A new tax system for managed investment trusts

Treasury Discussion Paper - October 2010

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Introduction

Thank you for the opportunity to provide these comments and submissions in respect of the new system of taxation for managed investment trusts (**MITs**). We consider these reforms are both necessary and important in encouraging investment in Australian managed investment trusts and in improving Australia's credentials as a regional financial services centre. Accordingly, we welcome the reforms and the opportunity to participate in the consultation process.

We provide some general comments below by way of introduction. Our specific comments and submissions on the consultation questions follow in the report.

The application of Division 6 is generally regarded as both technically challenging and practically difficult to administer. One of the reasons for this 'complexity' is the structure of the Division which requires the Commissioner of Taxation (**the Commissioner**) to be concerned (and potentially engaged) in issues of trust administration which are beyond the scope of tax administration and the efficient collection of tax. This is problematic for the Australian Taxation Office (**ATO**), industry and practitioners alike. The Australian Taxation Office decision impact statement which issued on 2 June 2010 following the High Court decision in *Commissioner of Taxation v. Phillip Bamford & Ors* identified the following trust issues as uncertain:

(a) what constitutes a receipt or an outgoing of a trust for the purposes of ascertaining the trust's distributable income of a period;

(b) the extent to which accounting principles are relevant in identifying and measuring the apportionable receipts and outgoings of a trust and therefore the trust's distributable income of a period (for example, cash versus accruals bases);

(c) whether a trustee can identify and measure the trust's distributable income using an accounting methodology that differs from the accounting methodology the trustee uses to account to beneficiaries as to the condition of the trust estate from period to period;

(d) the effect for trust law purposes of provisions in trust instruments (or trustee determinations) which purport to equate the trust's distributable income with its [tax] net income where the [tax] net income includes notional amounts (eg. franking credits or deemed capital gains) or where the time at which income is recognised for tax purposes differs from the time at which it is recognised for trust accounting purposes (eg. where trust assets are accounted for at fair value);

(e) how a trust's distributable income is to be determined where the trust instrument employs different notions of income for different purposes;

(f) the principles to be applied in identifying the section 97 'income of the trust estate' if a particular trust does not distinguish between income and capital for the purposes of ascertaining beneficiary entitlements to trust property;

(g) how paragraphs 97(1)(a), (b) and (c) are to be reconciled;

(h) how the statutory flow through provisions such as Subdivision 115-C of the ITAA 1997 (capital gains and trusts) and Subdivision 207-B of the ITAA 1997 (franking credits and trusts) interact with Division 6 given that a beneficiary's liability to be assessed on the [tax] net income of the trust under Division 6 may not correspond with the beneficiary's actual entitlement; and

(i) the manner in which Division 6 interacts with other provisions which rely on a beneficiary's present entitlement to the income of a trust (for example, Division 11A of the ITAA 1936).

The decision impact statement also notes that … *It has been suggested by some commentators that the High Court's observations about the manner in which the taxation law deals with trusts as distinct from companies (see paragraphs [19] and [20]) and the way in which it illustrated the differences between the parties' contentions as to 'that share' (see paragraph [15]) support the view that:*

- *amounts distributed to beneficiaries by trustees always retain the same character in the hands of the beneficiaries for trust and tax law purposes as they had in the hands of the trustees for those purposes; and*
- *Division 6 is an exclusive code for the taxation of beneficiaries.*

The Commissioner does not accept that the abovementioned passages can be read in that way and, in any event, he notes that those issues were not before the Court.

We submit that the following principles are important in formulating the new system of taxation for managed investment trusts:

- a trust is a conduit relationship and should be treated as such for taxation purposes;
- conduit treatment suggests that character flow through for income categories and tax attributes should apply for the investor;
- any new system of taxation for managed investment trusts should (wherever possible) not require the Commissioner to direct or engage in issues of trust administration.

If you require any further information in relation to the submissions and comments included in this report please do not hesitate to contact us.

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Responses to specific consultation questions

Consultation Question 1 - Whether any or all of the rules about trusts as MITs for the purposes of the capital account election (Division 275) should be incorporated in the concept of a MIT that applies generally to the treatment on MITs for income tax (but not withholding tax)?

We consider that any new system of taxation for managed investment trusts should apply a single and uniform definition for tax purposes. This is preferred from a simplicity perspective. Accordingly we consider that the definition of a MIT for the capital account election should be consistent with the definition of a MIT for any new system of taxation.

