



Tax Laws Amendment (Election Commitments No. 1) Bill 2008

Income Tax (Managed Investment Trust Withholding Tax) Bill 2008

Income Tax (Managed Investment Trust Transitional) Bill 2008

Bernard Pulle, Barbara Harris and Paige Darby
Economics Section

Contents

Purpose.	3
Background.	3
Managed Investment Trust Regime	3
What are managed investment trusts and how do they operate generally?	3
The managed investment industry and the property trust sector	5
The current withholding tax regime for certain distributions from Australian managed investment trusts.	5
The proposed new withholding tax regime for managed investment trusts	6
Prime Minister's Literary Awards	7
Position of significant interest groups/press commentary	8
Managed Investment Trust Withholding Tax	8
Prime Minister's Literary Awards	10
Financial implications	11
New Management Investment Trust Regime.	11
Income tax treatment of the Prime Minister's Literary Award	12
Main provisions.	12
Tax Laws Amendment (Election Commitments No. 1) Bill 2008	12

Schedule 1	12
Rate of withholding	13
Definition of Managed Investment Trust	13
Meaning of ‘fund payment’	15
Meaning of custodian	16
Schedule 2	17
Income Tax (Managed Investment Trust Transitional) Bill 2008	18
Rate of tax	18
Application	18
Income Tax (Managed Investment Trust Withholding Tax) Bill 2008	18
Rate of tax	19
Comparison of key features of the new law and current law	19
Concluding comments	19
The Regulation Impact Statement proposes ongoing review of the new Managed Investment Trust withholding regime	19
Attachment A – Comparison of key features of the new law withholding tax on managed investment trusts and the current law	21

Tax Laws Amendment (Election Commitments No. 1) Bill 2008

Income Tax (Managed Investment Trust Withholding Tax) Bill 2008

Income Tax (Managed Investment Trust Transitional) Bill 2008

Date introduced: 4 June 2008

House: House of Representatives

Portfolio: Treasury

Commencement: On Royal Assent.

Links: The [relevant links](#) to the Bill, Explanatory Memorandum and second reading speech can be accessed via BillsNet, which is at <http://www.aph.gov.au/bills/>. When Bills have been passed they can be found at ComLaw, which is at <http://www.comlaw.gov.au/>.

Purpose

The purpose of this package of three Bills is twofold:

- to provide a new final withholding tax regime for certain distributions from Australian managed investment trusts; and
- to provide income tax exemption for the Prime Minister's Literary Awards.

Background

Managed Investment Trust Regime

What are managed investment trusts and how do they operate generally?

A trust is a 'managed investment trust' (MIT) in relation to an income year if, amongst other things, the trust is a 'managed investment scheme' as defined by section 9 of the *Corporations Act 2001*.¹

1. Section 12-395 *Taxation Administration Act 1953*.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Managed investment schemes are also referred to as 'managed funds', 'pooled investments' or 'collective investments'. The Australian Securities and Investments Commission (ASIC) in its [website](#) sets out examples of what types of entities that could be MISs and what are not, as follows.

Managed investment schemes are also known as 'managed funds', 'pooled investments' or 'collective investments'. Generally in a managed investment scheme:

- people are brought together to contribute money to get an interest in the scheme ('interests' in a scheme are a type of 'financial product' and are regulated by the Corporations Act 2001)
- money is pooled together with other investors (often many hundreds or thousands of investors) or used in a common enterprise
- a 'responsible entity' operates the scheme. Investors do not have day to day control over the operation of the scheme.

Managed investment schemes cover a wide variety of investments. Some of the popular managed investment schemes that may be offered include:

- cash management trusts
- property trusts
- Australian equity (share) trusts
- many agricultural schemes (eg horticulture, aquaculture, commercial horse breeding)
- international equity trusts
- some film schemes
- timeshare schemes
- some mortgage schemes
- actively managed strata title schemes.

What types of investments are NOT managed investments schemes?

Generally, only investments that are 'collective' are managed investment schemes. Some examples of investments that are **not** managed investments schemes include:

- regulated superannuation funds
- approved deposit funds

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

- debentures issued by a body corporate
- barter schemes
- franchises
- direct purchases of shares or other equities
- schemes operated by an Australian bank in the ordinary course of banking business (eg term deposit).

Further details of the regulatory measures applicable to them are available in the same ASIC website.

