discount capital gains discount percentage is equal to 50 per cent (Erica was an individual and she was a resident of Australia for the whole of the ownership period).

The affordable housing discount capital gain percentage is equal to:

$$\begin{aligned} &= \frac{\text{Subdiv 115-B discount percentage}}{5} \times \frac{\text{Affordable housing days}}{\text{Total ownership days}} \\ &= \frac{50\%}{5} \times \frac{1,893}{2,316} \\ &= 8.17\% \end{aligned}$$

The discount percentage is equal to the sum of the Subdivision 115-B discount capital gain percentage and the affordable housing capital gains discount percentage, that is 58.17 per cent (50 per cent plus 8.17 per cent).

The capital gain from Step 3 is the capital gain following step 2 reduced by the discount percentage, that is:

$$\begin{aligned} &= \text{Step 2 capital gain} \times (1 - \text{discount percentage}) \\ &= \$100,000 \times (1 - 58.17\%) \\ &= \$41,830 \end{aligned}$$

Step 4 — apply the small business concession to any capital gain to which they apply

Erica's capital gain from the sale of the investment property does not qualify for the small business concessions. Therefore Erica's capital gain continues to be \$41,830.

Step 5 — add up the amounts of any capital gains (if any) remaining after step 4 — the sum is the net capital gain for the income year

Erica's capital gain from the sale of the investment property at the end of Step 4 is \$41,830. This is also her total capital gain for the 2024-25 income year as she has not realised any other capital gains during that year.

**Example 1.6 —Affordable housing capital gain — individual is a resident for only some of the ownership period**

William purchased a dwelling that was residential premises on 1 January 2015 which he used to earn rent for the whole time he owned it. William used the property to provide affordable housing from 1 January 2018 until 30 June 2023.

William moved to the United States of America on 1 July 2022, becoming a foreign resident for taxation purposes on and from that day.

On 30 June 2023 William signs a contract to sell the dwelling. He makes a gross capital gain (before any capital gains discount) of \$200,000.

William does not realise any other capital gains or losses in the 2022-23 income year and does not have any prior year capital losses.

William's net capital gain for the 2022-23 income year is calculated as follows:

Step 1 — reduce the capital gains made during the income year by the capital losses (if any) made during the income year

William's capital gain from Step 1 is \$200,000 as he has not realised any capital losses during the 2022-23 income year.

Step 2 — reduce the capital gains remaining at the end of Step 1 by any previously unapplied net capital losses from earlier income years

William's capital gain from Step 2 is \$200,000 as he does not have any capital losses from prior income years.

Step 3 — reduce by the discount percentage each amount of a discount capital gain remaining after Step 2

For the purpose of Step 3 the discount percentage is equal to the sum of the Subdivision 115-B discount capital gain percentage plus the affordable housing capital gains discount percentage.

The Subdivision 115-B discount capital gain percentage is equal to:

$$\begin{aligned} & \text{Number of days during discount testing period that you were} \\ = & \frac{\text{an Australian resident (but not a temporary resident)}}{2 \times \text{No days in discount period}} \\ = & \frac{2,738}{2 \times 3,103} \\ = & 44.11\% \end{aligned}$$

The affordable housing discount capital gain percentage is equal to:

$$\begin{aligned}
 &= \frac{\text{Subdiv 115-B discount percentage}}{5} \times \frac{\text{Affordable housing days}}{\text{Total ownership days}} \\
 &= \frac{44.11\%}{5} \times \frac{1,642}{2,738} \\
 &= 5.29\%
 \end{aligned}$$

Affordable housing days and total ownership days both exclude the number of days when the individual was a foreign or temporary resident.

The discount percentage is equal to the sum of the Subdivision 115-B discount capital gain percentage and the affordable housing capital gains discount percentage, that is 49.4 per cent (44.11 per cent plus 5.29 per cent).

The capital gain from Step 3 is the capital gain following step 2 reduced by the discount percentage, that is:

$$\begin{aligned}
 &= \text{Step 2 capital gain} \times (1 - \text{discount percentage}) \\
 &= \$200,000 \times (1 - 49.4\%) \\
 &= \$101,200
 \end{aligned}$$

Step 4 — apply the small business concession to any capital gain to which they apply

William’s capital gain from the sale of the investment property does not qualify for the small business concessions. Therefore William’s capital gain continues to be \$101,200.

