
Chapter #

Managed Investment Trusts: capital treatment

Outline of chapter

1.1 Schedule # to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to allow eligible Managed Investment Trusts (MITs) to irrevocably elect to apply the Capital Gains Tax (CGT) provisions as the primary code for the taxation of gains and losses on disposal of certain assets (primarily shares, units and real property). If a MIT is eligible to make an election and it has not done so, then any gains or losses on the disposal of eligible assets (excluding land, an interest in land, or an option to acquire or dispose of such an asset) will be treated on revenue account.

1.2 All of the legislative references in this chapter are to the ITAA 1997 unless otherwise specified.

Context of amendments

1.3 Broadly, a MIT is a public unit trust that is listed, widely held or publicly offered. The existing definition of a MIT is provided at section 12-400 of Schedule 1 to the *Tax Administration Act 1953* (TAA 1953). To retain trust taxation, a public unit trust cannot at any time during an income year operate, or control operations of, an entity that carries on activity that is not eligible investment business (EIB). Otherwise, the unit trust is taxed like a company. EIB is broadly defined under Division 6C of the *Income Tax Assessment Act 1936* (ITAA 1936) as investing in land for the purpose or primary purpose of deriving rent, or investing or trading in certain financial instruments, including shares in a company and units in a unit trust.

1.4 The treatment of gains and losses on disposals of investment assets by MITs may be on revenue or capital account. Gains and losses that are treated on capital account are taxed under the CGT regime. Beneficiaries that are individuals and superannuation funds are entitled to the CGT tax concessions on distributions of capital gains they receive. Foreign resident beneficiaries are not subject to withholding tax on an

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eligible MIT distribution attributable to a CGT gain, unless the gain relates to taxable Australian property.

1.5 In the 2009-10 Budget the Government announced that it would allow Australian MITs that are not taxed like companies to make an irrevocable election to treat gains and losses on the disposal of certain assets (primarily shares, units and real property) on capital account for taxation purposes, subject to appropriate integrity rules.

Summary of new law

1.6 Eligible MITs can irrevocably elect to apply the CGT provisions as the primary code to gains and losses on disposal of certain assets (primarily shares, units and real property), subject to integrity rules. Eligible MITs include retail and wholesale entities that are MITs as defined in section 12-400 of Schedule 1 to the TAA 1953 and other entities that meet the extended concept of a MIT for the purposes of this measure.

1.7 If a MIT is eligible to make an election but it has not done so, then any gains or losses on the disposal of eligible assets (other than land, an interest in land, or an option to acquire or dispose of land) will be treated on revenue account. Land is not subject to this deemed revenue account treatment and whether it is on capital or revenue account will be based on an application of the general principles of the tax law.

1.8 The CGT provisions will not apply to distributions from, and disposals of, 'carried interest' units in an eligible MIT; these amounts are included in assessable income of the carried interest unit holder to the extent that they are not already included in their assessable income.

1.9 The Commissioner of Taxation (Commissioner) is not able to amend assessments where an eligible MIT elects for CGT treatment that applies in the 2008-09 income year, in respect of income years prior to the 2008-09 income year, if such disposals would have been covered by this measure had it applied in the prior income year.

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Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
Eligible MITs can irrevocably elect to apply the CGT provisions as the primary code to gains and losses on disposal of certain assets (primarily shares, units and real property), subject to integrity rules.	The treatment of gains and losses on disposals of investment assets by MITs may be on revenue or capital account depending on the individual facts and circumstances.
If an MIT is eligible to make an election and they have not done so, then any gains or losses on the disposal of eligible assets (excluding land, an interest in land, or an option to acquire or dispose of such an asset) will be on revenue account.	No equivalent.
Amounts from distributions on and disposals of a 'carried interest' in an eligible MIT are included in assessable income, to the extent that they are not already included in the assessable income of the carried interest holder other than under the CGT provisions.	There is some doubt as to whether distributions and gains made on carried interest units are on revenue or capital account for unit holders of MITs.
The Commissioner cannot amend assessments where an eligible MIT elects CGT treatment that applies in the 2008-09 income year, in respect of income years prior to the 2008-09 income year if such disposals would have been covered by this measure had it applied in the income year.	The Commissioner may amend prior year assessments in accordance with section 170 of the ITAA 1936.