The concessions which currently apply for the MIT capital account election should apply equally for any broader MIT tax regime.

Consultation Question 2 - Should the core clearly defined rights rules (CDRR) be supplemented by tests which would allow some types of MITs (eg registered MISs) to automatically satisfy the requirement in situations where rules already operate to prohibit a MIT from acting in a manner inconsistent with the core rules? If yes, in which situations should these tests apply?

We understand that a registered MIS must have a constitution, and that constitution must set out the income entitlements of members in the MIS. All parties are bound by this constitution. In addition, a Responsible Entity has fiduciary duties to the members of the MIS which impose clear obligations that must be exercised by the Responsible Entity. In this regard, due to the operation of the Corporations Law, including common law and equity principles, the members of registered MIS' should have defined rights and entitlements to the income and capital of the MIS. On this basis, we would recommend the CDRR include a provision which states that registered MIS' are deemed to satisfy the CDRR. This would ensure that registered MIS' have a clear 'gateway' or ‘pathway’ into the attribution method of taxation –which is appropriate where such entities would ordinarily satisfy the CDRR in any case.

We consider however that supplementary rules in addition to the CDRR may add further complexity to the core rules. Maintaining simplicity and consistency for those entities that qualify as MITs should be preferred and accordingly we prefer an approach which deems certain requirements to be satisfied.

Consultation Question 3 - Would it be possible for the clearly defined rights rules ("CDRR") to accommodate trustee powers to accumulate income in the trust or issue units at a significant discount without impacting on the integrity of the rules?

In principal, we consider that it will be possible for the CDRR to accommodate trustee powers to accumulate income in the trust provided the issue and redemption price under the trust is calculated at NAV (net asset value) or NAV net of transaction costs. This follows because any investor will continue to have an entitlement to this accumulated income through the unit redemption price and any new units will issue at a price which reflects the accumulated income.

However, the issue of units at a significant discount may impact on the integrity of the CDR rules. Where there are circumstances in which the issue of units at a discount is permitted, it will be necessary to introduce integrity rules. In particular, the following issues would need to be considered:

(a) How should the rules be developed? For example, should they be principle based with specific examples in the explanatory memorandum providing situations covering off the main areas that would satisfy the CDRR (ie when the market value of the units is considered to be impacted)?;

(b) Will there be defined testing times or would it be continuous?; and

(c) Will there be de-minimus rules and thresholds?.

ETFs or registered managed investment trusts may be excepted from these integrity rules.

Consultation Question 4 - Is it appropriate to describe 'constituent documents' by way of a general principle, similar to the approach adopted by the Board in its report, or should specific rules which list those documents that form a part of a MIT's constituent documents be adopted?

We submit that it would be more appropriate to describe constituent documents by way of a general principle (supported by examples in the legislative notes or explanatory memorandum to provide additional guidance where this will facilitate interpretation). In our view, specific listing rules can be too prescriptive and it will be difficult to list all the appropriate documents or instruments that would be required to evidence clearly the rights of beneficiaries in all cases. What is important is that there are 'constituent documents' entered between or which govern the arrangements between the investor and the Responsible Entity or trustee.

Consultation Question 5 - Are specific rules required to ensure that amounts of tax income are appropriately attributed where a unit in a MIT is sold or redeemed during an income year? If so, what rules would be appropriate?

In our view, it is not strictly necessary to introduce specific rules to ensure that appropriate amounts of taxable income are attributed in circumstances where units are sold or redeemed since the requirement to allocate the taxable income on a 'fair and reasonable' basis should result in an appropriate attribution of taxable income. In devising appropriate rules, we submit that the overriding objective should be to ensure certainty of tax liability for investors while allowing the trustee to administer trust matters independently of any ATO involvement. This is subject to the guiding principles that the trustee must allocate the taxable income of the MIT between the beneficiaries on a fair and reasonable basis, consistent with their rights under the constituent documents.

One issue which could be clarified in formulating these requirements is a relaxation of any strict requirement that may suggest a need to correlate the time of derivation or receipt of the taxable amount with the time of allocation of taxable income.

