2015

EXPOSURE DRAFT

MANAGED INVESTMENT TRUSTS

EXPLANATORY MATERIAL

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Chapter 1
Overview of the new tax system for managed investment trusts

Outline of chapter

1.1 This Exposure Draft Bill amends the *Income Tax Assessment Act 1997* (the ITAA 1997) and the *Taxation Administration Act 1953* (the TAA 1953) to introduce a new tax system for managed investment trusts.

1.2 This chapter provides an overview of the new tax system for managed investment trusts.

1.3 All legislative references in this Explanatory Memorandum are to the ITAA 1997 unless otherwise indicated.

Context of amendments

1.4 The new tax system for managed investment trusts follows recommendations that the Board of Taxation made in its Report on the *Review of the Tax Arrangements Applying to Managed Investment Trusts* in August 2009 (the Board's Report).

1.5 In undertaking its Review, the Board concluded that the current taxation arrangements applying to trusts create a level of complexity and uncertainty for managed investment trusts that is unacceptable for an industry of its significance to the economy. This is primarily the result of the current trust taxation provisions in Division 6 of Part III of the *Income Tax Assessment 1936* (ITAA 1936) being largely developed at a time before trusts were used in Australia as widely-held, commercially operated, collective investment vehicles.

1.6 The new tax system for managed investment trusts will ensure that the managed funds industry is able to continue to operate through trust structures having regard to:

- the commercial needs of the industry;
- the needs of investors;
- the need to ensure appropriate integrity;

- compliance costs of managed investment trusts and their members; and
- administrative costs of the Australian Taxation Office.

1.7 This Exposure Draft Bill implements the recommendations of the Board of Taxation to create a new tax system for certain managed investment trusts.

1.8 The new tax system will significantly improve the operation of the taxation law for managed investment trusts by increasing certainty, allowing greater flexibility and reducing compliance costs. These reforms will enhance the competitiveness of Australia's funds management industry.

1.9 The new tax system has been actively sought by the managed funds industry. Industry representatives and other key stakeholders have been extensively consulted during the development of the new tax system for managed investment trusts.

Summary of new law

1.10 This Exposure Draft Bill will introduce a new tax system for certain managed investment trusts. The new tax system will apply to a managed investment trust whose members have clearly defined interests in relation to the income and capital of the trust (see Chapter 2). These trusts are referred to as attribution managed investment trusts (attribution MITs or AMITs).

1.11 Under the new tax system, attribution MITs will have the following benefits:

- the trust will qualify as a fixed trust for income tax purposes (see Chapter 2);
- for income tax purposes, the trust will be able to attribute amounts of taxable income, exempt income, non-assessable non-exempt income, tax offsets and credits to members on a fair and reasonable basis in accordance with their interests as set out in the constituent documents of the trust (see Chapter 3); and
- if a trust discovers a variance between the amounts actually attributed to members for an income year, and the amounts that should have been attributed, the trust will be able to

reconcile the variance in the income year that it is discovered by using the ‘unders and overs’ regime (see Chapter 4).

1.12 In addition, the amendments:

- make the trustees of attribution MITs liable to pay tax in some circumstances (see Chapter 5); and
- ensure that the Pay As You Go (PAYG) withholding provisions and the withholding tax liability provisions apply appropriately to attribution MITs and their members, including members that are custodians (see Chapter 6).

1.13 The new tax system will provide benefits to members of an attribution MIT (as explained in Chapter 7) because:

- a ‘character flow-through’ model will apply to ensure that amounts derived or received by the trust that are attributed to members retain the character they had in the hands of the trustee for income tax purposes;
- double taxation that might otherwise arise will be reduced because members will be able to make annual upward and downward adjustments to the cost bases of their interests in the trust; and
- the taxation treatment of tax deferred distributions made by the trust is clarified.

1.14 Finally, the amendments will:

- repeal the public unit trust rules in Division 6B of Part III of the ITAA 1936 (see Chapter 8); and
- exclude superannuation funds and exempt entities that are entitled to a refund of excess imputation credits from the application of the 20 per cent tracing rule for public trading trusts in Division 6C of Part III of the ITAA 1936 (see Chapter 8).

Application and transitional provisions

1.15 The amendments to introduce a new tax system for managed investment trusts apply to income years starting on or after 1 July 2015.

1.16 The amendments to extend the scope of eligible investors for the purpose of the widely held requirements that must be satisfied for a trust to qualify as a managed investment trusts apply from 1 July 2014.

1.17 Transitional rules, which are still to be developed, will ensure the amendments to clarify the taxation treatment of tax deferred distributions will apply from 1 July 2011 (as announced in the 2014-15 Mid-Year Economic and Fiscal Outlook).

1.18 The application and transitional provisions are explained in detail in Chapter 9.

Chapter 2
Eligibility to apply the managed investment trust reforms

Outline of chapter

2.1 This Chapter explains:

- the criteria that a managed investment trust must satisfy to qualify as an attribution MIT that is eligible to use the new tax system;
- the broad consequences that arise if a managed investment trust qualifies to be an attribution MIT;
- changes to improve the structure of the income tax law by transferring the definition of a *managed investment trust* to the ITAA 1997; and
- changes to broaden the eligibility criteria to be a managed investment trust.

Context of amendments

2.2 Currently, subsection 995-1(1) of the ITAA 1997 defines a *managed investment trust* to have the same meaning as in the managed investment trust withholding provisions in Subdivision 12-H of Schedule 1 to the TAA 1953. Under that section, a trust is a managed investment trust if, broadly:

- the trustee of the trust is an Australian resident, or the central management and control of the trust is in Australia;
- the trust carries out most of its investment management activities in relation to Australian assets in Australia;
- the trust does not carry on or control an active trading business;
- the trust is a managed investment scheme (within the meaning of the *Corporations Act 2001*);

- the trust is sufficiently widely-held and not closely-held – in this regard, special counting rules apply where investors in a managed investment trust are specified widely-held entities; and
- the trust is operated or managed by an appropriately regulated entity.

2.3 Key objectives of the managed investment trust withholding tax rules are to encourage foreign investment in Australian assets, increase the export of Australian funds management services and provide certainty for foreign investors in managed investment trust by imposing a concessional final withholding tax on those foreign investors.

2.4 Under Division 275 of the ITAA 1997, managed investment trusts (as defined in the section 12-400 of Schedule 1 to the TAA 1953), together with certain other trusts that are treated as managed investment trusts) can elect to apply the capital gains tax (CGT) provisions to gains and losses made on the disposal of certain assets held as passive investments (deemed capital account treatment).

2.5 Under the new tax system, a trust will qualify as an attribution MIT that is eligible to use the new tax system if, generally:

- the trust is a managed investment trust; and
- the members of the trust have clearly defined interests.

2.6 These eligibility criteria are consistent with the recommendations of the Board of Taxation. In this regard, the Board stated (at paragraph 2.28 of the Board's Report) that:

> Accordingly, the Board considers that the most appropriate balance between allowing access to the attribution rules and other measures and maintaining certainty and integrity is to introduce a requirement that, in order to qualify as a Regime MIT, the beneficiaries' rights to income, including the character of income, and capital must be clearly established at all times in the trust's 'constituent documents'. The rights should only be able to be changed by a change in the trust's 'constituent documents'.

Summary of new law

2.7 A trust will qualify as an attribution MIT that is eligible for the new tax system if, generally:

- the trust is a managed investment trust; and
- the members of the trust have clearly defined interests.

2.8 If a trust is an attribution MIT that is eligible to apply the new tax system:

- for income tax purposes, the trust will be able to attribute amounts of taxable income, exempt income, non-assessable non-exempt income, tax offsets and credits to members on a fair and reasonable basis in accordance with their clearly defined interests in the trust (see Chapter 3);
- for income tax purposes, the trust will be able to attribute amounts of taxable income, exempt income, non-assessable non-exempt income, tax offsets and credits to members on a fair and reasonable basis in accordance with their interests as set out in the constituent documents of the trust (see Chapter 3); and
- if a trust discovers a variance between the amounts actually attributed to members for an income year, and the amounts that should have been attributed, the trust will be able to reconcile the variance in the income year that it is discovered by using the 'unders and overs' regime (see Chapter 4).

2.9 In addition, the amendments:

- make the trustees of attribution MITs liable to pay tax in some circumstances (see Chapter 5); and
- ensure that the PAYG withholding provisions and the withholding tax liability provisions apply appropriately to attribution MITs and their members, including members that are custodians (see Chapter 6).

2.10 The new tax system will provide benefits to members of an attribution MIT (as explained in Chapter 7) because:

- a 'character flow-through' model will apply to ensure that amounts derived or received by the trust that are attributed to members retain the character they had in the hands of the trustee for income tax purposes;
- double taxation that might otherwise arise will be reduced because members will be able to make annual upward and

downward adjustments to the cost bases of their interests in the trust; and

- the taxation treatment of tax deferred distributions made by the trust is clarified.

2.11 For the purposes of working out whether a managed investment trust qualifies as an attribution MIT and applying the attribution model, debt-like instruments issued by the trust will be treated as debt interests (rather than as membership interests).

2.12 The key consequences that arise if a managed investment trust qualifies as an attribution MIT are that:

- an attribution model will apply to the managed investment trust, instead of the general trust provisions in the income tax law in Division 6 of Part III of the ITAA 1936; and
- the managed investment trust will be treated as a fixed trust for the purposes of the income tax law.

2.13 In order to improve the structure of the income tax law, the definition of *managed investment trust* is being transferred to the ITAA 1997 from Schedule 1 to the TAA 1953, with some minor changes to:

- extend the start-up period during which a trust does not need to meet the widely-held and not closely-held requirements to qualify as a managed investment trust; and
- modify the widely-held requirements to extend the list of eligible investors in a managed investment trust.

Comparison of key features of new law and current law

New law	*Current law*
A trust will be an attribution MIT that is eligible to apply the new tax system if, broadly: • the trust is a managed investment trust; and • the members of the trust have clearly defined interests.	No equivalent.

<table>
<tr><td>Debt-like instruments issued by the trust will be treated as debt interests for the purposes of:
• working out whether a managed investment trust qualifies as an attribution MIT; and
• applying the attribution model.</td><td>Debt-like instruments issued by a managed investment trust are not treated as debt interests.</td></tr>
<tr><td>The new tax system in Division 276 of the ITAA 1997 will apply to an attribution MIT and its members.</td><td>The general trust provisions in Division 6 of Part III of the ITAA 1936 apply to a managed investment trust and its members.</td></tr>
<tr><td>A managed investment trust that is an attribution MIT will be treated as a fixed trust for the purposes of the income tax law.</td><td>A managed investment trust is a fixed trust for the purposes of the income tax law only if the beneficiaries of the trust have vested and indefeasible interests in the income and capital of the trust.</td></tr>
<tr><td>A managed investment trust will be defined in the ITAA 1997, with modifications to:
• extend the start-up period during which a trust does not need to meet the widely-held and not closely-held requirements to qualify as a managed investment trust; and
• modify the widely held requirements so that an eligible investor in a managed investment trust includes:
– a foreign life insurance company regulated under a foreign law; and
– an entity that is, directly or indirectly, a wholly owned subsidiary of an entity that is an eligible investor, or two or more entities that are eligible investors.</td><td>A managed investment trust is defined in Schedule 1 to the TAA 1953.</td></tr>
</table>

Detailed explanation of new law

2.14 A trust will qualify as an attribution MIT that is eligible for the new tax system if:

- the trust is a managed investment trust; and
- the members of the trust have clearly defined interests.

2.15 For the purposes of working out whether a managed investment trust qualifies as an attribution MIT and applying the attribution model, debt-like instruments issued by the trust will be treated as debt interests.

2.16 The key consequences that arise if an managed investment trust qualifies as an attribution MIT are that:

- an attribution model will apply to the managed investment trust, instead of the general trust provisions in the income tax law in Division 6 of Part III of the ITAA 1936; and
- the managed investment trust will be treated as a fixed trust for the purposes of the income tax law.

2.17 To improve the structure of the income tax law, the definition of *managed investment trust* is being transferred to the ITAA 1997 from Schedule 1 to the TAA 1953. Some minor changes are being made to:

- extend the start-up period during which trusts do not need to meet the widely-held and not closely-held requirements to qualify as a managed investment trust; and
- modify the widely-held requirements to extend the list of eligible investors in a managed investment trust.

Eligibility to be an attribution MIT

2.18 A trust will be an attribution MIT (or AMIT) that is eligible to apply the new tax system if:

- the trust is a managed investment trust in relation to an income year;
- the members of the trust have clearly defined interests at all times when the trust is in existence in an income year;

- where the trust is a managed investment trust in relation to an income year solely because of section 275-15, the only member of the trust is a managed investment trust; and
- any criteria specified in the regulations are satisfied in relation to the trust.

[Schedule 2, item 2, subsection 276-10; Schedule 9, item 1, definitions of 'AMIT' and 'attribution managed investment trust (or AMIT)' in subsection 995-1(1)]

Trust is a managed investment trust

2.19 A trust will be a managed investment trust in relation to an income year if it satisfies the requirements in section 275-5 for the whole of the income year.

2.20 However, if temporary circumstances that are outside the control of the trustee cause the trust to fail the requirements that must be satisfied in order for it to qualify as a managed investment trust, the trust will be treated as being a managed investment trust in relation to the income year if it is fair and reasonable to do so (based on the criteria specified in paragraph 275-50(d)). ***[Schedule 1, item 3, subsections 275-5(2) and section 275-50]***

2.21 Section 275-40 allows a trust to be treated as a managed investment trust for certain purposes if, among other things:

- the only member of the trust is a specified widely-held entity (with some exceptions); or
- the only member of the trust is a managed investment trust.

2.22 If a trust is a managed investment trust in relation to an income year solely because of section 275-40, the trust will be eligible to be an attribution MIT only if the only member of the trust is a managed investment trust. ***[Schedule 2, item 2, paragraph 276-10(c)]***

Clearly defined interests

2.23 To qualify as an attribution MIT, the members of a trust must have clearly defined interests in the income and capital of the trust. The clearly defined interests test is an integrity measure to ensure that:

- there is an objective benchmark for the attribution of tax consequences of the activities of the trust to its members; and
- only trusts which are sufficiently non-discretionary receive the benefits available to attribution MITs — such as deemed fixed trust treatment.

2.24 If a trust is a managed investment scheme that is registered under the *Corporations Act 2001*, members of the trust will have clearly defined interests in the trust at a particular time if:

- assuming that the trust is an attribution MIT for the income year in which the time occurs, the amount of each member component for the income year of each member of the trust can be worked out on a fair and reasonable basis in accordance with the constituent documents of the trust;
  - the constituent documents include the trust constitution and any supporting documentation (such as a prospectus or other document that sets out the terms of the members' interests); and
- the rights 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.

[Schedule 2, item 2, paragraph 276-15(1)(a) and subsection 276-15(2)]

2.25 If a trust is a managed investment scheme that is not registered under the *Corporations Act 2001*, members of the trust will have clearly defined interests if:

- assuming that the trust is an attribution MIT for the income year in which the time occurs, the amount of each member component for the income year of each member of the trust can be worked out on a fair and reasonable basis in accordance with the constituent documents of the trust; and
- 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;
- the trustee has an obligation to treat members who hold interests in the same class equally and members who hold interest of different classes fairly; and
- the constituent documents can be changed only:
  - by the trustee, if the trustee reasonably considers that the change will not adversely affect the rights of members; or
  - by a resolution that has been passed by at least 75 per cent of the votes cast by member entitled to vote on the resolution — that is, a resolution that meets the

requirements of a special resolution within the meaning of the *Corporations Act 2001*;

– by a resolution that has been passed by at least 50 per cent of the total votes that may be cast by member entitled to vote on the resolution (including members who are not present in person or by proxy) — that is, a resolution that meets the requirements of an extraordinary resolution within the meaning of the *Corporations Act 2001*.

[Schedule 2, item 2, paragraph 276-15(1)(b), subsections 276-15(2) and (3)]

2.26 The additional conditions in subsection 276-15(3) that apply to a managed investment scheme that is not registered under the *Corporations Act 2001* ensure that interests of members are not clearly defined if the trustee can easily modify those interests by implementing or changing the constituent documents of the trust. Registered managed investment schemes are required to meet equivalent conditions under the *Corporations Act 2001*.

2.27 Therefore, with some limited exceptions, if a trustee of a trust has the discretion to determine the entitlement to the income and capital of the trust of each member of the trust, or to determine the character of income distributed to each member, then the members of the trust will not have clearly defined interests.

2.28 However, the Commissioner of Taxation has a discretion to treat a trust as having clearly defined interests if the Commissioner considers that it is reasonable to conclude that the right of each member of the trust to the income and capital of the trust is clearly defined at a particular time. In reaching this conclusion, the Commissioner must consider:

- the constituent documents of the trust; and
- any other matter that the Commissioner considers to be relevant.

[Schedule 2, item 2, paragraph 276-15(1)(c), subsections 276-15(4) and (5)]

Example 2.1

ABC Trust is a listed managed investment trust with a single class of units.

The constituent documents for the trust specify that members of the trust have an entitlement to a share of the income and capital of the trust based on the number of units that they hold in the trust.

The trustee is unable to differentiate between members when making distributions of income and capital except where a member that holds a large number of units redeems their unit holding and the trustee is required to dispose of assets to fund the redemption.

The members of ABC Trust have clearly defined interests in the income and capital of the trust. Therefore, ABC Trust will be an attribution MIT.

Example 2.2

DEF Trust is a listed managed investment trust with two classes of units — Class A units and Class B units.

The constituent documents for the trust specify that:

- members of the trust that hold Class A units have an entitlement to a share of all of the income of the trust based on the number of Class A units that they hold in the trust; and
- members of the trust that hold Class B units have an entitlement to a share of all of the capital of the trust based on the number of Class B units that they hold in the trust.

The members of DEF Trust have clearly defined interests in the income and capital of the trust. Therefore, DEF Trust will be an attribution MIT.

Example 2.3

XYZ Trust is a discretionary hybrid managed investment trust with two classes of members — Class A members and Class B members.

At the end of each income year, the trustee is able to determine how much income and capital is allocated to Class A members. The trustee is also able to determine the character of the income that is allocated to Class A members. Any remaining income and capital is allocated to Class B members.

The members of XYZ Trust do not have clearly defined interests in the income and capital of the trust. Therefore, XYZ Trust will not be an attribution MIT.

Criteria specified in the regulations

2.29 Additional criteria that must be satisfied for a trust to be eligible to be an attribution MIT may be specified in the regulations. ***[Schedule 2, item 2, paragraph 276-10(1)(d)]***

Attribution MIT with multiple classes of members

2.30 If the interests in the income and capital of the attribution MIT are divided into classes, the attribution MIT will be able to apply the attribution regime separately to each class of interests if:

- the rights arising from each of the interests in the income and capital of the attribution MIT in a particular class are the same as the rights arising from every other of those interests in that class;
- each of those interests in a particular class are distinct from each of those interests in another class; and
- the trustee of the attribution MIT has made a choice to apply the attribution regime separately to each class of interests.

[Schedule 2, item 2, subsections 276-20(1) and (2)]

2.31 In these circumstances, the attribution regime will apply separately to each class of interests, except for:

- Subdivision 276-A — that is, for the purpose of determining whether a managed investment trust qualifies as an attribution MIT; and
- paragraphs 276-420(2)(a), (2)(d), (5)(a) and (5)(b) — that is, for the purpose of working out the overall base year shortfall, the overall base year excess and the net variance threshold, which are relevant for determining whether unders and overs of the trust need to be uplifted.

[Schedule 2, item 2, subsection 276-20(2) and section 276-425]

2.32 The choice by an attribution MIT to apply the attribution regime separately to each class of interests must be in writing and is irrevocable. The way that the attribution MIT prepares its income tax return for an income year is sufficient evidence of the making of the choice. ***[Schedule 2, item 2, subsections 276-20(3) to (5)]***

2.33 If the trustee of the attribution MIT makes a choice to apply the attribution regime separately to each class of interests, the choice applies to the income year in which the choice is made and to every subsequent income year. ***[Schedule 2, item 2, subsection 276-20(6)]***

2.34 If a choice is made to treat each class of interests as a separate attribution MIT, each class will effectively be treated as a separate trust with separate trust property. The assessable income and allowable deductions and other trust attributes relating to the class will need to be identified by reference to the assets supporting that class. In addition, transactions and events involving those assets (including intra-entity dealings within the actual attribution MIT involving the deemed separate attribution MIT) will need to be recognised for tax purposes as though the class was in fact a separate entity.

Debt-like AMIT instruments

2.35 A debt-like AMIT instrument in an attribution MIT is treated as a debt interest in the attribution MIT. A distribution in relation to the instrument is treated as interest for the purposes of the interest withholding tax provisions. The distribution may also be treated as a deduction in working out the trust components of an attribution MIT. ***[Schedule 2, item 2, section 276-690]***

2.36 The objective of treating a debt-like AMIT instrument in an attribution MIT as a debt interest in the attribution MIT is to ensure that:

- the criteria to qualify as an attribution MIT operate appropriately for managed investment trusts with debt-like interests (as holders of debt-like AMIT instruments will not be members of the trust;

- the attribution rules do not apply to the holders of debt-like AMIT instruments;

- an attribution MIT can deduct returns on debt-like AMIT instruments in appropriate circumstances; and

- debt-like AMIT instruments are treated as debt for the purposes of applying other provisions in the income tax law (such as the thin capitalisation provisions).

2.37 An instrument that gives rise to an interest in an attribution MIT is a debt-like AMIT instrument in relation to the attribution MIT if it has the following debt-like features:

- any distribution relating to the interest is fixed, at the time the interest was created, by reference to the amount subscribed for the interest but is solely at the discretion of the trustee of the attribution MIT;

- the interest, and any other interest in the attribution MIT that is in the same class as the interest, ranks above all other membership interests in the trust in the event that:

  - the trust ceases to exist; or
  - where the attribution MIT is a managed investment scheme, the scheme is under administration or is being wound up; and

- if, in relation to a particular period, the trustee of the attribution MIT does not make a distribution relating to the interest, then the constituent documents of the attribution MIT prohibit:
  - a distribution relating to any other membership interest in the attribution MIT; and
  - a distribution relating to a membership interest in another entity if that interest is stapled together with a membership interest in the attribution MIT.

