

TREASURY DISCUSSION PAPER

MANAGED INVESTMENT TRUSTS – ELECTION TO ALLOW CAPITAL GAINS TAX TO BE THE PRIMARY CODE FOR DISPOSALS OF SHARES, UNITS AND REAL PROPERTY

PURPOSE

1. This discussion paper sets out in general terms the scope and application of this measure as a basis for consultation on the design and implementation of the measure.

BACKGROUND

2. In the 2009-10 Budget, the Government announced it would allow Australian Managed Investment Trusts (MITs) to make an irrevocable election to treat gains and losses on disposal of eligible investments in shares, units in unit trusts and real property on capital account for taxation purposes, subject to appropriate integrity rules.
3. Under this measure the capital gains tax (CGT) provisions in the *Income Tax Assessment Act 1997* (ITAA 1997) would be the primary code for taxing gains and losses on disposal of eligible investments by eligible MITs that make the election. Further details of the measure are outlined in the Assistant Treasurer and Minister for Competition and Consumer Affairs' media release on the 12 May 2009. The media release is available on the Assistant Treasurer's website [Treasury Ministers Portal](#).
4. Ordinarily, gains and losses on disposal of investments may be on revenue or capital account depending on the nature of the activities of the investor and the facts and circumstances of the investment. If the CGT provisions apply to the disposal of investments by trustees of a MIT, then certain investor beneficiaries in MITs are entitled to CGT tax concessions on distributions of capital gains.

KEY DESIGN FEATURES OF THE MEASURE

5. The measure is to apply where all the following conditions are satisfied:
 - the MIT is an eligible Australian MIT;
 - the gains and losses arise on disposal of eligible assets by the trustee of the MIT;
 - the disposal is an eligible disposal; and
 - the trustee of the MIT makes or has made an irrevocable election to apply the CGT regime to all eligible disposals.

WHAT IS AN ELIGIBLE AUSTRALIAN MIT?

Eligibility

6. To be eligible to elect into CGT treatment:
 - the unit trust must be an Australian MIT for the whole of an income year; and
 - the unit trust must not be a trust taxed like a company (that is, a corporate unit trust or public trading trust).
7. As noted in the Assistant Treasurer's press release of 12 May 2009, for the purposes of this measure, an eligible MIT will include a resident wholesale unit trust wholly owned by one or more eligible Australian MITs, provided that the trust carries on eligible investment business (as per the rules in Division 6C of the *Income Tax Assessment Act 1936* (ITAA 1936)).
8. The starting point for defining a MIT for this measure is Subdivision 12-H of Schedule 1 of the *Taxation Administration Act 1953* (TAA 1953).
9. Broadly, a unit trust will be an Australian MIT in relation to an income year where all the following conditions are satisfied at the time the first fund payment in relation to the income year is made:
 - the trust has a relevant **connection with Australia** (at the time of the first fund payment or at an earlier time in the income year);
 - the trust must satisfy certain **requirements of the Corporations Act 2001** (Corporations Act) pertaining to the management of investments; and
 - the trust is either **listed or widely held**.

Connection with Australia

10. The connection with Australia can be established in one of two ways. First, a trustee of the trust can be an Australian resident for income tax purposes. Where there are multiple trustees, the connection with Australia is satisfied if any one of those trustees is an Australian resident. Alternatively, the trust's central management and control can be located in Australia.
11. In either instance, the connection must exist at some time during the income year up to and including the time of making the first fund payment.
12. These tests broadly align with the residency test for trusts set out in Divisions 6 and Division 6C of Part III of the ITAA 1936.

Corporations Act 2001 requirements in relation to managed investments

13. A unit trust must be associated with the management of investments as regulated by the Corporations Act to be a MIT. This means that at the time of making the first fund payment (see paragraph 20 below) the trust must be a 'managed investment

scheme' operated by a 'financial services licensee' whose licence covers operating such a managed investment scheme. The terms 'managed investment scheme' and 'financial services licensee' are defined in the Corporations Act.

