Draft legislation for proposed new Managed Investment Trust regime released

In this issue:

*Proposed new Managed Investment Trust tax regime*
Proposed new Managed Investment Trust regime

After many years of consultation, the Government has released exposure draft legislation for the proposed new tax regime for managed investment trusts (MITs) and a number of related amendments.

The MIT regime, which was originally announced in 2010 (and originally intended to apply from 1 July 2011) has been deferred numerous times over the intervening period. The draft legislation released on 9 April 2015 reflects the previously announced start date of 1 July 2015 for the new regime. However, it is understood that the Government intends to defer the start date for another year, such that the new regime will apply to income years starting on or after 1 July 2016 with an option to elect in one year earlier (for income years commencing on or after 1 July 2015).

Again, whilst not addressed in the draft legislation, it is understood that existing MITs will need to exercise a choice to adopt the MIT regime.

The draft legislation not only seeks to implement the new MIT regime, but also proposes some changes to the existing definition of MIT contained in the tax law, and makes some other related amendments.

As a result of these reforms there will broadly be three types of MITs for tax purposes:

- ‘Ordinary’ MIT: an ‘ordinary’ MIT is eligible to make a MIT capital account election which deems the MIT to hold certain assets on capital account. Ordinary MITs that do not make a capital account election in the first year that they meet the definition of a MIT are deemed to hold their assets on revenue account and carried interests are on revenue account.

- Withholding MIT: a withholding MIT has the same base outcomes as an ‘ordinary’ MIT but has the benefit of the concessional withholding provisions in respect of certain fund payments to non-residents in Subdivision 12-H of Schedule 1 of the Taxation Administration Act 1953 (TAA 1953) and Division 840 of the Income Tax Assessment Act 1997 (ITAA 1997).

- Attribution MIT (AMIT): an AMIT (and its members) will be subject to the new attribution regime outlined below (referred to hereafter as the AMIT regime), as well as a number of related amendments. The AMIT regime will be contained in the proposed new Division 276 of the ITAA 1997. An AMIT may or may not be a withholding MIT.

The rules for the taxation of trusts and their beneficiaries in Division 6 of Part III to the Income Tax Assessment Act 1936 (ITAA 1936) will continue to apply to trusts that are not MITs, to ordinary MITs and in some respects to withholding MITs that are not AMITs, and to any existing MITs that do not make the once-off choice to adopt the AMIT regime (assuming the final law is amended to include such a choice). Division 6 will not apply to AMITs and their beneficiaries.
**Key features of the AMIT Regime**

- An AMIT is a managed investment trust where the interests of members are “clearly defined”.

- An AMIT will be treated in the same way as a fixed trust for tax purposes.

- Trust components (including both taxable and non-taxable amounts, and offsets) of an AMIT will be allocated or attributed to members on a fair and reasonable basis (not based on present entitlement to distributable income).

- Streaming of components based upon the tax characteristics of members is not permitted, although examples are provided of powers considered acceptable for this purpose, (for example where the constituent documents give the trustee the power to direct an amount arising from the sale of an asset to a particular member if the member redeems its interests in the AMIT and the streaming is done to fund the redemption).

- “Unders” and “overs” will be determined on a component by component “character” basis, and are generally carried forward and dealt with in the year of “discovery”. There is a four year time limit on the discovery of “unders” and “overs”.

- Where net “overs” of offset characters and/or net “unders” of other characters are material, those amounts must be increased or "uplifted" to compensate the revenue for the delay in tax receipts. The trustee will have the ability to reissue annual tax statements to avoid the uplift arising to the trust and shift the burden of any interest and penalties to the members.

- Administrative penalties can apply to the trustee of an AMIT where material “unders” and “overs”, as defined, arise due to intentional disregard of a taxation law or recklessness by the trustee as to the operation of a taxation law.

- AMITs will be required by law to provide members with annual tax statements within three months of the end of the income year.

- Members of an AMIT will be taxed on the parts of the AMIT's trust components that are attributed to them as if they derived those amounts in their own right and in the same circumstances as the AMIT.