[Schedule 2, item 2, section 276-695]

2.38 Except for the purposes of working out whether a trust qualifies as a managed investment trust or as an attribution MIT:

- a debt-like AMIT instrument in an attribution MIT is treated as a debt interest in the attribution MIT; and
- a distribution on a debt-like AMIT instrument in an attribution MIT is treated as a cost incurred by the attribution MIT in relation to a debt interest issued by the attribution MIT.

[Schedule 2, item 2, subsection 276-700(1)]

2.39 Consequently, a debt-like AMIT instrument in an attribution MIT is not treated as a membership interest for the purposes of working out whether a trust qualifies as a managed investment trust or as an attribution MIT. As a result, the holder of a debt-like AMIT instrument is not a member of the trust for the purpose of:

- the widely-held and not closely-held tests for determining if the trust is a managed investment trust;
- the clearly defined interests test for determining if the trust is an attribution MIT; and
- the attribution model (including the unders and overs regime) that applies to an attribution MIT.

2.40 For the purpose of applying the dividend, interest and royalty withholding tax provisions in the income tax law, a distribution to an entity that is the holder of a debt-like AMIT instrument is treated as interest. ***[Schedule 2, item 2, subsection 276-700(2)]***

2.41 In addition, a distribution made by an attribution MIT to the holder of a debt-like AMIT instrument is an allowable deduction for the purpose of working out the trust component of an income AMIT character under the attribution model, except to the extent that the distribution is attributable to exempt income or non-assessable non-exempt income of the attribution MIT. ***[Schedule 2, item 2, section 276-710]***

Changes to constituent documents to qualify as an attribution MIT

2.42 Trustees of existing managed investment trusts will need to embark on due diligence activities to determine whether changes are required to be made to trust deeds, other constituent documents, product disclosures and other investor material in order to apply the new tax system.

2.43 Concerns have been raised that tax consequences may arise if the constituent documents of a trust are changed in order to apply the new tax system.

2.44 However, the Australian Taxation Office has issued a Taxation Determination stating that, if the terms of a trust are changed pursuant to a valid exercise of a power contained in the trust's constituent documents, no capital gains tax consequences arise as a result of the change (see Taxation Determination TD 2012/21).

Consequences of being an attribution MIT

2.45 If a managed investment trust qualifies to be an attribution MIT to an income year, then:

- the attribution MIT is treated in the same way as a fixed trust throughout the income year;
- amounts related to the income and tax offsets of the attribution MIT, determined by the trustee to be of a particular character, are attributed to members, generally retaining that character; and

- under and over estimations of amounts at the trust level are carried forward and dealt with in later years on a character-by-character basis.

[Schedule 2, item 2, section 276-1]

An attribution MIT is taken to be a fixed trust

2.46 A managed investment trust that is an attribution MIT will be taken to be a fixed trust for income tax purposes. That is, for the purposes of the income tax law, a member of the attribution MIT for an income year will be taken to have a vested and indefeasible interest in a share of the income and capital of the attribution MIT throughout the income year. ***[Schedule 2, item 2, sections 276-50 and 276-55]***

Division 6 of Part III of the ITAA 1936 does not apply

2.47 The new tax system in Division 276 of the ITAA 1997 will apply to an attribution MIT and its members. As a result, the provisions in Division 6 of Part III of the ITAA 1936 that generally apply to trusts and their beneficiaries will not apply to an attribution MIT and its members. ***[Schedule 6, item 2, section 95AAD of the ITAA 1936]***

Transfer of the definition of *managed investment trust* to the ITAA 1997

2.48 The definition of *managed investment trust* is currently located in section 12-400 of Schedule 1 to the TAA 1953. That definition is central to the operation of:

- the circumstances in which a trust is an attribution MIT (as defined in the ITAA 1997) that is eligible to apply the new tax system;
- the circumstances in which a trust is a managed investment trust that can choose deemed capital account treatment under the ITAA 1997; and
- the circumstances in which a trust is a managed investment trust that is subject to the PAYG withholding tax rules in the TAA 1953.

2.49 Consequently, to improve the structure of the income tax law, the definition of *managed investment trust*, together with several supporting provisions, is being transferred from Schedule 1 to the TAA 1953 to the ITAA 1997.

2.50 As a result, Schedule 1 to the TAA 1953 is being amended to:

- replace the definition of *managed investment trust* with a new definition of *withholding MIT*;
- repeal sections 12-400 to 12-404.

[Schedule 1, items 3 and 5; Schedule 3, item 2, section 12-383 of the TAA 1953]

2.51 In addition, the definition of ***managed investment trust***, together with several supporting provisions, is being inserted into Subdivision 275-A of the ITAA 1997. ***[Schedule 1, item 3, sections 275-5 to 275-35]***

2.52 A range of consequential amendments are also being made to support the new structure. ***[Schedule 1, items 1 to 4, sections 275-1, 275-40, 275-45, 275-50 and 275-200; Schedule 6, item 4, subsection 102T(16)]***

2.53 The transfer of provisions does not change the circumstances in which:

- a managed investment trust can apply deemed CGT treatment or;
- the PAYG withholding tax rules in Division 12 of Schedule 1 to the TAA 1953 apply to a managed investment trust.

Circumstances in which a trust will qualify as a managed investment trust

2.54 Changes are being made to broaden the circumstances in which a trust will qualify as a managed investment trust. These changes:

- extend the start-up period during which trusts do not need to meet the widely-held and not closely-held requirements to qualify as a managed investment trust; and
- modify the widely-held requirements to extend the list of eligible investors in a managed investment trust.

2.55 As these changes to extend the scope of eligible investors for the purpose of the widely held requirements apply on or after 1 July 2014, the widely-held requirements in the current law are being amended in the same way. ***[Schedule 7, items 1 to 3, subsection 12-402(3) in Schedule 1 to the TAA 1953)]***

Extend the start-up period during which trusts do not need to meet the certain requirements to qualify as a managed investment trust

2.56 To qualify as a managed investment trust, a trust must satisfy certain widely-held and not closely-held membership requirements for an income year. Currently, if a trust is created during the period starting 6 months before the start of the income year and ending at the end of the income year, these requirements are taken to have been satisfied by the trust for the income year.

2.57 A modification is being made to extend the start-up period during which trusts are taken to meet the widely-held and not closely-held requirements to qualify as a managed investment trust from six months to twelve months. ***[Schedule 1, item 3, subsection 275-5(6)]***

Extend the list of eligible investors in managed investment trusts

2.58 A registered managed investment trust can qualify as widely-held if:

- one of the entities that is a member of the trust is a specified widely-held entity (for example, a complying superannuation fund that has at least 50 members) that holds more than 25 per cent of the interest in, control of, or rights to distributions from, the trust; and
- no other single entity holds more than a 60 per cent equivalent interest in the trust.

2.59 A modification is being made to the widely held requirements so that an eligible investor in a managed investment trust includes:

- a foreign life insurance company regulated under a foreign law; and
- an entity that is, directly or indirectly, a wholly owned subsidiary of an entity that is an eligible investor, or two or more entities that are eligible investors.

[Schedule 1, item 3, paragraphs 275-15(4)(b) and (k)]

Chapter 3
The attribution model for managed investment trusts

Outline of chapter

3.1 This Chapter explains the operation of the attribution model of taxation for attribution MITs. Under the attribution model, an attribution MIT must:

- determine the overall amounts of particular AMIT characters for the trust for an income year; and
- attribute amounts with particular AMIT characters for that income year to members on a fair and reasonable basis in accordance the constituent documents of the trust.

Context of amendments

3.2 Trusts, including managed investment trusts, are currently taxed under the general trust provisions in Division 6 of Part III of the ITAA 1936. The principles underlying the general trust provisions are, broadly, that:

- a beneficiary's taxable income for a year includes a proportionate share of the *net income* of the trust where the beneficiary is presently entitled to a share of the *income* of the trust; and
- the trustee of the trust is taxed on the *net income* of the trust which has not been included in the assessable income of a presently entitled beneficiary.

3.3 The Board of Taxation identified a range of practical difficulties in applying the rules in Division 6 to managed investment trusts because, for example, some of the key concepts in Division 6 may be unclear.

3.4 The attribution model for attribution MITs will provide greater certainty for trustees and beneficiaries by aligning the commercial and tax consequences of the activities of a managed investment trust and providing flow-through of amounts with specific tax characters.

3.5 The attribution model has been developed in consultation with key stakeholders and is consistent with the current commercial practices of managed investments trusts.

Summary of new law

3.6 This Chapter explains the attribution model of taxation for attribution MITs. Under the attribution model, an attribution MIT must:

- determine the overall amounts of particular AMIT characters for the trust; and
- attribute amounts with particular AMIT characters to members of the trust for that income year in accordance with specified attribution principles.

Trust components of particular AMIT characters

3.7 Under the attribution model of taxation, a trustee of an attribution MIT must first calculate the total of the amounts associated with the various activities of the trust that attract different tax consequences. The total of each amount is referred to as a ***trust component*** of a particular AMIT character. There are four broad categories of AMIT characters:

- income AMIT characters;
- exempt income AMIT characters;
- non-assessable non-exempt income AMIT characters; and
- offset AMIT characters.

Attributing amounts to members

3.8 Once the various trust components of particular AMIT characters for an income year are calculated, the trustee of an attribution MIT must attribute a share of the trust components calculated to each member of the AMIT on a fair and reasonable basis in accordance the constituent documents of the trust.

3.9 The amount attributed to a particular member (which is referred to as a ***member component*** of a particular AMIT character) is based on the member's clearly defined interests in the attribution MIT.

Comparison of key features of new law and current law

New law	***Current law***
The trustee of an attribution MIT will determine the amount of the trust components of particular AMIT characters and create a document recording those amounts (the determined trust components).	The trustee of a managed investment trust must calculate the net income of the trust and, in some cases, determine to what extent it is taken to have a particular income tax character.
The trustee will: • work out on a fair and reasonable basis how much of the determined trust component of a particular AMIT character should be attributed to each member (the member component of a particular AMIT character); and • issue a statement to each member (an AMMA statement) advising them of that amount (the determined member component of a particular AMIT character).	A beneficiary of a managed investment trust is taxed on a proportion of the net income of the trust, based on the share of trust income that the beneficiary is presently entitled to.

Detailed explanation of new law

3.10 This Chapter explains the attribution model of taxation for attribution MITs. Under the attribution model, an attribution MIT must:

- determine the overall amounts of particular AMIT characters for the trust; and
- attribute amounts with particular AMIT characters to members of the trust in accordance with attribution principles for that income year.

Determine trust components of particular AMIT characters

3.11 To work out the amount that is to be attributed to each member for an income year, an attribution MIT must:

- work out the trust component of each AMIT character it derives for the income year; and

- determine the amount of the trust component (the determined trust component) of each AMIT character that it uses as the basis for attributing amounts to members.

[Schedule 2, item 2, section 276-265]

What is an AMIT character?

3.12 Amounts (including tax offsets) derived or received by an attribution MIT have particular AMIT characters. Each amount derived can have only one AMIT character. The specific AMIT character of a particular amount will depend on the activities of the attribution MIT that gave rise to the amount and the source of the amount. An amount of a particular AMIT character will be attributed to members of the attribution MIT on a fair and reasonable basis and retain its character in the hands of the members. As a result, for income tax purposes, members of the attribution MIT will recognise the amounts attributed to them in the same way that the amounts were recognised by the attribution MIT. ***[Schedule 2, item 2, section 276-145]***

3.13 AMIT characters are divided in to four categories:

- income AMIT characters — such as discount capital gains, non-discount capital gains, amounts that are subject to dividend, interest or royalty withholding tax; and ordinary or statutory income from a foreign source;
- exempt income AMIT characters;
- non-assessable non-exempt AMIT characters; and
- tax offset AMIT characters — such as franking credits received and foreign income tax paid by the trust.

[Schedule 2, item 2, section 276-150; Schedule 9, items 1, 4 and 6, definitions of 'AMIT character', 'exempt AMIT character', 'income AMIT character', 'NANE AMIT character' and 'offset AMIT character' in subsection 995-1(1)]

3.14 The Commissioner has the power to specify additional income AMIT characters, exempt AMIT characters and tax offset AMIT characters in a legislative instrument. ***[Schedule 2, item 2, subsections 276-150(7) and (8)]***

3.15 When deciding whether to specify further AMIT characters in a legislative instrument, the Commissioner should have regard to:

- the primary objective of ensuring that members of an attribution MIT have sufficient information to allow them to properly comply with the income tax law in relation to their own tax affairs; and

- the secondary objective of minimising the compliance burden of attribution MITs.

What is the trust component of an AMIT character?

3.16 To work out how much of an amount of a particular AMIT character is attributed to each member for an income year, an attribution MIT must first work out the trust component of that AMIT character for the income year.

3.17 The ***trust component*** of a particular AMIT character for the income year is basically the total amount of that AMIT character (net of expenses) derived by the attribution MIT for the income year. ***[Schedule 2, item 2, sections 276-265 and 276-280; Schedule 9, item 6, definition of 'trust component' in subsection 995-1(1)]***

3.18 The attribution MIT must apply some specific rules to work out the amount of a trust component of a particular AMIT character for an income year. ***[Schedule 2, item 2, subsection 276-280(2), sections 276-285 and 276-290]***

3.19 First, the trust component of each AMIT character must be calculated as if the trustee was liable to pay tax and was an Australian resident taxpayer. ***[Schedule 2, item 2, subsection 276-285(1)]***

3.20 Second, amounts subject to withholding tax are non-assessable non-exempt income. However, for the purposes of working out the amount of a trust component of a particular AMIT character, the attribution MIT should treat amounts subject to withholding tax as if they are not non-assessable non-exempt income. This is to ensure that amounts derived by the attribution MIT that are subject to foreign resident interest, dividend, royalty, or managed investment trust withholding tax do not need to be split between trust components of an income AMIT character and a non-assessable non-exempt income AMIT character. ***[Schedule 2, item 2, subsection 276-285(2)]***

3.21 Third, an amount that is derived by the attribution MIT can have only one AMIT character. ***[Schedule 2, item 2, subsection 276-285(3)]***

3.22 Fourth, the sum of each income AMIT character must equal the total assessable income of the trust less all allowable deductions. However, if an attribution MIT makes a tax loss (because its allowable deductions exceed its assessable income), the sum of the amount of each income AMIT character must be zero. ***[Schedule 2, item 2, subsections 276-285(4) and (5)]***

3.23 Fifth, an under or over that the attribution MIT had in a previous income year is disregarded. This is because the under or over will generally be reflected in the attribution MIT's trust component for that previous income year. ***[Schedule 2, item 2, subsection 276-285(6)]***

3.24 Finally, the attribution MIT must allocate deductions among the different income AMIT characters using the deduction allocation rules. ***[Schedule 2, item 2, section 276-290]***

3.25 Under the deduction allocation rules:

- deductions that relate directly to an amount of assessable income making up a trust component must initially be applied only to reduce that assessable income;
- deductions that relate to more than one or more amounts of assessable income must be apportioned between those amounts on a reasonable basis; and
- any remaining deductions (after applying the first two rules) must be apportioned between the remaining amounts of assessable income on a reasonable basis.

[Schedule 2, item 2, subsections 276-290(1) and (2)]

3.26 For these purposes, the attribution MIT must determine whether a deduction is directly related to a particular amount on a reasonable basis. ***[Schedule 2, item 2, subsection 276-290(3)]***

3.27 Factors that are relevant in determining whether the allocation of a deduction is reasonable include:

- whether the deduction was incurred in the course of deriving income of a particular income AMIT character;
- whether the deduction is factored into the financial risk management of the assets from which the particular income AMIT character arises;
- whether the deduction more directly relates to other income AMIT characters; and
- whether the trustee uses a consistent methodology for allocating deductions to income AMIT characters.

3.28 The ordinary rules affecting when losses or outgoings are deductible for trusts, such as those governing the recoupment of carry-forward of trust losses and the requirement to apply losses against net exempt income, apply for the purposes of calculating the trust components of an attribution MIT.

3.29 If there is no amount of a particular AMIT character after being reduced by losses or outgoings, the trust component of that AMIT character is taken to be nil. ***[Schedule 2, item 2, paragraph 276-355(7)(a)]***

3.30 If an attribution MIT makes a capital loss, the capital loss must be applied to reduce capital gains. The trustee can choose the order in which to apply capital losses against capital gains (consistent with the current treatment of capital losses). The attribution MIT will make a net capital gain if its capital gains for an income year exceed its capital losses.

3.31 However, if an attribution MIT has more than one class of members, capital losses related to assets that one class of members has an interest in should not offset capital gains that a different class of members has an interest in as this would be inconsistent with the principle that losses should be applied on reasonable basis.

Example 3.1

The ABC trust is an attribution MIT that invests in Australian equities and derives dividends, interest and capital gains. The ABC trust incurs a number of general expenses relating to the day-to-day operation of the trust (such as interest and accounting fees).

The trustee of the ABC trust has consistently maintained a policy of allocating non-capital expenses against income components of assessable income (income AMIT characters) that are not capital gains. The trustee only allocates these expenses against net capital gains when these gains exceed the other income components of assessable income.

The allocation of deductions on this basis is considered to be reasonable because this approach is consistent with established standard industry practice that is currently applied by a significant number of managed investment trusts.

What is the determined trust component of an AMIT character?

3.32 An attribution MIT must create a document that records the amount of the trust component for each AMIT character for an income year. The document must state expressly the amount of the trust component for each particular AMIT character for an income year and be used as the basis for attributing amounts to an entity that is a member of the attribution MIT during the income year. ***[Schedule 2, item 2, subsection 276-275(1)]***

3.33 The document can be in electronic form or in writing.

3.34 If the attribution MIT revises the trust component for a particular AMIT character for an income year, the attribution MIT can revise the document. In that event, the latest document is the relevant document for these purposes. ***[Schedule 2, item 2, subsection 276-275(2)]***

3.35 The ***determined trust component*** of a particular AMIT character for an income year is the amount stated to be the trust component of that AMIT character in the document that the attribution MIT creates for this purpose. ***[Schedule 2, item 2, sections 276-265 and 276-270; Schedule 9, item 1, definition of 'determined trust component' in subsection 995-1(1)]***

3.36 The determined trust component of a particular AMIT character for an income year is the total amount of that particular AMIT character derived by an attribution MIT for the income year which is attributed to its members.

Attribute amounts of particular AMIT characters to members

3.37 An attribution MIT must attribute the determined trust component of each AMIT character for an income year to its members. This is to ensure that an amount of an AMIT character that is derived or received by an attribution MIT for income tax purposes flows through the attribution MIT to its members and retains its AMIT character. As a result, members will recognise the amount of an AMIT character in broadly the same way as it would be recognised if the member had derived or received an amount of that AMIT character directly.

3.38 To achieve this, the attribution MIT must:

- work out the member component of each particular AMIT character for the income year; and
- attribute the amount of the member component (the determined member component) of each AMIT character for the income year to each member.

[Schedule 2, item 2, section 276-200]

What is the member component of an AMIT character?

3.39 The ***member component*** of an AMIT character for a particular member of an attribution MIT is so much of the determined trust component of that character that is attributable to the membership interests held in the attribution MIT by the member. ***[Schedule 2, item 2, section 276-215; Schedule 9, item 1, definition of 'member component' in subsection 995-1(1)]***

3.40 The amount attributed to members:

- must be worked out on a fair and reasonable basis in accordance with the constituent documents of the attribution MIT; and
- must not, to any extent, involve streaming of character amounts — that is, no part of the determined trust component of a particular AMIT character should be attributed to a particular member because of the tax characteristics of the member.

[Schedule 2, item 2, subsections 276-215(3) and (4)]

3.41 An amount attributed to members will have been worked out on a fair and reasonable basis in accordance with the constituent documents of the trust if the attribution is consistent with the clearly defined interests of the members.

3.42 Therefore, the attribution will not satisfy the key principles if, for example, all member components of a foreign source income character are attributed solely to non-resident members where both Australian resident and non-resident members have interests in the foreign assets of the trust.

3.43 However, there are three specific circumstances where the attribution principles in subsections 276-215(3) and (4) will not be breached.

3.44 First, the attribution principles will not be breached if a trust component of a capital gain AMIT character is attributed to a particular member in circumstances where the trustee of an attribution MIT exercises a power in its constituent documents to stream an amount arising from the sale of an asset to a particular member if:

- the member redeems one or more of their membership interests in the attribution MIT; and
- the streaming is made to fund the redemption.

[Schedule 2, item 2, subsection 276-215(5)]

3.45 This will allow an attribution MIT to sell assets in order to fund a large redemption by one of its members and not disadvantage on-going members of the attribution MIT.

3.46 Second, the attribution principles will not be breached if the amount attributed to a particular member reflects the fact that:

- the activities of the attribution MIT give rise to an economic benefit or economic detriment for its members at a particular time (the activity time);
- the amount of the trust components of the attribution MIT for an income year ending after the activity time are affected by those activities; and
- the member is a member of the attribution MIT at a time in income year, but was not a member of the attribution MIT at the activity time.

[Schedule 2, item 2, subsection 276-215(6)]

3.47 As a result, a trustee of an attribution MIT will be able to attribute a part of trust component reflecting a capital gain to a member without determining if the CGT event giving rise to the capital gain occurred during a part of the year in which the member had interests in the attribution MIT. In addition, it will allow the trustee to attribute in a manner that reflects the membership of the trust during different parts of the year.

3.48 Third, the attribution principles will not be breached if the amount attributed to a particular member reflects the fact that:

- an amount of an under relating to a base year increases a trust component of an AMIT character for a later income year, or an amount of an over relating to a base year decreases a trust component an AMIT character for a later income year; or
- the member is a member of the attribution MIT at a time in the later income year, but was not a member of the attribution MIT at a time in the base year.

[Schedule 2, item 2, subsection 276-215(7)]

3.49 This ensures that the unders and overs system, which essentially allows for a variance to be reconciled in the income year in which the variance is discovered, can operate effectively.

3.50 As holders of debt-like instruments are not to be treated as members of the trust, the trust must not attribute member components solely on account of the debt-like instrument. ***[Schedule 2, item 2, section 276-700]***

What is the determined member component of an AMIT character?

3.51 The ***determined member component*** of a particular AMIT character for an income year is the amount of a particular member's member component of that AMIT character stated by the attribution MIT in the latest AMIT member annual statement (or AMMA statement) that is sent to the member for the income year. ***[Schedule 2, item 2, section 276-210; Schedule 9, item 1, definition of 'determined member component' in subsection 995-1(1)]***

What is an AMMA statement?

