Greenwoods & Freehills

Tax Brief

10 May 2010

New Managed Investment Trust Tax Regime

The long-awaited Report by the Board of Taxation into the taxation of Managed Investment Trusts ('**MITs**') was released by the Assistant Treasurer on 7 May 2010, together with the Government's response. While some aspects of the proposals may be considered far-reaching, it is probably more accurate to describe the recommendations, and the Government's responses, as evolutionary rather than revolutionary. In many respects, the Government has decided to adopt and endorse current practices within the MIT sector and provide a framework to allow the sector to grow.

This Tax Brief examines the Board's Report, the Government's responses and the next steps on the path to implementing these important proposals.

While the Board's Report provides direction that the MIT industry needs in the tax system, the Government's response is less than complete and does not fully match its rhetoric about making Australia a funds management hub. The Government is no doubt suffering some tax indigestion after last week's Henry Review and may be distracted by possible further financial turmoil in international markets. It will still be necessary for the MIT sector to press the Government to adopt the several Board recommendations that it is considering further. As the commencement date for the new regime is 1 July 2011 and the Government plans to publish further consultation documents shortly, this new MIT regime is an important project which requires immediate and ongoing industry attention.

1. Background – a long road

The Board's review of MITs had its genesis in considerable lobbying by the MIT sector prior to the 2007 election. On 22 February 2008, the then Assistant Treasurer announced a review by the Board of Taxation of the tax arrangements applying to managed funds operating as MITs (see our Tax Brief at http://www.gf.com.au/829_624.htm).

The terms of reference given to the Board of Taxation were somewhat restricted and, in many ways, broadly reflected the existing regime for taxing trusts, including:

1. aligning the tax treatment of MIT beneficiaries with that applying if they had received the income directly;
2. limiting the activities of MITs to primarily passive investment;
3. assessing beneficiaries on their share of the net income of the trust irrespective of whether they received it, as long as they had a right to receive;

4. taxing trustees on any net income of the trust that is not assessable to beneficiaries in a particular income year; and
5. quarantining trust losses within the trust with limits on subsequent utilisation.

As part of its terms of reference, the Board was also requested to explore alternatives to the concept of present entitlement – the existing basis for the taxation treatment of beneficiaries of trusts – and to consider international developments. The Board was also asked to consider whether a dedicated regime for the taxation of MITs could be introduced and whether it would reduce complexity, increase certainty and minimise compliance costs. It was further tasked to consider potential reforms to Division 6C, whether a separate regime for the taxation of Real Estate Investment Trusts (‘**REITs**’) should be implemented and to what extent any of its recommendations should be extended to other trusts.

On 29 October 2008, the Board of Taxation released a Discussion Paper (see our Tax Brief at http://www.gf.com.au/829_698.htm) to facilitate consultation.

One issue identified early in the process was whether MITs should be allowed to elect for exclusive capital gains tax treatment of trust assets. The Board provided interim advice to this effect and the changes were announced in the 2009 Budget (see our Tax Brief at http://www.gf.com.au/829_753.htm). This measure is currently working its way through Parliament.

The Board completed the remainder of its review, reporting to the Government in the second half of 2009.

Since that time, there have been several court decisions on the general principles of taxing trusts. One of the most important consequences of the Board's report may well prove to be formally de-coupling the taxation of MITs from the rules for privately-held trusts, which are prone to these kinds of disputes and ill-suited to treatment under the tax regime which the Board has proposed for MITs.

2. The Report and Government responses – some good, and …

The Board's report made some 48 recommendations many of them going to the detail of the operation of a proposed MIT regime. The Government has broadly accepted the Board's recommendations with a few notable exceptions. The Assistant Treasurer indicated that the new regime will be implemented with effect from 1 July 2011.

Of the recommendations accepted, the Assistant Treasurer emphasised:

- providing an elective attribution model to replace the notion of present entitlement;
- implementing rules in relation to ‘unders and overs’ to avoid re-issuing statements for revised distributions by trusts;
- removing double taxation of capital gains caused by differences between asset value and equity value; and
- abolishing the corporate unit trust provisions in Division 6B.

While these particular decisions are important and welcome, the balance of the 48 recommendations contain much of the detail of the operation of a dedicated MIT regime and it is important to be aware of these. For example,

- deeming a MIT to be a fixed trust will overcome problems under a number of provisions including those dealing with trust losses, franking rules and CGT;
- proposals regarding arm's length rules for dealings between MITs and subsidiaries, stapled entities and other related entities raises questions about the procedures that will need to be put in place and the consequences that could flow from such a requirement;
- how far the anti-streaming rule will go and whether existing arrangements will be unintentionally captured by such a rule.