Step 5 — Add up the amounts of any capital gains (if any) remaining after step 4 — the sum is the net capital gain for the income year.

William’s capital gain from the sale of the investment property at the end of Step 4 is \$101,200. This is also his total capital gain for the 2022-23 income year as he has not realised any other capital gains during that year.

## Reporting requirements for community housing providers

1.62 Community housing providers that issue affordable housing certification must provide an annual report notifying the Commissioner in the approved form of the details of all certifications that they provide during an income year (unless the Commissioner notifies that it is not required). Notification for an income year must be provided to the Commissioner on or before 31 days following the end of the relevant income year or within such further time that the Commissioner allows. *[Schedule 1, item 6, table item 11 of section 396-55 of Schedule 1 to the TAA 1953]*

## **Disclosure of information to state registrars about community housing providers**

1.63 Section 355-25 of Schedule 1 to the TAA 1953 of the confidentiality of taxpayer information provisions makes it an offence for a taxation officer to disclose tax information that identifies any entity, or is reasonably capable of being used to identify any entity, except in specified circumstances.

1.64 Community housing providers are regulated at the state and territory government level. The Commissioner of Taxation (Commissioner) will be permitted to disclose to the state and territory community housing registrars information about community housing providers for the purpose of the registrars determining whether they should be, or should continue to be, registered. It is envisaged that the Commissioner would inform the relevant state or territory registrar about information concerning a community housing provider registered with it if the Commissioner has information suggesting that community housing provider should no longer be registered. *[Schedule 1, item 5, table item 9 of subsection 355-65(8) of Schedule 1 to the TAA 1953]*

## **Application and transitional provisions**

1.65 The amendment to insert section 115-125 into the ITAA 1997 to provide an additional GGT discount applies to CGT events occurring on and after 1 January 2018. *[Schedule 1, subitem 7(1)]*

1.66 The amendments to insert Subdivision 980-A into the ITAA 1997 apply in relation to tenancies of affordable housing starting before, at or after 1 July 2017. The earlier start date allows the Subdivision to also apply for the affordable housing through MITs measure which applies concessional withholding tax treatment to certain member distributions from 1 July 2017 (see Chapter 2 for further details). *[Schedule 1, subitem 7(2)]*

1.67 The amendment to the confidentiality of taxpayer information provisions in the TAA 1953 applies in relation to records and disclosures of information made at or after the commencement of this Schedule, whether the information was obtained before, at or after the commencement of the Schedule to the Bill. *[Schedule 1, subitem 7(3)]*

1.68 Schedule 1 to this Bill commences on the first day of the next quarter following the day of Royal Assent. *[Clause 2]*



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## **Chapter 2**

# ***Affordable housing through managed investment trusts***

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### **Outline of chapter**

2.1 Schedule 2 to Treasury Laws Amendment (Reducing Pressure on Housing Affordability No. 2) Bill 2017 (this Bill) and the Income Tax (Managed Investment Trust Withholding) Amendment Bill 2017 (ITMIT Bill) amend taxation laws to encourage managed investment trusts (MITs) to invest in affordable housing. They:

- allow MITs to invest in dwellings that are residential premises (but not commercial residential premises) that are used to provide affordable housing primarily for the purpose of deriving rent; and
- apply the concessional 15 per cent withholding tax rate to fund payments:
  - to the extent they consist of affordable housing rental income and certain capital gains from dwelling used to provide affordable housing; and
  - that are paid or attributed to MIT members who are foreign residents of jurisdictions which Australia has listed as an exchange of information country (referred to as exchange of information countries in this Chapter).

2.2 For this Chapter the following terms have the same meaning as used in Chapter 1 (additional capital gains discount for affordable housing):

- commercial residential premises (refer to paragraphs 1.33 to 1.34);
- dwelling (refer to paragraphs 1.18 to 1.20);
- provide affordable housing (refer to paragraphs 1.26 to 1.48); and
- residential premises (refer to paragraphs 1.29 to 1.32).