3.52 An attribution MIT must notify each member of the amounts of each particular AMIT character that have been attributed to the member for an income year by giving the member an AMMA statement. The AMMA statement may be given in an electronic form

3.53 The attribution MIT must give an AMMA statement to each entity that was a member of the attribution MIT at any time in the income year. ***[Schedule 2, item 2, section 276-605]***

3.54 The AMMA statement for an income year must be given to the member of the attribution MIT within three months of the end of the income year. ***[Schedule 2, item 2, subsection 276-605(2)]***

3.55 However, an attribution MIT is not required to give an AMMA statement to an entity if:

- all of the entity's determined member components for the income year are nil; and
- all of the entity's membership interests in the attribution MIT have an AMIT cost base net amount for the income year of nil.

[Schedule 2, item 2, subsection 276-605(3)]

3.56 An attribution MIT can reconcile variances in calculating the trust component of a particular AMIT character that is attributed to members for an income year by reissuing AMMA statements to members for the income year to which the variance relates (instead of using the unders and overs system to reconcile those differences).

3.57 Therefore, the attribution MIT can issue revised AMMA statements to members after the end of the three month period. In that event, the revised AMMA statements issued to members effectively replace the original AMMA statements. ***[Schedule 2, item 2, subsection 276-605(4)]***

3.58 However, a revised AMMA statement must be given no later than three years after the end of the income year to which the AMMA statement relates. If a revised statement is given after the end of the three year period, it will not be an effective AMMA statement. ***[Schedule 2, item 2, subsection 276-610(5)]***

3.59 The AMMA statement must be in an approved form and must:

- include information that reflects the amount and AMIT character of each determined trust component; and
- state the amount of the AMIT cost base net amount for the income year in respect of the CGT asset that is the member's unit or interest in the attribution MIT; and
- be given to each entity that was a member of the attribution MIT at any time during the income year — this does not prevent an attribution MIT from giving an AMMA statement for a particular income year to an entity that became a member of the attribution MIT after the end of that income year where, under the constituent documents of the trust, the entity has rights to trust income derived in the particular income year.

[Schedule 2, item 2, section 276-610]

3.60 The approved form will be developed by the Commissioner of Taxation in consultation with key stakeholders, and is initially expected to be similar to the current standard distribution statement used by managed investment trusts.

Chapter 4
Reconciling variances in calculating trust components of particular AMIT characters

Outline of chapter

4.1 This Chapter explains how an attribution MIT can reconcile variances between the amounts actually attributed to members for an income year, and the amounts that should have been attributed, by:

- applying the unders and overs system in the income year in which the variance is discovered; or
- reissuing AMIT member annual statements (or AMMA statements) to members for the income year to which the variance relates.

Context of amendments

4.2 Trusts, including managed investment trusts, are currently taxed under the general trust provisions in Division 6 of Part III of the ITAA 1936.

4.3 The principles underlying the general trust provisions are, broadly, that:

- a beneficiary's taxable income for a year includes a proportionate share of the *net income* of the trust where the beneficiary is presently entitled to a share of the *income* of the trust; and
- the trustee of the trust is taxed on so much of the *net income* of the trust which has not been included in the assessable income of a presently entitled beneficiary.

4.4 The Board of Taxation identified a range of practical difficulties that arise for managed investment trusts in complying with the rules in Division 6. In this regard, the Board concluded that:

> 'As a result of complexity and time constraints, trustees of managed investment trusts can experience difficulty in obtaining final information to allow them to calculate, within a reasonable time at the

end of each financial year, the income and net income of the trust. Revisions may be required at a later time to ensure that the correct amounts are reported to the ATO and beneficiaries.' (Paragraph 4.32 of the Board's October 2008 Discussion Paper on the *Review of the Taxation Arrangements Applying to Managed Investment Trusts*)

'If a revision occurs, the amounts initially reported to beneficiaries may overstate or understate the correct amount of their share of the net income of the trust. Before the error is identified to them, beneficiaries may have already included the incorrect amounts in their income tax returns.' (Paragraph 4.34 of the Board's October 2008 Discussion Paper)

4.5 Trustees of attribution MITs are likely to continue to make revisions to the trust components of particular AMIT characters because:

- the calculations are complex;
- rounding discrepancies arise because, for example, the taxable income of an attribution MIT cannot be divided into the number of units in a way that gives rise to practical distribution numbers; and
- the attribution MIT has incomplete or interim information at the time it needs to do these calculations and needs to rely on external estimates.

4.6 In this regard, an attribution MIT will often have incomplete or interim information at the time it needs to work out the trust components of particular AMIT characters where it holds units in other attribution MITs and has not received final AMMA statements from those other attribution MITs. In these circumstances, the trustee has no alternative but to work out trust components of particular AMIT characters based on estimated amounts of those components.

4.7 Under the new tax system, attribution MITs will be able to reconcile a variance in calculating trust components of particular AMIT characters members for an income tax year in the income year that the variance is discovered.

4.8 The unders and overs system that applies to reconcile variances has been developed in consultation with key stakeholders and is consistent with the current approach used by managed investments trusts to reconcile variances in reporting amounts to their members.

Summary of new law

4.9 Under the new tax system for attribution MITs, an under or over will arise if a variance in a trust component is discovered.

- If a variance results in a trust component of a particular AMIT character being less than it should otherwise be, the attribution MIT generally has an ***under*** of that AMIT character.
- If a variance results in a trust component of a particular AMIT character being more than it should otherwise be, the attribution MIT generally has an ***over*** of that AMIT character.

4.10 Further adjustments may be made to a trust component if the net variance (considering all the unders and overs) is greater than:

- five per cent of the total trust components of the attribution MIT in the income year to which the under or over relates (the base year); and
- 0.4 per cent of the value of net assets of the attribution MIT for the base year.

4.11 When a trustee of an attribution MIT discovers an under or over of a particular AMIT character for an income year, the trustee can:

- attribute the under or over to members in the discovery year by adjusting the trust component of the relevant AMIT character in that year, which has the effect of reconciling a variance in the income year in which the variance is discovered; or
- reissue AMMA statements for the income year to which the variance relates to members, which has the effect of reconciling a variance in the income year to which the variance relates.

4.12 If a trust that was an attribution MIT ceases to be an attribution MIT for an income year, the trust will need to continue to identify unders and overs relating to the period that the trust was an attribution MIT that are discovered in later income years.

Comparison of key features of new law and current law

<table>
<tr><th>New law</th><th>Current law</th></tr>
<tr><td>If a variance occurs in calculating the trust component of amounts with particular AMIT characters, the trustee of an attribution MIT can:
• apply the unders and overs system to attribute the variance to members in the discovery year by adjusting the trust component of the relevant AMIT character in that year, which has the effect of reconciling the variance in the income year in which the variance is discovered; or
• revise the determined trust components for the income year to which the variance relates and reissue AMMA statements for that income year to members, which has the effect of reconciling the variance in the income year to which the variance relates.</td><td>If a variance occurs in calculating the amount of net income, the variance should be reconciled in the income year to which the variance relates. As a result:
• the trust may be required to reissue distribution statements to beneficiaries; and
• beneficiaries may need to seek amendments to their income tax returns.</td></tr>
</table>

Detailed explanation of new law

4.13 Trustees of an attribution MIT are likely to continue to make revisions to the trust components of particular AMIT characters because:

- the calculations are complex; and
- the trustee has incomplete information at the time it needs to do these calculations.

4.14 In this regard, an attribution MIT will often have incomplete or interim information at the time it needs to work out the trust components of particular AMIT characters where it holds units in other attribution MITs and has not received final AMMA statements from those other attribution MITs. In these circumstances, the trustee has no alternative but to work out trust components of particular AMIT characters based on estimated amounts of those components.

4.15 If the trustee of an attribution MIT makes a revision to the trust component of a particular AMIT character in an income year, the trustee can:

- apply the unders and overs system to attribute the variance to members in the discovery year by adjusting the trust component of a relevant AMIT character in that year, which has the effect of reconciling the variance in the income year in which the variance is discovered; or
- revise the determined trust components for the income year to which the variance relates and reissue AMMA statements for that income year to members, which has the effect of reconciling the variance in the income year to which the variance relates.

4.16 If a trust that was an attribution MIT ceases to be an attribution MIT for an income year, the trust will need to continue to identify unders and overs relating to the period that the trust was an attribution MIT that are discovered in later income years.

Key features of the unders and overs system

4.17 The unders and overs system applies to a trust that is an attribution MIT for an income year. ***[Schedule 2, item 2, section 276-340]***

4.18 Key features of the unders and overs system are that:

- an under-estimation in an income year of a particular AMIT character results in an *under* of that character;
- an over-estimation results in an *over* of that character; and
- unders and overs arise, and are dealt with, in the income year in which they are discovered (rather than the income year to which they relate).

[Schedule 2, item 2, section 276-335]

4.19 To apply the unders and overs system, the trustee of an attribution MIT must:

- determine if there is an under or over for an income year (the base year);
- adjust a trust component in income year in which the under or over is discovered (the discovery year); and
- if the under or over is substantial, increase (or ‘uplift’) the under or over to account for the loss of the time value of money.

4.20 If the variance is substantial and is the result of an intentional or reckless disregard of the law by the trustee, the trustee may also need to pay an administrative penalty. ***[Schedule 2, item 5, section 288-115 of Schedule 1 to the TAA 1953]***

4.21 When the trustee of an attribution MIT has fully reconciled unders and overs for a character over a period of time, the following two amounts should be equal:

- the sum of the ‘basic character amounts’ of that character over the period – that is, the trust component that should have been calculated without any adjustments for unders, overs or uplifts; and
- the sum of the determined trust components over the same period.

4.22 If there is a difference, that difference should be equal to the amount of uplift included in those trust components.

What is an under or over of an AMIT character?

4.23 To work out the amount of an under or over of a particular AMIT character for a base year, the attribution MIT must generally compare:

- the trust component for that AMIT character for the base year worked out based on the trustee’s knowledge at the discovery time — that is, the discovery year amount; and
- the determined trust component for that AMIT character for the base year — that is, the previous year amount.

[Schedule 2, item 2, subsections 276-355(1) and (3)]

4.24 The amount of an under or over must be worked out at the discovery time. The discovery time for a particular discovery year is just before the determined trust component of an AMIT character is worked out for the discovery year. This will allow the under or over to be included in the determined trust component for the discovery year. ***[Schedule 2, item 2, subsection 276-355(2)]***

4.25 To the extent the determined trust component falls short of the discovery year amount, the amount of the shortfall is generally an ***under*** of that AMIT character relating to the base year that the attribution MIT has in the discovery year. ***[Schedule 2, item 2, subsection 276-355(4); Schedule 9, item 6, definition of ‘under’ in subsection 995-1(1)]***

4.26 To the extent the determined trust component exceeds the discovery year amount, the amount of the excess is generally an ***over*** of that AMIT character relating to the base year that the AMIT has in the discovery year. ***[Schedule 2, item 2, subsection 276-355(5); Schedule 9, item 6, definition of 'over' in subsection 995-1(1)]***

4.27 AMITs can have unders and overs of the same AMIT character relating to the same base year in different discovery years. Therefore, if the discovery year is not the first income year after the base year, the trust must compare the discovery year amount for that income year with the discovery year amount for the most recent income year before the discovery year to determine if there is an under or over. ***[Schedule 2, item 2, subsection 276-355(6)]***

4.28 This ensures that an attribution MIT that has reconciled variances in a discovery year does not have to adjust its trust components for under and overs relating to the same variance in a later discovery year.

4.29 If an attribution MIT has no trust component of a particular AMIT character, the trust component of that AMIT character is taken to be nil for the purposes of working out the amount of an under or over. ***[Schedule 2, item 2, paragraph 276-355(7)(a)]***

4.30 Similarly, if an attribution MIT has no determined trust component of a particular AMIT character, the trust determined component of that AMIT character is taken to be nil for the purposes of working out the amount of an under or over. ***[Schedule 2, item 2, paragraph 276-355(7)(b)]***

4.31 A member of an attribution MIT who receives an AMMA statement must recognise the taxable member component of a particular AMIT character for the purposes of completing their own income tax return. The taxable member component of a particular AMIT character is generally the determined member component of that AMIT character recorded on the AMMA statement. However, in limited circumstances, the member can choose to recognise a taxable member component of a particular AMIT character that is different to the determined member component of that character. ***[Schedule 2, item 2, section 276-205]***

4.32 If a member of an attribution MIT makes a choice to recognise a taxable member component of a particular AMIT character that is different to the determined member component of that character, the attribution MIT can effectively disregard that choice for the purposes of working out the amount of an under or over. ***[Schedule 2, item 2, section 276-360]***

4.33 A trustee does not have to reconcile unders or overs of a particular AMIT character for a base year, once the amendment period for the base year has expired (that is, generally four years after the document for working out the determined trust component for the base year was created). ***[Schedule 2, item 2, section 276-365]***

How is an under or over reconciled?

4.34 When an under or over is discovered for a trust component of a particular AMIT character, the under or over is generally reconciled in the discovery year. The treatment of under or overs of a trust component of a particular AMIT character differs depending on whether the AMIT character is:

- an income AMIT character, exempt AMIT character or NANE AMIT character; or
- an offset AMIT character.

Unders or overs of an income AMIT character, exempt AMIT character or NANE AMIT character

4.35 If an under of a particular income AMIT character, exempt AMIT character or NANE AMIT character is discovered in an income year (the discovery year), the general principles are that:

- the trust component of the same AMIT character in the discovery year is increased by the amount of the under; and
- if multiple unders of the same AMIT character relating to more than one base year are discovered in the same year, the trust component of the same AMIT character in the discovery year is increased by the amount of all of the unders.

[Schedule 2, item 2, section 276-345]

4.36 If an over of a particular income AMIT character, exempt AMIT character or NANE AMIT character is discovered, the basic principles are that:

- the trust component of the same AMIT character in the discovery year is reduced by the amount of the over;
- if multiple overs of the same AMIT character relating to more than one base year are discovered in the same year, the trust component of the same AMIT character in the discovery year is reduced by the amount of all of the overs;

- if the trust component of an income AMIT character is reduced to nil, the remaining amount of the over (the *trust component deficit*) is applied to reduce the trust component of other income AMIT characters on a reasonable basis; and
- the amount of any remaining trust component deficit for the income year (the *carry-forward trust component deficit*) is carried forward to a later income year and reduces the trust components of the same AMIT characters in that later income year.

[Schedule 2, item 2, section 276-345]

4.37 The trust component of a particular income AMIT character, exempt AMIT character or NANE AMIT character is the amount calculated as follows:

Basic character amount

plus

(Total unders *less* Total overs)

plus

Total uplifts

less

Cross-character allocation amount

less

Carry-forward trust component deficit.

[Schedule 2, item 2, subsection 276-345(1)]

4.38 The *basic character amount* is the amount of a particular AMIT character that has been worked out under section 276-280 for the income year. ***[Schedule 2, item 2, subsection 276-345(1)]***

4.39 The *total unders* is the total of all unders of the particular AMIT character that the attribution MIT has in the income year, relating to all base years. ***[Schedule 2, item 2, subsection 276-345(1)]***

4.40 The *total overs* is the total of all overs of the particular AMIT character that the attribution MIT has in the income year, relating to all base years. ***[Schedule 2, item 2, subsection 276-345(1)]***

4.41 The *total uplifts* is the total of all uplifts (worked out under Subdivision 276-H) for the particular AMIT character in the income year, relating to all base years. ***[Schedule 2, item 2, subsection 276-345(1)]***

4.42 A cross-character allocation amount arises only in respect of a trust component that is an income AMIT character. If an attribution MIT has an over of a particular income AMIT character for an income year which exceeds the amount of that income AMIT character, the attribution MIT will have a ***trust component deficit*** for that income AMIT character for the income year. The trust component deficit for a particular income AMIT character can be allocated to other income AMIT characters on a reasonable basis. However, the amount that is allocated to another income AMIT character for the income year cannot exceed the amount of that income AMIT character for that income year. ***[Schedule 2, item 2, subsections 276-345(2) and (3); Schedule 9, item 6, definition of 'trust component deficit' in subsection 995-1(1)]***

4.43 The *cross-character allocation amount* in respect of a trust component that is an income AMIT character is the sum of:

- the amount of the trust component deficit for another income AMIT character for the income year that is allocated to the income AMIT character; and
- if the trust component is an income AMIT character that is foreign source income, the amount of the increase in that trust component in respect of a trust component deficit that is of a foreign income tax offset character.

[Schedule 2, item 2, subsection 276-345(1)]

4.44 The *carry-forward trust component deficit* is the trust component deficit for the income year for a trust component that is carried forward from a previous income year. In this regard, if the trust component worked out for an AMIT character for a particular income year is a negative amount, then:

- the trust component of that character for the income year is nil; and
- the negative amount (expressed as a positive amount) is the trust's *trust component deficit* of that character for the income year.

[Schedule 2, item 2, paragraphs 276-345(2)(a) and (b)]

4.45 The trust component deficit, reduced by the cross-character allocation amount, is the trust's ***carry-forward trust component deficit*** for the next income year. ***[Schedule 2, item 2, paragraph 276-345(2)(c) and (d; Schedule 9, item 1, definition of 'carry-forward trust component deficit' in subsection 995-1(1)]***

Example 4.1

For the 2015-16 income year, the ABC trust calculates that it has determined trust components of:

- $290,000 of foreign source income AMIT character; and
- $55,000 of other ordinary or statutory income AMIT character.

During the 2016-17 income year, the ABC trust receives further information regarding the 2015-16 income year. Therefore, it realises that the trust components for the 2015-16 income year consisted of:

- $300,000 of foreign source income AMIT character; and
- $50,000 of other ordinary or statutory income AMIT character.

Therefore in the 2016-17 income year, the ABC trust has, in relation to the 2015-16 income year:

- an under of foreign source income AMIT character of $10,000 (that is, $300,000 — $290,000); and
- an over of other ordinary or statutory income AMIT character of $5,000 (that is, $55,000 — $50,000).

The ABC trust must adjust its trust components of these AMIT characters for the 2016-17 income year to reflect these unders and overs.

For the 2016-17 income year, the ABC trust has basic character amounts (that is, trust components, unadjusted for new information regarding prior years) of:

- $200,000 of foreign source income AMIT character; and
- $100,000 of other ordinary or statutory income AMIT character.

Therefore, for the 2016-17 income year, the ABC trust has trust components of:

- foreign source income AMIT character of $210,000 (that is, $200,000 + $10,000); and
- other ordinary or statutory income AMIT character of $95,000 (that is, $100,000 — $5,000).

Unders or overs of an offset AMIT character

4.46 If an under of an offset AMIT character is discovered in an income year (the discovery year), the general principles are that:

- the trust component of the same offset AMIT character in the discovery year is increased by the amount of the under; and
- if multiple unders of the same offset AMIT character relating to more than one base year are discovered in the same year, the trust component of the same offset AMIT character in the discovery year is increased by the amount of all of the unders.

[Schedule 2, item 2, section 276-350]

4.47 If an over of an offset AMIT character is discovered, the basic principles are that:

- the trust component of the same offset AMIT character in the discovery year is reduced by the amount of the over;
- if multiple overs of the same offset AMIT character relating to more than one base year are discovered in the same year, the trust component of the same offset AMIT character in the discovery year is reduced by the amount of all of the overs; and
- if the trust component of an offset AMIT character is reduced to nil:
  - if the offset AMIT character is a foreign income tax offset — the remaining amount of the over (the *trust component deficit*) is grossed-up by the corporate tax gross-up rate and applied to reduce the trust component of an income AMIT character that is foreign source income; or
  - otherwise — the attribution MIT is liable to pay an amount of income tax equal to the amount of the trust component deficit.

[Schedule 2, item 2, section 276-350]

4.48 The trust component of a particular income AMIT character, exempt AMIT character or NANE AMIT character is the amount calculated as follows:

Basic character amount

plus

(Total unders *less* Total overs)

less

Total uplifts.

[Schedule 2, item 2, subsection 276-350(1)]

4.49 The *basic character amount* is the amount of a particular offset AMIT character that has been worked out under section 276-280 for the income year. ***[Schedule 2, item 2, subsection 276-350(1)]***

4.50 The *total unders* is the total of all unders of the particular offset AMIT character that the attribution MIT has in the income year, relating to all base years. ***[Schedule 2, item 2, subsection 276-350(1)]***

4.51 The *total overs* is the total of all overs of the particular offset AMIT character that the attribution MIT has in the income year, relating to all base years. ***[Schedule 2, item 2, subsection 276-350(1)]***

4.52 The *total uplifts* is the total of all uplifts (worked out under Subdivision 276-H) for the particular offset AMIT character in the income year, relating to all base years. ***[Schedule 2, item 2, subsection 276-350(1)]***

4.53 If the trust component worked out for an offset AMIT character for a particular income year is a negative amount, then:

- the trust component of that character for the income year is nil; and
- the negative amount (expressed as a positive amount) is the trust's ***trust component deficit*** of that character for the income year;

[Schedule 2, item 2, paragraphs 276-350(2)(a) and (b); Schedule 9, item 6, definition of 'trust component deficit' in subsection 995-1(1)]]

4.54 If the offset AMIT character is not a foreign income tax offset, the attribution MIT is liable to pay an amount of income tax equal to the amount of the trust component deficit. This is necessary because the excess tax offset attributed to a member will reduce that member's tax liability. Therefore, the imposition of an amount of income tax equal to the amount of the trust component deficit over will ensure that the revenue is not disadvantaged as a result of the variance that causes the over to arise. ***[Schedule 2, item 2, paragraph 276-350(2)(d) and subsection 276-350(4)]***

4.55 If the offset AMIT character is a foreign income tax offset, the cross-character allocation amount for the trust component of an income AMIT character that is foreign source income is increased by the trust component deficit multiplied by the corporate tax gross-up rate. ***[Schedule 2, item 2, paragraph 276-350(2)(d) and subsection 276-350(4)]***

4.56 The corporate tax gross up-rate is calculated using the following formula:

$$\frac{1 - \text{corporate tax rate}}{\text{corporate tax rate}}.$$

[Schedule 9, item 1, definition of 'corporate tax gross up rate' in subsection 995-1(1)]]

Uplifts for unders and overs

4.57 Where the unders and overs for a base year result in a substantial overall shortfall to revenue, trust components of income AMIT characters and offset AMIT characters may need to include an uplift. ***[Schedule 2, item 2, section 276-410]***

4.58 An uplift is applied to income AMIT characters and offset AMIT characters to:

- encourage the trustee of an attribution MIT to reconcile net unders of trust components of income AMIT characters, and net overs of trust components of offset AMIT characters, in a timely way;
- compensate for the time value of money lost as a result of the net unders of trust components of income AMIT characters, and net overs of trust components of offset AMIT characters, being brought to account in the discovery year instead of the base year; and
- ensure that the consequences of a tax shortfall resulting from variances in trust components are broadly consistent with the consequences that arise when variances occur for individual taxpayers in working out their own income tax affairs.

