Chapter 2

Views on the package of bills

2.1 This chapter evaluates the level of stakeholder support for a new tax system for managed investment trusts before examining concerns raised by stakeholders in regard to a number of specific provisions.

General views on the package of bills

2.2 The AMIT legislation has been in development since 2010 and has benefited from extensive consultation with all of the major stakeholders, including the Financial Services Council (FSC), Property Council of Australia (PCA) and the Australian Custodial Services Association (ACSA).[1]

2.3 All of the submissions received from stakeholders indicated support for the introduction of a new tax system for managed investment trusts. The FSC fully supported the passage of the regime as currently formulated, noting:

> There has been open and honest consultation with industry stakeholders and the regime is now workable and effective. We believe the legislation that has been presented to Parliament is a good compromise between the industry desire for simplicity versus the complexity of integrity measures to ensure compliance.[2]

2.4 Recognising the need for Australia to have world class asset management rules for MITs, EY supported:

> …tax reform for MITs and this package of optional AMIT measures (for eligible MITs) should be of overall significant benefit to the managed funds industry.[3]

2.5 The PCA outlined the benefits for the property investment industry:

> The reforms will provide certainty to industry and help attract patient long term capital that Australia needs to build prosperity.[4]

2.6 Even ACSA, which raised concerns with specific provisions of the bill, were:

> …generally supportive of the MIT reforms and the certainty created around long standing anomalies and gaps in the current trust tax legislative framework.[5]

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1 See, for example, AMP, *Submission 1*; and the Tax Institute and the Business Law Section of the Law Council of Australia, *Submission 3*.

2 *Submission 5*, p. 1.

3 *Submission 2*, p. [2].

4 *Submission 6*, p. 1.

5 *Submission 4*, p. 3.

2.7 Many stakeholders also welcomed the development of Law Companion Guidelines being released by the ATO prior to the legislation being enacted to complement the introduction of the new tax system.[6] To reduce risks associated with implementing the new tax system, the Australian Institute of Superannuation Trustees (AIST) advocated for continued development of the Law Companion Guidelines and other ATO rulings.[7]

Post-implementation review

2.8 Given the importance and complexity of the AMIT reforms, support for a post-implementation review has been suggested throughout the legislative development process.

2.9 The need for a post-implementation review was first raised in the 2009 report by the Board of Taxation:

> …the Board is concerned to ensure that industry practices do not develop that would undermine the integrity of the new MIT regime. To help address that concern, the Board is recommending that a Post-Implementation Review of the new MIT regime should be conducted after the legislation has been in operation for at least two years.[8]

2.10 Stakeholders also supported a post-implementation review. For example, EY recommended that a formal Treasury review be undertaken before the first year of operation as:

> Even with the excellent efforts of Treasury, the ATO and the industry sectors, it is inevitable that the Bill will require fine tuning.[9]

2.11 Some stakeholders considered that legislative amendments at this late stage were undesirable as this would affect implementation and indicated that a post-implementation review would enable any issues that arose during implementation to be addressed.[10] In particular, the FSC was concerned that:

> …any changes proposed by Parliament will not have the benefit of consultation between key users of the regime, Treasury or the ATO, and may result in adverse and unintended consequences.
>
> We note the legislation is detailed and for that reason, we understand that there is universal support amongst stakeholders that a post-implementation review be undertaken within 18–24 months of passage. This will allow a formal mechanism for review of any unintended consequences that may arise as industry moves into the implementation phase.[11]

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6 See, for example, Australian Institute of Superannuation Trustees, *Submission 7*; and EY, *Submission 2*.

7 *Submission 7*, pp. 2-3.

8 *Review of the Tax Arrangements Applying to Managed Investment Trusts*, August 2009, p. 2.

9 *Submission 2*, p. [2]

10 See, for example, PCA, *Submission 6*; and FSC, *Submission 5*.

11 *Submission 5*, p. 2.

2.12 The committee understands that Treasury has put forward a proposal to monitor the MIT reforms post-implementation.[12] The committee is confident that, where required, Treasury will be able to respond to any unforeseen circumstances and put forward a case for government to enact legislative change and remedy urgent issues that might arise. That said, this is a significant and substantial reform which the committee believes would benefit from a comprehensive and timely post-implementation review.

Concerns with specific provisions of the bills

2.13 While submissions were generally supportive of the new tax system for AMITs, a few stakeholders raised significant concerns in relation to the effect of the reforms on custodians and the feasibility of the commencement date.