The managed investment industry and the property trust sector

Australia is considered to be one of the major markets for funds management, with the industry managing assets worth more than \$1.4 trillion.² A feature of the industry is its increasing globalisation, with 20 per cent of assets held by Australian management funds now being overseas assets.³

The property trust sector forms a key part of the industry, and comprises around 40 per cent of Australian unit trusts. Australian listed property trusts (where the units are listed on the Australian Securities Exchange) currently represent 12 per cent of the world's listed real estate assets, despite Australia geographically comprising only 2 per cent of global real estate. Assets in property trusts are growing strongly, with over 40 per cent of these assets comprising overseas property. This sector is more internationalised than the industry generally. Foreign investment in Australian property trusts amounts to approximately 28 per cent of total investment in those trusts. Much of this is managed by Australian custodians.⁴

The current withholding tax regime for certain distributions from Australian managed investment trusts

Under current tax law Australian sourced dividend, interest and royalty income paid to foreign investors is subject to final withholding tax at the rates of 30 per cent, 10 per cent and 30 per cent respectively. These rates may be lower under Australia's tax treaties.

2. Explanatory Memorandum, paragraph 1.265, p. 65.

3. *ibid.*, paragraph 1.266.

4. *ibid.*, paragraph 1.267.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Distributions of other Australian sourced income, mainly, income related to property (that is, rental income and capital gains) are presently liable to non-final withholding at the rate of 30 percent.

The proposed new withholding tax regime for managed investment trusts

As part of the 2007 election, the Australian Labor Party (ALP) promised to lower the level of withholding tax on certain MIT distributions to foreign resident investors.

Labor will make Australian managed investment funds even more attractive to non-resident investors by relieving the tax burden. Labor's initiative will see the current 30 per cent withholding tax on distributions from Australian managed funds to non-resident investors halved to 15 per cent.⁵

This policy commitment stems back to the ALP dissenting report to the Senate Standing Committee on Economics inquiry into the Tax Laws Amendment (2007 Measures No. 3) Bill 2007 [Provisions] in June 2007:

The ALP proposes to halve the 30 per cent withholding tax on distributions from Australian managed funds to non-resident investors. This proposed 15 per cent rate is at the upper end of relevant international rates. It will place Australian fund managers in a much better position to be able to compete to manage the global pool of managed funds, which is tipped to reach \$60 trillion over the next three years.⁶

However, when the initiative was formally announced as part of the 2008-09 Budget by the Treasurer, the Hon. Wayne Swan, the reduction in withholding tax was greater than previously foreshadowed:

The Government has tonight announced it will substantially reduce the level of withholding tax from a non-final rate of 30 per cent to a final rate of 7.5 per cent on certain distributions from Australian managed investment trusts (MITs) to foreign resident investors. These arrangements will make Australia's withholding tax rate one

-
5. S. Crean (then Shadow Minister for Trade and Regional Development), *A strong future for Australia's exports*, media release, Canberra, 21 November 2008. Accessed on 13/06/2008 from <http://parlinfoweb.parl.net/parlinfo/Repository1/Library/partypol/734P60.pdf>
 6. 'Labor and Democrats Dissenting Report', *Senate Standing Committee on Economics report into the Tax Laws Amendment (2007 Measures No.3) Bill 2007 [Provisions]*, Canberra, 6 June 2007. p. 34. Accessed on 13/06/2008 from http://www.aph.gov.au/senate/committee/economics_ctte/completed_inquiries/2004-07/tlab_3_2007/report/report.pdf

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

of the most competitive in the world, and provide a significant boost to Australia's ability to compete globally.⁷

Schedule 1 of the Tax Laws Amendment (Election Commitments No. 1) Bill 2008 and the companion Income Tax (Managed Investment Trust Withholding Tax) Bill 2008 and the Income Tax (Managed Investment Trust Transitional) Bill 2008 will put in place a new final withholding tax regime for Australian managed investment trusts (MITs) on certain distributions called fund payments made to foreign investors resident in certain countries listed in regulations referred to as 'information exchange countries' at the following rate:

- 22.5 per cent for certain distributions in relation to the first income year starting on or after the first 1 July after the day on which Royal Assent is received for these bills;
- 15 per cent for certain distributions in relation to the second income year starting on or after the first 1 July after the day on which Royal Assent is received for these bills;
- 7.5 per cent for certain distributions in relation to the third and later income years starting on or after the first 1 July after the day on which Royal Assent is received for these Bills.

Prime Minister's Literary Awards

In his first ten days in office Kevin Rudd announced a Prime Minister's literary award, funded to the tune of \$1.2 million over four years, with the winner of each of the fiction and non-fiction categories to receive \$100,000 tax-free.⁸

The Minister for Environment, Heritage and the Arts announced the inaugural Prime Minister's Literary Awards as two tax-free prizes of \$100,000 for fiction and non-fiction works on 22 February 2008.⁹

Schedule 2 of the Tax Laws Amendment (Election Commitments No. 1) Bill 2008 aims to make the inaugural Prime Minister's Literary Awards tax-free.

