
Proposed changes to the operation of the IMR and MIT Regime

21 July 2017

In brief

In a media release on 19 July 2017, the Government has announced technical amendments that will improve the Managed Investment Trust (MIT) Regime and Investment Manager Regime (IMR). These changes remove tax uncertainty that was threatening to limit the intended operation of the regimes and in turn, frustrate the Government's policy to position Australia as a regional financial centre. Importantly, the announcement reflects a genuine desire on the part of the Government to listen and respond to industry feedback.

Overview

The broad thrust of government policy is to promote Australia as a financial services centre through two initiatives: *exporting* financial services and *importing* foreign capital.

- The IMR was introduced to remove tax uncertainty that was restricting the ability of Australian fund managers to provide services to foreign investment funds and also restricting investment by foreign funds in Australian assets.
- The MIT Regime is critical as it is our prevalent collective investment vehicle, both for Australian and foreign investors. Through its evolution to the new Attribution Managed Investment Trust (AMIT), the MIT Regime forms the foundation of our new corporate collective investment vehicle (CCIV).
- Relevantly, the CCIV is foreshadowed as the Australian domiciled investment vehicle to be adopted for cross border distribution under the Asia Region Funds Passport.

The critical requirement for successful implementation of these tax regimes is *certainty*. The amendments proposed by the Government address some known points of uncertainty. As further points of uncertainty emerge, the positive sign is that Government is willing to engage with industry to listen and respond.

Investment Manager Regime (IMR)

Australia's current IMR, which has been in place since 2015, seeks to attract foreign investment to Australia and promote the use of Australian fund managers by removing tax impediments to investing in Australia. Specifically, subject to meeting the appropriate tests, foreign funds that invest via an Australian fund manager are eligible to access IMR concessions in relation to gains and losses on the disposal of qualifying financial arrangements, and can disregard certain Australian income tax consequences.

Under the IMR a foreign investor that invests in Australia through a foreign fund or an independent Australian fund manager should be in the same tax position as if it had invested directly. However, due to recent uncertainty concerning the application and breadth of Australia’s tax residency rules, this outcome has not been clear and there has been some uncertainty as to whether foreign funds that invest through an Australian fund manager could be considered Australian tax residents.

The Government has indicated that it is committed to implementing an effective IMR whilst maintaining the integrity of Australia’s tax residency rules. Specifically, it will conduct consultation on whether a legislative amendment is required to ensure that the engagement of an Australian independent fund manager will not cause a fund that is legitimately established and controlled offshore to be an Australian resident. Any legislative amendment would be retrospective to apply from the start of the IMR regime in 2015.

The clarification of policy intent, and potential clarification of the law is welcomed, as it will help reduce uncertainty and promote a key objective of the IMR, being the use of Australian fund managers.

Managed Investment Trust (MIT) Regime

The announcement includes a number of proposed amendments to the MIT Regime, affecting both Attribution MITs (AMITs) - that is, those that are eligible, and have chosen to, adopt the elective attribution regime for the taxation of MITs and their investors - and in some cases MITs that are not eligible to be AMITs, or choose not to make the election to become an AMIT.

| <i>Proposed amendment</i> | <i>Observations</i> |
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| <p><i>Amending the definition of an AMIT to ensure that single unitholder widely held entities can access the AMIT regime.</i></p> <p>Under the current AMIT rules, it appears that certain MITs that have only one unitholder may only qualify as an AMIT where that unitholder is another MIT.</p> <p>Amendments will be made to clarify that a single unitholder MIT may also qualify as an AMIT where the unitholder is a complying superannuation fund, life company or certain other types of genuine widely held investors. The amendment will not extend to a single unitholder MIT being a withholding MIT.</p> | <p>This is a welcome amendment which acknowledges that it is common industry practice for widely held entities such as superannuation funds and life companies to invest through wholly-owned MITs. It will ensure a level playing field in allowing these MITs access to the benefits of AMIT status, such as clarity over fixed trust status, character flow through, and recognition of unders and overs.</p> <p>It may also allow a wholly-owned AMIT to attribute income with no cash distribution, with a cost base uplift of the units in the AMIT. This may avoid the need for unnecessary administration regarding reinvestment processes for such long term investors.</p> <p>It is indicated that the Government will consult with industry on the treatment of platforms, wraps and master trusts, as part of the Corporate Collective Investment Vehicle public consultation process.</p> |
| <p><i>Greater alignment between CGT outcomes for MITs and AMITs – cost base adjustments</i></p> <p>The Government has indicated it will bring greater alignment in the tax outcomes between AMITs and MITs by amending CGT Event E4 where it operates in respect of the distribution of non-assessable amounts with respect to MITs (but not, it would appear, for non-MITs).</p> <p>Currently, the distribution of the non-assessable component of a discounted capital gain may require the</p> | <p>The only example provided in the Government release as to how it is intended that this alignment will be achieved is to make amendments requiring cost base adjustments where MITs make distributions of the non-assessable part of direct discount capital gains sheltered by capital losses within the MIT.</p> <p>This is the same category of non-assessable amounts in respect of which the ATO has issued “Interim guidance” in recent years, cautioning trustees of non-AMITs that it</p> |