Withholding tax liability

2.14 In its submission, ACSA raised concerns that the withholding tax (WHT) rules contained in the new tax system would have widespread implications for foreign investors and custodians. It had raised these concerns about WHT liabilities for custodians with Treasury and the ATO on several occasions previously through the legislative development process:

> Ultimately, Treasury attempted to address our concerns by introducing a custodian indemnity—ACSA believes this is not sufficient because it introduces credit risk issues for custodians and is unlikely to be effective where the foreign client has sold out its units prior to the NRWHT [Non-Resident Withholding Tax] liability arising.[13]

2.15 As currently drafted, ACSA contended that trustees would not face any negative consequences where AMITs do not pay a sufficient cash distribution to cover the custodian's WHT liability. By contrast, custodians would have to recover the shortfall from foreign clients or pay the WHT liability from its own funds. The risk for custodians is heightened when foreign investors have sold out or are no longer with the custodian at the time the WHT liability arises. In addition, ACSA was concerned that WHT liabilities can be triggered for 'deemed payments' where no cash distributions are made, and that it is likely that these types of payments would be very common.[14]

2.16 A number of stakeholders responded to the WHT concerns raised by ACSA. The FSC commented that such situations were unlikely to occur:

> Whilst the MIT Regime theoretically allows a trust to attribute a tax liability to an investor and not provide sufficient cash to cover this liability, the situation would not arise in practice. FSC members have clearly indicated that the attribution regime will not result in changes to distribution policy. This is particularly the case in retail funds, where

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12 PCS, *Submission 6*, p. 2.

13 *Submission 4*, p. 3.

14 *Submission 4*, p. 4.

> investors must be provided with product disclosure statements under Corporations Law requirements. The commercial reality of suddenly changing distribution policy when investors are expecting income from a fund makes it highly unlikely and unpalatable for a trustee to do.[15]

2.17 In its response to questions on notice, Treasury noted that MITs face significant commercial pressure to pay out enough cash to cover any resulting tax liability. As a result, the circumstances described by ACSA would only occur in rare and exceptional cases.[16]

2.18 Similarly, the PCA sought to allay concerns about how the WHT provisions might affect the property sector:

> Listed property trusts generally have a stated distribution policy… In all but exceptional circumstances, listed property trusts distribute more than 30% of the taxable amounts subject to withholding tax (thus the cash distributions are sufficient to cover the withholding tax obligations).
>
> There could be rare situations where cash distributions are less than the withholding tax liability, for example, a financial crisis across the market, or the sale of a significant assets where the capital gain in reinvested in the fund…[17]

2.19 However, the PCA went on to highlight that the government had put in place indemnity for custodians:

> Under the proposed rules, in these rare circumstances, the custodians would have the withholding tax liability, however, the rules also provide the custodians with a right of indemnity against the non-resident investor on whose behalf they hold the interest in the AMIT to recover any amounts paid.[18]

2.20 Treasury highlighted that custodians typically have indemnity provisions in their custody agreements and that:

> If the custodian expects that there may be further potential withholding tax obligations, it could trigger clauses in its custody agreement allowing it to retain sufficient fund pending the finalisation of any withholding tax obligations. We understand that these clauses are already commonly included in custody agreements. Custodians can update their agreements to minimise any remaining risk, if required.[19]

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15 *Submission 5*, p. 4.

16 *Answers to Questions on Notice No. 1*, p. 1.

17 *Submission 6*, p. 4.

18 *Submission 6*, p. 5.

19 *Answers to Questions on Notice No. 1*, p. 2.

2.21 Further, Treasury informed the committee that the ATO would also take into account circumstances where a custodian was seeking to recover a WHT liability from a client when negotiating arrangements for payment.[20]

2.22 ACSA was also critical of the AMIT system adopting an attribution basis for determining WHT liabilities, noting that 'This novel approach to WHT collection is unique in the OECD world'.[21]

2.23 Treasury was adamant that the new tax system for AMITs does not change the broad framework for non-resident withholding tax:

> The withholding tax provisions in the MIT Bills before Parliament merely ensure that the withholding framework works in an attribution context.[22]

2.24 A potential divergence in the definition of 'fund payment' for AMITs and existing MITs was highlighted in the ACSA submission as an important issue because the 'fund payment' is the base amount on which withholding tax is calculated.

2.25 The committee understands that it will be necessary to develop new withholding tax systems processes to administer the new tax system and the definition of 'fund payment' is pivotal to correctly define the base amount.

2.26 Treasury indicated to the committee that:

> …the new MIT rules are not intended to change the broad framework for non-resident withholding tax. The withholding tax provisions in the MIT Bills before Parliament merely ensure that the withholding framework, including the fund payment concept, works in an attribution context.[23]

2.27 While recognising the concerns of the custodians, the committee agrees with the majority of stakeholders that the legislation should neither be delayed nor undermined by alterations to the withholding tax mechanisms. The committee understands that Treasury and the ATO will need to monitor implementation and act to rectify any urgent issues that arise.

Tax treatment of custodians holding units in AMITs

2.28 ACSA notes that the treatment of the relationship between custodians and clients has been a long-standing issue in the custodian industry. On behalf of custodians, ACSA has consistently argued for an endorsement in the broader tax framework of the 'look-through' approach that is adopted by custodians and their clients in practice for client investments.

2.29 The new tax system for AMITs explicitly introduces, in section 276-115, a 'look-through' provision for a custodian holding units on behalf of a client. ACSA believes that this provision, which only applies to AMIT arrangements:

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20 *Answers to Questions on Notice No. 1*, p. 3.

21 *Submission 4*, p. 5.