4.59 An attribution MIT must uplift certain trust components if it has an overall base year shortfall that exceeds the net variance threshold for the base year. ***[Schedule 2, item 2, section 276-415 and subsection 276-420(1)]***

4.60 An attribution MIT has an ***overall base year shortfall*** for a base year if the sum of the following amounts is positive:

- the total of the all unders, less any overs, of all income AMIT characters in all discovery years;
- the total of the all unders, less any overs, of all exempt AMIT characters in all discovery years
- the total of the all unders, less any overs, of all NANE AMIT characters in all discovery years; and
- the total of the all overs, less any unders, of all offset AMIT characters and net overs of offset AMIT characters in all discovery years.

[Schedule 2, item 2, subsections 276-420(2) and (3); Schedule 9, item 6, definition of 'overall base year shortfall' in subsection 995-1(1)]

4.61 If the sum of these amounts is negative, the attribution MIT has an ***overall base year excess*** for the base year equal to that amount (expressed as a positive amount). ***[Schedule 2, item 2, subsections 276-420(2) and (4); Schedule 9, item 6, definition of 'overall base year excess' in subsection 995-1(1)]***

4.62 An attribution MIT's ***net variance threshold*** for a base year is the greater of:

- five per cent of the total of the trust components for the base year; and
- 0.4 per cent of the value (determined in accordance with the accounting principles) at the end of the base year of the net assets of the trust.

[Schedule 2, item 2, subsection 276-420(5); Schedule 9, item 4, definition of 'net variance threshold' in subsection 995-1(1)]

4.63 As the net variance threshold is based on the trust component (rather than the determined trust component), the net variance threshold for a base year will vary as unders and overs relating to the base year are discovered.

4.64 The net variance threshold allows for a margin of under estimation or over estimation in working out trust components which reflects the total amounts arising on account of the activities of the trust and the total funds under management.

4.65 For the purpose of calculating an overall base year shortfall, overall base year excess or net variance threshold, a trust component of franking credit gross-up AMIT character is disregarded. This is because an equivalent trust component is already reflected in these amounts. ***[Schedule 2, item 2, subsection 276-420(6)]***

4.66 If an attribution MIT has an overall base year shortfall that exceeds the net variance threshold for a base year, then:

- an uplift must be calculated for each under of an income AMIT character that the attribution MIT has in a discovery year that remains after being proportionately reduced by overs of an income AMIT character; and

- an uplift must be calculated for each over of an offset AMIT character that the attribution MIT has in a discovery year that remains after being proportionately reduced by under of an offset AMIT character.

[Schedule 2, item 2, section 276-430]

4.67 The amount of each uplift is the amount of shortfall interest charge payable on an upliftable amount of each AMIT character where:

- the upliftable amount is the remaining net under of an income AMIT character or the remaining net over of an offset AMIT character;

- the amount of shortfall interest charge payable is worked out on a daily compounding basis over the period beginning four months after the end of the base year to which the variance relates and ending four months after the end of the discovery year for the under or over; and

- the rate of the charge for each day is the rate of shortfall interest charge for the last day in the discovery year.

[Schedule 2, item 2, section 276-435]

4.68 Each uplift of an income AMIT character is added to the trust component of the same income AMIT character in the first discovery year for which an uplift must be calculated. ***[Schedule 2, item 2, subsection 276-345(2) and section 276-440]***

4.69 Similarly, each uplift of an offset AMIT character is subtracted from the trust component of the same offset AMIT character in the first discovery year for which an uplift must be calculated. ***[Schedule 2, item 2, subsection 276-350(2) and section 276-440]***

4.70 If the an attribution MIT has multiple classes of interests and has made a choice under section 276-20 to apply the attribution regime separately to each class of interests, the attribution MIT must work out the overall base year shortfall, the overall base year excess and the net variance threshold for the trust as a whole (rather than separately for each class). ***[Schedule 2, item 2, section 276-425]***

Example 4.2

For the 2015-16 income year, the XYZ trust calculates that it has determined trust components of:

- $900,000 of foreign source income AMIT character (which is an income AMIT character);
- $2,000,000 of other ordinary or statutory income AMIT character (which is an income AMIT character); and
- $370,000 of foreign tax paid AMIT character (which is an offset AMIT character).

The XYZ trust has no other trust components.

During the 2016-17 income year, the XYZ trust receives further information regarding the 2015-16 income year. Therefore, it realises that the trust components for the 2015-16 income year consisted of:

- $1,000,000 of foreign source income AMIT character;
- $2,000,000 of other ordinary or statutory income AMIT character;
- $300,000 of foreign tax paid AMIT character.

Therefore in the 2016-17 income year, the XYZ trust has, in relation to the 2015-16 income year:

- an under of foreign source income AMIT character of $100,000 (that is, $1,000,000 — $900,000); and
- an over of foreign tax paid AMIT character of $70,000 (that is, $370,000 — $300,000).

The XYZ trust must include the amount of the under and over in its trust components of these AMIT characters for the 2016-17 income year.

The XYZ trust must also determine if the trust components of these AMIT characters need to be adjusted for uplifts by comparing the net variance threshold with the overall base year shortfall for the 2015-16 income year.

The net variance threshold for the 2015-16 income year is the greater of:

- $165,000, being 5 per cent of the sum of the actual trust components for the 2015-16 income year (that is, 0.05 x ($1,000,000 + $2,000,000 + $300,000) = 0.05 x $3,300,000); and

- $140,000, being 0.4 per cent of the net assets of the trust on 30 June 2016 on the assumption that the value of the net assets of the XYZ trust was $35 million on 30 June 2016 (that is, 0.004 x $35 million).

Therefore, the net variance threshold for the XYZ trust for the 2015-16 income year is $165,000.

In the 2015-16 income year, the XYZ trust has an overall base year shortfall of $170,000 which is composed of the sum of:

- $100,000 (for the under of the income AMIT character); and

- $70,000 (for the over of the offset AMIT characters).

As the overall base year shortfall ($170,000) is greater than the net asset threshold ($165,000), the XYZ trust must include uplifts for the under of foreign source income AMIT character and the over of foreign tax paid AMIT character.

To work out the amount of the uplift, assume that:

- the trust return was due on 31 October 2016 (meaning that there is 242 days between the due date of the return for the 2015-16 year and the end of the 2016-17 income year); and

- the rate of shortfall interest charge for the last day in the 2016-17 income year was 6 per cent.

Therefore:

- the uplift for the $100,000 under of foreign income AMIT character is $4,058 (that is, $\$100,000 \times (1 + 0.06/365)^{242} - \$100,000$).

- the uplift for the $70,000 over of foreign tax paid AMIT character is $2,841 (that is, $\$70,000 \times (1 + 0.06/365)^{242} - \$70,000$).

Consequently, in the 2016-17 income year, the XYZ trust must:

- increase the trust component of foreign source income by $4,058; and

- reduce the trust component of foreign tax paid by $2,841.

Example 4.3

In the 2015-16 income year, the XYZ trust calculates that it has a determined trust component of foreign source AMIT character of $200,000. However, its actual trust component of that character was $250,000.

The XYZ trust receives further information regarding the 2015-16 income year during the 2016-17 income year and again in the 2017-18 income year. Therefore:

- in the 2016-17 income year, the trust realises that the trust component of foreign source income AMIT character for the 2015-16 income year should have been $220,000; and
- in the 2017-18 income year, the trust realises that the trust component of foreign source income AMIT character for the 2015-16 income year should have been $250,000.

Other relevant facts for the XYZ trust are that:

- all other trust components have been calculated correctly;
- the net variance threshold for the 2015-16 year was $40,000;
- the trust return was due on 31 October 2016 (as a result, there were 242 days between the due date of the return for the 2015-16 year and the end of the 2016-17 income year, and 607 days between the due date of the return for the 2015-16 year and the end of the 2017-18 income year); and
- the rate of shortfall interest charge for both the last day in the 2016-17 income year and the last day in the 2017-18 income year was 6 per cent.

Therefore, in the 2016-17 income year:

- the trust increases its trust component of foreign source income for an under of $20,000 — that is, the difference between the determined trust component ($200,000) and the trustee's knowledge of the trust component for the 2015-16 income year just before it calculates its trust components for the 2016-17 income year ($220,000); and
- the trust does not adjust its trust component for an uplift on account of this under because their overall base year shortfall at that time ($20,000) is less than the net variance threshold ($40,000).

In the 2017-18 income year, the trust increases the trust component of foreign source income for the under of $30,000. This reflects the difference between:

- the previous year amount ($220,000); and
- the trustee’s knowledge of the trust component for the 2015-16 income year just before it calculates its trust components for the 2017-18 income year (that is, $250,000).

The overall base year shortfall for the 2015-16 income year ($50,000) exceeds the net variance threshold ($40,000). Therefore, the XYZ trust must calculate an uplift for each of the two unders it has discovered in relation to the 2015-16 income year — that is:

- the $20,000 under discovered in the 2016-17 income year; and
- the $30,000 under discovered the 2017-18 income year.

The uplift for the $20,000 under discovered in the 2016-17 income year is $812 (that is, $\$20,000 \text{ x } (1 + 0.06/365)^{242} - \$20,000$).

The uplift for the $30,000 under discovered in the 2017-18 income year is $3,148 (that is, $\$30,000 \text{ x } (1 + 0.06/365)^{607} - \$30,000$).

Consequently, in the 2017-18 income year, the XYZ trust must increase the trust component of foreign source income by $3,960 to account for the two uplifts.

Penalty for intentional or reckless disregard of the law

4.71 The trustee of an attribution MIT is liable to an administrative penalty if the overall base year shortfall or overall base year excess for the base year exceeds the net variance threshold as a result of the intentional or reckless disregard of the law. ***[Schedule 2, item 5, subsection 288-115(1) of Schedule 1 to the TAA 1953]***

4.72 The amount of the penalty is the highest of the following amounts that is applicable to the trustee:

- where there is an overall base year shortfall as a result of the intentional disregard of the law, 75 per cent of the overall base year shortfall multiplied by the top marginal tax rate (including Medicare levy and any temporary Budget repair levies).
- where there is an overall base year shortfall as a result of reckless disregard of the law, 50 per cent of the overall base year shortfall multiplied by the top marginal tax rate (including Medicare levy and any temporary Budget repair levies);

- where there is an overall base year excess as a result of intentional disregard of the law, the greater of 30 per cent of the overall base year excess multiplied by the top marginal tax rate (including Medicare levy and any temporary Budget repair levies) or 60 penalty units;

- where there is an overall base year excess as a result of reckless disregard of the law, the penalty is the greater of 20 per cent of the overall base year excess multiplied by the top marginal tax rate (including Medicare levy and any temporary Budget repair levies) or 40 penalty units.

[Schedule 2, item 5, section 288-115 of the TAA 1953]

4.73 These penalties are consistent with the administrative penalties that arise when an individual taxpayer intentionally or recklessly disregards in relation to their own income tax affairs.

4.74 The question as to whether there has been intentional or reckless disregarded of the law in a particular circumstance is determined in a manner consistent with the existing framework for administrative penalties (including remission of penalties) in Division 284 of Schedule 1 to the TAA 1953.

4.75 However, the trustee of an attribution MIT would not be taken to have intentionally or recklessly disregarded the law if, in working out estimates of the trust components of particular AMIT characters that are attributed to members, the trustee, for example:

- uses published estimates of amounts expected to be received by the attribution MIT from third party funds;

- contacts third party fund managers to request estimates of amounts expected to be received by the attribution MIT from that third party fund and, when provided, uses those estimates; or

- makes reasonable estimates of the distribution yield and tax components based on historical yield and tax component data.

What if a trust ceases to be an attribution MIT?

4.76 If a trust that was an attribution MIT ceases to be an attribution MIT for an income year, the trust will need to continue to identify unders and overs relating to the period that the trust was an attribution MIT that are discovered in later income years (the discovery year). ***[Schedule 2, item 2, section 276-755]***

4.77 In these circumstances, the trust will need to continue to work out unders and overs relating to a base year during which the trust was an attribution MIT. ***[Schedule 2, item 2, section 276-760]***

4.78 If the trust discovers an under or over that has the effect of increasing the amount of an AMIT character for the discovery year (worked out on the basis that the trust continued to be an attribution MIT), then:

- if the relevant AMIT character is an income AMIT character, the trust must treat the amount of the increase as assessable income of the trust for the discovery year;
- if the relevant AMIT character is an exempt AMIT character, the trust must treat the amount of the increase as exempt income of the trust for the discovery year;
- if the relevant AMIT character is a NANE AMIT character, the trust must treat the amount of the increase as non-assessable non-exempt income of the trust for the discovery year; or
- if the relevant AMIT character is an offset AMIT character, the trust must treat the amount of the increase as a tax offset of the trust for the discovery year of a kind corresponding to that character.

[Schedule 2, item 2, subsection 276-760(2) and section 276-765]

4.79 If the trust discovers an under or over that has the effect of decreasing the amount of an AMIT character for the discovery year (worked out on the basis that the trust continued to be an attribution MIT), then:

- if the relevant AMIT character is an income AMIT character that is a discount capital gain, the trust must treat half of the amount of the decrease as a capital loss of the trust for the discovery year;
- if the relevant AMIT character is an income AMIT character that is a non-discount capital gain, the trust must treat the amount of the decrease as a capital loss of the trust for the discovery year;

- if the relevant AMIT character is an income AMIT character other than a capital gain, the trust must treat the amount of the decrease as a deduction of the trust for the discovery year
- if the relevant AMIT character is an exempt AMIT character, the trust must treat the amount of the decrease as reducing the exempt income of the trust for the discovery year;
- if the relevant AMIT character is an NANE AMIT character, the trust must treat the amount of the decrease as reducing the non-assessable non-exempt income of the trust for the discovery year; or
- if the relevant AMIT character is an offset AMIT character, the trust must generally treat the amount of the decrease as reducing the tax offset or offsets of the trust for the discovery year of a kind corresponding to that character.

[Schedule 2, item 2, subsection 276-760(2) and section 276-770]

4.80 However, in the case of a relevant AMIT character that is an offset AMIT character which exceeds the total of the existing offsets of the trust (before the reduction under subsection 276-770(5)), the trustee is liable to pay tax on the amount of the excess at the top marginal tax rate (including the Medicare levy and any temporary Budget repair levies). ***[Schedule 2, item 2, subsection 276-770(6)]***

Chapter 5
Trustee liable to pay income tax

Outline of chapter

5.1 This Chapter explains circumstances in which the trustee of an attribution MIT is liable to pay income tax.

Context of amendments

5.2 Trusts, including managed investment trusts, are currently taxed under the general trust provisions in Division 6 of Part III of the ITAA 1936.

5.3 Where a trust has net income to which no beneficiary is presently entitled, the trustee is liable to tax in relation to that amount.

5.4 If a variance occurs that results in a shortfall in the amount of net income assessed to a beneficiary who is presently entitled, the beneficiary may need to seek an amendment to their income tax return.

5.5 In addition, under Division 6, the trustee of a managed investment trust is liable to pay income tax on amounts of net income referable to income of the trust to which a foreign resident beneficiary is presently entitled in some circumstances.

5.6 Under the new tax system for attribution MITs, the trustee of an attribution MIT will be liable to pay income tax if a discrepancy occurs in attributing amounts of determined trust components to members in some circumstances. This will occur where, as a result of that discrepancy, the taxable income of the attribution MIT for an income year is not fully attributed to members or where amounts are attributed in a way that is inconsistent with the attribution principles.

5.7 In addition, the trustee of an attribution MIT will continue to be liable to pay tax on amounts attributed to a foreign resident member in some circumstances.

5.8 Finally, the Board of Taxation recommended the introduction of a non-arm's length income rule for attribution MITs to protect the integrity of the corporate tax base (Recommendation 10). Under this rule, the trustee of an attribution MIT will be liable to pay tax on non-arm's length income.

5.9 The non-arm's length income rule removes the incentive for an attribution MIT to shift profits from an active business of a related party to the attribution MIT by engaging in non-arm's length activity.

Summary of new law

5.10 The trustee of an attribution MIT will be liable to pay income tax where:

- the amount of the determined member component of a particular AMIT character attributed to a member is different to what it should have been;
- the sum of the determined member components of a particular AMIT character attributed to members is less than the determined trust component of that character;
- unders of an income character are not properly carried forward; or
- overs of an offset character are not properly carried forward.

5.11 The trustee of an attribution MIT will also be liable to pay income tax on:

- a taxable member component that has been attributed to a foreign resident member in some circumstances; and
- non-arm's length income derived by the attribution MIT.

Comparison of key features of new law and current law

New law	*Current law*
The trustee of an attribution MIT will be liable to pay tax where: • the amount of the determined member component of a particular AMIT character attributed to a member is different to what it should have been;	Where a trust has net income to which no beneficiary is presently entitled, the trustee is liable to tax in relation to that amount. If a variance occurs that results in a shortfall in the amount of net income assessed to a beneficiary who is

• the sum of the determined member components of a particular AMIT character attributed to members is less than the determined trust component of that character; • unders of an income character are not properly carried forward; or • overs of an offset character are not properly carried forward.	presently entitled, the beneficiary may need to seek an amendment to their income tax return.
The trustee of an attribution MIT will be liable to pay tax on a taxable member component that has been attributed to a foreign resident member in some circumstances.	The trustee of a managed investment trust is be liable to pay income tax on amounts to which a foreign resident beneficiary is presently entitled in some circumstances.
The trustee of an attribution MIT will be liable to pay income tax non-arm's length income derived by the attribution MIT.	No equivalent.

Detailed explanation of new law

5.12 The trustee of an attribution MIT will be liable to pay income tax where:

- the amount of the determined member component of a particular AMIT character attributed to a member is different to what it should have been;
- the sum of the determined member components of a particular AMIT character attributed to members is less than the determined trust component of that character;
- unders of an income character are not properly carried forward; or
- overs of an offset character are not properly carried forward.

5.13 The trustee of an attribution MIT will also be liable to pay income tax on:

- a taxable member component that has been attributed to a foreign resident member in some circumstances; and
- non-arm's length income derived by the attribution MIT.

Incorrect attribution of single member components

5.14 The trustee of the attribution MIT may be liable to pay tax if:

- for an amount of an income or exempt income AMIT character — the determined member component falls short of the member component; or
- for an amount of a non-assessable non-exempt income or an offset AMIT character — the determined member component exceeds the member component.

[Schedule 2, item 2, sections 276-500 and 276-505]

5.15 If there is a shortfall between the determined member component and the member component of an income or exempt income AMIT character for a member for an income year, the trustee of the attribution MIT is liable to tax on the amount of the shortfall at the top marginal tax rate (including the Medicare levy and any temporary Budget repair levies). ***[Schedule 2, item 2, subsections 276-500(1), (2) and (4)]***

5.16 Similarly, if there is an excess between the determined member component and the member component of a non-assessable non-exempt AMIT character for a member for an income year, the trustee of the attribution MIT is liable to pay tax on the amount of the excess at the top marginal tax rate (including the Medicare levy and any temporary Budget repair levies). ***[Schedule 2, item 2, subsections 276-500(3) and (4)]***

5.17 A consequential amendment ensures that the Commissioner of Taxation can make an assessment for the trustee of an attribution MIT in relation to the ascertainment of a tax liability. ***[Schedule 6, item 1, definition of 'assessment' in section 6(1) of the ITAA 1936]***

5.18 The Commissioner can raise multiple liabilities for similar shortfalls in one assessment. For example, if there are multiple income AMIT character shortfall amounts for a particular income year because of variations relating to more than one member, the Commissioner may make one assessment of the trustee's liability to pay take on the sum of those income AMIT character shortfall amounts.

5.19 If there is an excess between the determined member component and the member component of an offset AMIT character for a member for an income year, the trustee of the attribution MIT is liable to pay tax on the amount of the excess at 100 per cent. This is because the excess tax offset attributed to the member reduces the member's tax liability by an equivalent amount (and may give rise to a refundable franking credit for the member). ***[Schedule 2, item 2, section 276-505]***

5.20 No tax is payable on a shortfall in respect of a franking credit gross-up AMIT character. This is because the corresponding excess in respect of a franking credit AMIT character will be taxed. ***[Schedule 2, item 2, section 276-510]***

Determined member components of a particular AMIT character less than the determined trust component

5.21 If the sum of all determined member components of a particular income AMIT character of all members of the AMIT for an income year falls short of the determined trust component of that character of the attribution MIT for the income year, the trustee of the attribution MIT is liable to pay tax on the amount of the shortfall at the top marginal tax rate (including the Medicare levy and any temporary Budget repair levies). ***[Schedule 2, item 2, subsection 276-515(1) and (2)]***

5.22 If the member component or the determined member component is of an income AMIT character that is a discount capital gain, then, for the purposes of working out the amount that the trustee is liable to pay income tax on, the amount of the component is doubled. This ensures that the trustee is liable to pay income tax on the component as though it were not a discount capital gain. ***[Schedule 2, item 2, subsections 276-515(3) and (4)]***

Unders of an income character not properly carried forward

5.23 The trustee of the attribution MIT is liable to pay tax if the attribution MIT has, for an income year, an under of an income AMIT character in the income year relating to an earlier income year (the base year), worked out on the basis of the trustee's knowledge at the discovery time, which falls short of the amount of that under if it had been worked out on the basis of what the trustee should have known. ***[Schedule 2, item 2, subsection 276-520(1)]***

5.24 In this regard:

- the base year is the income year to which the under actually relates;
- the discovery year is a later income year in which the variance in relation to the base year is discovered; and
- the correct under (based on what the trustee should have known), and the resulting shortfall, arise in the discovery year.