However, it is disappointing that some of the Board's recommendations were not adopted by the Government, such as:

- not changing the definition of Eligible Investment Business, even though it clearly needs modernisation, at least for REITs;
- not agreeing to the proposal to update the control test in Division 6C to allow MITs to operate taxable wholly owned entities (although the Government has said it will examine this further);
- deferring a more complete review of Division 6.

More broadly, the Government has hedged its position on several recommendations that are important to industry such as the retention of character of income flowing through trusts.

3. The future

The balance of this Tax Brief sets out the key recommendations made by the Board and details the Government's response. We also include comments on the possible impacts of proposals.

There is still clearly a long and arduous process of consultation that will follow and it will be important for industry participants to keep pressing their issues and make their views known so that they are properly addressed in the final design of the new MIT regime.

Recommendations of the Board of Taxation	Government's Response	Comments
Recommendation 1 The Board recommends that there be a specific taxation regime for qualifying MITs to be known as Regime MITs.	The Government agrees to this recommendation and will consult the managed fund industry on the implementation and design details.	This critical recommendation will lead to formally and finally de-coupling the taxation of most widely held managed funds from the rules for privately-held trusts and estates. There is still work to be in finalising what an MIT is. Treasury seems intent on narrowing the field which has important implications for these provisions. Unfortunately the Government has not taken this opportunity to clarify its intention.
Recommendation 2 The Board recommends that an MIT will be considered 'widely held' if it: • satisfies the definition in Subdivision 12-H; • is a wholesale trust which has 50 or more members directly (or indirectly, for example, through a trust or superannuation fund) and is subject to a suitable regulatory regime; or • is a wholesale trust which is wholly-owned directly or indirectly by one or more trusts which satisfy the definition in Subdivision 12-H or by a wholesale trust as above.	The Government agrees to this recommendation. The Government has broadly adopted the Board's definition of 'widely held' for the purpose of the deemed capital account rules for MITs, announced in the 2009-10 Budget.	Whilst the Government has stated that it has 'broadly' adopted the Board's definition, Treasury has in its most recent draft MIT definition failed to recognise that most foreign collective investment vehicles (CIVs) are not trusts. CIVs are a key source of funds into the Australian economy and attracting them is one of the supposed aims of the introduction of the MIT provisions. But the failure to recognise the nature of these CIVs in the 'widely held' test means that significant foreign capital may not be attracted to Australia by the MIT provisions.
Recommendation 3 The Board recommends that a trust will satisfy the 'clearly defined entitlements' requirement if the beneficiaries' rights to income (including the character of income) and capital are clearly established at all times in the trust's 'constituent documents.' The rights should only be able to be changed by a change in the trust's 'constituent documents.' The Board has recommended reference be made to the Corporations Act for these purposes.	The Government agrees to this recommendation. The Government will include a 'clearly defined entitlements' eligibility requirement in conjunction with the proposed attribution model (refer Recommendation 19).	The adoption of this recommendation is seen as positive and recognises the current practice for most unit trusts in the allocation of income and capital. It also acknowledges that MITs have limited ability to manipulate entitlements. It will be interesting to see if the proposed linkage to the Corporations Act is included in the proposed legislation given the difficulties this approach has caused in defining MITs. Also whilst the Government has not stated this explicitly, it would seem that integrity provisions based on the Corporations Act are seen to be required because the ability to amend a trust's constituent documents is generally wide-ranging.