Net capital gains for example will only be calculated at financial year end but it would be reasonable to allocate capital gains progressively to investors, including those investors which may redeem during the income year. A strict 'correlation' requirement would demand that any net capital gains only allocate to investors of the register at 30 June. This would be inequitable and could result in a redemption 'run' at year end. Accordingly, confirmation that although the taxable income may be calculated on a financial year end basis, the attribution of that income may occur progressively throughout the relevant income year, including to redeeming unitholders where this is consistent with a 'fair and reasonable' approach.

Consultation Question 6 - Would compliance issues be raised by a requirement under the attribution method that tax losses in respect of one class of unit holders cannot be used to reduce the tax income of another class of unit holders?

This fundamentally involves the following issues:

- issues of equity and fairness between the interests of the separate classes of investor and between existing, future and redeeming investors,
- tax timing - claiming tax losses in the current or following year ; and
- compliance burdens for the trustee (in being able to track and offset the losses in the current or subsequent year.

Compliance issues will be raised under the attribution method where tax losses in respect of one class of unit holders cannot be used to reduce the taxable income of another class of unit holders. In particular, it will be necessary to monitor and quarantine the losses according to each class. Quarantining losses in this way may be appropriate if there are in fact multiple trusts for tax purposes (that is, the trust property is held under separate trusts for separate classes of units) but in many cases the different classes will reflect separate fee arrangements rather than separate trusts in relation to separate assets. Moreover, loss quarantining may raise compensation issues for trustees and investors that will need to be addressed through the investment and pricing process.

Consultation Question 7 - Are any modifications to the proposed attribution rules needed to trustees of trusts where units may be traded on a more regular basis (compared to unlisted trusts), such as listed property trusts or exchanged traded funds?

Please refer to our response at question five. Any accumulated income should be reflected in the unit price received by the vendor and paid by the purchaser but the attribution of taxable income on a fair and reasonable basis should result in each of the vendor and purchaser being taxed on their appropriate share of the taxable income derived during the year.

Consultation Question 8 - What would be an appropriate principle for the proposed anti-streaming provision?

We consider that the integrity concerns to be addressed by Treasury in relation to anti-streaming and the excessive abuse of powers should be dealt with independently of the proposed MIT regime, since we consider these rules should be broader in application and not necessarily confined to MITs.

We submit that specific anti-streaming provisions are necessary in circumstances where investors have not paid a market value price (determined by reference to net asset value) for their entitlements in the MIT. In drafting the anti-streaming provisions, this underlying principle should establish clear guidelines (and examples provided for in the legislative notes or explanatory memorandum) to determine when the rules would be triggered.

We consider that where there is no valid commercial reason for making the change in a MIT's constituent documents, the general anti-avoidance provisions would apply.

We recommend that caution should be exercised to ensure that the proposed anti-streaming provisions are not too widely drafted which can lead to unintended consequences for legitimate transactions. For example, where a specific class of unitholders subscribe for units in a MIT and the subscription monies are used to acquire a class of assets (eg shares in a foreign company), the anti-streaming provisions should not apply in respect of the derivation of the income from that class of asset (even where foreign sourced income is subject to concessional treatment in the hands of non-resident unitholder).

Consultation Question 9 - If certain types of MITs (eg MISs) were to be treated as automatically eligible for the attribution method, would it be necessary to consider whether the anti-streaming and/or value shifting rules might need to apply beyond changes to a MIT's constituent documents?

From a horizontal equity perspective it would be preferred that entities automatically eligible for the attribution method are treated in the same manner as other entities in the context of the value shifting and anti streaming measures.

Consultation Question 10 - Is it practically feasible to have an alternative test for a de minimus amount based on a prescribed dollar value per unit?

We submit that it is not practically feasible to have an alternative test for a de minimus amount based on a prescribed dollar value per unit.

We submit that using a prescribed dollar value and multiplying by the number of units in a trust does not necessarily establish a threshold that relates to the actual size of the fund. For example, it may be possible to have two trusts with the same number of issued units, but with completely different net asset values and taxable income. Imposing the same de minimus threshold, based on a prescribed dollar value per unit may not be equitable as between both trusts. We recommend adopting a threshold test as a fixed dollar sum or based on a percentage of the trust's taxable income or net assets (e.g. the higher of (say) 5% of taxable income or (say) 5% of the average of the trust net assets during the income year).

Consultation Question 11 - If so, what would be an appropriate way for the government to determine a prescribed dollar value per unit?

