

LEGAL INSIGHT

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Practice Group:
Tax

Committee Report: New Tax System for Managed Investment Trusts

Australia Tax Alert

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On 10 March 2016, the Senate Economics Legislation Committee published the Report on the proposed legislation which will introduce a new system for taxing attribution managed investment trusts (AMITs).

Committee's Views on the Bill

The Committee expressed strong support for the proposed legislation, recommending that the Senate should pass the Bill. According to the committee, it is in the best interests of the fund management sector not to delay any further and to retain the commencement date of 1 July 2016.

The Committee's view is that the new tax system for AMITs is long overdue as these reforms will make Australia more competitive in the funds management industry and allow Australian funds to participate in the Asia Region Funds Passport. The Report also notes that all seven submissions received from stakeholders supported the introduction of a new tax system for AMITs. The submissions generally expressed the view that the proposed legislation is a good compromise between the industry desire for simplicity versus the complexity of integrity measures to ensure compliance, that the proposed reform should be of overall significant benefit to the managed funds industry and that the reforms will attract long term capital to Australia.

The Report notes the concerns expressed in some submissions:

- **Withholding Tax Liability**

Some commentators have stated that withholding tax (WHT) rules contained in the new tax system would have widespread implications for foreign investors and custodians.

Under the new tax system for AMITs, the trustees would not face any negative consequences where AMITs do not pay a sufficient cash distribution to cover the custodian's WHT liability. However, the custodians would have to recover any shortfall from foreign clients or pay the WHT liability from their own funds. The risk increases where foreign investors have sold out or are no longer with the custodian at the time when the WHT liability arises. Concerns have been expressed in particular about "deemed payments" where no cash distributions are made.

In response to the Committee's question about the issue, the Treasury noted that such circumstances would only occur in rare and exceptional cases, since MITs face significant commercial pressure to pay out enough cash to cover any resulting tax liability. It was also highlighted that custodians typically have indemnity provisions in their custody agreements and that "custodians can update their agreements to minimise any remaining risk, if required". Finally, the Treasury noted that the ATO would take into account circumstances where a custodian was seeking to recover a WHT liability from a client when negotiating arrangements for payment.

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- **Tax Treatment of Custodians Holding Units in AMITs**

The new rules as currently drafted introduce a "look-through" provision for a custodian holding units on behalf of a client. Concerns have been expressed that this provision would create confusion in the tax legislation for the tax treatment of custodians in the broader context. One of the submissions proposed is that the relevant provision should be removed from the legislation.

The Treasury responded that without the provision, there is an increased risk that the "tax liability of amounts attributed by an AMIT could arise for a custodian under the general trust tax rules", where it would not otherwise arise. The provision also ensures that characters of the amounts attributed by an AMIT can flow through to a custodian's client.

The Committee's view is that the provision will not create a look-through precedent for custodians in other areas and that it plays an important role in the new regime and should be retained.

- **Cost Base Adjustments for AMIT Units**

The new provisions introduce upward cost base adjustments on units where the cash distribution is less than the taxable components attributed to a member. These provisions will produce different outcomes for AMITs than those under the current provisions.

Concerns have been expressed that there has been no announced change in policy for cost base adjustments and that the provisions in their current form would lead to unintended outcomes.

Treasury responded that the new provisions are intended to reduce the scope of double taxation, while noting the concerns expressed and stating that "Treasury and the ATO will monitor the operation of the new rules to modify and rectify any unintended consequences". The committee agreed that the issue should be "closely monitored" during the implementation stage.

- **Commencement Date**

Some submissions expressed concerns that the commencement date of 1 July 2016 would leave insufficient time for fund managers, custodians and other investors to put in place the systems necessary to operate in line with the new rules. However, the committee believes it is in the best interests of the sector not to delay any further and to retain the commencement date as proposed.

In summary, while acknowledging the above concerns, the committee's view is that any unforeseen or unintended consequences that may arise during the implementation process will be dealt by the government "quickly".

With this in mind, the committee recommended a formal post-implementation review of the legislation and operation of the tax system for AMITs to be undertaken by Treasury and completed by 1 July 2018.

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