19 December 2008

Managed Investment Trust Review
The Board of Taxation
C/- The Treasury
Langton Crescent
CANBERRA ACT 2600
taxboard@treasury.gov.au

Via email

Dear Sir / Madam

SUBMISSION – REVIEW OF THE TAX ARRANGEMENTS APPLYING TO MANAGED INVESTMENT TRUSTS

Taxpayers Australia is pleased to provide a submission to The Board of Taxation in response to the public discussion paper – Review of the tax arrangements applying to Managed Investment Trusts.

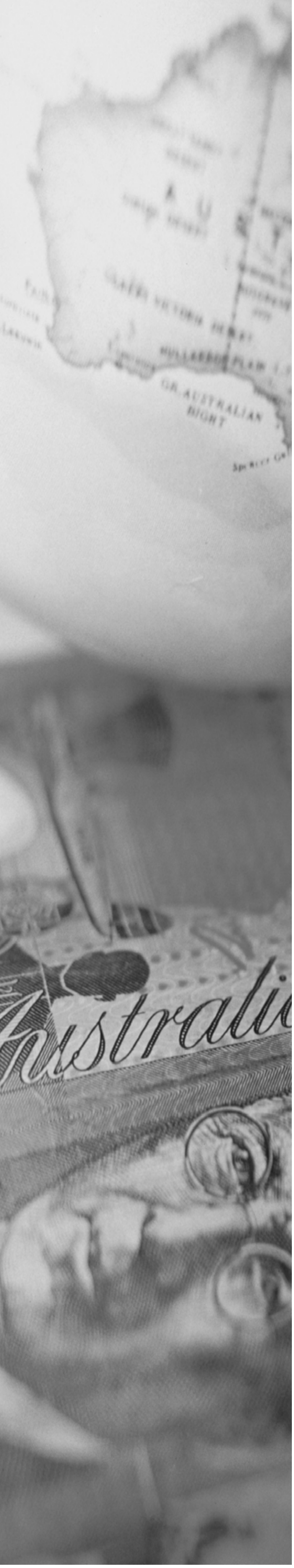
We commend the Board in engaging public opinion to consider the various issues surrounding managed investment trusts and are encouraged by the attempts to safeguard the integrity of the tax system as it applies to trusts.

The appended document sets out our views in response to the issues raised.

Should you wish to discuss any aspect of this submission please contact me on 1300 657 572 or Ms Jacqueline Hodges on same.

Yours sincerely

Heather Schache
General Manager - Taxation and Superannuation Publications



Taxpayers Australia Inc

Review of the tax arrangements applying to Managed Investment Trusts

Submission

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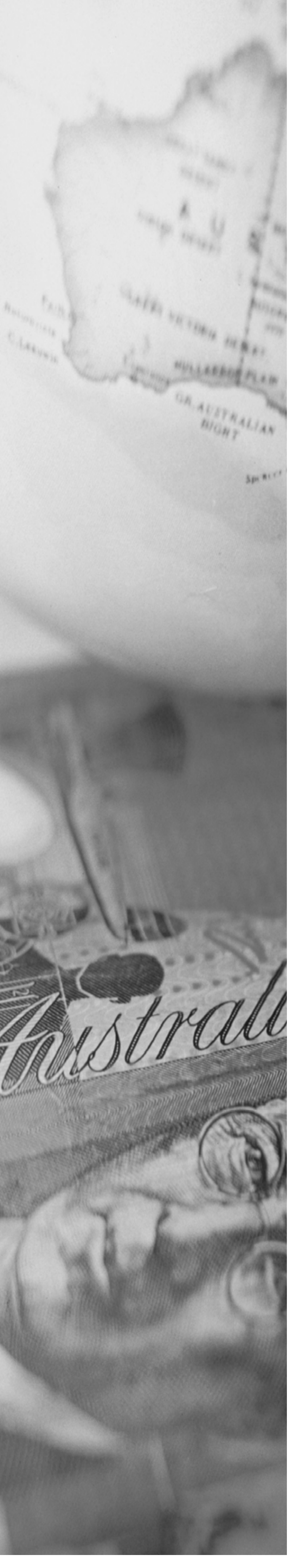

Background to Taxpayers Australia Inc

Taxpayers Australia Inc (formerly known as Australian Taxpayers Association) was established in 1919 and is a not-for-profit organisation committed to educating, informing and representing business and individual taxpayers alike.