- Members of AMITs will make adjustments to the cost base of their units in the AMIT where the distribution or money or property they receive is more than (downward adjustment) or less than (upward adjustment) their allocated share of the trust components.

- Subject to a limited transitional rule, the trustee of the AMIT will be liable to pay tax on any non-arm's length income derived by the trust. Tax will be levied at 47 per cent on the portion that exceeds the arm’s length amount. Interest income will not be subject to the non-arm’s length income rule if it is within a specified safe harbour.
Details of the proposed new rules

Changes to the existing definitions of MIT

As part of these measures, there will be some changes to the existing definitions of MIT currently contained in Subdivision 12-H of Schedule 1 of the TAA 1953 and in Subdivision 275-A of the ITAA 1997. These definitions apply for both withholding tax and capital account election purposes. While the changes appear substantial in that the primary definition of MIT is moved out of the TAA 1953 and into Subdivision 275-A, the requirements for a MIT that is subject to the withholding tax provisions and the capital account election are largely unchanged. The primary difference between an ordinary MIT (able to elect capital treatment) and a withholding MIT (also benefitting from the fund payment withholding rules) remains that a withholding MIT must have a substantial proportion of its investment activities carried out in Australia.

There will be, however, some welcome changes to the qualification rules for an ordinary MIT (which will be relevant for all purposes), including:

- From 1 July 2014, expanding the list of qualifying entities to include foreign life insurance companies and to allow tracing through entities (including companies) that are wholly owned by one or more qualifying entities. The current provisions only allow tracing through wholly owned subsidiaries of certain types of qualifying investors and where the entity is wholly owned by a single qualifying investor. This is a welcome change as entities that would otherwise be qualifying that chose to invest via a “blocker” entity (generally a company) can cause a trust to fail the widely held requirement under the existing rules; and

- Increasing the start-up concession period to a maximum of 2 years from the existing maximum of 18 months. This will give MITs additional time to meet the widely held and closely held criteria. This change will apply from the time that the AMIT provisions take effect.

The new regime for Attribution MITs

What is an Attribution MIT?

Broadly, a trust will be an Attribution Managed Investment Trust (AMIT) where it is an “ordinary” MIT under the proposed new definition to be contained in Subdivision 275-A and where the interests of members in the trust are “clearly defined”. There is no requirement for an AMIT to have a substantial proportion of investment management activities within Australia - this requirement will be limited to withholding MITs (although an AMIT may also seek to benefit from the withholding tax concessions).

The members of a trust will have clearly defined interests where:

- the amounts of each member component for the income year of each member of the trust can be worked out on a fair and reasonable basis (see below for further details regarding attribution of amounts to members); and

Changes to the definition of MIT will be welcomed by foreign investors and domestic fund managers
• the right of each member of the trust to the income and capital of the trust cannot be materially diminished through the exercise of a power or right.

There are additional requirements for trusts not registered under the Corporations Act 2001, specifically:

• the trustee is under an obligation to treat members of the same class and members who hold different classes fairly; and

• the constituent documents of the trust can only be modified, repealed or replaced by either a resolution that requires 75% approval of members based on votes cast, 50% approval of members based on total votes that may be cast by members eligible to vote, or by the trustee where the trustee considers that such a change will not adversely affect members’ rights.

There is also a discretion for the Commissioner to determine that a trust has clearly defined interests.

Existing MITs will need to review their trust deeds to determine whether members of the trust have clearly defined interests. Many deeds will need to be amended to allow attribution of taxable income to members (discussed further below). Depending on the extent of the amendments to the trust deed required, this may give rise to a risk of trust resettlement, with consequential tax and duty implications. The EM acknowledges this concern and refers to Taxation Determination TD 2012/21 which sets out the ATO’s views on resettlement.