Detailed explanation of new law

Scope and meaning of Managed Investment Trust

1.10 A unit trust will be an eligible MIT in relation to an income year if it meets the meaning of Managed Investment Trust in Subdivision 12-H in Schedule 1 to the TAA 1953 or the extended concept of MIT for the purposes of this Division.

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1.11 A unit trust will still be an eligible MIT for this measure if it is a managed investments scheme and would be required under the *Corporations Act 2001* to be operated by a financial service licensee and thus meet the definition in Subdivision 12-H, but for the fact that it is not required to be so registered as it is a Crown entity or because any instrument issued by the Australian Securities and Investment Commission has effect in relation to the entity or the scheme. *[Schedule #, item 1, subsection 275-5(3) of Division 275 of Part 3-25 of the ITAA 1997]*

1.12 An Australian resident unit trust will also be an eligible MIT in relation to an income year if the trust is operated by a financial services licensee (as defined by section 761A of the *Corporations Act 2001*) and the only members of the trust are MITs; life insurance companies; or complying superannuation funds, complying approved deposit funds or foreign superannuation funds with at least 50 members; or the trust is a wholesale trust which has at least 50 members (ignoring objects of a trust and individuals). However, the 50 member requirement will not apply in the start-up and wind-up phase. *[Schedule #, item 1, subsections 275-5(1) and (2) of Division 275 of Part 3-25 of the ITAA 1997]*

Example 1.1

PET Trust markets itself as a private equity trust and has large complying superannuation funds and other MITs as investors. PET Trust is an Australian resident trust and is managed investment scheme operated by a financial services licensee.

PET Trust does not meet the definition of MIT in section 12-400 in Schedule 1 to the *Taxation Administration Act 1953*.

However, as every member of the trust is either a MIT or complying superannuation fund, PET Trust is an eligible MIT for the purposes of this measure (as it meets the requirements in Section 275-5(1) of Division 275 of Part 3-25 in item 1 of the draft legislation).

1.13 An Australian resident unit trust will also be an MIT if every member of the trust is an eligible MIT in relation to the income year. *[Schedule #, item 1, subsection 275-5(4) of Division 275 of Part 3-25 of the ITAA 1997]*

1.14 To be an eligible MIT for an income year a unit trust must meet the definition at the time of making its first fund payment in the income year in accordance with Subdivision 12-H. However, if a unit trust does not make a fund payment in an income year, then it will still be an eligible MIT if it meets the definition on both the first and last day of the income year. *[Schedule #, item 1, subsection 275-5(5) of Division 275 of Part 3-25 of the ITAA 1997]*

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1.15 A trust will not be a MIT in relation to an income year, if it is a closely held trust (within the meaning of section 272-105 in Schedule 2F to the ITAA 1936) at any time during the income year. Broadly, this will be the case where 20 or fewer individuals hold or have the right to acquire 75 per cent or more of the beneficial interests in the income or property of the trust. *[Schedule #, item 1, subsection 275-5(7) of Division 275 of Part 3-25 of the ITAA 1997]*

1.16 If, apart from a particular circumstance, a trust would be an eligible MIT, the trust may still be an eligible MIT if, the circumstance is temporary and arose outside the control of the trustee of the trust, and it is fair and reasonable to treat the trust as an eligible MIT, having regard to a number of factors. These factors include, the nature of the circumstance, the actions (if any) taken by the trustee of the trust to address or remove the circumstance, the speed with which such actions were taken and the tax impact of such a decision. *[Schedule #, item 1, subsection 275-5(6) of Division 275 of Part 3-25 of the ITAA 1997]*

1.17 Certain requirements that are required to be met at a particular time in order to be an eligible MIT for the purposes of this measure, must be met at either the time the trustee of the MIT makes the first fund payment in relation to the income year or, in cases where a trustee does not make the first fund payment, at both the start and the end of the income year. *[Schedule #, item 1, subsection 275-5(8) of Division 275 of Part 3-25 of the ITAA 1997]*