We are not affiliated with any political party or any pressure group, and regularly make submissions to the Government on taxation and superannuation issues on behalf of our members and all Australian taxpayers. We are represented on major consultative forums with the Australian Taxation Office.

Taxpayers Australia Inc is also a founding member of the World Taxpayers Association and the Asia Pacific Taxpayers Union.

Our aim is to educate and inform taxpayers via our expert publications, online information, media and seminars on tax and superannuation issues and to bring to members the latest and most effective tax information.

Our members include tax advisers, accountants, tax agents, financial planners, business people, corporations, investors, students and individual taxpayers to whom we provide up-to-date information in plain English.

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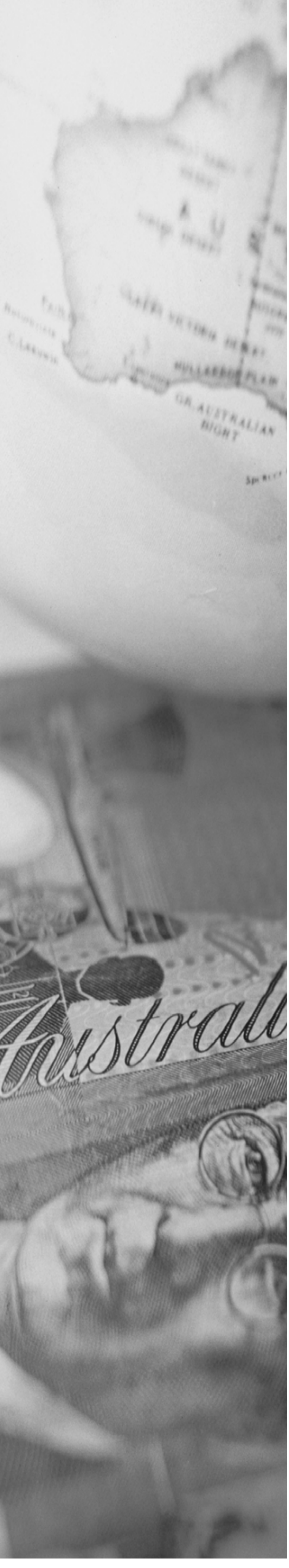

Executive Summary

Our submission sets out our comments on the tax arrangements applying to managed investment trusts in response to the questions raised in the following framing chapters:

Chapter 4:	Options for determining tax liabilities
Chapter 12:	Implications for other trusts

We are encouraged that the government is going to such lengths to safeguard the integrity of the tax system as it applies to trusts.

Taxpayers Australia maintains that the continued consultation with the peak bodies, industry participants and other relevant stakeholders is a key element in ensuring an equitable tax system.

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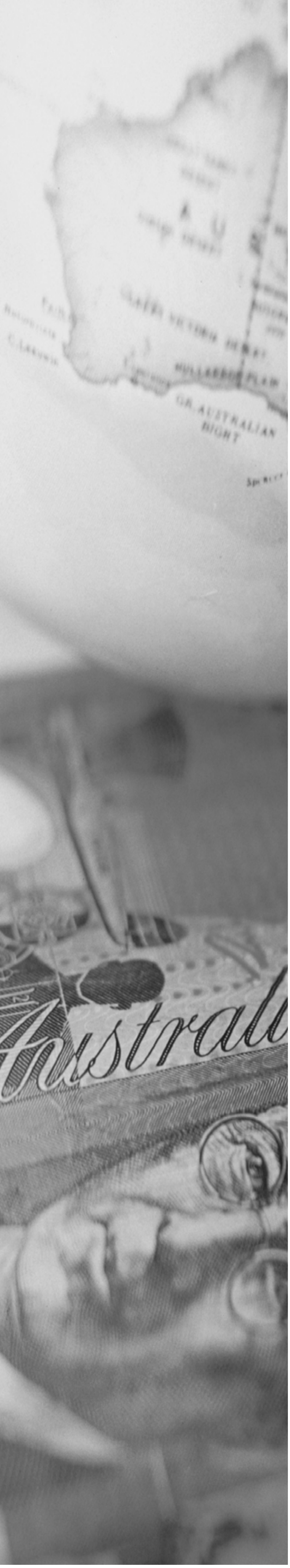

Options for determining tax liabilities

Alternatives to the present regime

The Board in this review has put forward alternative bases for taxing managed investment trusts and accordingly presented the following three options:

Option 1: the trustee could be assessed on the net income after allowing a deduction for certain distributions made to beneficiaries

Option 2: the trustee is exempt from taxation and instead tax on the net income of the trust is always assessable to beneficiaries, irrespective of the level of actual distributions made to them, and

Option 3: the trustee is exempt from taxation and instead tax on the net income of the trust is always assessable to beneficiaries provided a substantial minimum level of annual distributions of income is made to them within a specified period.