The new AMIT regime makes provision for trusts that have multiple classes of units or interests. An irrevocable choice will be available to effectively quarantine the revenue and capital losses of each class. Some managers may prefer this position as it will mean that losses in one class will not impact on other classes. In these circumstances, each class of interest in the AMIT will be treated as a separate AMIT, and the attribution regime applied accordingly to each class of interest.

An AMIT will be deemed to be a fixed trust for tax purposes as each member will be treated as having a vested and indefeasible interest in their share of income and capital of the trust – this is also a welcome change, as the difficulties with the current definition of “fixed trust” can be substantial, as are the consequences of failing to satisfy it (including the inability to carry forward and utilise prior year revenue losses, and the inability to flow out franking credits to beneficiaries).

**What is the attribution model of taxation?**

Division 6 of Part III of the ITAA 1936 will not apply to AMITs; rather the AMIT and its members will be taxed under an “attribution model”.

Rather than focusing wholly on the taxable income of the trust, the attribution model requires the trustee to determine “trust components” which includes both taxable and certain non-taxable amounts, and offsets. Each component has a specific AMIT character, and the trustee of the AMIT then attributes these components to members based on their membership interest. This is referred to as the member’s “determined member component” - that is, the amount stated to be the member’s share of each trust component in an annual statement provided by the AMIT, known as the AMIT member annual statement (AMMA statement).
Categories of AMIT Character | Sub-types
---|---
Income AMIT character | Discount capital gains and other capital gains from both taxable Australian property and assets that are not taxable Australian property
| Ordinary and statutory income from a source other than an Australian source
| Other ordinary and statutory income
Exempt AMIT character | Net exempt income derived by the trust
NANE AMIT character | Non-assessable, non-exempt income derived by the trust net of any expenses and foreign taxes
Offset AMIT character | Franking credits
| Foreign income tax paid by the trust

There are four types of AMIT characters, and a number of sub-types, which are outlined in the table above. Additional sub-types can be determined by legislative instrument. The AMIT will determine its trust components on the basis that the trustee is an Australian resident and is liable to pay tax, disregarding certain provisions that would otherwise provide anomalous outcomes. Special rules also apply in relation to the allocation of deductions against income and offset characters, as discussed further below.

Rules for allocation of deductions
The AMIT regime contains specific rules for allocating deductions to trust components. Broadly, deductions are allocated as follows:

- Deductions that relate directly to an amount of assessable income making up a trust component should be applied to reduce that assessable income first;
- Deductions that relate to more than one amount of assessable income should be apportioned between those amounts on a reasonable basis; and
- Any remaining deductions should be apportioned between the remaining amounts of assessable income on a reasonable basis.

A member will be subject to tax on amounts of an income AMIT character as stated in the AMMA statement as if the member had derived the amount or made the gain in its own right and in the same circumstances as the AMIT. The amount on which the member is assessed is not linked to any cash distribution received by the member, or to a present entitlement to distributable income. Similarly, a member will be entitled to offsets for amounts of an offset AMIT character, as stated in the AMMA statement, as if the member had paid the amount reflected in the AMMA statement in its own right and in the same circumstances as the AMIT.

In attributing trust components to members, the AMIT is required to follow the general principles stated below:

- The attribution must be worked out on a fair and reasonable basis in accordance with the constituent documents of the AMIT; and
- The attribution must not involve streaming of character amounts to members based on their tax characteristics. Examples are provided of powers of the trustee that will be considered acceptable in applying this test. One is where the constituent documents give the trustee of the AMIT the power to stream an amount arising from the sale of an asset to a particular member if the member redeems membership interests in the AMIT and the streaming is done to fund the redemption (sometimes referred to as “CGT stuffing”).
As a safeguard, if these principles have not been followed in attributing amounts to members, the member may determine its share of the trust components by applying the same principles, and choose to be assessed on this replacement amount. This choice must be made in writing and given to the Commissioner within four months after the end of the member’s income year. The member must also notify the trustee in writing where it disagrees with the amounts attributed to it by the trustee. Where this occurs, if the Commissioner is satisfied that both the member and the trustee of the AMIT have determined amounts on a fair and reasonable basis, the policy intention is that there will be no additional consequences for the AMIT or any of its members.