7. W. Swan (Treasurer), *Establishing Australia as a Regional Financial Hub*, media release, Canberra, 13 May 2008. Accessed on 13/06/2008 from <http://www.treasurer.gov.au/DisplayDocs.aspx?doc=pressreleases/2008/043.htm&pageID=003&min=wms&Year=&DocType=0>

8. Corrie Perkin, 'PM to reward Aussie writers', *Australian*, 5 December 2007, p. 3.

9. P. Garrett (Minister for the Environment, Heritage and the Arts), *Prime Minister's Literary Awards – Call for entries*, media release, Canberra, 22 February 2008. Accessed on 13/06/2008 from <http://parlinfoweb.parl.net/parlinfo/Repository1/Media/pressrel/PSQP60.pdf>

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Position of significant interest groups/press commentary

Managed Investment Trust Withholding Tax

Commentary on the reduction of the withholding tax has been substantially positive. Debate has centred on whether the reduction will help the industry's export ability, and the surprising reduced rate of 7.5 per cent.

In the week after the announcement, the *Australian Financial Review* provided the following commentary:

The federal government's initiative to slash the rate of withholding tax on distributions of Australian managed investment trusts to foreign investors has been warmly received by the property investment sector. But some argue it has failed to address the competitiveness of the broader funds management industry in Australia. The budget last week delivered bigger than expected withholding tax cuts.¹⁰

Property investment specialists yesterday applauded the federal government's plans to reduce the rate of withholding tax on distributions from Australian managed investment trusts to foreign resident investors by double the expected margin. Before coming to power, Labor had pledged to cut the rate of withholding tax to 15 per cent from 30 per cent in an attempt to promote the export of Australian financial services and create a regional financial services hub. The decision to reduce the rate to 7.5 per cent in three years' time caught the industry off guard.¹¹

The *Australian Financial Review* also reported Perennial Investment Partners chairman Michael Crivelli as questioning whether there should be taxes on funds management services at all:

... with the withholding tax cuts largely benefiting the real estate investment trusts, it did not go towards addressing the broader competitiveness of Australia as a funds management services provider on the world stage. He said the Australian regime should follow the tax-less model of Ireland and Luxembourg if the country wanted to be serious about attracting offshore money.¹²

-
10. N. Wan, 'Investment incentive gets warm reception', *Australian Financial Review*, 21/05/2008 p. 38. Accessed on 13/06/2008 from http://parlinfoweb.parl.net/parlinfo/Repository1/Media/npaper_3/N0IQ60.pdf
 11. S. Patten, 'Timetable delights overseas investors', *Australian Financial Review*, 15/05/2008, p. 12. Accessed on 13/06/2008 from http://parlinfoweb.parl.net/parlinfo/Repository1/Media/npaper_0/0SFQ60.pdf
 12. N. Wan, 'Investment incentive gets warm reception', *Australian Financial Review*, 21/05/2008 p. 38

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Industry organisations have been very supportive of reduction in withholding tax. Property Council Chief Executive Peter Verwer said in a media release:

This reform has come at a critical time for the real estate funds industry which is facing increased global competition for capital and a tightening market.

With the global market shake up, investors are searching for value and will not pay 30% tax in Australia when they can invest overseas for less than half that cost.

This measure is vital to retaining Australia's competitive advantage as a real estate fund manager and building our capacity as a financial hub in the region.¹³

Investment and Financial Services Association (IFSA) CEO Richard Gilbert has continued the association's support of the reduction after its [submissions](#) to the Senate Committee in June.

Overall, the Budget strategy places Australia on a sound, longer-term footing, with a focus on economic growth, lower inflation and productivity improvements in the context of a challenging global and domestic economic environment.

...

The decision to lower the Withholding Tax rate is critical to the maintenance of high levels of long-term offshore capital inflows to Australia. The management of these flows by Australian fund managers will enable additional investment into Australian infrastructure and property assets.¹⁴

Likewise, AMP Capital Managing Director Stephen Dunne has also welcomed the increased competitiveness the industry will experience.

Reducing the withholding tax for foreign residents will strengthen Australia's competitiveness as an international investment centre.

-
13. P. Verwer, *Tax reform will level the playing field for A-REITs*, media release, Property Council Of Australia, Sydney, 13 May 2008. Accessed on 13/06/2008 from <http://www.propertyoz.com.au/>
 14. R. Gilbert, *Budget send strong signal to international investors: Australian managed funds "open for business"*, media release, ISFA, Sydney 13 May 2008. Accessed on 13/06/2008. http://www.ifsa.com.au/Media%20Releases/2008_1305_Budget2008_IFSA%20response.pdf

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Australia is home to one of the world's leading funds management industries. As international pension markets continue to grow, Australia is well positioned to service the investment needs of these markets.¹⁵

In contrast, Deloitte International Tax Leader Peter Madden welcomed the reduction but questioned how successful it would be in enhancing Australia's future as a regional financial hub.