The Board seeks stakeholder comment on:

> ***… the high level options outlined above including comment on any issues that affect their workability as alternative models***

Taxpayers Australia acknowledges there are benefits from each option. Of the options put forward, we consider Option 3 provides the optimal position for both investors and Managed Investment Trusts (MIT).

Option 1 provides the simple solution of taxing at the originating point of income by assessing the trustees. However, further consideration would need to include:

- what tax rate would be applicable to the trustee
- would a franking credit attach and flow through to the beneficiary, and
- how would the distribution be treated in the hands of the beneficiary?

Under the model in Option 1, the potential for distributions to be claimed as a deduction creates even more confusion and conflict between trust law and tax law.

Option 2 and Option 3 outline similar approaches by ensuring distributions are only taxed in the hands of the beneficiary. It is noted

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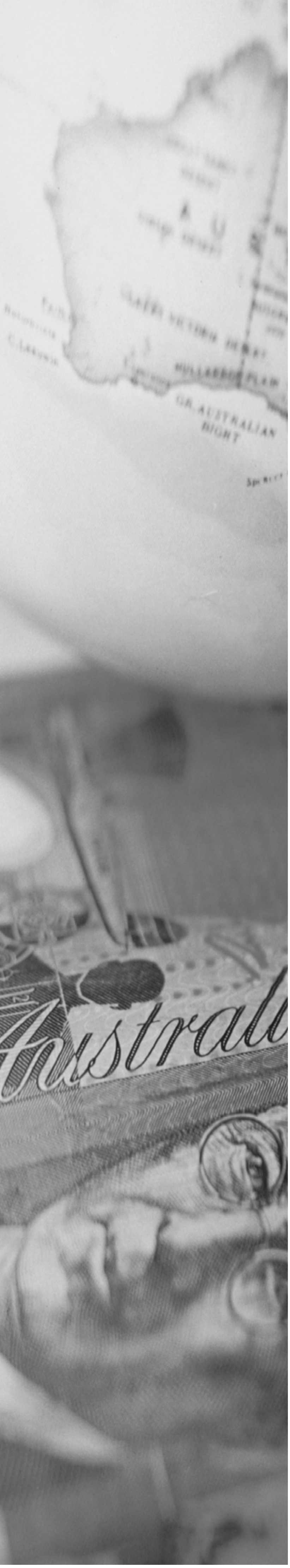


that, Option 2 may expose the beneficiary to increased risk of tax on accrued distributions. We consider the likelihood of distribution retention forming part of the financing decision model is highly probable, thereby leaving the beneficiary exposed to tax on accrued income. However, the act of retaining distribution flows lacks commercial sense mitigating the likelihood that distributions would never flow to the beneficiary.

Option 3 addresses this potential issue to beneficiaries by including a requirement that, a substantial minimum level of annual distributions is made. However, we suggest that, given the beneficiaries for an MIT could be considered as presently entitled to trust income, the level of distributions made should equate to the actual distributable amount. Albeit, some leeway provided by way of a de minimus provision could exist for errors.

Should government prefer to enact a 'substantial minimum level', we believe that punitive measures should be adopted into the legislation to ensure that trustees abide by that minimum.