**Treatment of Unders/Overs**

The AMIT regime contains specific rules for dealing with “unders” and “overs” – that is, variances in amounts determined at the trust level which in most cases will be carried forward and dealt with in later years. These rules attempt to legislate what has long been industry practice in this area, but also require the AMIT to adjust (“uplift”) the amount of certain adjustments in later income years if the variances are considered to have a negative impact on the revenue. They also provide for administrative penalties in certain circumstances.

“Unders” and “overs” are to be determined on a character-by-character basis. An “under” or “over” for a particular AMIT character component is the difference between the total of the amounts stated in the AMMA statement and the actual component. An under-estimation in an income year of a particular character results in an “under” of that character, and an over-estimation results in an “over” of that character. Under these rules, “unders” and “overs” will arise, and be dealt with, in the year in which they are discovered (called the discovery year).

Broadly, “unders” and “overs” are adjusted against amounts of the same character in the year in which they are discovered. This is done by way of a formula set out in the legislation. Where the trust has excess “overs” in an income year of an AMIT income character (that is, it does not have enough income in the discovery year to fully absorb a prior year “over” in an AMIT income character amount), the excess is able to be offset against other income AMIT character amounts on a “reasonable basis”, with any remaining amount carried forward to the next income year.

Where an excess “over” of a franking credit offset character arises (that is, where the trust does not have enough offsets in the discovery year to fully absorb a prior year “over” in respect of franking credits ), the trustee of the AMIT will be liable to pay income tax at a rate of 100 per cent on the excess amount. Practically, this means that an “over” in franking credits will result in a tax liability for the trustee of the AMIT if it cannot be absorbed in the year of discovery.

However, where such an excess “over” relates to a foreign tax offset character, the trust component for foreign source income is increased by the amount of the “over” grossed up by the corporate tax rate, rather than a penalty being imposed.

The trustee of an AMIT may choose to reissue AMMA statements for the income year to which an “under” or “over” relates instead of making an adjustment in the discovery year. Where this choice is made, the general provisions regarding “unders” and “overs” (including penalties and uplifts) will not apply.
There is a four year time limit for the discovery of “unders” and “overs”. This means that for investors considering acquiring a significant stake in an AMIT, full due diligence covering a four year period should be carried out to limit the potential for the acquiring investor to become subject to tax on any shortfall amounts (i.e. arising as a result of unders discovered within the four year time limit).

Strangely the proposed period for reissuing an AMMA statement is 3 years after the end of the income year which leaves a period of one year for which there may be “unders” and “overs” but for which the trustee cannot reissue an AMMA statement.

**Transitional rules for unders and overs**

Where the trust has “unders” or “overs” prior to the commencement date of the AMIT regime (referred to as transitional amounts), there will be several options for dealing with these.

Broadly, an AMIT can choose to transition the amounts and treat them as “unders” and “overs” in the new AMIT regime. If the “under” or “over” is transitioned into the AMIT regime it will not be subject to any uplifts that may otherwise apply if the net error threshold would be exceeded. Alternatively, the AMIT can take steps to address the error in line with the existing trust taxation rules in Division 6 of Part III of the ITAA 1936, which generally would require the AMIT to re-issue statements to beneficiaries in relation to the year of the error.

**Ceasing to be an AMIT**

If a trust ceases to be an AMIT, it will be required to continue to identify “unders” and “overs” that relate to years during which it was an AMIT and will generally make adjustments for these in the discovery year.

**Uplifts**

Broadly, where the total of net “unders” of income, exempt and NANE amounts and net overs of offset amounts (“overall base year shortfall”) for a base year exceeds a “net variance threshold”, a trust will be required to increase an income AMIT character for which there is an under and decrease an offset AMIT character for which there is an over at the trust level (both referred to as “uplifts”. The net variance threshold is the greater of five per cent of the sum of the trusts components (broadly equal to its trust’s taxable income plus its exempt and non-assessable non-exempt income) for the base year (the year to which the variance relates) and 0.4 per cent of the net asset value of the trust at the end of the base year, as determined according to accounting principles. The uplift amount is broadly calculated as an amount of shortfall interest charge that would be payable for a period beginning four months after the end of the base year, and ending at the end of the discovery year. No uplift will be required for an under where the AMIT would have been in a loss position taking into account the under.