Whilst the proposed 7.5% tax rate for foreign residents investing in Australian property trusts will be good for the commercial and rural property sectors, it is questionable how this enhances Australia as a regional financial hub.

The ultimate measure of success will be when fund managers move to Australia from established centres such as Singapore and Hong Kong as a result of such measures.¹⁶

Prime Minister's Literary Awards

The Tax Laws Amendment (Election Commitments No. 1) Bill 2008 only relates to making the award tax-free. It does not relate to the establishment of the awards, which does not require legislation.¹⁷ As such, the following commentary is provided for context only.

The announcement of the Prime Minister's Award served as an indication of how the Rudd Government would be treating the Arts community:

On the positive side was the announcement by Kevin Rudd in his first 10 days in office of a Prime Minister's literary award, funded to the tune of \$1.2 million over four years, with the winner of each of the fiction and non-fiction categories to receive a \$100,000 tax-free booty. The symbolism in the commitment - that the arts will occupy a more central role in society than they did under the Howard government -

-
15. S. Dunne, *AMP Capital welcomes Government's reduction to withholding tax*, media release, AMP Capital, Sydney, 13 May 2008. Accessed on 13/06/2008 from http://www.ampcapital.com.au/K2DOCS/F24C47CB-246A-40FB-A1DC-391865E82B8D/media-release_AMP-Capital-welcomes-Governments-reduction-to-withholding-tax_14-05-2008.pdf?DIRECT
 16. P. Madden, *Australia as a regional financial hub?*, media release, Deloitte, Sydney, 13 May 2008. Accessed on 13/06/2008 from http://www.deloitte.com/dtt/press_release/0,1014,sid%253D5527%2526cid%253D205839,00.html
 17. Other than for the appropriation of funds for the award.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

was reiterated this week by the inclusion of arts, film and design as one of 10 areas to be discussed at the government's 2020 Summit.¹⁸

Melbourne University Publishing CEO Louise Adler was likewise quoted in the *Australian*:

While congratulating the Government on its new \$100,000 Prime Minister's literary award, she said the gesture needed to be “underpinned by a commitment to the cyclical regeneration of such vital organisations as the ABC and the Australia Council”.¹⁹

There has been some criticism that the judging panel will not have final say, and can instead be overridden by the Prime Minister:

Kevin Rudd has reserved the right to overrule the judges of the inaugural Prime Minister's Literary Awards, with those chosen to pick the winners discovering only yesterday that their word may not be final.

“I'd be extremely pissed off if our recommendations were not accepted,” said author John Marsden, one of the “six eminent Australians” announced yesterday for the judging panel. “I'm sure in practical terms they've only put that in case we do something scurrilous.”²⁰

Financial implications

New Management Investment Trust Regime

The Explanatory Memorandum states that the financial impact (loss of government revenue) of the new management investment trust withholding tax regime is as set out in the following table.²¹

-
18. K. Strickland & M. Boland, ‘Wishing upon a star ... only to get a politician’, *Australian Financial Review*, 7 February 2008, p. 48. Accessed on 13/06/2008 from http://parlinfoweb.parl.net/parlinfo/Repository1/Media/npaper_0/53LP60.pdf
 19. C. Perkin, ‘Song and dance about arts’, *The Australian*, 4 February 2008, p. 4. Accessed on 13/06/2008 from http://parlinfoweb.parl.net/parlinfo/Repository1/Media/npaper_3/NTJP60.pdf
 20. R. Sorensen, ‘Judges find Rudd has final say on literary awards’, *The Australian*, 1 April 2008, p. 3. Accessed on 13/06/2008 from http://parlinfoweb.parl.net/parlinfo/Repository1/Media/npaper_2/D91Q60.pdf
 21. Explanatory Memorandum, p. 3

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

2008-09	2009-10	2010-11	2011-12
-\$60m	-\$125m	-\$210m	-\$235m

Income tax treatment of the Prime Minister's Literary Award

The Explanatory Memorandum states that the financial impact of the exemption from income tax of the Prime Minister's Literary Award will be nil.²²

Main provisions

Tax Laws Amendment (Election Commitments No. 1) Bill 2008

Schedule 1

Part 1 of Schedule 1 repeals existing Subdivision 12-H of Schedule 1 of the *Taxation Administration Act 1953* (TAA 1953) and inserts **proposed Subdivision 12-H** to provide for the withholding obligations of payers, including custodians and other entities, of certain income derived by foreign residents from MITs.

Proposed section 12-375 outlines how the withholding provisions in **proposed subdivision 12-H** will operate as follows.