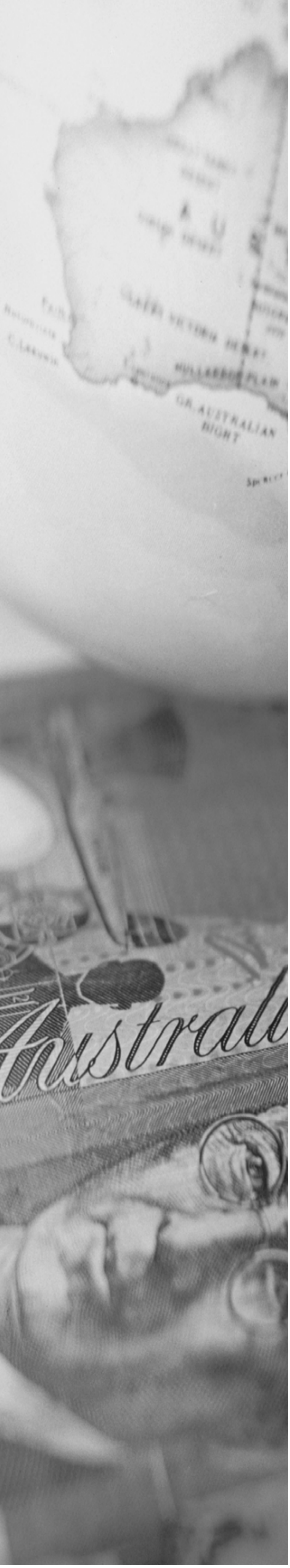
Another alternative, which is an extension of Option 1, would be the distribution of the after tax amount, whereby the trust is assessed but only distributes the net after-tax income. However, if such a distribution is made, it would seem the flow-through components of the distribution being tax deferred, capital gains, etc. are lost and the distribution take a form more comparable to a frankable dividend. We perceive this would be less favourable to investors.

Taxpayers Australia supports the rationale outlined in Option 3. We consider this option aligns the tax consequences on the trust income closer to the trust law outcomes. Furthermore, we support the requirement that distributions be made within a specified period.

> ***. . . the alternative that the current arrangements, which rely on Division 6 concepts such as trust income, share of trust income and present entitlement, could be modified to overcome the current issues and what modifications would be desirable.***

Taxpayers Australia considers that where available trustees should retain the discretion to apply the approach that provides the most satisfactory outcome, rather than disadvantage or penalise a beneficiary where trust income does not equate to the taxable distribution.

We defer this response to those key stakeholders who necessarily bear the responsibility for these key decisions.



Defining distributions

The Board seeks stakeholder comment on:

> ***… a definition of distribution that would provide clarity and ensure appropriate tax outcomes.***

Taxpayers Australia notes the requirements to develop a clear definition, particularly in respect of Options 1 and 2. For clarification, a distinction should be made between the components of a distribution and whether those components comprise income, capital, or a return of capital. We consider this distinction imperative in any definition to ensure trustees do not avail themselves of a deduction for a return of capital amount by virtue of deficient clarity in the law.

A simple approach would be to consider a distribution to be something of the nature that is assessable income in the hands of the beneficiary. Yet, this simple approach appears then to exclude a discountable portion of a capital gain or other exempt components. These irregularities are corrected in tax law; for example a discounted capital gain component of a distribution is grossed up in the hands of the recipient. Therefore, perhaps the assessable income approach will provide a suitable basis for a definition.

Taxpayers Australia considers a distribution for tax purposes should incorporate only those amounts that would be included as assessable income in the hands of the beneficiary.

The appropriate tax rate

The Board seeks stakeholder comment on:

> ***. . . applying the current section 99A tax rate on the undistributed taxable income of a trust would reflect an appropriate balance between integrity and equity considerations.***

The s99A tax rate is a punitive measure to ensure the integrity of the trustee. Where the beneficiaries of a trust are individuals or minors, taxing at the highest marginal rate appears justified.

However, if the majority of the unit-holders are corporate institutional investors, it would seem that the current taxing model is inequitable. Adopting the corporate rate would provide a more justifiable outcome.

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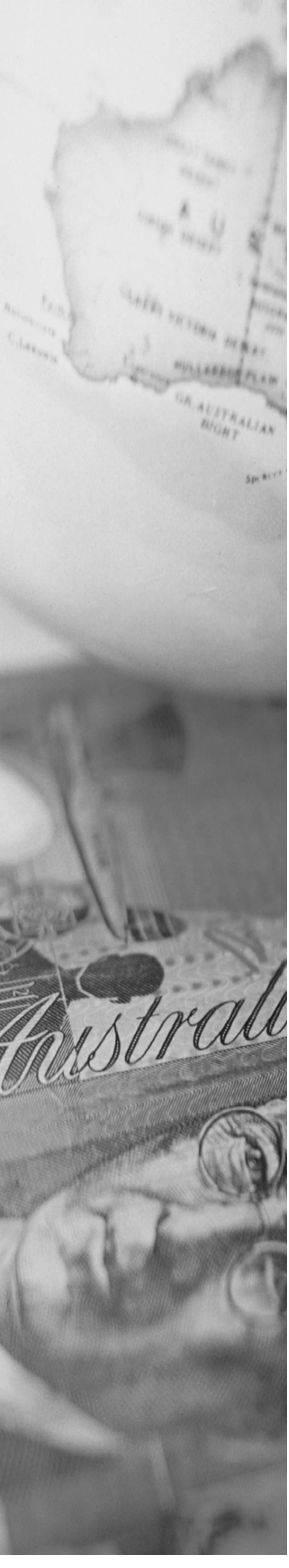


However, this level is not justified where the majority of investors are perhaps superannuation fund institutional investors.