Recommendations of the Board of Taxation	Government's Response	Comments
Recommendation 4 The Board recommends that there be no requirement that the rights in a trust be uniform in order to be a Regime MIT.	The Government agrees to this recommendation.	This adoption should be seen as a positive and an acknowledgement that trusts are used in wide range of circumstances. Their terms should not be legislatively constrained but rather should be able to be tailored to suit various commercial purposes. It is important that possible integrity rules are not allowed to impinge on sensible flexibility.
Recommendation 7 The Board recommends that complying superannuation entities and tax exempt entities which are entitled to a refund of franking credits should be excluded from the rule by which, when one or more persons or bodies exempt from income tax own 20% or more of the beneficial interest in a non-widely held trust, it causes the fund to be taken as a public unit trust. The rule should remain applicable only to tax exempt entities that are not entitled to a refund of franking credits.	The Government agrees to this recommendation.	This is a welcome change and will stop a trust becoming a public trading trust solely by virtue of a super fund or qualifying tax exempt entity increasing its interest in the trust over 20%. It will be particularly useful for small, 'club' deals in infrastructure projects and private property developments. However, it may not be a panacea for private equity funds, as such funds may still be considered to be 'offering units to the public.'
Recommendation 8 The Board recommends that MITs be considered to be undertaking primarily passive investment if they carry on an eligible investment business (EIB) as defined. An MIT will be treated as carrying on an EIB if at least 90% of its gross revenue is income from passive investments.	The Government does not agree to redefine eligible investment business at this time. It has undertaken to further examine the benefits of this recommendation, relative to its cost to revenue.	It is disappointing that the Government has not accepted these recommendations, especially in the real estate sector where the existing definition does not reflect the current market in securitised property. The 90% threshold would have provided more flexibility for the trust to maintain its 'flow through' status than was provided under the 2008 changes to the EIB definition. The Board's comment that turnover and profit rents paid between associates would not be EIB under its proposals (which purports to widen the existing EIB definition) is also concerning for stapled structures. This is an area that requires close attention by the MIT sector.

Recommendations of the Board of Taxation	Government's Response	Comments
Recommendation 9 The Board supports retaining the control test in its current form with the addition of an exception for a single wholly-owned taxable subsidiary. The Board recommends that trust taxation be retained if an MIT owns directly, or through a chain of entities, 100% of the ownership interests in a single taxable subsidiary company.	The Government agrees to retain the existing control test in Division 6C, but does not agree to the suggested modifications at this time. The "further examination" option proposed for Recommendation 8 is also proposed here, as it is for Recommendation 11 – extending Recommendations 8, 9 and 10 to all widely held MITs and other public unit trusts.	It is disappointing the Government has not accepted the Board's recommendations in this area. Currently there is an exemption from Division 6C even though the trust controls a trading entity where an existing stapled structure inserts a 'top hat' trust to hold the units and shares in the stapled trust and company. It seems inconsistent to allow some stapled entities to simplify their structure (allowing the head trust to wholly own a company) and yet not allow trusts within unstapled groups to wholly own a company. We consider that any concerns about 'profit stripping' from the company by the trust would be adequately dealt with by the arm's length dealing rule discussed under Recommendation 10 below.
Recommendation 10 The Board recommends that arm's length rules should apply to transactions between common interests or related interests of an MIT, including but not limited to subsidiaries and stapled entities.	The Government agrees to this recommendation.	This recommendation was probably inevitable given apparent concerns about profit stripping. However, it overlooks the protection already inherent in Part IVA and will lead to increased compliance costs, justifying pricing with a greater degree of precision than has been necessary in the past. Given the way other legislation affecting MITs has been approached, it will be necessary to monitor the legislative drafting in this area closely.
Recommendation 12 The Board recommends that if a widely held MIT or other public unit trust does not satisfy the eligible investment business test in Division 6C, the whole of the trust's taxable income for the year will be assessable to the trustee at the corporate tax rate. The trust would be subject to company-like taxation and it would not qualify to have trust taxation in that year of income.	The Government agrees to this recommendation in relation to public unit trusts. The Government notes that it has not at this stage agreed that widely held MITs that are not public unit trusts be subject to Division 6C.	The Board considered that simply taxing the 'tainted income' of an MIT would not be a sufficient deterrent to comply with Div 6C and that it would still allow a partially complying trust to obtain the tax advantages of trust taxation, such as the flow through of the CGT discount and tax deferred payments. However, the Board's recommendation was made in the context of reducing the EIB test to a floor of 90% passive investment income (discussed in recommendation 8 above) which has not been adopted. The problem that MITs subsequently found to have offended Division 6C are effectively unable to frank distributions, is still not addressed.