A managed investment trust may be required to withhold an amount from a payment of its Australian sourced net income (other than dividends, interest and royalties) if the payment is made to an entity whose address, or place for payment, is outside Australia. If the payment is made to another entity, the managed investment trust is required to make information available to the recipient outlining certain details in relation to the payment.

If a custodian receives a payment that is covered by that information, it is required to withhold an amount from any related later payment to an entity whose address, or place for payment, is outside Australia. If the later payment is made to another entity, the custodian is required to make information available in relation to that later payment.

If an entity that is not a custodian receives a payment that is covered by that information, it is required to withhold an amount from that payment if a foreign

22. Explanatory Memorandum, p. 4.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

resident becomes entitled to that payment. If a resident becomes entitled to the payment, the entity must make information available in relation to that payment.

Proposed Subdivision 12-H includes key definitions of ‘managed investment trust’ and ‘fund payment’ and ‘custodian’ considered below.

Rate of withholding

The rate at which tax is to be withheld by MITs, custodians and other entities is set out in **proposed subsections 12-385(3), 12-390(3) and 12-390(6)** respectively as follows.

The rate is:

- (a) if the address or place for payment of the recipient is in an information exchange country:
 - (i) 22.5% for *fund payments in relation to the first income year starting on or after the first 1 July after the day on which the *Tax Laws Amendment (Election Commitments No. 1) Act 2008* receives the Royal Assent; or
 - (ii) 15% for fund payments in relation to the following income year; or
 - (iii) 7.5% for fund payments in relation to later income years; or
- (b) otherwise—30%.

Proposed subsection 12-385 provides that an ‘information exchange country’ is a foreign country specified in the regulations for the purposes of this section.

Definition of Managed Investment Trust

Proposed section 12-400 of **new Subdivision 12-H**, sets out the meaning of managed investment trust (MIT).

A trust is an MIT in relation to an income year if:

- (a) the trustee of the trust makes the first fund payment in relation to the income year; and
- (b) the conditions in the table in **proposed subsection 12-400(1)** are satisfied at the time the payment is made.

These conditions are:

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

- the trustee was an Australian resident or the central management and control of the trust was in Australia (conditions in paragraph (a) and (b) respectively of table item 1 in **proposed subsection 12-400(1)**), and
- the trust is a managed investment scheme, as defined in section 9 of the *Corporations Act 2001* and is operated by a financial services licensee as defined in section 761A of that Act, whose licence covers operating such a managed investment scheme (conditions in table item 2 in **proposed subsection 12-400(1)**), and
- units in the trust are listed in an approved stock exchange in Australia (condition in paragraph (a) of table item 3 in **proposed subsection 12-400(1)** or the trust has at least 50 members, ignoring objects of a trust, (condition in paragraph (b) of table item 3 in **proposed subsection 12-400(1)**), or one of the entities covered by a paragraph of **proposed subsection 12-400(2)** is a member of the trust (condition in paragraph (c) of table item 3 in **proposed subsection 12-400(1)**).

The Explanatory Memorandum states that the requirement to ignore the objects of a trust in the condition in paragraph (b) of table item 3 is to ensure that a trust is widely held as a matter of substance.²³ Without this condition, a person could establish a trust that purports to be widely held (by having more than 50 discretionary beneficiaries) but is not widely held as a matter of substance.

The condition in paragraph (c) of table item 3 in **proposed subsection 12-400(1)** is to ensure that a trust will be considered to be widely held even if it has less than 50 members, if one of the members of the trust is an entity of a kind specified in **proposed subsection 12-400(2)**.

The entities specified are:

- a life insurance company (proposed paragraph 12-400(2)(a));
- a complying superannuation fund, complying approved deposit fund, or a foreign superannuation fund, as long as the fund has at least 50 members (proposed paragraph 12-400(2)(b));
- an Australian resident trust that is a managed investment scheme under the *Corporations Act 2001* 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) (**proposed paragraph 12-400(2)(c)**);

23. Explanatory Memorandum, paragraph 1.33, p.12.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

- 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 (**proposed paragraph 12-400(2)(d)**).

In addition, **proposed paragraph 12-400(2)(e)** provides that a trust where:

- the interests in which are owned directly or indirectly by an entity covered by an earlier paragraph; or
- the interests in which are held indirectly by an entity covered by an earlier paragraph through a chain of trusts

where the trust or each trust in the chain satisfy the conditions in **proposed paragraph 12-400(2)(c)**, is a specified entity.

Meaning of 'fund payment'

Proposed section 12-405 of **new Subdivision 12-H** of the TAA 1953 provides a meaning of 'fund payment'.