Simply prescribe a fixed dollar value or percentage that is an acceptable de minimus and relate unit value to this fixed dollar value:

$$\frac{\text{Net Asset Value \$}}{\text{Number of Units}} \qquad \frac{\text{Taxable Income \$}}{\text{Number of Units}}$$

Consultation Question 12 - In addition to the proposed rules for overs and unders in relation to the income of a trust, should there also be statutory rules for overs and unders relating to tax offsets? If so, what would be an appropriate de minimus threshold?

Where conduit treatment applies in calculating the taxable income of the trust, then taxable income should be taxed at the investor level only, so that offsets should only be relevant at the investor level. Accordingly, where the taxable income of the trust is allocated on a basis that is fair and reasonable then any corresponding offsets should accompany such income. We note that this was not the approach endorsed by the Supreme Court of Queensland in (*Thomas Nominees Pty Ltd ACN 010 049 788 v Thomas & Anor* [2010] QSC 417, Supreme Court of Qld, Applegarth J, 11 November 2010).

Consultation Question 13 - For the income year in which an under or over arises that is less than the de minimus threshold, what would be a suitable operative mechanism to ensure that the trustee does not need to issue revised distribution statements and that assessments made in accordance with distribution statements do not need to be amended?

We recommend a separate taxing regime be included in the *Income Tax Assessment Act 1997* for MITs (which would incorporate this operative mechanism). Where a distribution statement has been sent or prepared for distribution the trustee can elect to exclude any under or over amount that is below the prescribed de minimus. The trustee can elect to exclude this amount from the taxable income and carry the income/deduction forward to the next income year or in the case of an under – pay tax on this income (not out of the trust funds by personally by the trustee).

A pure conduit approach would require that any under or over retain its same character and source. Equally it may be possible to include this 'adjustment' as a separate amount. However, where there are valuable tax attributes attaching to this item of income (eg franking credits) then lump sum treatment would appear inequitable.

Where an under or over arises which is below the de minimus threshold then other adjustments may be required including:

- Division 6 should not apply and/or sections 99 and 99A of the *Income Tax Assessment Act 1936* may need to be amended;
- Part IVA should not apply; and
- the Commissioner cannot seek to amend a beneficiary's assessment simply because there is an over/under amount which is below the de minimus threshold.

Consultation Question 14 - In applying the carry forward of an under or over not exceeding the de minimus amount in a later income year:

(a) should constituent amounts (eg capital gains, franking credits) be applied specifically against an amount of the same type?

A pure conduit approach would require that this under or over amount retain its same character and source. Equally it may be possible to include this 'adjustment' as a separate amount. However, where there are valuable tax attributes attaching to this item of income (e.g.

franking credits) then lump sum treatment would appear inequitable. A fair and reasonable allocation of taxable income would require that this is allocated to the beneficiaries who were on the register at the close of the preceding financial year.

Whilst the trustee should have flexibility in applying overs/unders in the following income year (i.e. either as a lump sum amount available to offset against taxable income of the trust, or separated according to class of income), there is the risk that concessional tax treatment or attributes attached to separate classes of income may be lost where overs/unders are applied using a lump sum method.

In this regard, in order for beneficiaries to avail themselves of the concessional tax treatment attached to separate classes of income, it may be in the beneficiaries' interests for the trustee to apply the overs/unders in accordance with the class of income to which the amount relates (unless the trustee has paid the tax personally to avoid investor disclosure).

(b) if so, for what categories of amount should a separate under or over figure be calculated; and

If it is proposed that the trustee can only apply overs/unders against particular classes of income, we would recommend such overs/unders be retained where different tax treatment applies including:

- capital gains;
- dividends;
- interest;
- royalties;
- foreign sourced income; and
- all other income.

(c) if not, what would be a suitable rule in applying the amount carried forward?

Please refer to responses provided at a) and b) above.

Consultation Question 15 - What should be the specified period allowed for the trustee to reissue distribution statements to beneficiaries after becoming aware that there is an under exceeding the de minimus amount?