Election

1.18 An eligible MIT is able to irrevocably elect to apply the CGT provisions as the primary code to an eligible CGT disposal event that involves an eligible asset and has effect where certain other requirements are met. That election must be made in the approved form. *[Schedule #, item 1, subsection 275-10(1) & subsections 275-20(1), (2) and (4) of Division 275 of Part 3-25 of the ITAA 1997]*

1.19 An eligible MIT will meet one of the requirements for capital account treatment, if it is *not* a corporate unit trust (within the meaning of section 102J of the ITAA 1936) in relation to the income year in which the relevant CGT event happens, or a trading trust (within the meaning of Division 6C of the ITAA 1936) in relation to the income year in which it owned the CGT asset or the relevant CGT event happens. The MIT may still meet this requirement if, the circumstance is temporary and arose outside the control of the trustee of the trust, the trustee is not liable to pay income tax on the net income of the trust under section 102S of the ITAA 1936, and it is fair and reasonable that the eligible MIT meet this requirement, having regard a number of factors. These factors include,

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the nature of the circumstance, the actions (if any) taken by the trustee of the trust to address or remove the circumstance, the speed with which such actions were taken and the tax impact of such a decision. causes the MIT to be a trading trust (within the meaning of Division 6C of the ITAA 1936) in relation to the income year in which it owned the CGT asset or the relevant CGT event happens, *[Schedule #, item 1, subsections 275-17(1) and (2) of Division 275 of Part 3-25 of the ITAA 1997]*

1.20 If an eligible MIT (which is not a corporate unit trust or a trading trust) owns an eligible asset and a CGT event happens that involves the disposal or other realisation of that asset and the MIT has made the election to apply the CGT provisions, certain income and deduction provisions in the income tax law will no longer apply to the asset, as it will not be treated on revenue account. However, the income and deduction provisions may apply in certain situations, including where a capital gain or capital loss from the event is disregarded because of certain provisions, where land is trading stock or is part of a profit-making undertaking or plan, or where other eligible assets such as units or shares (acquired in an income year in which the election to apply the CGT provisions was not in force) are treated by the MIT as trading stock in its financial report and tax return in the income year preceding the income year in which the disposal occurs. *[Schedule #, item 1, subsections 275-10(1), (2), (3) and (4) of Division 275 of Part 3-25 of the ITAA 1997]*

Example 1.2

TJC Trust is an eligible MIT for the purposes of the capital account election. TJC Trust makes an irrevocable capital account election, which is in force for the 2008-09 income year and later income years.

In the 2010-11 income year, TJC Trust decides to dispose of units in a unit trust, which it had been treating as trading stock (in its financial report and tax return for the 2008-09 income year). The units were acquired in 2007.

Despite the fact that TJC Trust has made the capital account election which would ordinarily mean that the disposal of the units would be treated on capital account, given the situation, an exception would apply allowing the disposal of the units to be treated on revenue account as the units were acquired before the election was in force and have previously been treated by the MIT on revenue account as trading stock.

1.21 If an eligible MIT (which is not a corporate unit trust or a trading trust) acquires a CGT asset that is trading stock and incurs an outgoing in connection with the acquisition, and the election to apply the CGT provisions is in force, then certain income and deduction provisions

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in the income tax law will no longer apply in relation to the acquisition. As such, the acquisition of trading stock will not be treated on revenue account. *[Schedule #, item 1, subsections 275-10(5) and (6) of Division 275 of Part 3-25 of the ITAA 1997]*

1.22 For MITs that came into existence in the 2009-10 or later income years then the election needs to be made on or before the day it is required to lodge its income tax return for the income year in which it became a MIT. For all other MITs the election must be made on or before the latest of the following dates:

- the last day in the three-month period from the commencement of the measure;
- the last day of the 2009-10 income year; or
- if the Commissioner allows a later day for the MIT — then that later day.