5.25 The amount of the shortfall is reduced to the extent that the under for the base year is taken into account in a later income year. ***[Schedule 2, item 2, subsections 276-520(4) and (5)]***

5.26 If an attribution MIT has a shortfall under section 276-520, the trustee is liable to pay tax on the amount of the shortfall at the top marginal tax rate (including the Medicare levy and any temporary Budget repair levies). ***[Schedule 2, item 2, subsection 276-520(2)]***

5.27 If the trustee of an attribution MIT is liable to pay tax on the amount of a shortfall under section 276-520, the running balance account for the determined trust component is adjusted by the amount of the shortfall. ***[Schedule 2, item 2, subsection 276-520(3)]***

5.28 In this regard, the running balance account keeps track of the amount of unders and overs for a particular base year.

5.29 The trustee of an attribution MIT could be assessed on a shortfall under section 276-520 because, for example, the trustee and the Commissioner of Taxation disagree on the interpretation of a provision in the income tax law. If the trustee of an attribution MIT disagrees with the assessment, they may object to the assessment in the manner set out in Part IVC of the TAA 1953.

Example 5.1

The ABC Trust is an attribution MIT. In the 2017-18 income year, the ABC Trust discovers an amount of $1,000 that relates to the 2016-17 income year. The trustee considers that the discovered amount consists of:

- ordinary assessable income of $800; and
- non-assessable non-exempt income of $200.

Therefore, in the 2017-18 income year, the ABC Trust recognises:

- a $800 under of an ordinary income AMIT character; and
- a $200 under of a NANE AMIT character.

In the 2018-19 income year, the Commissioner of Taxation undertakes a compliance review and concludes that the whole of the discovered amount is an ordinary assessable income. As a result, $1,000 should have been recognised as an under of an ordinary income AMIT character.

If the trustee of the ABC Trust accepts the Commissioner's view, the trustee could adjust for the variance by recognising, in relation to the 2016-17 base income year:

- an additional $200 under of an ordinary income AMIT character; and
- a $200 over of a NANE AMIT character.

Alternatively, the trustee may be able to reissue AMMA statements to members for the 2016-17 base income year.

However, if the trustee does not accept the Commissioner's view, the Commissioner may make a shortfall assessment for the 2018-19 income year (that is, for the discovery year in which $200 shortfall arises). In that event, the trustee will be liable to pay shortfall taxation of $94 (that is, $200 x 47 per cent).

Overs of an offset character are not properly carried forward

5.30 The trustee of the attribution MIT is liable to pay tax if the attribution MIT has, for an income year, an over of an offset AMIT character in the income year relating to an earlier income year (the base year), worked out on the basis of the trustee's knowledge at the discovery time, which exceeds the amount of that over if it had been worked out on the basis of what the trustee should have known. ***[Schedule 2, item 2, subsection 276-525(1)]***

5.31 The amount of the excess is reduced to the extent that the over for the base year is taken into account in a later income year. ***[Schedule 2, item 2, subsections 276-525(4) and (5)]***

5.32 If an attribution MIT has an excess under section 276-525, the trustee is liable to pay tax on the amount of the excess at the top marginal tax rate (including the Medicare levy and any temporary Budget repair levies). ***[Schedule 2, item 2, subsection 276-525(2)]***

5.33 If the trustee of an attribution MIT pays tax on the amount of an excess under section 276-525, the running balance account for the determined trust component is adjusted by the amount of the excess. ***[Schedule 2, item 2, subsection 276-525(3)]***

Trustee taxed on taxable member components attributed to foreign residents

5.34 Under the attribution model of taxation, amounts related to income and tax offsets of an attribution MIT, determined by the trustee to be of a particular character, are attributed to members and generally retain that character. The amount that is attributed by an attribution MIT to members and generally retains its character is called the taxable member component of a particular AMIT character.

5.35 The ***taxable member component*** of a particular AMIT character for an income year of a member of an attribution MIT is generally the determined member component of that character for the income year. ***[Schedule 2, item 2, subsection 276-205(1); Schedule 9, item 6, definition of 'taxable member component' in subsection 995-1(1)]***

5.36 Currently, the trustee of a managed investment trust is liable to pay income tax on amounts to which a foreign resident beneficiary is presently entitled in some circumstances (section 98 of the ITAA 1936). Sections 276-95 to 276-110 effectively replicate the effect of section 98 for attribution MITs.

5.37 Therefore, consistent with the outcomes that arise for a managed investment trust under subsection 98(3) of the ITAA 1936, the trustee of an attribution MIT is liable to pay income tax if:

- a member of the attribution MIT has a taxable member component of an income AMIT character in respect of the attribution MIT for an income year;
- the member is not, in respect of that taxable member component, a beneficiary in the capacity of a trustee of another trust; and
- the member is a foreign resident at the end of the income year.

[Schedule 2, item 2, subsection 276-95(1)]

5.38 In these circumstances, the trustee of the attribution MIT is liable to pay income tax on the taxable member component to the extent that the component is:

- attributable to a period when the member is a resident; or
- attributable to a period when the member is a foreign resident and is attributable to an Australian source.

[Schedule 2, item 2, subsections 276-95(2) and (3)]

5.39 If a taxable member component is reflected in an AMIT DIR payment or a fund payment (and therefore is subject to withholding tax), the trustee is not liable to pay income tax on the amount. ***[Schedule 2, item 2, subsection 276-95(4)]***

5.40 An ***AMIT DIR payment*** is, broadly:

- an AMIT income character amount that is a dividend and is subject to withholding tax;
- an AMIT income character amount that is interest and is subject to withholding tax; or
- an AMIT income character amount that is a royalty and is subject to withholding tax.

[Schedule 3, item 6, section 12A-20 of Schedule 1 to the TAA 1953; Schedule 9, item 1, definition of 'AMIT DIR payment' in subsection 995-1(1)]

5.41 If the taxable member component is of an income AMIT character that is a discount capital gain, then, for the purposes of working out the amount that the trustee is liable to pay income tax on, the amount of the component is doubled. This ensures that the trustee is liable to pay income tax on the component as though it were not a discount capital gain. ***[Schedule 2, item 2, subsections 276-95(5) and (6)]***

5.42 The rate of tax payable by the trustee on the relevant taxable member component is:

- if the member is not a company, the marginal tax rate (including the Medicare levy and any temporary Budget repair levies) that applies to a foreign resident individual; or
- if the member is a company, the corporate tax rate.

[Schedule 2, item 2, subsection 276-95(2)]

5.43 If the trustee is liable to pay tax on the taxable member component attributed to a foreign resident member under section 276-95, the member is entitled to a refundable tax offset equal to the amount of tax paid by the trustee. ***[Schedule 2, item 2, section 276-100]***

5.44 In addition, consistent with the outcomes that arise for a managed investment trust under subsection 98(4) of the ITAA 1936, the trustee of an attribution MIT is liable to pay income tax if:

- a member of the attribution MIT has a taxable member component of an income AMIT character in respect of the attribution MIT for an income year;
- the member is, in respect of that taxable member component, a beneficiary in the capacity of a trustee of another trust; and

- the trustee of the other trust is a foreign resident at the end of the income year.

[Schedule 2, item 2, subsection 276-105(1)]

5.45 If a taxable member component is reflected in an AMIT DIR payment or a fund payment (and therefore is subject to withholding tax), the trustee is not liable to pay income tax on the amount. ***[Schedule 2, item 2, subsection 276-105(3)]***

5.46 The trustee of the attribution MIT is liable to pay income tax on the taxable member component to the extent that the component is not subject to withholding tax. However, the trustee is not liable to pay income tax on the taxable member component if it has an AMIT character that is:

- a capital gain on non-taxable Australian property; or
- foreign source income

[Schedule 2, item 2, subsections 276-105(2), (3) and (4)]

5.47 If the taxable member component is of an income AMIT character that is a discount capital gain, then, for the purposes of working out the amount that the trustee is liable to pay income tax on, the amount of the component is doubled. This ensures that the trustee is liable to pay income tax on the component as though it were not a discount capital gain. ***[Schedule 2, item 2, subsections 276-105(5) and (6)]***

5.48 The rate of tax payable on the relevant taxable member component is the top marginal tax rate (including the Medicare levy and any temporary Budget repair levies). ***[Schedule 2, item 2, subsection 276-105(2)]***

5.49 If the trustee is liable to pay tax on the taxable member component attributed to a foreign resident member under section 276-105 (the taxed component), the beneficiary of a trust who receives or is presently entitled to an amount that is reasonably attributable to the taxed component can deduct an amount equal to their share of the tax paid by the trustee under section 276-105, or get a refund of any excess tax paid by the trustee. ***[Schedule 2, item 2, subsection 276-110]***

Non-arm’s length income

5.50 The Board of Taxation recommended the introduction of a non-arm’s length income rule for attribution MITs to protect the integrity of the corporate tax base (Recommendation 10). The non-arm’s length income rule removes the incentive for an attribution MIT to shift profits from an active business of a related party by engaging in non-arm's length activity.

5.51 If an attribution MIT derives non-arm's length income, the trustee is taxed on the non-arm's length income at the top marginal rate (including Medicare levy and any temporary Budget repair levies) provided that:

- the non-arm's length income is reflected in one of more of the attribution MIT's trust components for the income year;
- the attribution MIT is a party to a scheme (which is defined in subsection 995-1(1) to mean, any arrangement, scheme, plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise), where the parties to the scheme are not dealing with each other at arm's length (the non-arm's length scheme); and
- at least one of the parties to the non-arm's length scheme is not an attribution MIT for the income year.

[Schedule 2, item 2, section 276-670]

5.52 An amount of ordinary income or statutory income is non-arm's length income of an attribution MIT for an income year if:

- the amount is derived from the non-arm's length scheme; and
- the amount is more than the amount that the attribution MIT might have been expected to receive if those parties had been dealing with each other at arm's length in relation to the scheme.

[Schedule 2, item 2, subsection 276-670(5); Schedule 9, item 5, definition of 'non-arm's length income' in subsection 995-1(1)]

5.53 However, an amount of income is not non-arm's length income if it is:

- a distribution from a corporate tax entity;
- a distribution from a trust that is not a party to the non-arm's length scheme; or
- a return that an entity pays or provides on a debt interest, if the rate (expressed on an annual basis) of the return does not exceed the greater of:

- the benchmark rate of return for the debt interest; and
- the base interest rate for the day on which the return is paid or provided, plus three percentage points — that is, a rate of return equal to rate of the shortfall interest charge.

[Schedule 2, item 2, paragraph 276-670(5)(c) and subsection 276-670(6)]

5.54 If an interest in an attribution MIT is a debt interest, the non-arm's length income rule focuses on the return from that debt interest rather than, for example, the principal of the loan. In this regard, as a safe harbour rule, the return on a debt interest is not non-arm's length income if the rate (expressed on an annual basis) of the return does not exceed the benchmark rate of return for the debt interest or the rate of the shortfall interest charge. However, the fact that the return on a debt interest exceeds the safe harbour rate of return is not conclusive evidence that the return is non-arm's length income — rather this will be determined based on the circumstances of each particular case.

5.55 If the trustee of an attribution MIT is liable to pay tax on an amount of non-arm's length income in an income year, each trust component of the attribution MIT for the income year that is attributable to the non-arm's length income is reduced by the amount that is subject to trustee taxation. This is to ensure that members of the attribution MIT are not taxed on the same amount. ***[Schedule 2, item 2, subsection 276-670(3)]***

5.56 The amount of non-arm's length income subject to tax is the amount of the excess, reduced by deductions that:

- are reflected in the amounts of the attribution MIT's trust components for the income year; and
- are attributable only to the amount of the non-arm's length income.

[Schedule 2, item 2, subsection 276-670(4)]

5.57 A transitional rule will apply if:

- an attribution MIT became a party to a scheme before the date that the Bill is introduced into the House of Representatives; and
- the parties to the scheme are not dealing with each other at arm's length.

[Schedule 8, item 2, subsection 276-670T(1) of the Income Tax (Transitional Provisions) Act 1997]

5.58 In these circumstances, any income derived by the attribution MIT before 1 July 2017 will not be taxed as non-arm's length income. ***[Schedule 8, item 2, paragraph 276-670T(1)(c) and subsection 276-670T(2) of the Income Tax (Transitional Provisions) Act 1997]***

Definition of assessment

5.59 A consequential amendment ensures that the Commissioner of Taxation can make an assessment for the trustee of an attribution MIT in relation to the ascertainment of a tax liability. The Commissioner can raise multiple liabilities in one assessment. ***[Schedule 6, item 1, definition of 'assessment' in section 6(1) of the ITAA 1936]***

Chapter 6
Operation of the withholding tax provisions

Outline of chapter

6.1 This Chapter explains how the PAYG withholding provisions and the withholding tax liability provisions apply to attribution MITs and their members.

Context of amendments

6.2 Under the dividend, interest and royalty withholding provisions (sections 128AF and 128B of the ITAA 1936, and sections 12-215, 12-250 and 12-285 of Schedule 1 to the TAA 1953), if a managed investment trust receives an amount of dividends, interest or royalties which flows through the trust and is paid to a foreign resident, the foreign resident is liable to withholding tax. The managed investment trust has a PAYG withholding obligation in relation to the dividends, interest or royalties that it pays to the foreign resident.

6.3 Under the managed investment trust withholding provisions (Subdivision 12-H of Schedule 1 to the TAA 1953), a managed investment trust is 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.

6.4 Investors frequently invest in managed investment trusts indirectly through another entity that is a custodian. An entity is a custodian if it is carrying on a business that consists predominantly of providing a custodial or depository service in accordance with an Australian financial services licence.

6.5 In this regard, the dividend, interest and royalty withholding provisions apply if a payment received by a foreign resident through an interposed entity is attributable to an amount of dividends, interest or royalties paid by an Australian resident. Therefore, if a custodian receives an amount from a managed investment trust that is attributable to dividends, interest or royalties, the custodian has a dividend, interest or royalty withholding obligation.

6.6 If a custodian receives a payment that is covered by information made available by a managed investment trust under the managed investment trust withholding provisions, the custodian 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 to the recipient outlining certain details in relation to that later payment.

6.7 If an entity that is not a custodian or a managed investment trust receives a payment that is covered by information made available by a managed investment trust under the managed investment trust withholding provisions, that other entity is required to withhold an amount from that payment if a foreign resident becomes entitled to that payment. If a foreign resident becomes entitled to the payment, the entity must make information available in relation to that payment.

6.8 The amount on which a managed investment trust withholding obligation arises is called a ***fund payment***. An amount is a fund payment only if it is made by a managed investment trust. A custodian or other entity that receives a payment that is attributable to a fund payment may be required to withhold from a subsequent on-payment of an amount to a foreign resident entity.

6.9 A foreign resident beneficiary of a managed investment trust that is a withholding MIT, custodian or other entity is liable to pay withholding tax on a fund payment (as defined in the managed investment trust withholding provisions), or a payment attributable to a fund payment, made by the managed investment trust, custodian or other entity (Subdivision 840-M of the ITAA 1997). An amount on which withholding tax is payable is non-assessable non-exempt income of the foreign resident beneficiary.

6.10 The amendments modify the dividend, interest and royalty withholding provisions, and the managed investment trust withholding provisions to ensure that the withholding provisions apply appropriately to taxable member components of an attribution MIT that are, directly or indirectly, attributed to a non-resident.

6.11 In this Chapter, a reference to an attribution MIT means an attribution MIT that is a withholding MIT.

Summary of new law

6.12 The amendments modify the operation of the dividend, interest and royalty withholding provisions so that they apply to a taxable member component of a dividend, interest or royalty income AMIT character that is attributed to a member by an attribution MIT as shown on an AMMA statement — that is, a deemed payment.

6.13 The amendments also modify the operation of the managed investment trust withholding provisions so that a fund payment includes a relevant taxable member component that is attributed to a member by an attribution MIT as shown on an AMMA statement — that is, a deemed payment.

6.14 The attribution MIT must pay the Commissioner of Taxation an amount that is equal to the amount that the trustee would have to withhold if the deemed payment was an actual payment.

6.15 In addition, if an attribution MIT attributes a taxable member component to a member that is a custodian and does not pay the custodian an amount of cash that is sufficient to cover the custodian's obligation to withhold an amount in relation to the deemed payment, the custodian can transfer the remaining part of the obligation back to the attribution MIT.

6.16 A member of an attribution MIT will be liable to withholding tax on a relevant taxable member component that is attributed to the member by an attribution MIT. However, the member can reduce their liability by the amount that is withheld or paid by an attribution MIT in respect of the attributed amount.

Comparison of key features of new law and current law

New law	*Current law*
A foreign resident is liable to withholding tax on a taxable member component of a dividend, interest or royalty income AMIT character that is attributed by an attribution MIT as shown on an AMMA statement.	If a managed investment trust receives an amount of dividends, interest or royalties which flows through the trust and is paid to a foreign resident, the foreign resident is liable to withholding tax.
An attribution MIT must withhold an amount from a taxable member component of a dividend, interest or royalty income AMIT character that is attributed to a member by an attribution MIT as shown on an	The managed investment trust has a dividend, interest or royalty withholding obligation in relation to the dividends, interest or royalties that it pays to the foreign resident.

AMMA statement— that is, a deemed payment.	
An attribution MIT must withhold an amount from a fund payment (other than a deemed payment) that is made to an entity whose address, or place for payment, is outside Australia. A fund payment for an attribution MIT includes an amount of its Australian sourced taxable member components (other than dividends, interest and royalties) that is attributed by the attribution MIT to the entity as shown on an AMMA statement — that is, a deemed payment. If the fund payment is made to another entity that has a place of payment or address in Australia, the attribution MIT must make information available to the recipient outlining certain details in relation to the fund payment.	A managed investment trust must withhold an amount from a fund payment that is made to an entity whose address, or place for payment, is outside Australia. A fund payment is an amount of the managed investment trust's Australian sourced net income (other than dividends, interest and royalties) that is paid by the trust to the entity. If the fund payment is made to another entity that has a place of payment or address in Australia, the managed investment trust must make information available to the recipient outlining certain details in relation to the fund payment.
If a custodian receives an amount of dividends, interest or royalties that is a deemed payment from an attribution MIT, the custodian must withhold an amount from any related later payment to an entity whose address, or place for payment, is outside Australia. If a custodian makes a fund payment that is a deemed payment to an entity whose address, or place for payment, is outside Australia, the custodian must pay the Commissioner an amount that is equal to the amount that the custodian would have to withhold if the deemed payment was an actual payment. If an attribution MIT makes a deemed payment to a member that is a custodian and does not pay the custodian an amount of cash that is sufficient to cover the custodian's payment obligation, the custodian can transfer the remaining part of the obligation back to the attribution MIT.	If a custodian receives an amount of dividends, interest or royalties from a managed investment trust, the custodian must withhold an amount from any related later payment to an entity whose address, or place for payment, is outside Australia. In the case of a fund payment, if the later payment is made to another entity that has a place of payment or address in Australia, the custodian must make information available to the recipient outlining certain details in relation to that later payment.

If the later payment is made to another entity that has a place of payment or address in Australia, the custodian is required to make information available to the recipient outlining certain details in relation to that later payment.	
If an entity that is not a custodian or a managed investment trust receives an amount of dividends, interest or royalties that is not a deemed payment from an attribution MIT, the entity must withhold an amount from any related later payment to an entity whose address, or place for payment, is outside Australia. If an entity makes a fund payment, that is a deemed payment to an entity whose address, or place for payment, is outside Australia, the entity must pay the Commissioner an amount that is equal to the amount that the entity would have to withhold if the deemed payment was an actual payment. If a foreign resident becomes entitled to the fund payment, the entity must make information available in relation to that fund payment.	If an entity that is not a custodian or a managed investment trust receives an amount of dividends, interest or royalties from a managed investment trust, the entity is required to withhold an amount from a subsequent payment attributable to the payment that a foreign resident becomes entitled to. In the case of a fund payment, if a foreign resident becomes entitled to the payment, the entity must make information available in relation to that fund payment.
A foreign resident beneficiary of an attribution MIT, custodian or other entity is liable to pay withholding tax on an amount of dividends, interest or royalties, or a fund payment, made by the attribution MIT, custodian or other entity. An amount on which withholding tax is payable is non-assessable non-exempt income of the foreign resident member or beneficiary.	A foreign resident beneficiary of a managed investment trust, custodian or other entity is liable to pay withholding tax on an amount of dividends, interest or royalties, or a fund payment, that is attributable to a payment made by the trust, custodian or other entity. An amount on which withholding tax is payable is non-assessable non-exempt income of the foreign resident beneficiary.

Detailed explanation of new law

6.17 The amendments modify the operation of the dividend, interest and royalty withholding provisions so that they apply to a taxable member component of a dividend, interest or royalty income AMIT character that is attributed to a member by an attribution MIT as shown on an AMMA statement — that is, a deemed payment.

6.18 The amendments also modify the operation of the managed investment trust withholding provisions so that a fund payment includes a relevant taxable member component that is attributed to a member by an attribution MIT as shown on an AMMA statement — that is, a deemed payment.

6.19 The attribution MIT must pay the Commissioner of Taxation an amount that is equal to the amount that the trustee would have to withhold if the deemed payment was an actual payment.

6.20 In addition, if an attribution MIT attributes a taxable member component to a member that is a custodian and does not pay the custodian an amount of cash that is sufficient to cover the custodian's obligation to withhold an amount in relation to the deemed payment, the custodian can transfer the remaining part of the obligation back to the attribution MIT.

6.21 A member of an attribution MIT will be liable to withholding tax on a relevant taxable member component that is attributed to the member by an attribution MIT. However, the member can reduce their liability by the amount that is withheld or paid by an attribution MIT in respect of the attributed amount.

Withholding provisions apply to withholding MITs

6.22 The withholding provisions apply to a managed investment trust that is a withholding MIT. A managed investment trust will be a *withholding MIT* in relation to an income year if:

- the trust is a managed investment trust (as defined in the ITAA 1997) for the income year;
- the trust meets the requirements in section 275-5(3) of the ITAA 1997 for the income year – that is, broadly:
  - at the time the trust makes the first fund payment in relation to an the income year, the trustee is an Australian resident or has its central management and control in Australia;
  - the trust is not a trading trust;
  - at the time the payment is made, the trust is a managed investment scheme;

  - at the time the payment is made, the trust has wholesale membership and satisfies certain licensing requirements or is registered under section 601EB of the *Corporations Act 2001*; and
  - the trust satisfies certain widely-held requirements and closely-held restrictions; and
- a substantial proportion of the investment management activities carried out in relation to the trust in respect of the following assets of the trust are carried out in Australia throughout the income year:
  - assets that are situated in Australia at any time in the income year;
  - assets that are taxable Australian property at any time in the income year; and
  - assets that are shares, units or interests listed for quotation in the official list of an approved stock exchange in Australia at any time in the income year.