As the circumstances surrounding different overs/unders may vary, and some amounts may be more difficult to quantify than others, there should some flexibility for the trustee in relation to the timing of reissuing distribution statements.
Under a principles based approach, once the trustee becomes aware of an under exceeding the de minimus threshold, it may be appropriate for the trustee to re-issue distribution statements "within a reasonable time period" or "as soon as practicable". Integrity measures may then need to be adopted to prevent trustees' abusing this rule. For example, having regard to:

- the time taken by the trustee in reissuing distribution statements;
- the nature and size of the under amount; and
- any other circumstances surrounding the reason for the under amount.

where the trustee did not reissue the distribution statements "within a reasonable time period" or "as soon as practicable", then, the administrative penalties may impose on the trustee.

Alternatively, it may be appropriate to impose a fixed (say 3 month) rule, where the trustee must re-issue distribution statements within (say) 3 months of becoming aware of an under amount exceeding the de minimus threshold.

Consultation Question 16 - What would be appropriate sanctions for a trustee intentionally (or recklessly) misstating the tax income of the trust?

Consistent with our comments under question 15, in order to protect the integrity of these rules, the Commissioner should have the power to impose administrative penalties on a trustee (in its personal capacity) where the trustee intentionally (or recklessly) misstates the taxable income of the trust. An appropriate penalty level could be calculated as a particular percentage of the amount misstated by the trustee. Only in limited circumstances, where in the opinion of the Commissioner, there has been gross misconduct by the trustee, resulting in a continual misstatement of the taxable income, should criminal sanctions be imposed.

Consultation Question 17 - Are there any significant compliance costs associated with requiring a MIT to track cost base movements on each event?

Depending upon the type of MIT and its information systems function, some MITs will face increased compliance costs to track cost base movements. The key issue will be whether a MIT has the systems capabilities to track such adjustments, and otherwise there will be set up costs to get systems and procedures compliant. This may be a barrier to entry or a cost of concessional treatment. That is, the ability to track such cost movements may be set as a condition for entering the MIT taxation regime. However, please note our comments below (refer Question 19) in relation to ETFs.

Consultation Question 18 - Should the requirement for MITs to notify unit holders of cost base adjustments be an annual requirement or should MITs be required to notify unit holders more frequently?

There will be a trade off required between the compliance obligations for the trustee of the MIT as opposed to keeping the unit holder updated on their cost base adjustments on a timely basis. To keep compliance costs to a minimum, formal written notification should occur on an annual basis. One way of addressing the trade off between timely information and compliance costs would be to allow unit holders access to the MIT's website where they could log on to their individual account details for their account only which would be regularly updated by the trustee (subject to the relevant IT system's functionality).

Consultation Question 19 - Are any modifications to the proposals warranted for MITs that are Exchange Traded Funds?

The key issue for the ETFs will be the compliance costs associated with providing cost base information to unitholders which change regularly and where the purchase price for the units is not known. ETF's may need to provide cost base adjustments only (rather than cost base details since the purchase price will not be known. These modifications will add to the complexity of these rules.

Consultation Question 20 - Is the proposed approach workable in practice?

We consider that the proposed approach is workable in practice and is in fact, consistent with how tax practitioners currently apply the law with respect to trusts. Specifically, the flow-through treatment of character and source is the proper recognition of the conduit nature of MITs which is intended to be a transparent vehicle and not an entity carrying on business in its own right or for its own account.

While Subdivision 115-C applies to ensure that capital gains made by trust estates flow through to the beneficiaries so that the beneficiaries are able to utilise their personal capital losses and apply the discount percentage (if eligible), the implications for the conduit nature of trusts is not clear.

It may be preferable to apply a pure conduit approach and therefore identify and include any tax attributes, concessions and/or tax gross-ups at the investor or beneficiary level only rather than at the MIT level.

Consultation Question 21 - Are there any alternative approaches that should be considered?

None identified but we are happy to consider further.

Consultation Question 22 - Under the proposed rule about non arm's length transactions in Division 6C:

(a) Should the market value treatment apply to transactions where a MIT does not deal at arm's length with another entity, transactions between an entity and its associates or both?

We understand that these proposed integrity measures should apply to transactions/dealings between stapled entities in order to prevent circumventing Division 6C and in particular the payment of company tax. Where this is the policy objective then we consider only the following transactions between a stapled company and trust represent integrity concerns which should be targeted:

- where the company charges the trust **less than** the arm's length price in respect of a transaction; and
- where the trust charges the company **more than** the arm's length price in respect of a transaction.

In this regard, the Commissioner's power to substitute market value pricing should be limited to the above scenarios, as such transactions may provide an opportunity to 'shift' profit from the company that is taxed to the tax transparent trust.