Recommendations of the Board of Taxation	Government's Response	Comments
Recommendation 13 The Board recommends that widely held MITs as defined in Recommendation 2 that meet the proposed new EIB rules be eligible to make the irrevocable election to apply the CGT regime to disposals of eligible assets. Where an MIT does not elect to apply the CGT regime, proceeds from the disposals of its eligible assets will be deemed to be on revenue account.	The Government has already agreed to this recommendation.	The Government has recently introduced provisions which allow qualifying MITs to elect to tax gains and losses on certain assets under the capital gains tax provisions. (For further, see our Tax Brief at http://www.gf.com.au/829_872.htm.) Although not identical, the provisions introduced broadly reflect the Board's recommendation, albeit with added complexity.
Recommendation 14 The Board recommends that: • a rule in similar terms to the superannuation fund capital account rule be introduced for eligible MITs. The assets covered by the legislative rule would be similar to those covered by section 295-85 of the ITAA 1997; and • hedges should have the same taxation treatment as the underlying assets.	The Government has already agreed to this recommendation.	Even though the Government has already acted on this recommendation, it is unfortunate the Government's response was more qualified than the Board's initial recommendation. One point worth noting is that character matching for hedged items will only be potentially available under the TOFA provisions in Division 230. Many conditions must be satisfied before an MIT can get the benefit of the hedging provisions in TOFA, even if the MIT is subject to TOFA and has made a valid hedging election.
Recommendation 18 The Board recommends that: • A legislative prohibition on amending previous years' assessments which relate to the characterisation of gains and losses made on the disposal of eligible MIT assets should be introduced as part of the new legislative rule.	The Government has already agreed to this recommendation.	If an entity makes a CGT election then that election will apply from the start of the 2008-09 income year. This was done in order to remove any possibility of MITs disposing of assets immediately prior to the introduction of the deemed CGT treatment and potentially claiming different treatment.

<table>
<tr><th>Recommendations of the Board of Taxation</th><th>Government's Response</th><th>Comments</th></tr>
<tr><td>Recommendation 19

The Board recommends an attribution model for determining the tax liabilities for Regime MITs and their beneficiaries.

The guiding principles of the model are:

a. a beneficiary is assessable on the amount of taxable income of the trust that the trustee allocates to the beneficiary;

b. the trustee must allocate the taxable income of the trust between beneficiaries on a fair and reasonable basis consistent with their rights under the trust's constituent documents and the duties of the trustee; and

c. the trustee will be taxed on any taxable income of the trust which the trustee fails to allocate to beneficiaries within three months of the end of the financial year.</td><td>The Government agrees to this recommendation.

MITs in the new MIT regime will be able to make an irrevocable election to apply an attribution model for determining the tax liabilities of their beneficiaries where the beneficiaries have clearly defined entitlements in the trust.</td><td>The attribution model recommended by the Board and agreed to by the Government dispenses with the concept of 'income of the trust estate' and 'present entitlement' in order to achieve flow through taxation outcomes for beneficiaries. The allocation by the trustee, having regard to the income and capital rights of beneficiaries, provides a method of flow through taxation that operates without regard to actual distributions to the beneficiaries. The trustee is given up to three months after year end to make the allocation.

It will be interesting to see how this provision interacts with the proposed anti-streaming rules.</td></tr>
<tr><td>Recommendation 21
The Board recommends that:
• a specific integrity rule be designed to address the situation where streaming of tax benefits or value shifting arises from changes to an MIT's constituent documents during the year;
• a specific integrity rule be designed to address the situation where the rights attaching to units in a Regime MIT are structured such that the taxable income of the trust is attributed to a tax exempt entity while other unit holders receive tax deferred or tax exempt distributions; and
• a post-implementation review of the new MIT regime be conducted after the legislation has been in operation for at least two years. The review should include, in particular, the attribution method of taxation. If specific integrity concerns are identified at this time, then it may be appropriate to introduce further targeted integrity rules.</td><td>The Government agrees to this recommendation and will consult on these rules as part of the process of developing the detailed design of the measure.

The Government agrees to consider a post-implementation review after the MIT regime has been in operation for at least two years.</td><td>It is to be expected that a new MIT regime would include tax integrity measures to discourage the development of potentially abusive practices. The consultation process will need to draw a clear distinction between what is abusive and outcomes that simply follow the income and capital rights of beneficiaries who have a differing tax status.