Listed or widely held requirement

14. Under Subdivision 12-H, a unit trust must be listed or widely held. For the purpose of this measure, this requirement will be satisfied if any of the following conditions are satisfied:
 - the units of the trust are listed on an approved stock exchange in Australia;
 - the trust has at least 50 members (a trust would not be held to have at least 50 members where the purported members of the trust do not have a fixed entitlement to a share of the income and capital of the trust); or
 - the trust has less than 50 members, but one of the members with a fixed entitlement is an entity of a specified kind. The entities specified will be:
 - a complying superannuation fund, complying approved deposit fund, or a foreign superannuation fund, as long as the fund has at least 50 members;
 - an Australian resident trust that is a managed investment scheme operated by a financial services licensee whose licence covers operating such a scheme and that is listed on an approved stock exchange or has at least 50 members (other than objects of the trust); and
 - an entity that is recognised, under a foreign law relating to corporate regulation, as having a similar status to a managed investment scheme and that has at least 50 members.
15. The types of entities specified above typically hold investments collectively. Unlike the definition in Subdivision 12-H, it is not proposed to include life insurance companies in this list as, unlike superannuation funds, their investments are generally on revenue account. Stakeholder comments are sought on this design issue.
16. The rules will provide for tracing through one or more interposed trusts where an entity that owns directly or holds indirectly the interests of the trust is of a type specified in the list above. However, it must be the case that each interposed trust is an Australian resident trust that is a managed investment scheme operated by a financial services licensee with a licence that covers operating a managed investment scheme.
17. The current tracing rule recognises that a managed investment scheme established by a wholesale trust would otherwise fail to satisfy the test of being widely held, even if interests in the wholesale trust were held by entities with more than 50 members.

An exception if a foreign resident individual has a substantial interest in the trust

18. Under Subdivision 12-H a trust is taken not to be widely held if any one foreign resident individual directly or indirectly:
- holds, or has the right to acquire, interests representing 10 per cent or more of the value of the interests in the trust;
 - has the control of, or ability to control, 10 per cent or more of the rights attaching to 'membership interests' (as defined in section 960-135 of the ITAA 1997) in the trust; or
 - has the right to receive 10 per cent or more of any distribution of income that the trustee may make.

Where any one of the conditions set out above is satisfied, the trust will not qualify as widely held.

19. Stakeholder comments are sought on the design of this foreign resident exception.

Examples of Australian MITs

Example 1

Rufus Unit Trust is a managed investment scheme that is operated by a financial services licensee whose licence covers operating that scheme. Rufus Unit Trust has a trustee that is an Australian resident. It is not listed on an approved stock exchange in Australia and has one member.

Interests in the Rufus Unit Trust are held by Colonial Unit Trust, a trust whose central management and control is in Australia. Colonial Trust is also a managed investment scheme operated by a financial services licensee whose licence covers operating that scheme. Colonial Unit Trust has three members.

One of the three members of Colonial Unit Trust is MW Superannuation Fund a complying superannuation fund that has at least 500 members.

Rufus and Colonial Unit Trusts will both satisfy the requirement of being widely held. Although Rufus Unit Trust only has one member, that member, Colonial Unit Trust, is a trust whose central management and control is in Australia, and is a managed investment scheme, interests in which are directly owned by an entity of the kind specified in the rules, being a complying superannuation fund (MW Superannuation Fund). Colonial Unit Trust is therefore also widely held.

Under the tracing rule, interests in the trust purporting to be a MIT must be owned directly or held indirectly by an entity of a kind specified in the MIT rules (referred to at paragraph 17).

Example 2

Assume the same facts as in Example 1, except that Rufus Unit Trust is not a managed investment scheme operated by a financial services licensee: Rufus Unit Trust would still be eligible to elect for capital account treatment as it is wholly owned by Colonial Unit Trust which is an eligible MIT and provided Rufus Unit Trust carries on eligible investment business (as per the rules in Division 6C of the ITAA 1936).

Test time

20. Under Subdivision 12-H, the relevant time for determining whether a trust is an Australian MIT for an income year is the time of the making of the first 'fund payment'. A fund payment is defined in section 12-405 of the TAA 1953. The existing definition of a MIT does not address the scenario where there is no fund payment in an income year.
21. One way of addressing this scenario would be to have the relevant time be:
 - the making of the first dividend, interest or royalty payment (referred to in paragraphs 12-405(1)(a), (b), or (c) of Schedule 1 of the TAA 1953) where applicable; or
 - both the first day and last day of the income year if no payments are made at all.
22. Where the relevant conditions (set out above) are satisfied the trust will be an Australian MIT for an income year, notwithstanding that the relevant conditions may not be satisfied at a later time in the income year.