The above rules are likely to require a detailed review of compliance systems.

**Penalties**

The trustee of an AMIT will also be liable for an administrative penalty where the trust’s overall base year shortfall (as discussed above) or overall base year excess (i.e. where the total of net overs of income, exempt and NANE amounts and net unders of offset amounts) exceeds the net variance threshold for the income year if this arose due to intentional disregard of a taxation law or recklessness by the trustee as to the operation of a taxation law. The penalty will be 47 per cent (or 49 per cent if the income year corresponds to a year in which the Temporary Budget Repair levy applies) of the following amounts:
## Reason for breach:

<table>
<thead>
<tr>
<th>Reason for breach:</th>
<th>Overall base year shortfall</th>
<th>Overall base year excess – the greater of</th>
</tr>
</thead>
<tbody>
<tr>
<td>Intentional disregard of a tax law</td>
<td>75% of the shortfall</td>
<td>(a) 30% of the excess; and</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(b) 60 penalty units*</td>
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<tr>
<td>Recklessness as to the operation of a tax law</td>
<td>50% of the shortfall</td>
<td>(a) 20% of the excess; and</td>
</tr>
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<td></td>
<td></td>
<td>(b) 40 penalty units*</td>
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</tbody>
</table>

* a penalty unit currently being $170

## Shortfalls

In addition to the penalties outlined above, there are a number of other scenarios where the trustee of an AMIT may be liable to pay tax in relation to what are known as “shortfalls”. This may occur, for example, where the trustee of an AMIT makes an error in attributing amounts to members in certain circumstances which result in some or all of the taxable income of the AMIT not being attributed to members, or where under of an income character or overs of an offset character are not properly carried forward. In these circumstances, the trustee of the AMIT will generally be liable to pay tax on the shortfall at the top marginal tax rate (including the Medicare levy and the Temporary Budget Repair levy, if applicable).

## Cost base adjustments

Annual cost base adjustments will occur where there is a difference between the distribution received by a member and the amounts included in the member’s assessable income under the AMIT regime. A new CGT event, E10, will occur where the cost base of the member’s interest in the AMIT has been reduced to nil, and a capital gain will arise equal to the excess. CGT event E10 will not happen where a member holds its interest in the AMIT on revenue account or as trading stock.

In contrast to the existing cost base rules (under CGT event E4), the new rule for AMITs will allow both upward and downward cost base adjustments to occur. The upward adjustments are intended to capture amounts included in the member’s assessable income on an attribution basis that are not received – that is, where the actual distribution falls short of the attributed (taxable) amount. This will ensure that the same income does not effectively get taxed twice.

The draft legislation also provides for similar cost base adjustments for members that hold their interests on revenue account. These will be treated broadly in a similar manner to that for capital holders outlined above (unless certain TOFA elections have been made).

## Treatment of tax deferred distributions

There has been long running uncertainty as to the treatment of tax deferred distributions, in particular for investors holding their interests on revenue account, with the ATO in the past arguing that these gave rise to immediate revenue gains. The rules for AMITs seek to deal with this issue by effectively creating a code for the treatment of these amounts as an adjustment to cost base. The introduction of a new rule to clarify this outcome is welcome news.
**Obligation to provide AMMA statement**

All AMITs will be required by law (with some limited exceptions) to provide members with an AMIT member annual statement (AMMA statement) within 3 months after the end of the income year setting out various details including:

- the amount that is to be distributed to the member;
- the extent to which an amount is a distribution of capital;
- the member’s allocated share of the trust components; and
- the amount of any CGT cost base adjustments required to the member’s units.