2.3 All legislative references in this Chapter, unless otherwise stated, are to the ITAA 1997.

## **Context of amendments**

2.4 In the 2017-18 Budget, the Government announced a package of measures designed to improve outcomes across the housing sector, from Australians struggling to put a roof over their head to those in affordable housing, private renters and first home buyers.

2.5 Several of these measures specifically address housing affordability for members of the community earning low to moderate incomes by providing incentives for investors to increase the supply of affordable housing that is available. Having access to affordable housing on a long-term basis will help to support Australian households manage life's challenges and assist in relieving the pressure from rising costs of living.

2.6 The Government recognises that increased private investment is required to provide more access to affordable rental housing. Specific measures addressing this issue include:

- an incentive for affordable housing investment through MITs (this measure); and
- a capital gains tax incentive for investments in affordable housing (see Chapter 1).

2.7 A MIT is a type of unit trust which investors can use to collectively invest in assets that produce passive income, such as shares, property or fixed interest assets. A trust qualifies as a MIT if it meets certain requirements set out in Division 275 of the ITAA 1997 for the income year it is in operation.

2.8 In the 2016-17 Budget, the Government announced that it would establish a tax and regulatory framework for two new CIVs:

- a corporate CIV; and
- a limited partnership CIV.

2.9 The Government intends that these CIVs will be able to invest in affordable housing in the same manner as MITs. It is intended that legislation to introduce the framework for the new types of CIVs will ensure members in CIVs have access to the additional affordable housing capital gains discount in the same manner as members of MITs.

2.10 There also currently is significant uncertainty about the eligibility rules for trusts being MITs if investments are made in dwellings that are residential premises. This is because there is a view that investment in residential property is not made for a primary purpose of earning rental income. It is instead for delivering capital gains from

increased property values, and therefore not eligible for the MIT tax concessions.

## **Summary of new law**

2.11 This measure enables trusts that invest in dwellings that are residential premises, but not commercial residential premises, to be MITs if:

- the dwelling is used for the purpose, or primarily for the purpose, of deriving rent from affordable housing; or
- the use of the dwelling as residential premises is incidental to the earning of other income from the asset of which the dwelling is a part.

2.12 This measure also clarifies the eligibility rules for trusts to be MITs if they invest in dwellings that are residential premises. This will help to provide investors with investment certainty. This change will not, however, affect MITs investing in commercial residential premises. This means that trusts can invest in commercial residential premises and qualify as MITs provided this investment is primarily for the purpose of deriving rent consistent with the eligible investment business rules.

2.13 This measure also provides incentives for MITs to invest in dwellings that are residential premises to provide affordable housing. The first incentive is a concessional 15 per cent withholding tax rate that applies to fund payments that are paid or attributed to foreign residents who are residents of exchange of information countries to the extent the payments are:

- affordable housing rental income; or
- gains realised from dwellings that the MIT has used to provide affordable housing for a total period or periods of at least 3,650 days (that is 10 years).

2.14 The existing 30 per cent withholding rate will continue to apply for all fund payments that are paid or attributed to members who are foreign residents of countries with which Australia does not have an exchange of information agreement.

2.15 The second incentive is targeted at Australian residents to allow them to apply the related CGT measure (see Chapter 1). Under that measure an additional affordable housing capital gains discount of up to 10 per cent applies to the extent a fund payment includes a capital gain realised if a CGT event occurs to a dwelling that the MIT used to provide

affordable housing for a total period or periods of at least 1,095 days (3 years).

2.16 Consistent with the CGT measure, dwellings used to provide affordable housing (see paragraphs 1.26 to 1.48) must satisfy the property management condition. This means that the tenancy or occupancy of the dwelling invested in by a MIT to provide affordable housing must be exclusively managed by an eligible community housing provider (see paragraphs 1.35 to 1.40 of Chapter 1).