Proposed subsection 12-405(1) states that the object of this section is to ensure that the total of the fund payments that the trustee of a trust makes in relation to an income year equals, as nearly as practicable, the net income of the trust, disregarding certain excluded amounts,

These excluded amounts are:

- a dividend, interest or royalty payment that is subject to, or exempted from a requirement to withhold under Subdivision 12-F of Schedule 1 of the TAA 1953,
- a capital gain or capital loss from a CGT event that happens in relation to a CGT asset that is not taxable Australian property,
- amounts that are not from an Australian source,

and disregarding deductions relating to excluded amounts.

The reader is referred to paragraphs 1.45 to 1.57 on pages 16 to 22 of the Explanatory Memorandum for details of the ascertainment of a fund payment with an example.

Proposed subsection 12-405(2) contains a three step method statement for working out the 'fund payment'.

Steps 2 and 3 involve anticipating the expected amounts of net income for the year and any later fund payments in relation to an income year respectively by the standards of a reasonable person. It involves an estimating process which calls for subjective judgment.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

However, the Explanatory Memorandum appears to suggest that the determination whether a payment is a fund payment is one that can be done on an objective basis:

1.57 Whether it is reasonable to conclude a specific portion of the payment is a fund payment is to be determined on an objective basis. The test is whether a reasonable person would consider that portion could be expected to form a part of the net income (suitably adjusted) of the trust at the end of the income year.²⁴

It is inevitable that the practical application of the provisions of **proposed subsection 12-405(2)** will present compliance burdens for MITs and administrative costs to the Commissioner as indicated below. Foreign investors too may be involved in disputes with MITs as to what part of an actual payment is a fund payment. This may involve challenging the subjective forecasts made by MITs and the methodology followed in working out particular fund payments.

Proposed subsections 12-405(4) and (5) provide that a payment will not be a fund payment in relation to an income year unless it is paid:

- during the income year;
- within three months after the end of the income year; or
- within a longer period as allowed by the Commissioner of Taxation (the Commissioner), but not exceeding the end of the income year.

This will involve the Commissioner being required to examine the validity of applications for extensions with additional administrative costs.

Meaning of custodian

Proposed subsection 12-390(9) provides a meaning of custodian and states that an entity is a custodian if the entity is carrying on business that consists predominantly of providing custodial or depository service as defined in section 766E of the *Corporations Act 2001*, pursuant to an Australian financial service licence.

However, under **proposed subsection 12-390(10)** the provisions for withholding by custodians and other entities in **proposed section 12-390** do not apply:

- (a) to a company unless the company would, apart from **proposed section 12-420**, be acting in the capacity as agent for the recipient, or
- (b) to an amount paid or received by an entity to the extent that no managed investment trust withholding tax is payable in respect of the amount or an amount reasonably attributable to the amount.

24. Explanatory Memorandum, paragraph 1.57, p. 18.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

The reader is referred to the Explanatory Memorandum, paragraphs 1.106 to 1.120,²⁵ for details and examples of when withholding is not required by custodians and other entities.

Part 2 of Schedule 1 inserts **new Division 840** into the *Income Tax Assessment Act 1997* (ITAA 1997) to provide the rules to determine whether a foreign resident is liable to pay income tax in respect of certain Australian sourced income paid by an MIT (other than dividends, interest and royalties) to such foreign resident or which such foreign resident is entitled to receive.

Briefly, the liability for MIT withholding tax is imposed on foreign residents in respect of amounts received or amounts they are entitled to receive, in respect of fund payments of a MIT. The operative provisions are in **proposed section 840-805** and covers payments from MITs (**proposed subsection 840-805(2)**), payments from custodians (**proposed subsection 840-805(3)**) and entitlements from other entities (**proposed subsection 840-805(4)**).

When a liability to pay MIT withholding tax is established, the liability is formally imposed, and the applicable rate is provided for in Income Tax (Managed Investment Trust Transitional) Bill 2008 and the Income Tax (Managed Investment Trust Withholding Tax) Bill 2008, considered below.

Part 3 of Schedule 1 includes consequential amendments to the following Acts:

- *Income Tax Act 1986*,
- *Income Tax Assessment Act 1936*,
- *Income Tax Assessment Act 1997*,
- *Income Tax (Transitional Provisions) Act 1997*, and the
- *Taxation Administration Act 1953*

Item 58 of Part 4 of Schedule 1 provides that the amendments made by **Schedule 1** apply to fund payments made in relation to the first income year **starting** on or after 1 July after the day on which this Act receives the Royal Assent and later.

Schedule 2

The amendments proposed by **Schedule 2** are intended to exempt the Prime Minister's Literary Awards from income tax.

25. Explanatory Memorandum, pp. 30–33.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Item 1 to the Bill amends section 11-10 of the *Income Tax Assessment Act 1997* (ITAA 1997) to add the Prime Minister's Literary Awards at the end of table item headed "prizes".