If the AMMA statement is not provided within 3 months after year end, the trustee will be liable to an administrative penalty.

As noted above, the trustee will in most circumstances have the ability to reissue the AMMA statement to rectify an “under” or “over” instead of carrying it forward and adjusting in the year of discovery.

**Interaction with withholding tax provisions**

Proposed new Division 12A of Schedule 1 of the TAA 1953 will modify the operation of the existing rules in Subdivision 12-H as it would apply to AMITs, and provides a new withholding tax obligation for AMITs on provision of an AMMA statement. Division 12A broadly treats the provision of an AMMA statement as a deemed fund payment equal to the sum of the taxable components reflected on the AMMA statement. As such, there are broadly three types of fund payments that need to be considered:

1. **Cash payments made during an income year, or after the end of an income year but before the issue of an AMMA statement in respect of that year. These fund payments will be subject to a modified operation of Subdivision 12-H. The amount of the fund payment will be determined in a similar manner to the existing method statement in Subdivision 12-H, with reference to taxable member components of an income AMIT character.**

2. **Deemed fund payment on provision of an AMMA statement. The withholding tax obligation that arises on provision of an AMMA statement broadly provides for “top-up” tax to be paid by an AMIT or custodian. This is discussed further below.**

3. **Cash payments made at the time of, or after, the provision of an AMMA statement and referable to the amount reflected in the AMMA statement. This is known as a “parallel actual payment”. The operation of the withholding provisions in Subdivision 12-H is switched off in respect of the parallel actual payments.**

**Deemed fund payment on provision of an AMMA statement**

Proposed new Subdivision 12A-B contains the withholding tax obligations in relation to deemed fund payments on provision of an AMMA statement. This is essentially a mechanism for “topping up” the amount of tax previously withheld on cash payments where this does not equal the amounts reflected in the AMMA statement to which withholding tax would normally apply.

Where the AMIT makes fund payment distributions directly to non-residents, the trustee of the AMIT must pay an amount of top up tax (at 15 or 30 percent, as applicable) to the Commissioner of Taxation.
Where the deemed fund payment is made via a custodian, the custodian is required to pay the top-up tax to the Commissioner, unless this exceeds the cash distribution paid by the AMIT, in which case the custodian will provide a notice to the trustee of the AMIT specifying the amount of the top-up tax required. By doing so, the custodian will effectively transfer the obligation to pay the top-up tax back to the AMIT.

If the deemed fund payment is made via an entity that is neither a custodian or a managed investment trust, the other entity is required to pay the top-up tax to the Commissioner, unless this exceeds the cash distribution paid by the AMIT. There is no obligation for the AMIT to pay the top-up tax in this scenario, rather the beneficiary retains the obligation under Division 840.

**Dividend, interest and royalty payments**

Amendments are also proposed to the dividend, interest and royalty withholding provisions to ensure they operate effectively for deemed payments made by AMITs on provision of an AMMA statement. In a similar mechanism to that outlined above for fund payments, the AMIT or custodian will be required to withhold an amount in respect of a deemed payment where the payment consists of dividend, interest or royalties and is subject to withholding tax.

**Arm’s length rule**

An arm’s length rule (which is based on the superannuation arm’s length rules) will be introduced which will see the trustee liable to pay tax at 47 per cent on any net income that is deemed to be “non-arm’s length income”. Broadly, “non-arm’s length income” will include any ordinary or statutory income derived by an AMIT under a scheme where:

- the parties are not dealing with each other at arm’s length and the income exceeds the amount that the entity might have been expected to derive if those parties had been dealing with each other at arm’s length; and
- at least one party to the scheme is not an AMIT.

In a welcome move, the Government has excluded from “non-arm’s length income” distributions from corporate tax entities, and distributions from trusts that are not party to the scheme under which the AMIT derived the income. Additionally, safe harbours have been included in relation to interest income so that it will not be caught by the non-arm’s length rule if it does not exceed the greater of:

- the benchmark rate of return for the interest, and
- the base interest rate for the day on which the return is paid or provided plus 3 percentage points (the base interest rate is broadly the 90 day bank bill rate published by the RBA).