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

<i>New law</i>	<i>Current law</i>
<b>MIT investment in dwellings that are residential premises</b>	
Trusts that invest in dwellings that are residential premises but not commercial residential premises can be MITs if: <ul style="list-style-type: none"> <li>• the dwelling is used for the purpose, or primarily for the purpose, of deriving rent from affordable housing;</li> <li>• they are constructing, altering, improving or repairing the dwelling to use it to later provide affordable housing;</li> <li>• they are preparing the dwelling for disposal immediately after having used it to provide affordable housing; or</li> <li>• the use of the dwelling as residential premises is incidental to the earning of other income (that is income from eligible investment business) from the asset of which the dwelling is a part.</li> </ul>	There is uncertainty whether MITs can invest in dwellings that are residential premises.
<b>Withholding tax rate — Foreign residents of exchange of information countries</b>	
A withholding tax rate of 15 per cent applies to fund payments paid or attributed to foreign residents who are residents of exchange of information	A withholding tax rate of 15 per cent applies to fund payments paid or attributed to foreign residents who are residents of exchange of information

<i>New law</i>	<i>Current law</i>
<p>countries to the extent that they are:</p> <ul style="list-style-type: none"> <li>– affordable housing rental income; or</li> <li>– gains realised from dwellings that the MIT has used to provide affordable housing for a period or periods of at least 3,650 days (10 years).</li> </ul> <p>An effective withholding tax rate of 30 per cent applies to fund payments paid or attributed to foreign residents who are residents of exchange of information countries. The 30 per cent rates applies to those payments to the extent that they are gains realised from dwellings that are residential premises that the MIT has used to provide affordable housing but that have not been used to provide affordable housing for a total period or periods of at least 3,650 days (that is 10 years).</p>	<p>countries.</p>

## Detailed explanation of new law

2.17 Schedule 2 to this Bill and the ITMIT Bill 2017 make amendments to enable MITs to invest in affordable housing and provide a concessional 15 per cent withholding tax rate for fund payments to the extent that they include affordable housing income.

### Enabling MITs to invest in affordable housing

2.18 Schedule 2 of this Bill makes amendments to enable MITs to invest in affordable housing subject to eligibility conditions. Some consequential amendments are also made to ensure that the tax law operates as intended.

#### *Residential premises a trust can invest in and be a MIT*

2.19 A trust can own an interest in a dwelling or otherwise control such an interest and be a MIT if:

- the dwelling is residential premises that are not commercial residential premises; and

- the trust at all times meets an eligibility condition (see paragraph 2.22).

*[Schedule 2, items 3 and 4, paragraph 275-10(3)(b) and subsection 275-10(4C)]*

2.20 A trust controls an interest in a dwelling that is residential premises if it controlled or was able to control, directly or indirectly, the affairs or operations of another entity in respect of the ownership by that other entity of that dwelling.

2.21 The amendment to the rules determining whether a trust is a MIT concerning the holding of residential premises does not apply to property that is commercial residential premises. This means that trusts can invest in commercial residential premises and be MITs provided this investment is primarily for the purpose of deriving rent consistent with the eligible investment business rules.

***Eligibility conditions for dwellings that are residential premises (but not commercial residential premises)***

2.22 The eligibility conditions for dwellings that are residential premises (but not commercial residential premises) are:

- investing in a dwelling used to provide affordable housing for the purpose or primarily for the purpose of deriving rent;
- constructing, altering, improving or repairing a dwelling to use it for a later period in the way described in the first dot point in this paragraph;
- preparing a dwelling for disposal immediately after having used the dwelling previously in the way described in the first dot point in this paragraph; and
- the use of a dwelling as residential premises is incidental to the earning of other income that is eligible investment business from the dwelling or an asset of which the dwelling is a part.

*[Schedule 1, item 4, subsection 275-10(4D)]*

2.23 References to using a dwelling that is residential premises to provide affordable housing has the same meaning as used in Chapter 1 (additional capital gains discount for affordable housing).

2.24 An interest in a dwelling that a trust holds that is used to provide affordable housing will need to be held for the purpose, or primarily for the purpose, of deriving rent. ‘For the purpose, or primarily for the purpose of deriving rent’ has the same meaning as it does for the definition of eligible investment business in section 102M of the

*Income Tax Assessment Act 1936* (ITAA 1936). Each such investment will need to be considered on its merits.