[Schedule 3, item 2, section 12-383 of Schedule 1 to the TAA 1953]

6.23 These amendments do not change the broad circumstances in which a managed investment trust has a PAYG withholding obligation. The amendments are necessary as a result of the amendments to transfer the definition of managed investment trust from the TAA 1953 to the ITAA 1997.

Amount attributed taken to be a deemed payment

6.24 The modifications to the operation of the dividend, interest and royalty withholding provisions, and to the managed investment trust withholding provisions, are required so that the provisions apply appropriately to deemed payments.

6.25 Therefore, the current dividend, interest and royalty withholding provisions, and the managed investment trust withholding provisions, will continue to apply to relevant cash payments made by an attribution MIT to a foreign resident prior to the time that a deemed payment is made.

What is a deemed payment?

6.26 Under the attribution model, the amount included in the assessable income of a member (the taxable member component) is based on the amount of the determined trust component that has been attributed to the member by an attribution MIT — that is, the taxable member component as reflected in the AMMA statement that is given to the member by the attribution MIT.

6.27 An amount that has been attributed to a member by an attribution MIT is taken to be a payment (a *first deemed payment*) that is made by the attribution MIT to the member. A deemed payment arises if:

- an entity (the *first recipient*) is or was a member of the attribution MIT at any time during the income year; and
- the attribution MIT gives an AMMA statement for the income year to the first recipient.

[Schedule 3, item 6, subsection 12A-200(1) of Schedule 1 to the TAA 1953]

Application of the withholding provisions to deemed payments

6.28 For the purpose of applying dividend, interest and royalty withholding provisions, and the managed investment trust withholding provisions, the trustee of an attribution MIT is taken to have made a payment of the amount of the first deemed payment to the first recipient at the time the attribution MIT gave the first recipient an AMMA statement. ***[Schedule 3, item 6, paragraph 12A-200(2)(a) of Schedule 1 to the TAA 1953]***

6.29 The amount of the first deemed payment is the total of the first recipient's taxable member components of an income AMIT character for the income year as reflected in the AMMA statement. ***[Schedule 3, item 6, paragraph 12A-200(2)(b) of Schedule 1 to the TAA 1953]***

6.30 The amount of the first recipient's taxable member component as reflected in the AMMA statement is the same as the determined member component worked out by the attribution MIT in respect of the first recipient. This is because the attribution MIT's payment obligation arises at the time that it attributes the relevant AMIT character amounts to the member.

6.31 For the purpose of applying dividend, interest and royalty withholding provisions, the first recipient is taken to have derived the first deemed payment at the time that the trustee of the attribution MIT gave the first recipient the AMMA statement. ***[Schedule 3, item 6, subsection 12A-200(3) of Schedule 1 to the TAA 1953]***

Deemed payments by custodians

6.32 If the member of an attribution MIT is a custodian, the amount attributed to the custodian (as reflected in the AMMA statement) will be passed on to one or more other entities (the *subsequent recipient*) that are beneficiaries of the custodian. In these circumstances, the custodian is taken to have made a *subsequent deemed payment* of the amount attributed to it (as reflected in the AMMA statement) provided that the subsequent recipient:

- starts to have, at a time, a present entitlement to an amount that is attributable to all or part of the first deemed payment; or
- would start to have, at a time, such a present entitlement if the first deemed payment was an actual payment of an amount.

[Schedule 3, item 6, subsections 12A-200(4) and (5) of Schedule 1 to the TAA 1953]

6.33 The amount of the subsequent deemed payment is the amount that the subsequent recipient is presently entitled to, or would be presently entitled to if the subsequent deemed payment was an actual payment. ***[Schedule 3, item 6, paragraph 12A-200(5)(b) of Schedule 1 to the TAA 1953]***

6.34 If the subsequent recipient is another custodian, then the other custodian will be taken to be a first recipient and the beneficiaries of that other custodian will be taken to have made a subsequent deemed payment to its beneficiaries on the same basis. Where there is a chain of custodians, this process will be repeated until the subsequent recipient is not a custodian. ***[Schedule 3, item 6, subsection 12A-200(6) of Schedule 1 to the TAA 1953]***

What is a parallel actual payment in respect of a deemed payment?

6.35 It is likely that an attribution MIT will make actual payments (parallel actual payments) in respect of a deemed payment to its members in relation to an income year. These actual payments can be made during the income year or after the end of the income year.

6.36 The taxable member component that is attributed to a member for an income year (as reflected in the AMMA statement that is given to the member) is likely to be greater than or equal to the parallel actual payments made to the member for the income year.

6.37 A payment by an attribution MIT will be a *parallel actual payment* in respect of a deemed payment if :

- the payment and the deemed payment are both attributable to the same member component for the attribution MIT; and

- the payment does not arise due to an AMMA statement being given to the member or to a custodian.

[Schedule 3, item 6, section 12A-205 of Schedule 1 to the TAA 1953; Schedule 9, item 6, definition of 'parallel actual payment' in subsection 995-1(1)]

Operation of the dividend, interest and royalty withholding provisions

6.38 The amendments modify the dividend, interest and royalty withholding provisions so that they operate effectively for deemed payments made by an attribution MIT. ***[Schedule 3, items 1 and 6, subsection 128AF(1) of the ITAA 1936, section 12A-5 of Schedule 1 to the TAA 1953]***

Deemed payments by an attribution MIT

6.39 If a trustee of an attribution MIT receives a payment of dividends, interest and royalties from another entity to which a foreign resident becomes entitled, the attribution MIT does not have a withholding obligation under subsection 12-215(1), 12-250(1) or 12-285(1) in respect of that payment if the payment arises because it is a deemed payment. ***[Schedule 3, item 6, subsection 12A-10(1) of Schedule 1 to the TAA 1953]***

6.40 However, the trustee may need to withhold an amount in respect of the deemed payment under Subdivision 12A-C if the deemed payment is an AMIT DIR payment. An ***AMIT DIR payment*** in relation to an income year is a payment that is:

- an AMIT income character amount that is a dividend and is subject to withholding tax;
- an AMIT income character amount that is interest and is subject to withholding tax; or
- an AMIT income character amount that is a royalty and is subject to withholding tax.

[Schedule 3, item 6, subsections 12A-20(1) and (2) of Schedule 1 to the TAA 1953; Schedule 9, item 1, definition of 'AMIT DIR payment in subsection 995-1(1)]

6.41 However, a payment is not an AMIT DIR payment in relation to an income year if:

- the payment it is a parallel actual payment in respect of another payment that is made on or after the time that the deemed payment is taken to be made; and
- the other payment is an AMIT DIR payment.

Deemed payments by a custodian

6.42 If a custodian receives a payment of dividends, interest and royalties from an attribution MIT to which a foreign resident becomes entitled, the custodian does not have a withholding obligation under subsection 12-215(1), 12-250(1) or 12-285(1) in respect of that payment if the payment arises because it is:

- a deemed payment; or
- a parallel actual payment in respect of a deemed payment.

[Schedule 3, item 6, subsections 12A-10(2) and (3) of Schedule 1 to the TAA 1953]

6.43 However, the custodian may need to withhold an amount in respect of the deemed payment under Subdivision 12A-C.

Requirement to give a notice or make information available in respect of a deemed payment

6.44 If an attribution MIT receives a payment of dividends, interest or royalties and makes a deemed payment in relation to those amounts to another entity, then the attribution MIT must give a notice to, or make information available to, the other entity in respect of the deemed payment. The notice or information is necessary for the other entity to meet its withholding obligations in relation to the deemed payment. ***[Schedule 3, item 6, section 12A-15 of Schedule 1 to the TAA 1953]***

6.45 If the other entity (including a custodian) makes a subsequent deemed payment, the other entity must give a notice to, or make information available to, recipients of the subsequent deemed payment. ***[Schedule 3, item 6, section 12A-15 of Schedule 1 to the TAA 1953]***

6.46 These requirements are consistent with the notice and information requirements that apply to fund payments and are necessary to ensure compliance with the dividend, interest and royalty withholding obligations for deemed payments.

Operation of the managed investment trust withholding provisions

6.47 The amendments modify the managed investment trust withholding provisions so that a withholding MIT is 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. ***[Schedule 3, item 6, section 12A-100 of Schedule 1 to the TAA 1953]***

6.48 A withholding MIT has an obligation to withhold amounts in respect of fund payments it makes to non-resident members. ***[Schedule 3, item 3, subsection 12-385(1) of Schedule 1 to the TAA 1953]***

6.49 The rate of withholding on fund payments that are made by a withholding MIT are set out in section 12-385 of Schedule 1 to the TAA 1993.

6.50 The objective of the modifications is to ensure that attribution MITs have an obligation to pay an amount on certain taxable member components that are attributed to a member by an attribution MIT as shown on the AMMA statements — that is, deemed payments. The amount that is payable is equivalent to the amount of a managed investment trust withholding obligation that would have arisen if the deemed payments were actual payments.

6.51 In particular, the modifications:

- modify the definition of fund payment — that is, attribution MITs will apply the new definition in section 12A-115 (instead of section 12-405) of Schedule 1 to the TAA 1953; and
- revise the circumstances in which an attribution MIT, custodian or other entity has a PAYG withholding obligation so that:
  - the payment obligation for an attribution MIT in relation to a deemed payment that is a fund payment will arise under sections 12A-210 and 12A-255 (instead of subsection 12-385(1)) of Schedule 1 to the TAA 1953;
  - the payment obligation for a custodian that is a member of an attribution MIT in respect to a deemed payment that is a fund payment from the attribution MIT will arise under sections 12A-215 and 12A-220 (instead of subsection 12-390(1)) of Schedule 1 to the TAA 1953; and
  - the payment obligation for another entity that is a member of an attribution MIT in respect to a deemed payment that is a fund payment from the attribution MIT will arise under section 12A-230 (instead of subsection 12-390(4)) of Schedule 1 to the TAA 1953.

6.52 However, key elements of the managed investment trust withholding provisions in Schedule 12-H of Schedule 1 to the TAA 1953 will continue to apply to attribution MITs. For example:

- sections 12-385 and 12-390 will continue to apply to require an attribution MIT, custodian or other entity to withhold an amount from a payment that is an actual payment;
- sections 12-385 and 12-390 will continue to apply to specify the rate of withholding on fund payments (including deemed payments) made by an attribution MIT, custodian or other entity;
- the requirements in section 12-395 for managed investment trusts, custodians and other entities to give certain notices or make information available will continue to apply to an attribution MIT, custodian or other entity; and
- section 12-410, which specifies recipients of fund payments in respect of whom a PAYG withholding amount must be withheld, will continue to apply to an attribution MIT, custodian or other entity.

Deemed payments by an attribution MIT

6.53 If a trustee of an attribution MIT makes a fund payment that is a deemed payment, the attribution MIT does not have a withholding obligation under subsection 12-385(1) in respect of the deemed payment. ***[Schedule 3, item 6, subsection 12A-105(1) of Schedule 1 to the TAA 1953]***

6.54 However, the trustee may need to withhold an amount in respect of the deemed payment under Subdivision 12A-C.

Deemed payments by a custodian

6.55 If a fund payment is made by a custodian, the custodian does not have a withholding obligation under subsection 12-390(1) in respect of the payment if the payment arises because it is:

- a deemed payment; or
- a parallel actual payment in respect of a deemed payment.

[Schedule 3, item 6, subsection 12A-105(2) of Schedule 1 to the TAA 1953]

6.56 However, the custodian may need to withhold an amount in respect of the deemed payment under Subdivision 12A-C.

Deemed payments by another entity

6.57 If a fund payment is made by an entity (other than an attribution MIT or a custodian), the entity does not have a withholding obligation under subsection 12-390(4) in respect of the payment if the payment arises because it is:

- a deemed payment; or
- a parallel actual payment in respect of a deemed payment.

[Schedule 3, item 6, subsection 12A-105(3) of Schedule 1 to the TAA 1953]

6.58 However, the other entity may need to withhold an amount in respect of the deemed payment under Subdivision 12A-C.

Requirement to give a notice or make information available in respect of a deemed payment

6.59 The current requirements in section 12-395 for managed investment trusts, custodians and other entities to give certain notices or make information available will continue to apply to an attribution MIT, custodian or other entity. ***[Schedule 3, item 6, section 12A-110 of Schedule 1 to the TAA 1953]***

Fund payment for an attribution MIT

6.60 A *fund payment* is defined in section 12-405 of Schedule 1 to the TAA 1953 to mean, broadly, a component of an actual payment made to a beneficiary by a managed investment trust that represents a distribution of the Australian source net income (other than dividends, interest and royalties) of the trust.

6.61 Therefore, a key modification to the managed investment trust withholding provisions is to switch off the section 12-405 definition of *fund payment* for attribution MITs. ***[Schedule 3, items 4 and 5, subsection 12-405(1A) of Schedule 1 to the TAA 1953]***

6.62 A new definition of ***fund payment*** will apply to a managed investment trust that is an attribution MIT. ***[Schedule 3, item 6, section 12A-115 of Schedule 1 to the TAA 1953; Schedule 9, item 3, definition of 'fund payment' in subsection 995-1(1) of the ITAA 1997]***

6.63 The object of section 12A-115 is to ensure that the total of fund payments that an attribution MIT makes in relation to an income year equals, as nearly as practicable, the total of its taxable member components for the income year that are of an income AMIT character disregarding taxable member components of an income AMIT character that are excluded components. ***[Schedule 3, item 6, subsections 12A-115(1) and (3) of Schedule 1 to the TAA 1953]***

6.64 Excluded components are taxable member components of an income AMIT character that are:

- discount capital gains from a CGT asset that is not taxable Australian property;
- non-discount capital gains from a CGT asset that is not taxable Australian property;
- dividends, interest and royalties that are subject to withholding tax;
- foreign source income; or
- specified by the Commissioner of Taxation for these purposes in a legislative instrument.

[Schedule 3, item 6, subsections 12A-115(3) and (4) of Schedule 1 to the TAA 1953]

6.65 The amount of a fund payment for an attribution MIT is worked out applying the method statement in subsection 12A-115(5) of Schedule 1 to the TAA 1953. The fund payment may be an actual payment or a deemed payment that the trustee makes in relation to an income year. The amount of the fund payment may be:

- the amount of the actual payment or deemed payment; or
- the amount of the actual payment or deemed payment, increased or reduced as a result of the method statement.

[Schedule 3, item 6, subsection 12A-115(5) of Schedule 1 to the TAA 1953]

6.66 To work out the amount of a fund payment, an attribution MIT must apply the method statement in subsection 12A-115(5).

6.67 Under step 1 of the method statement, the actual payment or deemed payment must be reduced by the amount that is attributable to the excluded components. ***[Schedule 3, item 6, step 1 of the method statement in subsection 12A-115(5) of Schedule 1 to the TAA 1953]***

6.68 Under step 2 of the method statement, the trustee must work out what is reasonable to expect will be the total taxable member components of an income AMIT character for the attribution MIT in relation to the income year, disregarding the excluded components (the step 2 amount). In working out the step 2 amount, a capital gain from taxable Australian property of the trust that was or would be reduced under step 3 of the method statement in subsection 102-5 of the ITAA 1997 (that is, a discount capital gain), is taken to be double the amount it actually is. ***[Schedule 3, item 6, step 2 of the method statement in subsection 12A-115(5) of Schedule 1 to the TAA 1953]***

6.69 Under step 3 of the method statement, the amount of the fund payment is so much of the step 2 amount that is reasonable having regard to:

- the object of the fund payment provision (as mentioned in subsection 12A-115(2));
- the step 1 amount;
- the amounts of any earlier fund payments made by the attribution MIT in relation to the income year — that is, for example, the amount of any interim cash distributions made to members during the income year; and
- the expected amounts of any later fund payments the attribution MIT expects to make in relation to the income year.

[Schedule 3, item 6, step 3 of the method statement in subsection 12A-115(5) of Schedule 1 to the TAA 1953]

6.70 The amount of the total taxable member components of an income AMIT character for the attribution MIT for the income year (including the amount of any excluded components), and the expected amount of any later fund payments, is worked out based on the trustee's knowledge at the time when the actual payment is made. However, in the case of a deemed payment, the amount is worked out based on the AMMA statement. ***[Schedule 3, item 6, subsections 12A-115(6) and (7)]***

6.71 The amount of a fund payment can take into account the expected amounts of any later fund payments an attribution MIT expects to make in relation to the income year. Therefore, when an attribution MIT makes an actual payment to a member, the trustee can take into account an expected later deemed payment in working out the amount of the fund payment in relation to the actual payment. As a result, the amount of the fund payment can exceed the amount of the actual payment.

6.72 A payment is not a fund payment in relation to an income year if:

- the payment it is a parallel actual payment in respect of another payment that is made on or after the time that the deemed payment is taken to be made;
- the other payment is a fund payment.

[Schedule 3, item 6, subsections 12A-115(8)]

6.73 In addition, an amount is not a fund payment in relation to an income year unless it is paid:

- during the income year;
- within 3 months after the end of the income year; or
- within a longer period allowed by the Commissioner of Taxation.

[Schedule 3, item 6, subsections 12A-115(9)]

6.74 The Commissioner may allow a longer period for an amount to be a fund payment only if the Commissioner is of the opinion that:

- if the other payment arises at a time because it is a deemed payment — the attribution MIT complied with the requirement in subsection 276-605(2) of the ITAA 1997 to give an AMMA statement within three months of the end of the income year; or
- otherwise — the trustee of the attribution MIT was unable to make the payment during the income year, or within three months after the end of the income year, because of circumstances beyond the influence or control of the trustee.

[Schedule 3, item 6, subsections 12A-115(10)]

Example 6.1

An attribution MIT (the ABC trust) has 100 members holding equal interests in the trust. The ABC trust makes four cash distributions of an income AMIT character to each member in relation to the 2016-17 income year:

- an interim cash distribution of $10,000 on 31 October 2016;
- an interim cash distribution of $10,000 on 31 January 2017;
- an interim cash distribution of $10,000 on 30 April 2017;

- a final cash distribution of $8,000 on 31 August 2017.

The ABC trust gives an AMMA statement for the 2016-17 income year to the members on 31 August 2017 (at the same time that it makes the final cash distribution). The total taxable member component for the income year for each member recorded on the AMMA statement is $45,000.

Neither the actual distributions nor the taxable member component contain any income AMIT characters that are excluded components.

Applying the method statement in subsection 12A-115(5) of Schedule 1 to the TAA 1953, the ABC trust will have made a fund payment to each member in respect of each cash distribution.

In addition, the ABC trust will have made a fund payment to each member in respect of the taxable member component for the income year for each member as recorded on the AMMA statement. That is, the ABC trust will be taken to have made a deemed payment of $45,000.

The final cash distribution of $8,000 that was made at the same time that AMMA statements were given to members is a parallel actual payment, and therefore is not a fund payment.

The fund payment is respect of the deemed payment will be $15,000, worked out as follows:

- the deemed payment —— $45,000;
- reduced by the amount attributable to excluded components — nil
- reduced by the amount of earlier fund payments — $30,000.

Therefore, the ABC trust would have made the following fund payments in respect of the 2016-17 income year:

- an actual cash payment of $10,000 on 31 October 2016;
- an actual cash payment of $10,000 on 31 January 2017;
- an actual cash payment of $10,000 on 30 April 2017; and
- a deemed payment of $15,000 on 31 August 2017.

Attribution MITs must withhold amounts in relation to deemed payments

Deemed payments that are dividends, interest or royalties

6.75 If the trustee of an attribution MIT receives a payment of dividend, interest and royalties from another entity, the trustee will have a dividends, interest or royalties withholding obligation in respect of a deemed payment, to the extent that the deemed payment is an AMIT DIR payment that is made to a foreign resident. ***[Schedule 3, item 6, subsection 12A-210(1) of Schedule 1 to the TAA 1953]***

6.76 The amount that the attribution MIT must pay to the Commissioner of Taxation is the amount that it would have to withhold under subsection 12-215(1), 12-250(1) or 12-285(1) if the AMIT DIR payment was an actual payment. ***[Schedule 3, item 6, subsections 12A-210(2) and (3) of Schedule 1 to the TAA 1953]***

6.77 The attribution MIT must pay the amount to the Commissioner at the same time that it has to withhold or pay other amounts to the Commissioner — that is, under Division 16 of Schedule 1 to the TAA 1953. ***[Schedule 3, item 8, section 16-7 of Schedule 1 to the TAA 1953]***

Deemed payments that are fund payments

6.78 The trustee of an attribution MIT will have a managed investment trust withholding obligation in respect of a deemed payment, to the extent that the deemed payment is a fund payment that is made to a foreign resident. ***[Schedule 3, item 6, subsection 12A-210(1) of Schedule 1 to the TAA 1953]***

6.79 The amount that the attribution MIT must pay to the Commissioner of Taxation is the amount that it would have to withhold under section 12-385 if the fund payment was an actual payment. ***[Schedule 3, item 6, subsections 12A-210(2) and (3) of Schedule 1 to the TAA 1953]***

6.80 The attribution MIT must pay the amount to the Commissioner at the same time that it has to withhold or pay other amounts to the Commissioner — that is, under Division 16 of Schedule 1 to the TAA 1953. ***[Schedule 3, item 8, section 16-7 of Schedule 1 to the TAA 1953]***

6.81 If an attribution MIT makes an actual payment that is a fund payment, the attribution MIT will continue to have an obligation to withhold an amount from the actual payment under subsection 12-385(1) of Schedule 1 to the TAA 1953.

Amounts covered by a notice from a custodian

6.82 The amount that a custodian that is a member of an attribution MIT must pay in respect of a deemed payment is reduced if the custodian has not received sufficient cash distributions from the attribution MIT to satisfy its payment obligation. In these circumstances, the attribution MIT becomes liable for the amount of the payment equal to the remaining part of the obligation (the shortfall) as specified in a notice given by the custodian to the attribution MIT.