[Schedule #, item 1, subsection 275-20(3) of Division 275 of Part 3-25 of the ITAA 1997]

1.23 For MITs that came into existence in the 2009-10 income year or later income year the choice is in force for the time in the income year in which it came into existence and later income years. For all other MITs the election is in force for the 2008-09 income year and later income years. *[Schedule #, item 1, subsection 275-20(5) of Division 275 of Part 3-25 of the ITAA 1997]*

Example 1.3

Page Trust is an eligible MIT for the purposes of the capital account election and has existed for many years. Page Trust makes an irrevocable capital account election on the last day of the 2009-10 income year (assuming that is the latest date on which it can make the election).

Despite the fact that the actual election was made in the 2009-10 income year, the capital account election will be in force for the 2008-09 income year and later income years.

In this case, if Page Trust had acquired shares in the 2008-09 income year it would need to treat the shares on capital account from the time of acquisition, as the capital account election would be in force for the 2008-09 income year.

1.24 In situations where an MIT (which is not a corporate unit trust or a trading trust) is eligible to make the capital election and it has not done

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so, then a gain or loss from the disposal of, ceasing to own, or other realisation of an eligible asset will be treated on revenue account, to the extent that it has not already been so treated. For the purposes of this deeming revenue treatment, eligible assets do not include land, an interest in land, or an option to acquire or dispose of such an asset. However, applying the ordinary principles of law, the disposal of such an asset will receive revenue treatment if the land is a revenue asset of the MIT.

[Schedule #, item 1, section 275-25 of Division 275 of Part 3-25 of the ITAA 1997]

Example 1.4

Rutherford Trust is an eligible MIT for the purposes of the capital account election and has existed for many years. The trust *does not make* an irrevocable election to treat its investments in shares, units and land on capital account.

The trust invests primarily in shares and units. The trust also invests in land for rent which is used as a shopping centre. For the 2007-08 income year, consistent with general tax law principles, the trust treats its investments in units, shares and land on capital account.

As the trust has not made a capital account election, the disposal of units and shares after commencement of the measure will be treated on revenue account. However, any disposal of its investment in land may still be on capital account under general tax law principles.

Example 1.5

Bennett Trust is an eligible MIT for the purposes of the capital account election and has existed for many years. The trust does not make an irrevocable election to treat its investments in shares, units and land on capital account. In income years prior to the 2008-09 income year the trusts trades in shares and units and holds these assets on revenue account consistent with general tax law principles.

As the trust has not made a capital account election, disposal of units and shares after commencement of the measure will continue to be on revenue account. As the trust is already treating its investments in units and shares on revenue account, the deemed revenue account rule will not alter the treatment of these assets.

Eligible assets

1.25 If an eligible MIT has made a valid election then the CGT provisions will apply to certain CGT assets owned by the MIT or gains and losses on disposal or other realisation of eligible assets that result in the happening of a CGT event.

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1.26 Eligible (covered) assets are:

- shares in a company;
- units in a unit trust;
- land (including an interest in land); and
- a right or option to acquire or dispose of one of the assets listed directly above.

[Schedule #, item 1, subsection 275-15(1) of Division 275 of Part 3-25 of the ITAA 1997]

Example 1.6

Wilson Trust was created in 2009-10 income year. The trust is an eligible MIT for the purposes of the capital account election. The trust makes an irrevocable capital account election in the 2009-10 income which is in force for the 2009-10 income year and later income years.

The trust invests primarily in units and shares. The trust also invests in land for rent used as a shopping centre. Disposal of these assets will be assessed under the CGT provisions.

In addition to these investments, the trust holds investments in ASX SPI 200®1 Futures (a derivative product). These investments are not eligible investments and will not be deemed to be assessed under the CGT provisions.

1.27 An asset will not, however, be covered by a capital account election if it is a financial arrangement to which Division 230 of the ITAA 1997 applies or a debt interest. *[Schedule #, item 1, subsection 275-15(2) of Division 275 of Part 3-25 of the ITAA 1997]*

Example 1.7

Bell Trust was created in 2009-10 income year. The trust is an eligible MIT for the purposes of the capital account election. The trust makes an irrevocable capital account election in the 2009-10 income which is in force for the 2009-10 income year and later income years.