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| <p>unit holder of an AMIT to reduce the cost base of their units whereas a unit holder of a non-AMIT in the same situation would not. Some trustees have raised concerns given these potential outcomes as to whether it is in their member's interests to enter into the AMIT regime.</p> <p>The changes will apply to distributions made in relation to the 2017-18 income years and future income years.</p> | <p>considers that the distribution of these amounts should give rise to a reduction in the cost base for unit holders, rather than being treated as a CGT concession amount.</p> <p>The Government announcement has not addressed concerns raised as to the operation of the cost base adjustment provisions for the unit holders of AMITs that produce an unfavourable result compared to the same scenario for a non-AMIT (e.g. where expenses or revenue losses are offset against discount capital gains).</p> <p>It is hoped that there will be an opportunity for further consultation to address concerns as to cost base adjustment outcomes for AMIT unit holders. Further issues may also arise from any other changes announced in relation to MIT unit holders intended to align outcomes with those of AMIT unit holders.</p> |
| <p><i>MITs with substituted accounting periods - Eligibility to become AMITs</i></p> <p>Under the current law, early balancers may not technically be able to opt into the MIT regime as early as was intended.</p> <p>Amendments will clarify that a MIT with an income year commencing other than on 1 July can elect to be an AMIT with effect from its first income year starting on or after 1 July 2015.</p> | <p>MITs with substituted accounting periods are common, particularly in the property and infrastructure sectors.</p> <p>This is a technical correction which will remove an unintended restriction and allow all eligible MITs with a substituted accounting period the option to elect into the AMIT regime from an earlier point.</p> <p>In making this amendment, the Government should have regard to the operation of transitional provisions within the MIT Regime and ensure that given the different start dates, AMITs with substituted accounting periods are able to access these if required.</p> |
| <p><i>Redefine the meaning of fund payment to ensure tax neutral outcomes</i></p> <p>This proposed amendment is intended to ensure that the calculation of a "fund payment" for both MITs and AMITs will exclude capital gains and losses on assets that are not Taxable Australian Property (TAP).</p> | <p>The intention of this technical amendment is to ensure that no scenario exists in calculating a fund payment amount whereby TAP capital gains will be offset with non-TAP capital losses. In this way, the tax implications of an investment via a MIT or AMIT should broadly align with those of a direct investment.</p> <p>Systems changes may be required by some stakeholders to reflect this outcome.</p> <p>Particular attention should be given to the drafting of amendments to the definition of "fund payment" (both in the general case and for AMITs).</p> |
| <p><i>Amendments to clarify the MIT and AMIT withholding tax rules</i></p> <p>The MIT withholding provisions will be amended to clarify that they apply to the amount of a fund payment that is attributed by an AMIT. Consequential amendments will also be made to the definition of dividends, interest and royalties to refer to AMIT dividend, interest and royalty payments.</p> | <p>Under the current drafting of the withholding tax provisions it was considered unclear that a MIT withholding liability could apply to an amount greater than the cash paid to a beneficiary (including where no cash had been paid and there was a deemed payment only).</p> <p>Since a fund payment will include the amount attributed, where the amount attributed to a taxpayer by an AMIT exceeds the amount paid, withholding will be applied</p> |

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| <p>Amendments will also be made to clarify that a deemed payment can arise where no fund payment is made for the income year.</p> <p>The application of TFN withholding to AMITs will be clarified to ensure the amount of the payment for this purpose (including deemed payments) is calculated appropriately.</p> | <p>against the attributed amount rather than the amount paid.</p> <p>This may also result in system challenges where withholding tax calculations rely on cash payments being made.</p> <p>There has been uncertainty as to the operation of the TFN withholding provisions in respect of distributions made by an AMIT, so clarification of this position is welcomed.</p> |
| <p><i>Additional transitional rules regarding franked distributions for trusts that ceased to be public trading trusts or corporate unit trusts as part of the MIT reforms</i></p> <p>The Government intends to amend the law to rectify unintended drafting issues and provide greater clarity in the operation of the transitional rules relating to the treatment of the franking accounts of trusts which ceased to be taxed as corporates from 1 July 2016.</p> <p>In particular, it will be clarified that:</p> <ul style="list-style-type: none"> • franking credits of these trusts were not cancelled when the trust ceased to be a corporate unit trust or public trading trust; • franking credits cannot be attached to distributions of post-30 June 2016 income; and • in the case of a trust that ceased to be a corporate unit trust, distributions of pre-1 July 2016 income will retain the character of a unit trust dividend when paid to a unit holder. | <p>There has been uncertainty on all these points given the current drafting of the transitional provisions.</p> <p>The proposed amendments will provide clarity and appear to align with the original policy intention that broadly speaking, during the period of operation of the transitional provisions, these trusts would effectively continue to be treated as ‘corporate tax entities’ in respect of franking account debits or credits or the payment of franked distributions.</p> |
| <p><i>Treatment of CGT discount amounts in the AMIT unders and overs regime.</i></p> <p>The AMIT unders and overs regime currently requires discount capital gains amounts to be doubled for the purposes of calculating a rounding adjustment and the trustee shortfall tax. The proposed amendment will ensure that discount capital gains are properly taken into account in the calculation of these amounts.</p> | <p>This is a technical correction intended to address uncertainty with regards to the existing provisions.</p> |
| <p><i>CGT event E10 where starting base is nil.</i></p> <p>This proposed amendment will clarify that CGT event E10 can happen in an income year where the cost base of the asset is nil at the start of the income year.</p> | <p>This is a technical correction to address an interpretative issue with the existing provisions.</p> |

The takeaway

The changes announced aim to provide greater certainty by clarifying the rules, to reduce unintended outcomes.

The question then arises as to whether the clarification amendments will themselves create further unintended outcomes. As always, this depends upon the rigour of the diagnosis and the quality of the fix.

Our observation is that the Government is moving in the right direction, both in terms of reducing uncertainty and its engagement with industry, which is to be applauded.

The competitiveness and growth of our financial services sector is important to our prosperity. This is best served when Government and industry constructively collaborate, as evidenced in these announced changes.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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