6.83 Therefore, an attribution MIT must pay the Commissioner an amount equal to the amount of the shortfall in respect of a deemed payment that is covered by a notice from the custodian. ***[Schedule 3, item 6, section 12A-225 of Schedule 1 to the TAA 1953]***

6.84 Once the notice has been received, the attribution MIT must pay the amount to the Commissioner at the same time that it has to withhold or pay other amounts to the Commissioner — that is, under Division 16 of Schedule 1 to the TAA 1953. ***[Schedule 3, item 8, section 16-7 of Schedule 1 to the TAA 1953]***

Custodian that is a member of an attribution MIT must withhold amounts in relation to deemed payments

Deemed payments that are dividends, interest or royalties

6.85 If a custodian receives a deemed payment from an attribution MIT, the custodian will have a dividend, interest or royalties withholding obligation in respect of a subsequent deemed payment that is an AMIT DIR payment to the extent that:

- all or some of the subsequent deemed payment is reasonably attributable to the part of an earlier payment received by the custodian that was an AMIT DIR payment; and
- the subsequent deemed payment is made to a foreign resident.

[Schedule 3, item 6, subsection 12A-215(1) of Schedule 1 to the TAA 1953]

6.86 The amount that the custodian must pay to the Commissioner of Taxation is the amount that it would have to withhold under subsection 12-215(1), 12-250(1) or 12-285(1) if the AMIT DIR payment was an actual payment. ***[Schedule 3, item 6, subsections 12A-215(2) and (3) of Schedule 1 to the TAA 1953]***

6.87 The custodian must pay the amount to the Commissioner at the same time that it has to withhold or pay other amounts to the Commissioner — that is, under Division 16 of Schedule 1 to the TAA 1953. ***[Schedule 3, item 8, section 16-7 of Schedule 1 to the TAA 1953]***

Deemed payments that are fund payments

6.88 If a custodian receives a deemed payment from an attribution MIT, the custodian will have a managed investment trust withholding obligation in respect of a subsequent deemed payment to the extent that:

- all or some of the subsequent deemed payment is reasonably attributable to the part of an earlier payment received by the custodian that was a fund payment and is covered by a notice or information under section 12-395; and
- the subsequent deemed payment is made to a foreign resident.

[Schedule 3, item 6, subsection 12A-215(1) of Schedule 1 to the TAA 1953]

6.89 The amount that the custodian must pay to the Commissioner of Taxation is the amount that it would have to withhold under subsection 12-390(1) if the fund payment was an actual payment. ***[Schedule 3, item 6, subsections 12A-215(2) and (3) of Schedule 1 to the TAA 1953]***

6.90 The custodian must pay the amount to the Commissioner at the same time that it has to withhold or pay other amounts to the Commissioner — that is, under Division 16 of Schedule 1 to the TAA 1953. ***[Schedule 3, item 8, section 16-7 of Schedule 1 to the TAA 1953]***

6.91 If a custodian makes an actual payment that is a fund payment, the attribution MIT will continue to have an obligation to withhold an amount from the actual payment under subsection 12-390(1) of Schedule 1 to the TAA 1953.

Reduction in withholding obligation if insufficient cash and notice given to attribution MIT

6.92 The amount that the custodian must pay is reduced if it has not received sufficient cash distributions from the attribution MIT to satisfy the liability.

6.93 Therefore, if, on or before the day on which the deemed payment arises, the custodian has not received a parallel actual payment in respect of the deemed payment, the amount that the custodian must pay to the Commissioner is reduced to nil. ***[Schedule 3, item 6, paragraphs 12A-215(4)(a) and 12A-215(5)(a) of Schedule 1 to the TAA 1953]***

6.94 If, on or before the day on which the subsequent deemed payment arises, the custodian has received a parallel actual payment in respect of the subsequent deemed payment that falls short of the amount that the custodian must pay, the amount that the custodian must pay to the Commissioner is reduced to the amount of the parallel actual payment. ***[Schedule 3, item 6, paragraphs 12A-215(3)(b) and 12A-215(4)(b) of Schedule 1 to the TAA 1953]***

6.95 The custodian must pay the amount to the Commissioner at the same time that it has to withhold or pay other amounts to the Commissioner — that is, under Division 16 of Schedule 1 to the TAA 1953. ***[Schedule 3, item 8, section 16-7 of Schedule 1 to the TAA 1953]***

6.96 If the amount that the custodian must pay to the Commissioner is reduced due to an insufficient parallel actual payment, the custodian must give a notice to the trustee of the attribution MIT that made the fund payment. ***[Schedule 3, item 6, subsections 12A-65(1) and 12A-65(2) of Schedule 1 to the TAA 1953]***

6.97 The notice must specify the amount that the custodian was unable to pay the Commissioner in respect of the fund payment. The custodian must give the notice to the attribution MIT trustee no later than 30 days after the day on which the subsequent deemed payment arises. ***[Schedule 3, item 6, subsections 12A-220(3) and 12A-220(4) of Schedule 1 to the TAA 1953]***

6.98 If the custodian fails to notify the attribution MIT trustee of the withholding amount that the custodian is unable to pay the Commissioner due to insufficient actual payments, the custodian is liable to pay the Commissioner a penalty equal to the amount of the shortfall. ***[Schedule 3, item 6, subsection 12A-220(5) Schedule 1 to the TAA 1953]***

Example 6.2

An attribution MIT (the DEF trust) has 100 members, one of whom is a custodian.

The DEF trust gave the AMMA statement for the 2016-17 income year on 15 August 2017 to the custodian. The AMMA statement states that the total taxable member component of an income AMIT character in relation to the income year is $100,000. The taxable member component does not contain any income AMIT characters that are excluded components. The amount of the taxable member component on the AMMA statement is a deemed payment.

On the same day, the DEF trust made an actual cash payment of $10,000 to the custodian on 15 August 2017. This payment is a parallel actual payment in respect of the deemed payment, and therefore is not a fund payment.

Therefore, the amount of the fund payment is the amount of the deemed payment ($100,000).

The DEF does not have a managed investment trust withholding obligation in relation to the amount attributed to the custodian at the time the AMMA statement is given because the custodian is an Australian resident.

The custodian has not derived any other taxable income. The sole beneficiary of the custodian is a not an Australian resident and is presently entitled to the whole amount that has been attributed to the custodian by the DEF trust.

The custodian will be required to pay an amount in respect of the deemed payment. If the deemed payment had been an actual payment, the withholding rate for the payment would be 15 per cent. Therefore, the custodian is required to pay an amount of $15,000 ($100,000 x 15%).

However, the custodian has a parallel actual payment of only $10,000 for the 2016-17 income year from which it has to discharge the withholding obligation. Therefore, the custodian can:

- reduce the amount of their payment to $10,000; and
- transfer part of the payment obligation equal to the amount of the shortfall ($5,000) to the DEF trust.

Therefore, by 14 September 2016, the custodian must:

- pay $10,000 to the Commissioner; and
- notify the DEF trust of the shortfall that relates to the 2015-16 income year ($5,000);

The DEF trust must pay the amount of the shortfall ($5,000) to the Commissioner.

Entity (other than a managed investment trust or a custodian) that is a member of an attribution MIT must withhold amounts in relation to deemed payments

Deemed payments that are dividends, interest or royalties

6.99 If an entity (other than a managed investment trust or a custodian) that is a member of an attribution MIT receives a deemed payment from an attribution MIT, the entity will have a dividend, interest or royalties withholding obligation in respect of the deemed payment to the extent that:

- the deemed payment is an AMIT DIR payment that is covered by a notice or information under subsection 12A-15; and
- a foreign resident receives, or becomes entitled to receive, an amount reasonably attributable to the AMIT DIR payment.

[Schedule 3, item 6, subsection 12A-230(1) of Schedule 1 to the TAA 1953]

6.100 The amount that the entity must pay to the Commissioner of Taxation is the amount that it would have to withhold under subsection 12-215(1), 12-250(1) or 12-285(1) if the AMIT DIR payment was an actual payment. ***[Schedule 3, item 6, subsection 12A-215(2) of Schedule 1 to the TAA 1953]***

6.101 The entity must pay the amount to the Commissioner at the same time that it has to withhold or pay other amounts to the Commissioner — that is, under Division 16 of Schedule 1 to the TAA 1953. ***[Schedule 3, item 8, section 16-7 of Schedule 1 to the TAA 1953]***

Deemed payments that are fund payments

6.102 If an entity (other than a managed investment trust or a custodian) that is a member of an attribution MIT receives a deemed payment from an attribution MIT, the entity will have a managed investment trust withholding obligation in respect of a deemed payment to the extent that:

- the deemed payment is a fund payment that is covered by a notice or information under subsection 12-395; and
- a foreign resident receives, or becomes entitled to receive, an amount reasonably attributable to the fund payment

[Schedule 3, item 6, subsection 12A-230(1) of Schedule 1 to the TAA 1953]

6.103 The amount that the entity must pay to the Commissioner of Taxation is the amount that it would have to withhold under subsection 12-390(4) if the fund payment was an actual payment. ***[Schedule 3, item 6, subsections 12A-230(2) of Schedule 1 to the TAA 1953]***

6.104 The entity must pay the amount to the Commissioner at the same time that it has to withhold or pay other amounts to the Commissioner — that is, under Division 16 of Schedule 1 to the TAA 1953. ***[Schedule 3, item 8, section 16-7 of Schedule 1 to the TAA 1953]***

Entity does not receive a parallel actual payment

6.105 If, within 30 days after the day on which the deemed payment arises, the entity has not received a parallel actual payment in respect of the deemed payment, the amount that the entity must pay to the Commissioner is reduced to nil. ***[Schedule 3, item 6, paragraphs 12A-230(3)(a) and 12A-230(4)(a) of Schedule 1 to the TAA 1953]***

6.106 If, within 30 days after the day on which the deemed payment arises, the entity has received a parallel actual payment in respect of the deemed payment that falls short of the amount that the entity must pay, the amount that the entity must pay to the Commissioner is reduced to the amount of the parallel actual payment. ***[Schedule 3, item 6, paragraphs 12A-230(3)(b) and 12A-230(4)(b) of Schedule 1 to the TAA 1953]***

6.107 The entity must pay the amount to the Commissioner at the same time that it has to withhold or pay other amounts to the Commissioner — that is, under Division 16 of Schedule 1 to the TAA 1953. ***[Schedule 3, item 8, section 16-7 of Schedule 1 to the TAA 1953]***

Member entitled to a credit for amounts withheld or paid

6.108 A foreign resident member or beneficiary of an attribution MIT, custodian or other entity (including a managed investment trust that is not an attribution MIT) is liable to pay withholding tax on a fund payment or amount attributable to a fund payment (including a deemed payment) made by the attribution MIT, custodian or other entity.

6.109 An amount on which withholding tax is payable is non-assessable non-exempt income of the foreign resident member or beneficiary.

6.110 If an attribution MIT withholds or pays an amount in respect of the attributed amount, the member is entitled to a credit for the amount paid or withheld. As a result, the member's liability is reduced by this amount. ***[Schedule 3, item 15, section 18-32 of Schedule 1 to the TAA 1953]***

Consequential amendments

6.111 A range of consequential amendments are made to support the new PAYG withholding regime for attribution MITs. ***[Schedule 3, items 7, 9 to 14, sections 16-1, 16-20, 16-25, 16-30 and 16-140 of Schedule 1 to the TAA 1953]***

6.112 In addition, for the purposes of applying section 18-65 of Schedule 1 to the TAA 1953, if an entity paid an amount to the Commissioner of Taxation purportedly under Subdivision 12A-C (that is, in relation to a deemed payment), the entity is treated as having withheld an amount under Division 12. ***[Schedule 3, item 16, subsection 18-65(1A) of Schedule 1 to the TAA 1953]***

6.113 This will ensure that section 18-65 of Schedule 1 to the TAA 1953 applies appropriately to deemed payments.

Chapter 7
Taxation consequences for members

Outline of chapter

7.1 This Chapter explains the operation of the attribution model of taxation for members of attribution MITs. Under the attribution model of taxation:

- a 'character flow-through' model will apply to ensure that amounts derived or received by the trust that are attributed to members retain the character they had in the hands of the trustee for income tax purposes;
- double taxation that might otherwise arise will be reduced because members will be able to make annual upward and downward adjustments to the cost base of their interests in the trust; and
- the taxation treatment of tax deferred distributions made by the trust is clarified.

Context of amendments

7.2 Under the general trust provisions in Division 6 of Part III of the ITAA 1936, beneficiaries of a managed investment trust are taxed on a share of the net income that reflects the share of trust income to which they are presently entitled.

7.3 The present entitlement model is complex and causes uncertainty for managed investment trusts and their members. Therefore, to provide greater certainty to members, the Board of Taxation recommended (Recommendation 19) the adoption of the attribution model (which results in members being taxed on amounts attributed to a member by an attribution MIT).

7.4 A key objective of the attribution model is to ensure that a member who invests in an attribution MIT is taxed on the income and other amounts that are derived or received by the trust in broadly the same way that they would have been taxed if they had held the assets of the attribution MIT directly.

7.5 Currently, the cost base and reduced cost base of membership interests held by the member in a trust (including a managed investment trust) are adjusted downwards in relation to certain non-assessable distributions made by the trust. To prevent the double non-taxation of amounts received by members of the trust, this can result in:

- a capital gain arising for a member of a trust under CGT event E4 in certain circumstances; or
- a greater capital gain, or reduced capital loss, on the disposal of the membership interests.

7.6 The Board of Taxation recommended (Recommendation 26) that the scope of CGT event E4 be broadened for attribution MITs to allow upward adjustments of the cost base and reduced cost base of membership interests. This will overcome concerns about the potential for double taxation when a beneficiary sells an interest before receiving a distribution from an attribution MIT.

7.7 In addition, in some cases trusts make tax deferred distributions to members. These tax deferred distributions are generally applied to:

- reduce the cost bases of membership interests that are CGT assets; and
- reduce the tax costs of membership interests that are revenue assets.

7.8 However, as the current taxation treatment of tax deferred distributions is uncertain, the amendments apply to confirm that current practice for attribution MITs.

Summary of new law

7.9 Under the attribution model of taxation, amounts related to income and tax offsets of an attribution MIT, determined by the trustee to be of a particular character, are attributed to members and generally retain that character.

7.10 In addition, adjustments are made to the cost base of membership interests held by a member. The cost base of membership interests is increased to reflect amounts of determined trust components that are included in the member's assessable income. The cost base of membership interests is reduced to reflect:

- trust distributions that the member becomes entitled to; and

- the value of tax offsets attributed to the member.

7.11 In addition, tax deferred distributions made by an attribution MIT to a member will be applied to:

- reduce the cost bases of membership interests that are CGT assets; and
- reduce the tax costs of membership interests that are revenue assets.

Comparison of key features of new law and current law

New law	*Current law*
The taxable member component of a particular AMIT character flows through an attribution MIT to its members and retains its character. The taxable member component of a particular AMIT character is generally the determined member component of that character — that is, the amount recorded on the AMMA statement sent to the member by the attribution MIT. In limited circumstances, a member can nominate a different taxable member component of a particular AMIT character.	A share of the net income of a managed investment trust is included in the assessable income of beneficiaries to the extent that those beneficiaries are presently entitled to shares of the net income of the trust. Specific provisions in the income tax law ensure that certain amounts of net income of a managed investment trust that have a particular character retain that character when passed on to beneficiaries. Tax offsets of a managed investment trust generally flow through to beneficiaries.
The cost base and reduced cost base of membership interests held by the member in an attribution MIT are adjusted downwards if the member's entitlements from the attribution MIT exceed the assessable amounts received from the attribution MIT. This can result in: • a capital gain arising for a member of a trust under CGT event E10 in certain circumstances; or • a greater capital gain, or reduced capital loss, on the disposal of the membership interests. The cost base and reduced cost base	The cost base and reduced cost base of membership interests held by the member in a trust (including a managed investment trust) are adjusted downwards in relation to certain non-assessable distributions made by the trust. This can result in: • a capital gain arising for a member of a trust under CGT event E4 in certain circumstances; or • a greater capital gain, or reduced capital loss, on the disposal of the membership interests.

of membership interests are adjusted upwards if the member's entitlements from the attribution MIT are less than the assessable amounts received from the attribution MIT. This can result in a reduced capital gain, or greater capital loss, on the disposal of the membership interests.	
Tax deferred distributions made by an attribution MIT to a member will be applied to: • reduce the cost bases of membership interests that are CGT assets; and • reduce the tax costs of membership interests that are revenue assets.	The taxation treatment of tax deferred distributions made by a trust to its members is uncertain.

Detailed explanation of new law

7.12 Under the attribution model of taxation, amounts related to income and tax offsets of an attribution MIT, determined by the trustee to be of a particular character, flow through to members and generally retain that character.

7.13 In addition, adjustments are made to the cost base of membership interests held by a member. The cost base of membership interests is increased to reflect amounts of determined trust components that are included in the member's assessable income. The cost base of membership interests is reduced to reflect:

- trust distributions that the member becomes entitled to; and
- the value of tax offsets attributed to the member.

7.14 In addition, tax deferred distributions made by an attribution MIT to a member will be applied to:

- reduce the cost bases of membership interests that are CGT assets; and
- reduce the tax costs of membership interests that are revenue assets.

Members taxed on taxable member components

7.15 Under the attribution model of taxation, amounts related to income and tax offsets of an attribution MIT, determined by the trustee to be of a particular character, are attributed to members and generally retain that character. ***[Schedule 2, item 2, section 276-75]***

7.16 The amount that are attributed by an attribution MIT to members and generally retains its character is called the taxable member component of a particular AMIT character.

What is the taxable member component of a particular AMIT character?

7.17 The ***taxable member component*** of a particular AMIT character for an income year of a member of an attribution MIT is generally the determined member component of that character for the income year. ***[Schedule 2, item 2, subsection 276-205(1); Schedule 9, item 6, definition of 'taxable member component' in subsection 995-1(1)]***

7.18 The ***determined member component*** of a particular AMIT character for an income year of a member of an attribution MIT is the amount stated by the attribution MIT to be the member's member component of that AMIT character in the AMIT's latest AMMA statement for the income year. ***[Schedule 2, item 2, subsection 276-210(1); Schedule 9, item 1, definition of 'determined member component' in subsection 995-1(1)]***

7.19 A taxpayer is responsible for ensuring that the taxable income reported on an income tax return is correct. The taxpayer who holds investments will often rely on information provided by other parties to determine the amount that is correctly included in their assessable income. However, the taxpayer must make appropriate judgements to ensure that they report the correct amount of assessable income.

7.20 Therefore, in some circumstances, a member of an attribution MIT may not wish to rely on the taxable member component of a particular AMIT character that is reported by the attribution MIT on an AMMA statement. Therefore, a member can make a choice to nominate a different taxable member component of a particular AMIT character for the income year. The choice can be made by a member only if:

- the attribution MIT has not worked out the member's member component of a particular AMIT character for an income year on a fair and reasonable basis in accordance with the constituent documents of the attribution MIT, or

- the attribution MIT has streamed particular AMIT character amounts to a particular member.

[Schedule 2, item 2, subsections 276-205(6) and (7)]

7.21 The choice must be in writing and be given to the Commissioner of Taxation within four months of the end of the member's income year. In addition, the choice must state:

- the income year to which the choice relates;
- what the member considers the member component of the particular AMIT character for the income year to be; and
- why the member considers that the determined member component of the particular AMIT character worked out by the attribution MIT does not accord with the requirements in section 276-215 — that is, broadly, why the determined member component was not worked out by the attribution MIT on a fair and reasonable basis in accordance with its constituent documents.

[Schedule 2, item 2, subsections 276-205(2) and (3)]

7.22 The way that the member prepares their income tax return is sufficient evidence of the making of the choice. ***[Schedule 2, item 2, subsection 276-205(4)]***

7.23 If a member makes a choice to nominate a different taxable member component of a particular AMIT character for an income year, the member must notify the attribution MIT of the choice.

7.24 The notice must be made in writing and be given to the attribution MIT within four months of the end of the member's income year. In addition, the notice must state:

- the income year to which the notice relates;
- what the member considers the member component of the particular AMIT character for the income year to be; and
- why the member considers that the determined member component of the particular AMIT character worked out by the attribution MIT does not accord with the requirements in section 276-215 — that is, broadly, why the determined member component was not worked out by the attribution MIT on a fair and reasonable basis in accordance with its constituent documents.

[Schedule 2, item 2, subsections 276-205(2) and (5)]

7.25 The alternative amount worked out by a member must be based on a trust component — that is, the aggregate amount that the attribution MIT should have calculated. Therefore, the attribution MIT does not have to reconcile the difference between its calculation and the member's calculation through the unders and overs system.

7.26 Consequently, the amount of an over of income or exempt AMIT character, and under of an non-assessable non-exempt or offset AMIT character, is reduced by the difference between:

- the alternative amount (the taxable member component); and
- the member component of that character for that member (which is an amount based on a *determined* trust component).

[Schedule 2, item 2, subsection 276-360]

Taxable member component of an income AMIT character, exempt AMIT character or NANE AMIT character attributed to a member

7.27 A member of an attribution MIT is taken to have derived, received or made an amount that is a taxable member component of an income AMIT character, exempt AMIT character or NANE AMIT character:

- in the member's own right (rather than as a member of a trust); and
- in the same circumstances as the attribution MIT derived, received or made the amount that is reflected in the taxable member component.

[Schedule 2, item 2, subsections 276-80(1) and (2)]

7.28 A taxable member component of an income AMIT character, exempt AMIT character or NANE AMIT character includes:

- an AMIT character that is specifically listed in section 276-150; and
- an AMIT character that is specified by the Commissioner of Taxation in a legislative instrument.

7.29 Consequently, if a taxable member component of an income AMIT character, exempt AMIT character or NANE AMIT character is attributed to a member by an attribution MIT, so that the member is taken to have derived, received or made the amount reflected in the taxable member component, the effects for the member are:

- including an amount in the member's assessable income, exempt income or non-assessable non-exempt income;
- determining whether the member has made a capital gain from a CGT event; and
- determining the extent to which the member's net capital loss has been utilised.

[Schedule 2, item 2, subsection 276-80(3)]

7.30 For example, if the taxable member component has the AMIT character of foreign source income, it is included in the member's assessable income in the same way that it would be included if the member had derived or made the foreign source income in their own right. If the member is a foreign resident, section 6-5 will operate so that the amount will not be included in the member's assessable income.