The trust holds a non-equity share interest in Kennedy Limited, a listed company. Non-equity share is a legal form share that is not an equity interest in the company. Gains or losses from disposal of this interest will not be deemed to be treated on capital account as it is a debt interest.

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Taxation of Carried Interests

1.28 Distributions of amounts to a carried interest unit holder and proceeds from the disposal of carried interest units in an eligible MIT will be included in the assessable income of the unit holder, to the extent that amounts are not already included in their assessable income, other than under the CGT provisions. For the purposes of this measure, carried interest relates to CGT assets that were acquired because of services to be provided to the MIT by the holder of the CGT asset or an associate, as a manager of the MIT, an employee of a manager or an associate of such a manager or employee. *[Schedule #, item 1, section 275-100 of Division 275 of Part 3-25 of the ITAA 1997]*

Restrictions on prior year amendments

1.29 The Commissioner cannot amend assessments where an eligible MIT has made a CGT election that applies in the 2008-09 income year in respect of income years prior to the 2008-09 income year in relation to asset disposals if they would have been treated on capital account if the measure had applied in the prior income year. *[Schedule #, item 3, section 275-10 of Division 275 of Part 3-25 of the Income Tax (Transitional Provisions) Act 1997]*

Example 1.8

Cleary Unit Trust is an eligible MIT that makes the irrevocable capital account election.

In the previous income year to the year in which the capital account election was in force, Cleary Trust makes a gain on the disposal of shares, which were treated as capital assets. Therefore, the gain on disposal was treated on capital account. If the capital account election had applied when Cleary Trust had disposed of the shares, the disposal would have been treated on capital account.

In this situation, the Commissioner cannot amend the previous assessment relating to the disposal of shares, on the basis that the disposal of shares should have been treated on as a revenue asset. However, Cleary Trust may give the Commissioner written consent to amend the assessment to treat the gain on the disposal of the shares on revenue account (this does not mean that Commissioner will then make such as amendment).

If in the previous assessment, Cleary Trust has recorded the gain on the disposal of the shares as \$20,000 of assessable income and the Commissioner believes the disposal of shares should have represented a gain of \$40,000 of assessable income, the Commissioner may amend

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the assessment to include the \$40,000 (the normal amendment period applies).

Application and transitional provisions

1.30 These amendments broadly apply in relation to eligible CGT events that happen on or after the start of the 2008-09 income year. *[Schedule #, item 5(1)]*

1.31 The amendment which provides that the acquisition of trading stock will be treated on capital account when an election is in force, applies in relation to the acquisition of assets on or after the start of the 2008-09 income year. *[Schedule #, item 5(2)]*

1.32 The amendments which deem certain assets to be on revenue account when an election is not made, apply to disposals of assets, cessations of ownership of assets and other realisations of assets which take place on or after the Royal Assent. *[Schedule #, item 5(3)]*

1.33 The amendments concerning 'carried interests' in MITs apply in relation to entitlements to distributions that arises on or after the Royal Assent, or disposal of assets that happen on or after the Royal Assent. *[Schedule #, item 5(4)]*

Consequential amendments

1.34 An amendment is made to insert section 45-286 in Schedule 1 into the TAA 1953 to include in a taxpayer's **instalment income** for a period trust income or trust capital of a eligible MIT that the MIT distributes to, or applies for the benefit of, the taxpayer during that period. The trust income or trust capital is only included in the taxpayer's instalment income in cases where the income or capital is not already included in a taxpayers instalment income and the eligible MIT is an Australian resident trust and meets the requirements of section 275-17 of the ITAA 1997. *[Schedule #, item 4, section 45-286 in Schedule 1 to the TAA 1953]*

1.35 These amendments apply in relation to distributions or applications of benefits that are made on or after the Royal Assent. *[Schedule #, item 5(5)]*

1.36 An additional amendment is made to amend the definition of **instalment income** in subsection 995-1(1) of the ITAA 1997 to account for the amendment described directly above, which includes certain

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amounts in a taxpayer's instalment income. [*Schedule #, item 2, subsection 995-1(1)(definition of instalment income) of the ITAA 1997*]

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