A post-implementation review is to be welcomed, as it is inevitable that particular situations or circumstances will come to light where the operation of the new MIT regime requires clarification or amendment to operate in the manner envisaged.</td></tr>
</table>

Recommendations of the Board of Taxation	Government's Response	Comments
Recommendation 22 The Board recommends that legislative rules be introduced which provide that where units issued by a Regime MIT meet the 'substantially equivalent to a loan' test in Division 207 of the ITAA 1997, they will not be subject to the general method for allocating the taxable income for Regime MITs. Instead, the amount accruing to these unit holders should be taxable to them as interest and these amounts should reduce the taxable income of the Regime MIT.	The Government has decided to defer consideration of this issue to further examine the benefits of this recommendation, relative to its cost to revenue.	A more considered response to this recommendation is clearly required. Any implementation of this measure will need to consider what sort of 'loan' or 'debt' test should be adopted, and whether the policy (if implemented) should allow existing arrangements to be grandfathered, with perhaps an option to 'elect in' being provided. It should be regarded as a bad tax policy outcome if those who have chosen to invest in units of one particular class (in the full knowledge of the tax profile of distributions) are disadvantaged or advantaged over investors in another class due to the introduction of this tax measure.
Recommendation 23 Subject to Recommendation 4, the Board recommends that: • Regime MITs be able to make an irrevocable election to be subject to the proposed attribution method of taxation; • a Regime MIT must satisfy the qualifying criteria at all times; and • if an MIT fails to satisfy the qualifying criteria it should be able to maintain taxation treatment as a Regime MIT provided the failure was the result of inadvertent or minor circumstances and reasonable steps are being taken to rectify the failure in a reasonable time.	The Government agrees to this recommendation.	This measure provides a higher degree of certainty for both the trustee and investors in relation to the tax treatment of distributions. That such an election is irrevocable is common with many other tax measures. The flexibility to deal with circumstances that might otherwise jeopardise the Regime MIT status of a trust is to be welcomed, but clear guidance should be provided about how this measure will be administered. In some cases, given that a trustee is charged with the balancing of various interests of different beneficiaries, reasonable steps may indeed require a considerable, but not unreasonable, time for the situation to be resolved. A statutory deadline could prove counterproductive to the policy objective here.

Recommendations of the Board of Taxation	Government's Response	Comments

Recommendation 25
 	
The Board recommends that:
• beneficiary-level cost base adjustments remain with modification for Regime MITs; and
• any legislative modification to the current approach to beneficiary-level cost base adjustments generally ensures that:
    • the non-assessable part of a Regime MIT distribution which is attributable to a permanent tax difference is not to be 'clawed back' on the sale of a beneficiary's units except to the extent that the value of the permanent difference was already reflected in the calculation of the cost base of the units;
    • tax deferred distributions attributable to temporary tax differences, such as unrealised capital gains, are not, other than to the extent they represent returns on 'debt like' units, taxable to a resident or non-resident beneficiary as ordinary income under section 6-5 of the ITAA 1997 but may be subject to an adjustment to the cost base of the beneficiary's units; and
    • tax deferred distributions attributable to temporary tax differences that represent a return on a 'debt-like' unit are taxable to the beneficiary as interest and do not result in a cost base adjustment to the debt-like unit.
	The Government agrees that beneficiary level cost base adjustments remain, as they currently apply, in respect of non-revenue account unit holders.
	
	However, the Government does not agree to the non-assessable part of an MIT distribution which is attributable to a permanent tax difference not being 'clawed back' on the sale of a beneficiary's units. The Government considers that whether a claw back arises should be determined on a case by case basis, having regard to the policy objective of the tax measure which gives rise to the non-assessable part.
	
	The Government has also decided to defer consideration of the treatment of tax deferred distributions:
	• attributable to temporary tax differences (in relation to revenue account unit holders); and
	• in respect of debt-like interests (see also Recommendation 22),
	
	in order to further examine the benefits of these parts of the recommendations, relative to their cost to revenue.
		The requirement of applying a case by case approach to claw backs in relation to permanent differences creates significant administrative and compliance burdens – eg, there would be a need to trace the effect of individual permanent differences through to distribution, and presumably additional disclosure obligations will be required in order to advise unitholders of the necessary cost adjustments.
		
		Although the Government's responses to the recommendations in Chapter 7 do not discuss the specifics of any legislative measure that will be introduced to deal with revenue account unitholders, a number of the Government's comments appear to foreshadow the possibility that tax-deferred distributions to revenue account unitholders will be taxed as ordinary income.
		
		This is an issue that needs to be monitored closely by the MIT industry as there still seems to be an agenda of applying different rules to banks, insurance companies etc.
		
		While such an approach has a long history in Australia, it is not the international norm and is counter-productive for the Government's objective of making Australia a financial hub. Investors from foreign countries will not expect to be treated differently in such cases.