22 *Answers to Questions on Notice No. 1*, p. 7.

23 *Answers to Questions on Notice No. 1*, p. 13.

> …is not necessary and would create confusion in the tax legislation for the tax treatment of custodians in the broader context noted above.[24]

2.30 ACSA proposed that section 276-115 should be removed from the legislation.

2.31 In response, Treasury contended that:

> Section 276-115 was inserted for the benefit of custodians to ensure that the new MIT rules interact properly with the existing tax law, where a custodian is interposed between an AMIT and an investor. 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 they would not otherwise arise. This provision also ensures that characters of amounts attributed by an AMIT can flow through to a custodian's client.[25]

2.32 In addition, the introduction of section 276-115 will not create a look-through precedent for custodians in other areas.[26]

2.33 The committee is satisfied that section 276-115 plays an important role in the new tax system and should be retained.

Cost base adjustments for AMIT units

2.34 The new tax system for AMITs introduces upward costs base adjustments on units where the cash distribution is less than the taxable components attributed to a member. ACSA notes that this provision will produce different outcomes for AMITs than the current provisions relating to certain non-assessable amounts paid by a unit trust to a unit holder.[27]

2.35 ACSA's concern is that there has been no announced change in policy for cost base adjustments as would occur under the new arrangements and that the legislation, as drafted, would lead to unintended outcomes. Indeed, ACSA reports that:

> Treasury agreed the outcome was unusual and responded by saying the outcome was not intended and would be changed. However, the final MIT Bill was not changed in this respect.[28]

2.36 EY also noted that there are some drafting issues with the capital gains tax cost base uplift rules which would need adjustment.[29]

2.37 Treasury commented that the introduction of new cost base adjustment rules is intended to benefit investors and reduce the scope of double taxation. The AMIT tax system will result in custodians having to develop new reporting systems as part of the implementation process and this will mean that custodians will have to deal with

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24 *Submission 4*, p. 6.

25 *Answers to Questions on Notice No. 1*, p. 8.

26 Treasury, *Answers to Questions on Notice No. 1*, p. 9.

27 *Submission 4*, p. 7.

28 *Submission 4*, p. 7.

29 *Submission 2*, p. [2].

MITs under both the new and existing rules. Treasury noted the concerns of ACSA regarding the operation of the new rules:

> As the new tax system for AMITs is a significant change, Treasury and the ATO will monitor the operation of the new rules to identify and rectify any unintended consequences.
>
> We will consider this issue further in consultation with industry and the ATO.[30]

2.38 The committee considers that the issue of cost base adjustments should be closely monitored during the implementation phase. Treasury and the ATO should work quickly with government to resolve any urgent issues that may rise.

Commencement date

2.39 There was some discussion in submissions about whether it was appropriate to commence the new regime on 1 July 2016. The AIST was concerned that:

> …the change contained in the bills will require significant investment in new technology in order to accommodate the levels of transparency required. This is needed to ensure that at any given point in time, investors can look through to the investments in their portfolio and the tax events associated with them.[31]

2.40 Reflecting these concerns, AIST recommended that the commencement date for the reforms be pushed back to 1 July 2017 thereby allowing fund managers, custodians and other investors to put in place the systems necessary to better utilise the new rules.[32]

2.41 Given the extensive legislative development process, however, many stakeholders were keen to see the legislation pass and allow the AMIT tax regime to commence. For example, EY commended:

> …the speedy passage of the Bills through Parliament in order to allow for their adoption and implementation by managed funds, administrators and other service providers in accordance with the highly anticipated scheduled application dates.[33]

2.42 In addition, the Tax Institute and the Business Law Section of the Law Council of Australia noted that:

> The introduction of the legislation will require significant investment by industry. It is important for this reason that the legislation is introduced as a matter of urgency.[34]

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30 *Answers to Questions on Notice No. 1*, p. 11.

31 *Submission 7*, p. 3.

32 *Submission 7*, p. 3.

33 *Submission 2*, p. [1].

34 *Submission 3*, p. [1].

2.43 While acknowledging that significant investment will be required to administer the new tax system, the committee believes that it is in the best interests of the sector not to delay any further and to retain the commencement date of 1 July 2016.

Committee view on the bill

2.44 The committee believes that the new tax system for AMITs is long overdue and will modernise the tax treatment of managed investment trusts. These reforms will make Australia more competitive in the funds management industry and allow Australian funds to participate in the Asia Region Funds Passport.

2.45 Noting the concerns of some stakeholders, the committee is satisfied that any unforeseen or unintended consequences that may arise during the implementation process will dealt with by the government quickly. Further, the committee proposes a review of the new tax system within 24 months of commencement in order to provide an avenue through which stakeholders can also express concerns.

Recommendation 1

2.46 The committee recommends that a comprehensive and formal post-implementation review of the legislation and operation of the tax system for attribution managed investment trusts (AMITs) be undertaken by Treasury and completed by 1 July 2018.

Recommendation 2

2.47 The committee recommends that the Senate should pass the bill.

Senator Sean Edwards

Chair