Australia has a reportedly high level of self managed superannuation funds and individual investors. As such the tax rate of beneficiaries spans from concessionally taxed to potentially the highest tax margin. Furthermore, the tax rate of the individual investor is complicated by, for example, the stage of life or residency. Determining a separate and effective tax rate for MITs would seem difficult given the known span of beneficiary tax levels.

We are not entirely satisfied that a separate tax rate should be adopted for an MIT. While we support a reduction to personal tax, Taxpayers Australia does not want to espouse the eradication of the tax revenue. To that end we do not support a change in the tax rate.

> ***. . . there are means, other than applying the top marginal rate, for preserving integrity.***

As stated in the preceding commentary, we acknowledge the difficulty in determining a punitive tax rate. We also acknowledge and support a punitive tax.

One alternative would be to tax MITs as a corporate entity and provide a distribution in the form of a franked dividend. We note that Taxpayers Australia does not support this alternative.

Scoping the alternatives

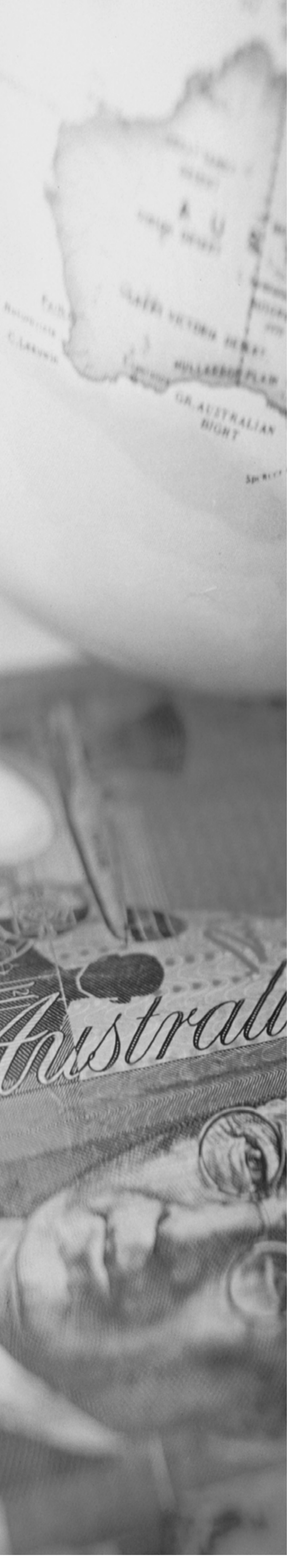
The Board seeks stakeholder comment on:

> ***…the scope to move to a receipts based approach under a model that allows trustees a deduction for their distributions.***

Taxpayers Australia acknowledges some support for the move to a receipts based approach.

We express concerns that this approach undermines the trust law concepts of indefeasible present entitlement with respect to the taxing point being the year when distributions are applied for the benefit of the beneficiary. We are less supportive of a model that allows trustees a deduction for their distributions.

Although the MITs issue a tax statement, it is known that in practice some taxpayers incorrectly include actual distributions received in the



tax returns. Altering the taxing point of distributions to a receipts basis, may alleviate some confusion with respect to timing.

Taxpayers Australia considers the issue of an annual tax statement sufficient for a taxpayer to correctly apply their distribution.

> ***The feasibility of other options to simplify arrangements for beneficiaries including changing the tax year for MITs.***

Taxpayers Australia acknowledges the intention that a tax year ending 31 March would allow for trustees to provide a final distribution on or before 30 June of a year. This may potentially, dissipate the confusion of some taxpayers as to the amount of taxable distributions to be included in their tax returns.

Taxpayers Australia does not consider there is a need to create a tax year specifically for MITs. Trustees currently provide taxpayers with an annual taxation statement which indicates the components to be included in the tax return.