Recommendations of the Board of Taxation	Government's Response	Comments
Recommendation 26 The Board recommends that the cost base of a beneficiary's units in a Regime MIT be adjusted in the following circumstances: • where taxable income is attributed to a beneficiary, then the cost base of the beneficiary's units should be increased by the amount attributed (adjusted upwards for certain CGT amounts that are currently disregarded under CGT event E4 such as the discount component of a capital gain, and downwards to reflect the value of certain tax offsets such as the gross-up component of a franking credit); and • where distributions are received, the cost base will be reduced by the amount of the distribution.	The Government agrees to this recommendation in principle, in so far as it relates to addressing the potential double taxation that may arise in certain circumstances, including for revenue account holders. The details will be developed in the context of implementation of the detailed design of a new MIT regime.	The Board's recommendations envisage a system where an investor's cost base in units will now move up as well as down. Not surprisingly, consequential recommendations in the Report inevitably involve significant reporting obligations on the managers of Regime MITs so that investors can perform these calculations.
Recommendation 30 The Board recommends that all 'unders and overs,' however arising, below a *de minimis* level of either 5% of the net income of the Regime MIT for a year or a prescribed dollar value per unit be carried forward into the next income year following identification of the under or over. For 'unders and overs' below the *de minimis* level no amount of interest or penalty would be payable by the trustee or the Commissioner.	The Government agrees to this recommendation.	The Board increased the *de minimis* threshold from the 2% – suggested in the October 2008 Discussion Paper – to 5%, a figure favoured by the majority of submissions. The threshold covers all types of 'unders and overs' discovered in later years. Further consultation will be sought on whether a set dollar value per unit is a practical alternative to a set percentage of net income. The carry forward approach adopted reflects the common practice for 'unders and overs.'

Recommendations of the Board of Taxation	Government's Response	Comments
Recommendation 32 The Board recommends that where an 'under' exceeds the set de minimis, the trustee may reissue distribution statements to beneficiaries and undertake a revised attribution of taxable income. If the trustee does not reissue distribution statements to beneficiaries or re-attribute within a certain timeframe, then the trustee will be assessed on the amount of tax shortfall at the top marginal tax rate. In accordance with the current s. 99A, when the trustee distributes an amount of income which has been assessed to it at the top marginal rate, this amount will be non-assessable, non-exempt income of the beneficiary.	The Government agrees to this recommendation.	The Board states that taxing a trustee (that elects not to reissue) at the highest marginal rate on 'unders' acts as an incentive to calculate taxable income correctly in the first instance. This is a flawed argument as trustees often do not have complete information within three months of the end of the income year. The MIT industry should continue discussions with Government about the most practical approach to this issue as part of the consultation process. The timeframe by which a trustee must reissue distribution statements is subject to further consultation.
Recommendation 33 It is recommended that where an 'over' exceeds the de minimis, then the Regime MIT trustee must reissue distribution and/or attribution statements to beneficiaries.	The Government agrees to this recommendation.	The Board considered that there was no practical and fair way for beneficiaries to receive a refund of the additional tax paid without the trustee reissuing a distribution statement and the beneficiary amending their return. There is no discussion of the timeframe for reissue or the penalties that may be applicable for not doing so. There is a remote possibility that a beneficiary may be out of time and cannot amend their return. This is not considered in the Report.
Recommendation 42 Division 6B should be abolished, provided an arm's length rule is introduced as part of the EIB rules proposed under the new MIT regime.	The Government agrees to this recommendation.	The abolition of Division 6B removes a significant impediment to companies restructuring their affairs (and is particularly relevant to property staples). Curiously, the Board put a proviso in the recommendation that the Division only be abolished if the arm's length rule in Recommendation 10 was adopted. The arm's length rule is more relevant to the control issue for ongoing dealings between entities in a staple under Division 6C, rather than Division 6B which is concerned with companies restructuring (often to create a stapled trust). In this context, the Board's comment may simply be seen as supporting Recommendation 10. Furthermore, as an arm's length rule has been accepted by the Government, it will apply to MITs in any event.