The trustee will only be liable to tax in respect of any amount that exceeds the arm’s length amount, and this can be further reduced by any deductions attributable to the non-arm’s length income. Any amounts that are subject to taxation at the trustee level under this rule will not be included in the trust components that are attributed to members under the attribution model.

Cross staple arrangements would likely fall within this category where an AMIT is receiving income from the stapled company, including interest income (but subject to the safe harbour) and rental income. Whilst not stated in the draft legislation, the Explanatory Memorandum, states that the non-arm’s length rule is not intended to apply to the quantum of a loan but rather to the interest rate on cross-staple loans. Rent received by an AMIT in under a cross-staple arrangement is also likely to be caught. As the test requires the parties to be dealing at arm’s length to
avoid breaching the rule, it will be of utmost importance for appropriate rent profiling and benchmarking to be carried out and expert advice sought regarding the appropriate arm’s length rent.

Additionally, arrangements entered into by entities owned by the AMIT (ie. non-AMIT sub-trusts) may fall within the rules as the income distributed by these entities to the AMIT may be seen to be non-arm’s length income derived by the AMIT.

Whilst, the stated policy of the arm’s length rule is to apply only to income of an AMIT, as this income can include distributions from sub-trusts, the current draft wording means that sub-trusts must also ensure their expenses are on an arm’s length basis otherwise the distributions from the sub-trusts to the AMIT may be non-arm’s length income. This dramatically expands the scope of the rule and the resulting compliance costs and risk level.

As a result, arrangements such as long term construction contracts, investment management agreements, property management agreements and financing (including hedging arrangements) may fall within the ambit of the arm’s length rule.

The Government has included a limited transitional rule to allow existing MITs to restructure their arrangements. The arm’s length rule will not apply to income derived by the AMIT before 1 July 2017 where it relates to a scheme entered into by the AMIT before the introduction of these rules into Parliament.

**Debt-like instruments**

The AMIT regime will include a specific rule to deal with debt-like instruments issued by AMITs. For the purposes of working out whether a managed investment trust qualifies as an AMIT and applying the attribution model, certain debt-like instruments will be treated as debt interests. This will have a number of flow-on effects, including:

- the trustee will not be required to attribute any trust components to the holder of a debt-like instrument;
- distributions made to the holder of a debt-like instruments will, in most cases, be deductible in working out the AMIT’s trust components;
- the debt-like instrument will count toward an entity’s thin capitalisation debt capital amount; and
- interest withholding tax may apply to a distribution made to a non-resident holder of a debt-like instrument as though it was a payment on a debt interest.

**Other proposed amendments**

**20 per cent rule for public trading trusts**

Under Division 6C of the ITAA 1936, a public unit trust that does not carry out a wholly eligible investment business can be taxed in a similar manner to a company. The existing rule in Division 6C which deems a trust to be a public unit trust where certain exempt entities and superannuation funds hold 20 per cent or more direct or indirect interests in the trust is to be repealed with effect from 1 July 2015. This is a welcome move that will alleviate many of the problems associated with superannuation funds investing in trusts.

There are a number of transitional issues that will need to be considered for trusts that cease to be public trading trusts as a result of this change in the law, including the ability to pass out franking credits in respect of tax while the trust was subject
to tax like a company. Public trading trusts that have elected to be the head company of a tax consolidated group will be unaffected by this change, as they will continue to be treated as companies for all purposes of the income tax law.

**Repeal of Division 6B**

It is also proposed that Division 6B of Part III of the ITAA 1936, which sought to tax corporate unit trusts in a similar manner to companies, will be repealed with effect from 1 July 2015. The transfer of businesses or assets by a company into a trust should be captured by the application of the proposed arm’s length rule for AMITs, and therefore, as recommended by the Board of Taxation, Division 6B should no longer be required.

**Let’s Talk**

For a deeper discussion of how this issue might affect your business, please contact:

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