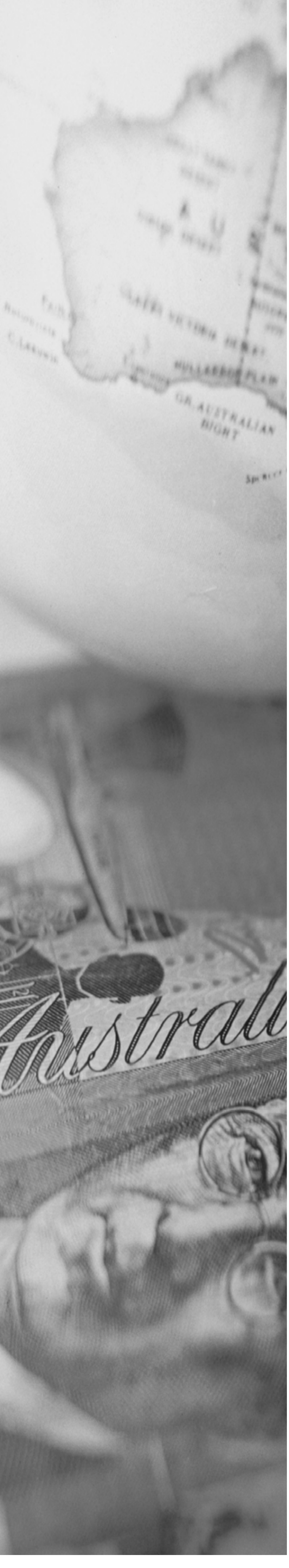
The Board also requests comment on an extension on the time limit for calculating trust income and distributions to align with the withholding reporting framework.

Taxpayers Australia supports a three-month grace period for MITs and for simplicity and consistency in the legislation recommends the three-month period be adopted for all trusts. Taxpayers Australia does not support the adoption of a new tax year specific to the MIT sector.

> ***Whether, under the trustee assessment and deduction model, resident individuals should be the only class of beneficiaries assessable on a receipts basis.***

As noted in the previous commentary the Board infer that the purpose of this review is to simplify arrangements for beneficiaries, yet by determining that the receipts basis for assessing distributions should only apply to residents creates a second set of rules and thus, complexity.

Taxpayers Australia does not support the differentiation of the tax treatment for beneficiaries based on residency. This suggestion increases both the complexity of the tax system and risk of confusion.



An approach to correcting errors

The Board seeks stakeholder comment on:

> ***. . . the desirability of adopting either a simple carry forward approach or a deduction/credit approach for correcting errors in calculating the net income of the trust. The Board also requests comments on how these approaches would interact with the Options for determining tax liabilities outlined in paragraph 4.8.***

Taxpayers Australia fully supports the adoption of a carry forward approach to correcting errors. This would alleviate the duplication arising from a reporting and compliance perspective for both the trustee and the relevant beneficiaries.

As noted earlier, Taxpayers Australia supports Option 3 where the trustee has a duty to distribute the majority of trust income and the beneficiary is liable to tax.

We do not consider that the amount be highlighted as an error but simply incorporated into the distribution for the following year. Accordingly, as the distribution is only reported and applied for the benefit of the beneficiary in the subsequent year, the tax point will be the following year.

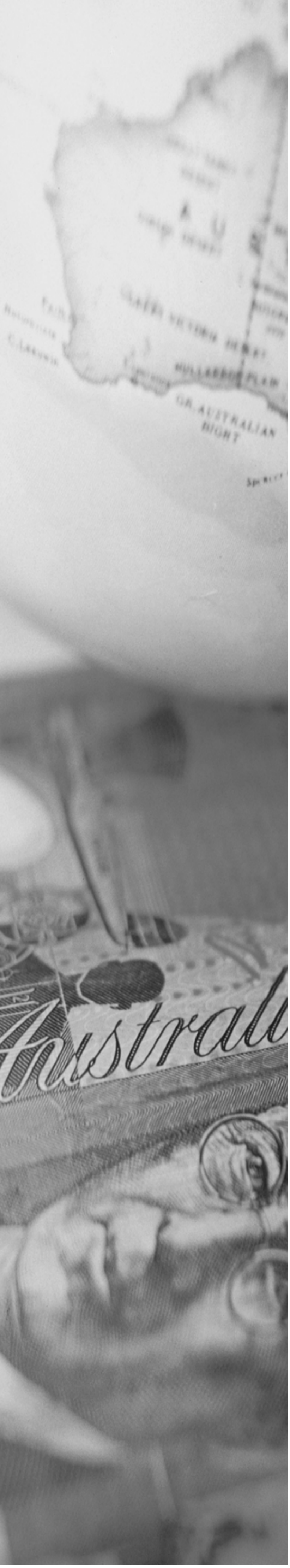
Such errors should not make a substantial impact on the tax revenue. As the accounts of MITs are audited, we perceive that any error or omission would be immaterial. However, where the error is material the amount should be adjusted in the year of the error.