In addition, while we support the objectives behind these proposals, we note that at the same time, the industry requires certainty on what qualifies as arm's length dealings. This is important as there should be some clear basis or benchmark to enable taxpayers to identify and defend their relevant dealing/transaction as being conducted on arm's length terms – particularly where the consequences of Division 6C applying are so objectionable (loss of tax transparent status).

To establish an appropriate set of guiding principles requires an examination of not only the type of transactions involved, but also the various industry sectors concerned. We have set out below some examples as a guide:

Industry	Transaction/Dealing	Benchmark Examples
Financial Sector	Interest charged under a loan between the company and trust	Similar to determining the arm's length debt amount under the thin capitalisation rules, the arm's length interest rate may be determined by comparing the interest rate charged by commercial lending institutions for debt interests, on terms and conditions that would reasonably be expected to apply if the lending institution and the lender were dealing with each other at arm's length. A benchmark percentage rate of interest should be set for loans from the trust (maximum rates) and loans to the trust (minimum rates).
All	Management fee charged for services provided	[An arm's length fee for management services may be determined having regard to the fee currently charged between unrelated parties (not stapled entities) in the same industry sector).]
Infrastructure	Rent	Due to nature of this industry, it may be appropriate to obtain a private binding ruling from the Commissioner that the rent charged is at arm's length.
Retirement Villages	Rent	Arm's length rental rates may be determined having regard to industry market research reports for the retirement village sector.

Industry	Transaction/Dealing	Benchmark Examples
Retail Property	Rent	Arm's length rental rates may be determined having regard to industry market research reports for the retail property sector.

In this regard, the proposed legislation or supporting extrinsic materials should include a list of examples or guidance, as above, to assist stapled entities in establishing an appropriate supportable arm's length rate for transactions between such entities.

(b) Should the market value treatment also apply to the other party to the transaction?

On the basis that the proposed arm's length dealings rule is intended to operate as an integrity measure to prevent trusts circumventing Division 6C then it is arguable that no mirror treatment need apply.

Where the company charges the trust **<u>less than</u>** the arm's length price in respect of a transaction then there is no policy imperative to apply arms length rules to the company. However, where the trust charges the company **<u>more than</u>** the arm's length price in respect of a transaction, it may be appropriate to deny the trust an income tax deduction for the excess amount.

(c) Are there any exemptions from the rule appropriate?

Consistent with our responses under questions a) and b), we would recommend the following exemptions to apply to the arm's length rule:

- where the company charges the trust **<u>more or less than</u>** the arm's length price in respect of a transaction; and
- where the trust charges the company **<u>less than</u>** the arm's length price in respect of a transaction.
- to the extent the trust can provide documentary evidence supporting the pricing applied to a transaction (consistent with the table above setting out guidance for determining arm's length rates), an exemption should be available to the trust.

Consultation Question 23 - What are the possible types of amendments to deeds that may be required to be made (in particular, to satisfy the clearly defined rights requirement) and would they likely result in a resettlement?

A *resettlement* is not defined for the purposes of the Income Tax Assessment Acts. The High Court has identified three main indicia of continuity of the trust:

(a) the constitution of the trusts under which the fund operated,

(b) the trust property, and

(c) membership.

The observations of the Full Federal Court in *Commercial Nominees* (cited below) suggest that the circumstances in which a resettlement may arise will be limited where any amendment is made in accordance with and in reliance on an existing power included in the trust deed – refer *Federal Commissioner of Taxation v Commercial Nominees of Australia Limited (1999) 167 ALR 147* paragraphs 49 to 56 (as follows):

56. So long as any amendment of the trust obligations relating to such trust property is made in accordance with any power conferred by the instrument creating the obligations, and continuity of the property that is the subject of trust obligation is established, there will be identity of the "taxpayer" for the purposes of section 278 and sections 79E(3) and 80(2), notwithstanding any amendment of the trust obligation and any change in the property itself.