Recommendations of the Board of Taxation	Government's Response	Comments
Recommendation 43 The Board recommends that a trust which qualifies as a Regime MIT will be deemed to be a fixed trust for all other provisions of the taxation law.	The Government agrees to this recommendation in principle in respect of MITs that have clearly defined entitlements. The design details, including appropriate integrity rules, will be developed in the context of developing the new MIT regime.	Currently, a trust must meet the definition of a 'fixed trust' in order to access certain concessions (particularly, to carry forward losses passing through franking credits and to access the CGT scrip-for-scrip rollover). The uncertainty surrounding this definition almost always requires an ATO ruling for any significant transaction (in which the ATO generally exercises a discretion to treat the trust as if it was a fixed trust). The Board reasons, correctly, that its 'clearly defined entitlements' requirement ensures that interests in the trust 'should remain sufficiently stable such that the trust should not be considered 'discretionary'. Therefore, a Regime MIT should be deemed a fixed trust for all purposes of the Act. The Government agreement in principle is welcome, but its reference to 'integrity rules' is concerning.
Recommendation 44 It is recommended that a roll-over provision be introduced which provides that if the amendment of an MIT's constituent documents, in order to qualify as a Regime MIT results in a resettlement, no adverse taxation consequences will arise.	The Government will give this recommendation further consideration as part of the consultation on the implementation and design details of an MIT regime.	The Board noted that some trusts may need to amend their constituent documents to meet the Regime MIT requirements, and that a roll-over provision be inserted to defer any CGT impacts should such amendments give rise to a resettlement. The Government's decision to defer consideration of this recommendation is disappointing as it seemingly ignores the fact that the Regime MIT requirements in the Board's report are different to the requirements of the current MIT definition (and thus, many trusts will have to amend their deeds). There remains a real danger that many bona fide MITs will be precluded from being Regime MITs due to this resettlement risk.
Recommendation 45 The Board recommends that other 'widely held' MITs and public unit trusts which are 'engaged in primarily passive investments' but do not satisfy the 'clearly defined rights' requirement should be able to benefit, as applicable, from the recommendations the Board has made on: • the treatment of 'debt like' units (Chapter 5); • character retention and flow-through (Chapter 6); • addressing double taxation (Chapter 7); and • international considerations (Chapter 9).	This recommendation relates to a number of other recommendations, some of which the Government will be considering further in due course. The Government will therefore give further consideration to this recommendation in the context of examining the other recommendations.	The Board notes that many 'widely held' trusts that are engaged in primarily passive investments' may not satisfy the 'clearly defined rights' requirement to be a Regime MIT. Nonetheless, the Board feels these trusts should have access to the rules in recommendations 13 to 18, 22, and 24 to 34. As not all of the Board's recommendations were accepted by the Government, this recommendation is similarly qualified.

Recommendations of the Board of Taxation	Government's Response	Comments
Recommendation 48 The Board recommends that: • the existing Division 6 rules be the subject of a wider review to consider if some of the other Options for determining tax liabilities, such as the distribution model or the patch model, might usefully be applied to types of trusts that are not MITs; and • IDPS and similar bare trust type arrangements should be excluded from taxation under Division 6 generally.	The Government has decided to defer consideration of this recommendation.	While it is disappointing that Division 6 will not be reviewed in the short term, the Henry Review also recommended action in this area and review is necessary addressed, especially as regards IDPS. While the full tax agenda of the Government has to be recognised, it is considered that this is an area which requires earlier rather than later attention.

Greenwoods & Freehills

For further information, please contact

Sydney

Simon Clark
61 2 9225 5957
simon.clark@gf.com.au

Josh Cardwell
61 2 9225 5887
joshua.cardwell@gf.com.au

James Pettigrew
61 2 9225 5979
james.pettigrew@gf.com.au

Andrew Mills
61 2 9225 5966
andrew.mills@gf.com.au

Andrew White
61 2 9225 5984
andrew.white@gf.com.au

Anthony Watson
61 2 9225 5990
anthony.watson@gf.com.au

Chris Colley
61 2 9225 5918
chris.colley@gf.com.au

Melbourne

Toby Eggleston
61 3 9288 1454
Toby.Eggleston@gf.com.au

Richard Buchanan
61 3 9288 1903
richard.buchanan@gf.com.au

Adrian O'Shannessy
61 3 9288 1723
adrian.oshannessy@gf.com.au

These notes are in summary form designed to alert clients to tax developments of general interest. They are not comprehensive, they are not offered as advice and should not be used to formulate business or other fiscal decisions.
Greenwoods & Freehills Pty Limited ABN 60 003 146 852
Level 39 MLC Centre Martin Place Sydney NSW 2000 Australia Facsimile (02) 9221 6516 Telephone (02) 9225 5955

Liability limited by a scheme approved under Professional Standards Legislation
Doc id. 510075667