2.25 Factors that need to be considered to determine whether an investment in a dwelling is held for the purpose, or primarily for the purpose of deriving rent include:

- the trust's investment strategy;
- the length of time the dwelling is intended to be held for, and any plan for disposal;
- any arrangements entered into or activities undertaken by the trustee (including in relation to the development of the property, its management, and other incidental activities);
- features of the dwelling affecting its suitability for rent by affordable housing tenants; and
- projected rental yields and capital growth to determine the purpose for holding the dwelling.

2.26 To satisfy the eligible investment business rules the MIT will generally need to hold dwellings used to provide affordable housing for significantly longer than a period of three or more years — the period before resident individuals will be eligible to receive the additional capital gains discount for affordable housing (see Chapter 1).

2.27 To satisfy the requirement of investing primarily for the purpose of deriving rent, the dwelling must typically be held for a minimum period. This varies, and needs to be considered taking into account the circumstances of the investment. For example, the Commissioner, in recent advice had regard to the nature of the investment, such that it ensured that the property would be held for the long-term and that the net rental yield would likely exceed the capital growth of the property over the 10 year rental period.

2.28 A trust will also be taken to be investing in the dwelling primarily for the purposes of deriving rent in any income year in which it satisfies the safe harbour test in section 102MB(2) of the ITAA 1936 (75 percent or more of income from rent and other requirements).

### ***Consequential amendments***

2.29 Two consequential amendments are made to ensure that the law operates as intended.

#### ***Trading trust rule for trusts seeking to be MITs***

2.30 A trust is a MIT for an income year if it satisfies the MIT requirements in Subdivision 275-A of the ITAA 1997. One of these requirements is that the trust is not a trading trust for the income year.

2.31 Section 102N of the ITAA 1936 provides that a trust is a trading trust for an income year if the trustee (in the capacity of trustee of the trust), at any time during the income year, carried on a trading business or controlled or was able to control, directly or indirectly, the affairs or operations of another entity in respect of the carrying on by that other entity of a trading business.

2.32 Section 102M of the ITAA 1936 then provides that a trading business means a business that does not consist wholly of eligible investment business. Section 102M provides that eligible investment business means:

- investing in land for the purpose, or primarily for the purpose, of deriving rent; or
- investing or trading in certain equities, financial instruments and financial arrangements.

2.33 Some of the activities that trusts can undertake concerning dwellings that are residential premises (but not commercial residential premises) and be a MIT would not otherwise be eligible investment business. An example is the construction of a dwelling, even if it is to be used to provide affordable housing for the purpose, or primarily for the purpose, of deriving rent.

2.34 Therefore an amendment is made so that, for the purpose of applying the trading trust test in subsection 275-10(4), investments in dwellings that are residential premises (but not commercial residential premises) are disregarded if at all times they satisfy the eligibility conditions (see paragraphs 2.22). [*Schedule 1, item 3, subsection 275-10(4)*]

*Definition of public trading trust*

2.35 Subsection 102T(16) of the ITAA 1936 has the effect that if a trust is a public trading trust then it cannot be a MIT.

2.36 A unit trust is a public trading trust if it satisfies the requirements set out in section 102R of the ITAA 1936. They are:

- it is a public unit trust in relation to the relevant year of income;
- it is a trading trust in relation to the relevant year of income; and
- it is a resident unit trust in relation to the relevant year of income or it was a public trading trust in relation to a year of income preceding the relevant year of income.

2.37 Under section 102M of the ITAA 1936 a trading trust is a trust that carries on business that is not wholly eligible investment business.

2.38 Most trusts that are MITs would satisfy the first and third conditions for being a public unit trust, meaning that the only reason they are not public trading trusts is because they are not trading trusts. As noted in paragraph 2.22 some of the activities that trusts can undertake for dwellings that are residential premises (but not commercial residential premises) and be MITs do not come within the meaning of eligible investment business. Therefore a significant number of trusts that invested in affordable housing activities would ordinarily be public trading trusts, meaning that they could not be MITs.