Special rules for trusts that are created or cease to exist during an income year

23. The requirement that a MIT be listed or widely held may be difficult to satisfy in the income year in which the trust is starting up or winding up. For this reason, there are special rules that require a trust to satisfy only the requirements of:
 - being an Australian resident trust; and
 - a managed investment scheme operated by a financial services licensee whose licence covers operating such a scheme,in the start-up or wind-up year.
24. The subdivision 12-H rules do not allow a trust to qualify as a MIT for two successive income years by utilising the start-up phase in the first year and wind-up phase in the following year. This is because these exceptions to the widely held requirement cannot be used together.

MIT is not taxed like a company

25. An Australian MIT should be eligible to make an election to be treated on capital account if it is not a trust taxed like a company.
26. A MIT is taxed like a company if Division 6B or Division 6C of the ITAA 1936 applies to the MIT. Division 6C applies to a MIT if the MIT is a public trading trust. Division 6B applies if the MIT is a corporate unit trust.
27. A design issue that requires some consideration is what should happen when a MIT that had previously elected to be on capital account, is taxed like a company in one year of income, then resumes trust taxation in later years.

28. Comments are sought on what grounds it should be possible for the election to remain in force in subsequent years on income.

ELIGIBLE ASSETS

29. The assets which are proposed to be subject to capital account treatment under this measure are:

- investments in real property (land), including an interest in real property;
- investments in shares in a company; and
- investments in units in a unit trust;

which satisfy the eligible investment business rules in Division 6C of the ITAA 1936 and which are not debt interests, Division 230 financial arrangements or trading stock.

30. Legislative options to implement this outcome include:

- a rule similar to the superannuation fund rule in section 295-85 of the ITAA 1997, which would include carve-outs from capital account treatment for non-equity financial arrangements and other things, such as trading stock; or
- a rule that lists the specific assets which could receive capital account treatment (such as shares, units and real property) and leave the treatment of other financial arrangements to the ordinary income rules, including where appropriate to the Taxation of Financial Arrangements (TOFA) rules in Division 230 of the ITAA 1997.

ELIGIBLE DISPOSALS

31. The disposal of the eligible asset constitutes a CGT event arising from the disposal or other realisation of ownership of the asset for the purposes of the CGT provisions.

APPROPRIATE INTEGRITY AND OTHER RULES

32. If the trustee of an eligible MIT elects or has elected to apply the CGT regime as the primary code for taxing gains and losses on eligible disposals of eligible assets, then the CGT regime will apply to all such disposals in an income year by the trustee of an eligible MIT for the first income year on or after the 2008-09 income year. That is, for existing MITs the first income year will be 2008-09. Otherwise it will apply from the first income year when a MIT is created.
33. Where an eligible MIT has elected and applied the CGT regime to disposals of eligible assets in an income year, the CGT regime will also apply to subsequent gains and losses on eligible assets acquired in that income year.

APPLICATION DATE

34. Where the trustee of a MIT makes an election, the CGT regime will apply to all eligible disposals of eligible assets from the first income year commencing on or after the 2008-09 income year.
35. The start date of this proposal raises the issue of what could be done to provide certainty to taxpayers in respect of prior year trust returns. MITs that have historically been self assessing certain disposals on capital account would, no doubt, want some assurance that if they elect into the new capital account regime, prior years' returns will not be adjusted by the Commissioner. Conversely, if a MIT elects into the capital account regime, should they be able to amend prior year returns to obtain the best taxation outcome, be it on revenue or capital account.
36. Comments are sought on possible solutions to this issue, including for example, a legislative prohibition on amending prior year returns where a MIT elects into the regime.

Submissions

We invite interested parties to lodge written submissions on the design of this measure.

Submissions should be made by Friday, 10 July 2009 to:

General Manager
Business Tax Division
The Treasury
Langton Crescent
Parkes ACT 2600

Attention : Raphael Cicchini

or by email to: SBTR@treasury.gov.au

fax: (02) 6263 4466