Item 2 adds **proposed subsection (3)** at the end of section 51-60 of the ITAA 1997 to exempt from income tax the Prime Minister's Literary Award, if it would otherwise be assessable income.

Item 3 provides that the amendments made by **Schedule 2** apply to assessments for the 2007-08 income year and later income years.

Income Tax (Managed Investment Trust Transitional) Bill 2008

The Income Tax (Managed Investment Trust Transitional) Bill 2008 imposes income tax on amounts attributable to fund payments derived by foreign resident investors in accordance with section 840-805 of the *Income Tax (Transitional Provisions) Act 1997*.

This Bill, when enacted, meets the requirement in section 55 of the Constitution that a law imposing taxation shall deal only with the imposition of taxation and any provision therein dealing with any other matter shall be of no effect.

Proposed section 3 of the Bill provides that tax known as income tax, to the extent that that tax is payable on an entity in accordance with section 840-805 of the *Income Tax (Transitional Provisions) Act 1997*, is imposed on amounts to which that section applies.

Rate of tax

Proposed section 4 of the MIT Transitional Bill provides that the rate of tax imposed by this Act is 22.5%.

Application

Proposed section 2 of the MIT Transitional Bill provides that the Act commences on the day on which it receives the Royal Assent.

Income Tax (Managed Investment Trust Withholding Tax) Bill 2008

The Income Tax (Managed Investment Trust Withholding Tax) Bill 2008 imposes income tax on amounts attributable to fund payments derived by foreign resident investors under section 840-805 of the *Income Tax Assessment Act 1997*.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

This Bill, when enacted meets the requirement in section 55 of the Constitution that a law imposing taxation shall deal only with the imposition of taxation and any provision therein dealing with any other matter shall be of no effect.

Proposed section 3 of the Bill provides that tax known as income tax, to the extent that that tax is payable on an entity in accordance with section 840-805 of the *Income Tax Assessment Act 1997*, is imposed on amounts identified in that section as the fund payment part.

Rate of tax

Proposed section 4 of the MIT Withholding Tax Bill provides that the rate of tax imposed by this Act is:

- (a) if the entity is a resident of an information exchange country:
 - (i) 15% for fund payments in relation to the income year following the first income year starting on or after the first 1 July after the day on which the *Tax Laws Amendment (Election Commitments No. 1) Act 2008* receives the Royal Assent; or
 - (ii) 7.5% for fund payments in relation to later income years; or
- (b) Otherwise—30%.

Comparison of key features of the new law and current law

The Explanatory Memorandum (at pages 8-9) gives a summary of the key features of the proposed law in relation to the withholding tax regime and the current law. For ease of reference this comparison is set out in Attachment A to this Bills Digest.

Concluding comments

The Regulation Impact Statement proposes ongoing review of the new Managed Investment Trust withholding regime

In considering the meaning of fund payment in the Main provisions section of this Bills Digest it was pointed out that there is a requirement for trustees of Managed Investment Trust (MITs) to make subjective judgments of expectations of the net income of a trust and the expected amounts of later fund payments in relation to an income year. This is likely to result in adding to the compliance burdens of trustees as well as additional administrative costs to the Australian Tax Office (ATO). The Explanatory Memorandum states that the Government expects that the new MIT withholding tax regime will impose

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

compliance costs on MITs and interposed entities for the first and second transitional years as they will need to modify their systems to adjust to the new withholding regime. However, it states that ongoing compliance costs are expected to be minimal.²⁶

The Regulation Impact Statement (RIS) contained in the Explanatory Memorandum states that the consultation on the draft legislation was possible for a limited period. Paragraph 1.316 states:

Consultation on the draft legislation commenced following announcement of the measure in the 2008-09 Budget. As the Government intends the measure to take effect from the 2008-09 income year, it was only possible to undertake consultation for a limited period.²⁷

The proposal was first publicly announced in the 2008 Budget on 13 May 2008 and the package of bills was introduced in the House of Representatives on 4 June 2008. It would appear that the consultation period was arguably inadequate to consider the full implications of the implementation of the new final MIT withholding tax regime. The Explanatory Memorandum notes that Treasury and the ATO will monitor the new withholding tax regime, as part of the whole taxation system, on an ongoing basis.²⁸

The Treasurer in his [Budget Speech](#) on 13 May 2008 proposed ‘the most comprehensive review of Australia’s tax system since World War II’, the object of which was stated as follows:

We need a tax system that is fairer, that is simpler, that better rewards people for their hard work, that responds to our environmental and demographic challenges, that makes us internationally competitive, and that creates the incentives to invest in our productive capacity. One that supports national prosperity beyond the mining boom.²⁹

The new withholding tax regime for MITs may be part of an overall review of the taxation of trusts generally in the context of an entity tax regime to tax companies, trusts and partnerships in the same way as companies.