Taxpayers Australia recommends that the error be carried forward and applied in the subsequent year, unless the amount is considered material.

> ***. . . how any approach adopted could address the inequities in the allocation of tax liabilities which can arise when unit holders redeem or sell their units before errors in the calculation of the net income of the trust have been identified.***

Taxpayers Australia proposes that where a unit-holder sells or redeems their units and an error is subsequently identified, the trustee should bare the cost.

We suggest that where an error giving rise to an additional tax liability cannot be transferred to the relevant beneficiary, the trustee should correct the error by drawing on reserve accounts. Conversely,



where an error results in a tax benefit the trustee may obtain the benefit banking the amount back into a reserve account.

Taxpayers Australia recommends that trustees bear the tax liability on errors that cannot be applied to the relevant unit-holder correctly.

> ***. . . under either approach to correcting errors in the calculation of net income of the trust, whether there is a need for a de minimus rule of up to say 2 per cent of the net income and if yes, what should be the consequences of breaching the de minimus rule.***

Taxpayers Australia does not fully support the need for a de minimus rule with respect to calculation of net income. However, we do contend that errors should be carried forward unless the error is material. This decision could be left to the trustees based on the opinion formed by the auditors of the financial report.

Taxpayers Australia recommends that should a de minimus rule apply, the rate be adopted that is consistent with generally accepted accounting principles and current audit practices.

> ***. . . whether the Commissioner of Taxation should have discretion to increase the de minimus in special circumstances, and if so, what circumstances.***

Allowing the Commissioner discretionary powers to raise the limit of a de minimus rule is inconsistent with the existence of a de minimus rate. Furthermore, this option potentially introduces separate rules for different taxpayers.

Taxpayers Australia does not support the contention that the Commissioner has special powers to increase the de minimus rate, should the de minimus rule be adopted.

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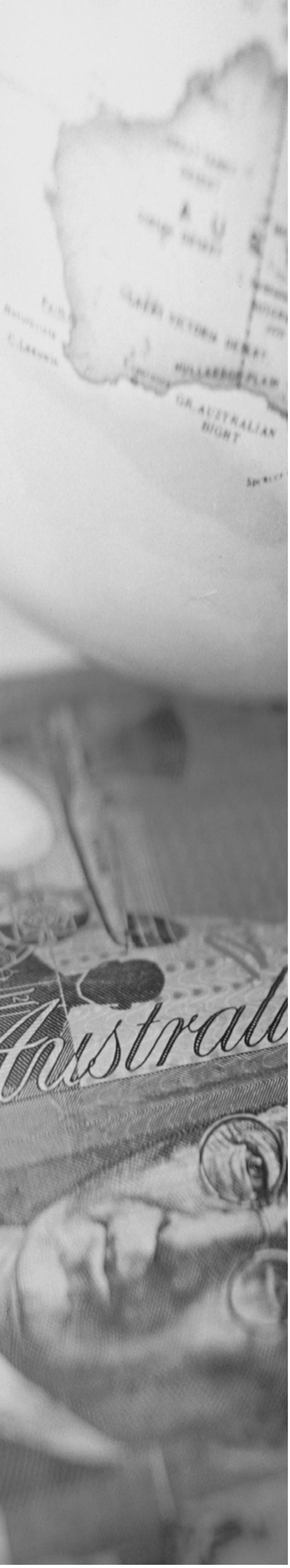

Implications for other trusts

Options for change

The Board seeks stakeholder comment on:

> ***. . . whether any options for change that you have commented upon for MITs should be extended to other trusts.***

Taxpayers Australia supports the simplification of the tax laws to ensure integrity and equity. We recommend that if the three-month grace period as noted in paragraph 4.29, p26 of the Consultation Paper is adopted, that this be extended to all consistently across all trusts.

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