2.39 Therefore the definition of public trading trust is amended to ensure that in considering if a trust is a public trading trust, affordable housing activities as set out in the eligibility conditions for dwellings that are residential premises (but not commercial residential premises) that trusts can undertake and be MITs are disregarded. This includes constructing, altering, repairing and improving the dwelling and some other activities. [*Schedule 2, item 1, subsection 102R(5) of the ITAA 1936*]

### **Apply 15 per cent withholding tax rate for fund payments to the extent that they are composed of certain affordable housing income**

2.40 The MIT final withholding tax rate applies to fund payments paid or attributed by a MIT to a foreign resident. A fund payment, broadly, is a distribution or attribution by a MIT of its net income from Australian sources (other than dividends, interest and royalties) and capital gains from taxable Australian property.

2.41 The concessional MIT final withholding tax rate is prescribed in paragraph 4(1)(a) of the *Income Tax (Managed Investment Trust Withholding Tax) Act 2008* (ITMITA 2008). Where the fund payment is from a MIT investing in affordable housing the rate of the final withholding tax is 30 per cent. The rate is reduced to 15 per cent where the recipient of the fund payment is resident in an information exchange country as listed in Regulation 44E of the *Taxation Administration Regulations 1976*.

2.42 The trustee of a MIT (or other entity where the fund payment is paid or attributed indirectly through one or more Australian intermediaries) is required to withhold an amount from a fund payment it makes to an entity with an address outside of Australia (or where the payer is authorised to make payments outside Australia). The MIT withholding rate is prescribed in subsections 12-385(3), 12-390(3) and 12-390(6) of Schedule 1 to the TAA 1953. Generally the rate at which

the MIT or other entity withholds is the same as the MIT final withholding tax rate.

2.43 In relation to affordable housing, the concessional rate of MIT withholding tax of 15 per cent will apply to fund payments to the extent that they are payments or attributions of:

- affordable housing rental income; or
- gains (capital or revenue gains) realised from dwellings that the MIT has held and used to provide affordable housing for 10 or more years.

2.44 A withholding rate of 30 per cent (the 15 per cent concessional rate and an additional 15 per cent rate) applies to ‘fund payments’ from a MIT to the extent it is an ineligible affordable housing payment. Ineligible affordable housing payments are amounts paid or attributed from a gain from a CGT event occurring in relation to a CGT asset that is an ownership interest in a dwelling if the dwelling was not used by the MIT to provide affordable housing on or after 1 July 2017 for a period or periods totalling at least 10 years before the CGT event occurs. *[Schedule 1, items 6, 7, 10 and 11 of the Bill and items 1 and 2 of the ITMIT Bill, section 980-100 and subsection 995-1(1) of the ITAA 1997, subsections 12-385(3A), 12-390(3A) and 12-390(6A) of Schedule 1 to the TAA 1953 and section 2A and subsection 4(1) of the ITMITA 2008]*

### **Example 2.1 — Fund payments made by a MIT**

The MNO MIT has invested in dwellings using them to provide affordable housing primarily for the purpose of earning rent for a number of years.

In the 2033-34 income year the MNO MIT has the following assessable income:

- \$100,000 of affordable housing rental income;
- a \$50,000 capital gain resulting from the sale of the Blue Housing Flats in which all of the dwellings have been used to provide affordable housing for 9 years; and
- a \$300,000 capital gain resulting from the sale of the Yellow Housing Flats in which all of the dwellings have been used to provide affordable housing for 15 years.

The whole of the income and capital gains of the MNO MIT for the 2033-34 income year is paid out to its members.

Withholding at the rate of 15 per cent applies to all components of fund payments the MNO MIT distributes to members who are residents of countries which are exchange of information countries.

Additional withholding at the rate of 15 per cent (in addition to the withholding of 15 per cent that applies to the whole of the fund payment) applies to any part of the fund payment that is an ineligible affordable housing gain that the MNO MIT distributes to members who are residents of countries which are exchange of information countries. For the MNO MIT, this applies to the component of the fund payment that is comprised of the part of the net capital gain from the sale of the Blue Housing Flats. This is because those dwellings had not been used to provide affordable housing for the purpose, or principally for the purpose, of deriving rent for a period or periods totalling at least 3,650 days (10 years).