Mr Tony Slater has also observed (AH Slater QC 'Amendment of Trust Instruments', Society of Trust and Estate Practitioners Sydney, 29 September 2009) that any amendment made in exercise of a power conferred by a trust instrument does not amount to creating a new trust (for CGT Event E1 purposes). His reasoning is as follows:
Although the Income Tax Assessment Acts describe a 'trust' as an' entity', in law and for the purposes of the Acts a trust estate is neither a thing nor a legal personality; rather, and accurately, a trust is a relationship among trustee, beneficiaries or objects, and trust property. The only thing is the trust property and the only personality which can deal with trust assets is the trustee. But neither a change in the trust property nor a change in the trustee will of itself bring to an end the trust estate; equity fixes the new trustee with the obligations of the old, and impresses on new trust property the claims of the beneficiaries on the old property.

Accordingly, it should follow that there should be limited (if any) circumstances in which a resettlement may result in:

- one trust coming to an end and being replaced by another trust; or

- an original trust continuing but one or more new and separate trust estates come into existence.

However, this view is not wholly supported in the Australian Taxation Office Statement of Principles - *Creation of a New Trust – Statement of Principles August 2001.* According to the Statement of Principles, a resettlement arises from a fundamental change to the essential nature and character of the trust relationship and will depend upon:

(a) the terms of the original trust

(b) the power of the trustee

(c) the original intentions of the settlor

According to the Statement of Principles, a resettlement can result from variations under a power in the deed and a variation by agreement among the beneficiaries. The statement notes that it is important to distinguish between changes which are merely procedural and those which fundamentally redefine the relationship between the trustee and beneficiaries in respect of the trust property. It is generally only changes of the latter type which will give rise to a new trust. However:

- it is sometimes unclear whether a variation of terms is fundamental or merely procedural;
- extensive procedural changes may be taken into account along with other changes in considering whether there is a new trust; and
- in some circumstances new trusts have been held to arise even though their terms have been very similar to a prior arrangement (e.g. Davidson v. Chirnside).

In these circumstances and in the interests of certainty it will be preferable to include a statutory period that follows the commencement of the new tax system for MITs to allow changes to be made with certainty that they will not cause a resettlement of the trust.

Consultation Question 24 - Are many MITs likely to wish to amend trust deeds?

We expect that some amendments to align a trust deed with the new tax system will be necessary although it is difficult to know ahead of reviewing the legislative drafting the exact nature of those amendments required.

Consultation Question 25 - What would be appropriate roll-over relief where a resettlement of a trust occurs as a result of a MIT amending its constituent documents so as to be eligible for the attribution method of taxation?

We submit that a resettlement exemption should apply in circumstances where a MIT's constituent documents are amended in order to align with the new tax system for MITs – refer comments at question 23 above.

Consultation Question 26 - Should the trustees of MITs be required to notify unit holders of the amount of unders and overs identified and to be carried forward? If so, what would be the best way for the notification to occur?

To provide investors with full and complete information an MIT should be required to advise investors of the amount of the unders and overs – for example through the website – but only where the trustee has not elected to be personally liable to pay the tax on this amount of income. A way of balancing timely reporting and the trustees compliance costs would be to allow investors to access their account on line to obtain this information rather than the trustee providing formal written statements.

Consultation Question 27 - Do some MITs need time before the commencement of the new attribution rules to amend trust deeds, if so, what would be a reasonable amount of time to allow?

There should be a further consultation process to allow industry to review the exposure draft legislation and consider what further trust deed amendments will be required. Once this process has been completed, there should then be additional time to allow the industry to implement changes to its documentation and systems, to address the changes. In this regard, once final legislation has been released there should be sufficient time to allow industry to address these changes. We expect that industry will have a better understanding of the minimum time required.

Consultation Question 28 - By what date would industry need to implement changes to its systems and how much time would it be likely to take industry to make those changes?

Please refer our response to consultation question 27.

Consultation Question 29 - What specific interaction issues should be addressed in the legislation and what are possible solutions to those issues?

The implementation of conduit treatment for items of income which have 'attaching' or accompanying tax attributes such as dividends and capital gains.

Consultation Question 30 - What amendments should be made to the withholding tax (and associated PAYG withholding) provisions to ensure that they mesh appropriately?

Where an actual or constructive payment has not been made during a financial year, then there will need to be a deeming provision to trigger withholding obligations where there is an attribution of taxable income to non resident investors. This deeming provision would trigger interest, royalty and dividend withholding tax requirements. Additionally the attribution of the taxable income would be a deemed or constructive 'fund payment' so that MIT withholding obligations will trigger for the purposes of Subdivision [12-400 of the *Taxation Administration Act 1953*].

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