7.31 If the taxable component is of an income AMIT character that is a discount capital gain, then the amount reflected in the taxable member component is double the amount of the component. ***[Schedule 2, item 2, subsection 276-80(4)]***

7.32 This ensures that the member recognises the whole of the capital gain. If the member is entitled to a discount capital gain, the member will take the amount of the discount capital gain into account when working out their net capital gain. The discount percentage for the discount capital gain will be determined based on the member's characteristics. For example:

- if the member is an Australian resident individual, the discount percentage will be 50 per cent;
- if the member is a complying superannuation fund, the discount percentage will be 33 1/3 per cent.

7.33 If a member has a taxable member component of an offset AMIT character for an income year, the member is taken to have paid or received the amount reflected in the taxable member component:

Taxable member component of an offset AMIT character attributed to a member

7.34 If a member has a taxable member component of an offset AMIT character for an income year, the member is taken to have paid or received the amount reflected in the taxable member component:

- in the member's own right (rather than as a member of a trust); and
- in the same circumstances as the attribution MIT paid or received the amount that is reflected in the taxable member component.

[Schedule 2, item 2, subsections 276-80(5) and (6)]

7.35 As a result, if a taxable member component of an offset AMIT character is attributed to a member by an attribution MIT, possible effects are:

- the member may be entitled to a tax offset; or
- the member may be entitled to a credit for an amount withheld from a withholding payment.

[Schedule 2, item 2, subsection 276-80(7)]

7.36 Therefore, for example:

- if an attribution MIT pays foreign tax on foreign source income, the member will be taken to have paid that foreign tax for the purposes of working out whether they are entitled to a foreign income tax offset; or
- if an attribution MIT receives a franked dividend, the member will be taken to have received that franked dividend (and the attached franking credits) for the purposes of working out whether they are entitled to a franking credit tax offset.

Circumstances of the trustee that are not attributed to members

7.37 The circumstances in which the member is taken to have derived, received, made or paid an amount of a particular AMIT character do not include:

- the residence of the trustee of the attribution MIT; and

- the place of central management and control of the attribution MIT.
- the status of the trustee of the attribution MIT as a qualified person under the imputation holding period and related payment rules.

[Schedule 2, item 2, subsection 276-80(8)]

Operation of the dividend imputation holding period and related payment rules

7.38 If an entity receives a franked dividend (either directly from a company or indirectly through a trust), the entity generally includes the amount of the franking credits in assessable income and receives a corresponding tax offset equal to the amount of franking credits attached to the dividend. However, these taxation outcomes differ if the entity does not satisfy the dividend imputation holding period and related payment rules.

7.39 To ensure that the dividend imputation holding period and related payment rules apply appropriately to franked dividends that flow through an attribution MIT, the member is not taken to have derived, received or made the amount of a franked distribution (and the attached franking credits) for the purpose of applying those rules. ***[Schedule 2, item 2, subsection 276-80(9)]***

7.40 Consequently, the member will continue to apply the dividend imputation holding period and related payment rules as though:

- the attribution MIT received the franked distribution (and the attached franking credits); and
- the franked distribution (and the attached franking credits) flowed indirectly to the member through the attribution MIT.

Relationship with the withholding rules

7.41 If a taxable member component that is attributed to a member by an attribution MIT is reflected in an AMIT DIR payment or a fund payment (and therefore is subject to withholding tax), the member is not taken to have derived, received or made the amount for the purpose of applying Division 11A of Part III of the ITAA 1936, Subdivision 840-M of the ITAA 1997 or Division 12 of Schedule 1 to the TAA 1953. ***[Schedule 2, item 2, section 276-85]***

7.42 This will ensure that the withholding tax provisions will continue to operate effectively for foreign resident members of an attribution MIT.

7.43 An ***AMIT DIR payment*** is, broadly:

- an AMIT income character amount that is a dividend and is subject to withholding tax;
- an AMIT income character amount that is interest and is subject to withholding tax; or
- an AMIT income character amount that is a royalty and is subject to withholding tax.

[Schedule 3, item 6, section 12A-20 of Schedule 1 to the TAA 1953; Schedule 9, item 1, definition of 'AMIT DIR payment in subsection 995-1(1)]

No double counting

7.44 Section 276-85 ensures that the taxable member component of a particular AMIT character is not included in the member's assessable income under more than one provision in the income tax law.

7.45 If an amount is included in the assessable income of a member of an attribution MIT for an income year in respect of the member's interest in the attribution MIT under a provision of the income tax law other than because the member is taken to have derived, received or made the amount under section 276-80, the amount included under that other provision is reduced by the amount included because of section 276-80. ***[Schedule 2, item 2, subsections 276-90(1) and (2)]***

7.46 However, if the amount that is attributed to a member of an attribution MIT is a gain or loss that the member makes from a financial arrangement that is taxed under the Taxation of Financial Arrangements provisions (Division 230 of the ITAA 1997), then those provisions (rather than section 276-80) will continue to apply to the gain or loss. ***[Schedule 2, item 2, subsections 276-90(1) and (3)]***

Cost base adjustments when non-assessable distributions are made to members

7.47 A member will make a capital gain or capital loss when a CGT event happens to their membership interests. This could happen, for example, when the member sells their membership interests. A capital gain arises if the capital proceeds received by the member exceed the cost base of the membership interests. A capital loss arises if the capital proceeds received by the member are less than the reduced cost base of the membership interests.

7.48 Currently, the cost base and reduced cost base of membership interests held by the member in a trust (including a managed investment trust) are adjusted downwards in relation to certain non-assessable distributions made by the trust. To prevent the double non-taxation of amounts received by members of the trust, this can result in:

- a capital gain arising for a member of a trust under CGT event E4 in certain circumstances; or
- a greater capital gain, or reduced capital loss, on the disposal of the membership interests.

7.49 The Board of Taxation recommended (Recommendation 26) that the scope of CGT event E4 be broadened for attribution MITs to allow upward adjustments of the cost base and reduced cost base of membership interests. This will overcome concerns about the potential for double taxation when a beneficiary sells an interest before receiving a distribution from an attribution MIT.

7.50 Therefore, the cost base and reduced cost base of a member's membership interests in an attribution MIT will be adjusted by the AMIT cost base net amount for the income year. The ***AMIT cost base net amount*** for the income year is:

- if, for an income year, the AMIT cost base reduction amount in respect of the membership interests exceeds the AMIT cost base increase amount, the amount of the excess; or
- if, for an income year, the AMIT cost base reduction amount in respect of the membership interests falls short of the AMIT cost base increase amount, the amount of the shortfall.

[Schedule 4, item 3, sections 104-107B and 104-107C; Schedule 9, item 1, definition of 'AMIT cost base net amount' in subsection 995-1(1)]

7.51 The ***AMIT cost base reduction amount*** for the income year is, to the extent that it is reasonably attributable to the CGT asset that is the membership interests, the total of:

- any money and the market value of any property that the member starts to have a right to receive from the attribution MIT in the income year, where that right is indefeasible or is reasonable likely not to be defeated;

– for the purpose of working out whether the right is indefeasible, section 276-55 (which deems a member's interests in an attribution MIT to be indefeasible) is disregarded; and

- all amounts of tax offset that the member has a right to receive from the attribution MIT in the income year.

[Schedule 4, item 3, section 104-107D; Schedule 9, item 1, definition of 'AMIT cost base reduction amount' in subsection 995-1(1)

7.52 The ***AMIT cost base increase amount*** for the income year is, to the extent that they are reasonably attributable to the CGT asset that is the membership interests, the sum of:

- all amounts included in the member's assessable income (either because of section 276-80 or because of another provision in the income tax law) for the income year, worked out on the assumption that the member is an Australian resident; and
- the amount by which the non-assessable part mentioned in section 104-70 is reduced by the operation of section 104-71, worked out on the assumption that CGT event E4 happens because the attribution MIT makes a payment to the member in respect of the membership interests.

[Schedule 4, item 3, section 104-107E; Schedule 9, item 1, definition of 'AMIT cost base increase amount' in subsection 995-1(1)]

7.53 If the AMIT cost base net amount for the income year is an excess, then the cost base and reduced cost base of the membership interests is reduced by the AMIT cost base net amount (but not beyond nil). ***[Schedule 4, item 3, subsection 104-107B(2)]***

7.54 If the AMIT cost base net amount exceeds the cost base of the membership interests, the member will make a capital gain under CGT event E10 equal to the amount of the excess at the time at which the reduction occurs. ***[Schedule 4, item 3, section 104-107A]***

7.55 However, a capital gain does not arise under CGT event E10 if the membership interest is a revenue asset, trading stock or a pre-CGT asset acquired before 20 September 1985. ***[Schedule 4, item 3, section 104-107A]***

7.56 If the AMIT cost base net amount for the income year is a shortfall, then the cost base and reduced cost base of the membership interests is increased by the AMIT cost base net amount. ***[Schedule 4, item 3, subsection 104-107B(1) and (3)]***

7.57 The cost base and reduced cost base of the membership interests must be adjusted by the AMIT cost base net amount:

- at the end of each income year; or
- if a CGT event happens to the membership interests during an income year, just before the time of the CGT event.

[Schedule 4, item 3, subsection 104-107B(4)]

7.58 Consequential amendments ensure that:

- CGT event E10 is listed in the table of CGT events; and
- CGT event E10 is not a realisation event as defined in section 977-5.

[Schedule 4, items 1 and 4, sections 104-5 and 977-5]

Tax-deferred distributions made to members

7.59 If a tax deferred distribution is made to a member of an attribution MIT, the amount of distribution will not be included in the member's assessable income. Instead:

- in the case of a membership interest that is held on capital account — the amount of the tax deferred distribution will reduce the cost base and reduced cost base of the membership interest;
- in the case of a membership interest that is held on revenue account — the amount of the tax deferred distribution will reduce the cost of the membership interest.

7.60 A tax deferred distribution will arise in relation to a membership interest that is held by a member in an attribution MIT if:

- the member starts to have a right to receive any money or the market value of any property from the trustee of an attribution MIT in an income year;
- the right is indefeasible or is reasonable likely not to be defeated;

  – for the purpose of working out whether the right is indefeasible, section 276-55 (which deems a member's interests in an attribution MIT to be indefeasible) is disregarded;

- the right is not remuneration or consideration for the member providing finance, services, goods or property to the trustee of the attribution MIT or to another person;

- the right is reasonably attributable to a CGT asset that is a membership interest in the attribution MIT;

- the CGT asset is not trading stock or a TOFA financial arrangement; and

- as a result of the member starting to have the right, the CGT asset's AMIT cost base reduction amount for the income year is increased because of the operation of section 104-107D.

[Schedule 4, item 3, subsection 104-107F(1)]

7.61 The tax-deferred distribution derived from the membership interest is not included in the member's assessable income. That is, the following provisions (the ordinary income and deduction provisions) will not apply because the member starts to have the right:

- section 6-5 (about ordinary income);

- section 6-10 (about statutory income), except to the extent that the section applies in relation to section 102-5 (about net capital gains);

- section 8-1 (about general deductions);

- sections 15-15 and 25-40 (about profit-making undertakings or plans); or

- sections 25A and 52 of the ITAA 1936 (about profit-making undertakings or schemes).

[Schedule 4, item 3, subsections 104-107F(2) and (3)]

7.62 If a membership interest in an attribution MIT is held by the member on capital account, the cost base and reduced cost base of the membership interest will be adjusted because of the operation of section 104-107B. As a result, a higher capital gain, or reduced capital loss, will arise when a CGT event happens to the membership interest.

7.63 However, the cost of an asset that is a membership interest in an attribution MIT is adjusted if:

- the member starts to have a right to receive any money or the market value of any property from the trustee of an attribution MIT in an income year;
- the right is indefeasible or is reasonable likely not to be defeated;
  - for the purpose of working out whether the right is indefeasible, section 276-55 (which deems a member's interests in an attribution MIT to be indefeasible) is disregarded;
- the right is not remuneration or consideration for the member providing finance, services, goods or property to the trustee of the attribution MIT or to another person;
- the CGT asset is a revenue asset;
- the CGT asset is not trading stock or a TOFA financial arrangement; and
- as a result of the member starting to have the right to receive a tax-deferred distribution:
  - the CGT asset's AMIT cost base reduction amount for the income year is increased by an amount (the ***cost reduction amount***) because of the operation of section 104-107D; or
  - the CGT asset's AMIT cost base increase amount is increased by an amount (the ***cost increase amount***) because of the operation of section 104-107E.

[Schedule 4, item 3, subsection 104-107G(1)]

7.64 In these circumstances, for the purpose of applying the ordinary income and deduction provisions at the time the CGT event happens to the membership interests:

- if the AMIT cost base reduction amount for the income year is increased by an amount because of the operation of section 104-107D — the cost of the membership interests is reduced by the cost reduction amount (but not below zero); or

- if the AMIT cost base increase amount for the income year is increased by an amount because of the operation of section 104-107E — the cost of the membership interests is increased by the cost increase amount.

[Schedule 4, item 3, subsections 104-107G(2) and (3)]

7.65 As a result, if membership interests in an attribution MIT are held by the member on revenue account, the cost of the membership interest will generally be reduced. Consequently, a higher revenue gain, or reduced revenue loss, will arise on the disposal of the membership interest.

7.66 However, if the CGT asset's AMIT cost base reduction amount for an income year is increased by the cost reduction amount, and the cost reduction amount exceeds the cost of the membership interests just before the time the CGT event happens, then the member's assessable income for the income year in which that time occurs is to include:

- if the cost of the membership interests was zero just before that time — the cost reduction amount; or
- otherwise — the excess amount of the cost reduction amount over the cost of the membership interests just before that time.

[Schedule 4, item 3 subsections 104-107G(4) and (5)]

7.67 Section 118-20 applies to reduce capital gains made from a CGT event if, broadly, the capital gain is included in a taxpayer's assessable income or exempt income under a provision of the income tax law that is outside the Part 3-1 of the ITAA 1997 (which contains the CGT provisions). As a result, where an amount is included in assessable income as both ordinary income and as a capital gain, the ordinary income provisions prevail.

7.68 Therefore, to ensure that section 118-20 operates appropriately where section 104-107G applies to adjust the cost of membership interests in attribution MITs that are revenue assets, section 104-107G is taken to be outside of Part 3-1 for the purposes of applying section 118-20. ***[Schedule 4, item 3 subsection 104-107G(7)]***

Chapter 8
Miscellaneous amendments

Outline of chapter

8.1 This Chapter explains miscellaneous amendments to:

- repeal the public unit trust rules in Division 6B of Part III of the ITAA 1936; and
- exclude superannuation funds and exempt entities that are entitled to a refund of excess imputation credits from the application of the 20 per cent tracing rule for public trading trusts in Division 6C of Part III of the ITAA 1936.

Context of amendments

8.2 Division 6B of Part III of the ITAA 1936 applies to certain public unit trusts. The Division was introduced in 1981 to discourage the reorganisation of companies involving the transfer of assets or businesses into a resident public unit trust in which the shareholders would take equity to avoid continued company tax and shareholder taxation treatment and to attract trust tax treatment instead. The Division was introduced when the then classical system of company taxation applied. Since 1981, the company imputation system and capital gains tax have been introduced.

8.3 The Board of Taxation recommended (Recommendation 42) that, if the proposed arm's length income rules are introduced for attribution MITs, Division 6B should be abolished.

8.4 Division 6C of Part III of the ITAA 1936 operates to tax trusts like companies. Division 6C applies if a trust is both:

- a trading trust (that is, broadly, a trust that carries on activities other than eligible investment business, such as an active business that does not merely involve passive investment); and
- a public unit trust.

8.5 Division 6C currently has a look through provision that results in certain non-widely-held trusts becoming public unit trusts that must comply with the eligible investment business rules or be taxed like companies. This occurs when one or more person or bodies which are exempt from income tax or are complying superannuation entities own 20 per cent or more of the beneficial interests in the trust (the 20 per cent tracing rule).

8.6 The Board of Taxation recommended that membership interests held in a trust by tax exempt entities and complying superannuation entities which are entitled to a refund of franking credits should be disregarded for the purposes of applying the 20 per cent tracing rule.

Summary of new law

8.7 The amendments will:

- repeal the public unit trust rules in Division 6B of Part III of the ITAA 1936; and
- modify Division 6C of Part III of the ITAA 1936 so that membership interests held in a trust by tax exempt entities and complying superannuation entities which are entitled to a refund of franking credits will be disregarded for the purposes of applying the 20 per cent tracing rule that applies to determine whether a trust is a public trading trust.

Comparison of key features of new law and current law

New law	***Current law***
Division 6B of Part III of the ITAA 1936 will be repealed.	Division 6B of Part III of the ITAA 1936 applies to discourage the reorganisation of companies involving the transfer of assets or businesses into a resident public unit trust in which the shareholders would take equity to avoid continued company tax and shareholder taxation treatment and to attract trust tax treatment instead.

Division 6C of Part III of the ITAA 1936 will be modified so that membership interests held in a trust by tax exempt entities and complying superannuation entities which are entitled to a refund of franking credits will be disregarded for the purposes of applying the 20 per cent tracing rule that applies to determine whether a trust is a public trading trust.	Under Division 6C of Part III of the ITAA 1936, membership interests held in a trust by tax exempt entities and complying superannuation entities which are entitled to a refund of franking credits are taken into account for the purposes of applying the 20 per cent tracing rule that applies to determine whether a trust is a public trading trust.

Detailed explanation of new law

8.8 The amendments will:

- repeal the public unit trust rules in Division 6B of Part III of the ITAA 1936; and
- modify Division 6C of Part III of the ITAA 1936 so that membership interests held in a trust by tax exempt entities and complying superannuation entities which are entitled to a refund of franking credits will be disregarded for the purposes of applying the 20 per cent tracing rule that applies to determine whether a trust is a public trading trust.

Repeal of Division 6B

8.9 The public unit trust rules in Division 6B of Part III of the ITAA 1936 are repealed. ***[Schedule 6, item 3]***

Modification to Division 6C

8.10 Membership interests held in a trust by tax exempt entities and complying superannuation entities which are entitled to a refund of franking credits will be disregarded for the purposes of applying the 20 per cent tracing rule that applies to determine whether a trust is a public trading trust. ***[Schedule 5, item 1, section 102MD of the ITAA 1936]***

8.11 As a result, a trust will not be a public trading trust that is taxed like a company merely because such an entity holds more than 20 per cent of interests in a trust.

8.12 A consequential amendment is made to preserve the current effect of provisions that include superannuation contributions and other payments in the assessable income of a complying superannuation entity. ***[Schedule 5, item 2, section 295-173]***

Chapter 9
Application and transitional provisions

Outline of chapter

9.1 This Chapter explains application and transitional provisions for the new tax system for managed investment trusts.

Application provisions

New tax system for attribution MITs applies from 1 July 2015

9.2 The amendments to introduce a new tax system for managed investment trusts apply to income years starting on or after 1 July 2015. ***[Schedule 8, subitem 1(1)]***

Extension of widely held requirements applies from 1 July 2014

9.3 The changes to extend the scope of eligible investors for the purpose of the widely held requirements apply on or after 1 July 2014. ***[Schedule 8, subitem 1(2)]***

9.4 These changes are beneficial to managed investment trusts and have been actively sought by key stakeholders.

Transitional provisions

Non-arm's length income derived from existing arrangements

9.5 If an attribution MIT derives non-arm's length income, section 276-670 will apply so that the trustee is taxed on the non-arm's length income at the top marginal rate (including Medicare levy and any temporary Budget repair levies) provided that:

- the non-arm's length income is reflected in one of more of the attribution MIT's trust components for the income year; and

- the attribution MIT is a party to a scheme (which is defined in subsection 995-1(1) to mean, any arrangement, scheme, plan, proposal, action, course of action or course of conduct, whether unilateral or otherwise), where the parties to the scheme are not dealing with each other at arm's length (the non-arm's length scheme);

- at least one of the parties to the non-arm's length scheme is not an attribution MIT for the income year.

[Schedule 2, item 2, section 276-670]

9.6 A transitional rule will apply if:

- an attribution MIT became a party to a scheme before the date that the Bill is introduced into the House of Representatives; and

- the parties to the scheme are not dealing with each other at arm's length.

[Schedule 8, item 2, subsection 276-670T(1) of the Income Tax Transitional Provisions Act 1997]

9.7 In these circumstances, any income derived by the attribution MIT before 1 July 2017 will not be taxed as non-arm's length income. ***[Schedule 8, item 2, paragraph 276-670T(1)(c) and subsection 276-670T(2) of the Income Tax Transitional Provisions Act 1997***

Existing managed investment trusts that come into the new tax system

9.8 Transitional rules will apply to existing managed investment trusts that come into the new tax system with unders and overs relating to an earlier income year. The transitional rules apply if:

- a trust becomes an attribution MIT for a starting income year;

- the trust existed in an earlier income year (the base year); and

- the trust is an attribution MIT for the income year (the discovery year) that is the starting income year or a later income year.

[Schedule 8, item 2, section 276-800 of the Income Tax (Transitional Provision) Act 1997]

9.9 The starting income year is the 2015-16 income year. ***[Schedule 8, item 2, subsection 276-805(6) of the Income Tax (Transitional Provision) Act 1997]***

9.10 The transitional rule applies if the attribution MIT has an under or over of an AMIT character in the discovery year in relation to a base year. For these purposes:

- the trust is taken to be an attribution MIT for the base year and for every income year between the base year and the starting income year; and
- if the trust sent distribution statements to members for an income year prior to the starting income year, the trust is taken to have sent AMMA statements to those members.

[Schedule 8, item 2, subsections 276-805(1) and (2) of the Income Tax (Transitional Provision) Act 1997]

9.11 If the transitional rule applies, the under or over in relation to a base year is taken to be an under or over of the same AMIT character in the discovery year. However, Subdivision 276-H does not apply to uplift the amount of the under or over. ***[Schedule 8, item 2, subsections 276-805(3) and (4) of the Income Tax (Transitional Provision) Act 1997]***

9.12 However, the transitional rule does not apply if the under or over was discovered before the starting income year and the existing income tax law operates to produce an effect that appropriately recognises the under or over. ***[Schedule 8, item 2, subsection 276-805(5) of the Income Tax (Transitional Provision) Act 1997]***

Tax deferred distributions

9.13 Transitional rules, which are still to be developed, will ensure the amendments to clarify the taxation treatment of tax deferred distributions (sections 104-107F and 104-107G) will apply from 1 July 2011 (as announced in the 2014-15 Mid-Year Economic and Fiscal Outlook).