Withholding at the rate of 30 per cent applies to any fund payments the MNO MIT distributes to members who are residents of countries which are not exchange of information countries.

Withholding does not apply to fund payments made to members who are Australian residents (for taxation purposes). However they will need to include fund payments they receive in their assessable income (applying the same tax characteristics to those payments that they had for the MIT).

2.45 No changes are made to the following withholding rates that apply to members who are foreign residents but are not residents of exchange of information countries:

- the 30 per cent final withholding tax rate that applies to those foreign residents; or
- the 30 per cent withholding rate that MITs must apply to fund payments that they make or attribute to these members.

## **Application and transitional provisions**

2.46 The amendment to the definition of public trading trust applies in relation to years of income commencing on or after 1 July 2017. *[Schedule 2, subitem 12(1)]*

2.47 The amendments to clarify that MITs can only invest in dwellings that are residential premises (but not commercial residential premises) in certain circumstances and the associated transitional rule (refer to paragraph 2.51 to 2.56) apply in relation to income years commencing on and after 1 July 2017. *[Schedule 2, subitem 12(2)]*

2.48 The amendments to the ITMITA 2008 and the TAA 1953 concerning the rate of withholding tax that applies to members of MITs who reside in exchange of information countries have effect for income years commencing on and after 1 July 2017. *[Schedule 2, subitems 12(4), (5) and (6) of the Bill and item 3 of the ITMIT Bill]*

2.49 The amendment to insert the definition of ineligible affordable housing gain into the ITAA 1997 applies from the [date of announcement]. This ensures that the additional 15 per cent withholding tax that may otherwise apply to a gain realised from the disposal of a dwelling that was residential premises does not apply if the CGT event from which the gain arose occurred before the time of the announcement.  
*[Schedule 2, subitem 12(3)]*

2.50 Schedule 2 to the Bill and the ITMIT Bill 2017 commence on the first day of the next quarter following the day of Royal Assent.  
*[Clause 2 of the Bill and clause 2 of the ITMIT Bill]*

### **Transitional rule concerning investing in dwellings that are residential premises**

2.51 The amendments to clarify that MITs can only invest in dwellings that are residential premises (but not commercial residential premises) in certain circumstances (see paragraphs 2.19 to 2.28) are intended to give effect to the longstanding interpretation of the law that investment in residential premises is primarily motivated by the pursuit of capital gains.

2.52 The amendments also help to better target tax concessions for foreign investors and are consistent with the Government's intention of encouraging investment in affordable housing by MITs. If trusts could invest in any residential premises this would undermine the Government's policy intent of encouraging MITs to invest in affordable housing as affordable housing would likely deliver a lower rental yield.

2.53 However the Government recognises that MITs may have existing investments in dwellings that are residential premises that they have acquired in the past. Accordingly, the amendments contain a transitional provision where trusts that are MITs that invested in residential premises (that are not commercial residential premises) prior to the announcement of the change in the tax law have 10 years before they need to comply with this restriction. This transitional arrangement only applied to existing investments in dwellings that are residential premises that had been acquired before the [announcement day].

2.54 However the amendments to clarify that MITs can only invest in dwellings that are residential premises (but not commercial residential premises) in certain circumstances will not apply to a dwelling until 1 October 2027 if the trust:

- was a MIT for the income year which included the announcement day; and

- invested or controlled an investment in an ownership interest in the dwelling continuously from the [announcement day].

2.55 A trust that holds a dwelling to which the transitional rule applies will need to either only use that dwelling for affordable housing use to which the eligibility criteria in paragraph 2.22 apply or dispose of that dwelling by 1 October 2027 if it wants to continue to be a MIT. *[Schedule 2, item 8, section 275-900 of the Income Tax (Transitional Provisions) Act 1997]*

2.56 A consequential amendment is also made to the definition of ineligible affordable housing gain to ensure that tax concessions continue to be available to gains realised from CGT events happening to dwellings to which the transitional rule applies (while that rule applies). *[Schedule 2, item 9, section 980-100 of the Income Tax (Transitional Provisions) Act 1997]*