26. Explanatory Memorandum, pp. 3-4.

27. Explanatory Memorandum, p. 74.

28. Paragraph 1.328, p. 75.

29. The Hon. Wayne Swan, ‘Budget Speech 2008-09’, *Second Reading of Appropriation Bill (No. 1) 2008-09*, 13 May 2008. Accessed on 14 May 2008 from <http://www.aph.gov.au/Budget/2008-09/content/speech/html/speech-01.htm>

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Attachment A – Comparison of key features of the new law withholding tax on managed investment trusts and the current law

Extract from the Explanatory Memorandum - pages 8 and 9

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
The trustee of a managed investment trust must withhold an amount from fund payments paid to an entity whose address or the place of payment is outside Australia.	The trustee of a managed investment trust is liable to withhold an amount from fund payments paid to a foreign resident or to an entity whom the trustee has reasonable grounds to believe is a foreign resident.
A custodian must withhold an amount on payments representing or reasonably attributable to a fund payment paid to an entity whose address or the place of payment is outside Australia. The custodian must, in respect of amounts received by it and later on-paid, have received a notice or accessed relevant information in relation to the amounts.	An Australian intermediary (a custodian) must withhold an amount from payments representing or reasonably attributable to a fund payment made to a foreign resident or to an entity whom the trustee has reasonable grounds to believe is a foreign resident. To be an intermediary the entity must, among other things, be in receipt of a notice setting out relevant details of a payment received from another entity.
An entity that is neither a trustee of a managed investment trust nor a custodian must withhold an amount from a payment it receives if a foreign resident is, or becomes entitled, to all or part of the payment. The entity must, in respect of amounts received by it, have received a notice or accessed relevant information in relation to the amounts.	A trustee of a trust is liable to pay tax on a foreign resident beneficiary's share of the net income of the trust.

9

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

<i>New law</i>	<i>Current law</i>
There is no obligation to withhold an amount if there is no underlying managed investment trust withholding tax liability.	No equivalent.
Where withholding is required, the rate of withholding is 30 per cent, but is reduced where the recipient is in a foreign jurisdiction that has effective exchange of information on taxation matters with Australia.	Where withholding is required, the rate of withholding is at the corporate tax rate.
Where withholding is not required because the recipient is not an entity whose address, place of payment or (in some cases) residence is outside Australia, the entity making the payment is required to provide the recipient with a notice or publish certain information in relation to the payment. Failure to give a notice or make this information available gives rise to an administrative penalty.	Where withholding is not required, the entity making the payment may provide a notice with certain information in relation to the payment. Notices are not mandatory, but without a notice the entity is not considered to be an intermediary and the ordinary rules of trust taxation (rather than the managed fund withholding rules) will apply.
Managed investment trust withholding tax is a final tax. An amount on which managed investment trust withholding tax is payable is not assessable and is not exempt income.	Managed investment trust withholding tax is a non-final tax. To the extent that the net income of a trust is represented by or reasonably attributable to an amount from which withholding was required, Division 6 of the ITAA 1936 does not bring to tax the net income, and the ultimate beneficiary is entitled to a credit for a relevant portion of the amount withheld.
The rate of managed investment trust withholding tax payable is 30 per cent, but is reduced where the entity liable to the tax is resident of a foreign jurisdiction that has effective exchange of information on taxation matters with Australia.	The rate of tax payable depends on whether the foreign resident is an individual, company or trust. Tax is imposed at the relevant marginal rate.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

© Copyright Commonwealth of Australia

This work is copyright. Except to the extent of uses permitted by the *Copyright Act 1968*, no person may reproduce or transmit any part of this work by any process without the prior written consent of the Parliamentary Librarian. This requirement does not apply to members of the Parliament of Australia acting in the course of their official duties.

This work has been prepared to support the work of the Australian Parliament using information available at the time of production. The views expressed do not reflect an official position of the Parliamentary Library, nor do they constitute professional legal opinion.

Feedback is welcome and may be provided to: web.library@aph.gov.au. Any concerns or complaints should be directed to the Parliamentary Librarian. Parliamentary Library staff are available to discuss the contents of publications with Senators and Members and their staff. To access this service, clients may contact the author or the Library's Central Entry Point for referral.

Members, Senators and Parliamentary staff can obtain further information from the Parliamentary Library on (02) 6277 2469.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.

Warning:

This Digest was prepared for debate. It reflects the legislation as introduced and does not canvass subsequent amendments.

This Digest does not have any official legal status. Other sources should be consulted to determine the subsequent official status of the Bill.