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The General Manager
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The Treasury
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Dear Sir/Madam

MANAGED INVESTMENT TRUSTS – CAPITAL GAINS TAX ELECTION

The Taxation Institute of Australia (**Taxation Institute**) is pleased to provide comments on the Treasury discussion paper, *Managed Investment Trusts – Election to allow capital gains tax to be the primary code for disposals of shares, units and real property* (**Discussion Paper**) which was released for public comment on 1 June 2009.

The Taxation Institute welcomes the proposal to allow Managed Investment Trusts (**MITs**) to make an election to treat gains and losses on disposal of certain investments on capital account for taxation purposes.

The Discussion Paper sets out the key requirements which must be satisfied for this measure to apply. These are as follows:

- ***Eligible MITs*** – the MIT must be an eligible Australian MIT;
- ***Eligible assets*** - gains and losses must arise on disposal of eligible assets;
- ***Eligible disposal*** - the disposal must be an eligible disposal; and
- ***Election*** - the trustee of the MIT must have made an irrevocable election to apply the CGT regime to all eligible disposals (**CGT Election**).

The Taxation Institute's comments in relation to each of these requirements are outlined below.

1. Eligible Australian MIT

To be eligible to make the CGT election, a MIT must (amongst other requirements):

- have the relevant connection with Australia;
- satisfy certain requirements of the *Corporations Act 2001* (**Corporations Act**); and
- be either listed or widely held.

The connection with Australia test will be determined at the time the MIT makes its first "fund payment" (typically a distribution other than interest, dividends or royalties) for the year. If no fund payment is made, the Discussion Paper proposes that the test will be applied either when the first distribution of interest, dividend or royalty is made, or, if no such payment is made, then on both the first and last days of the current year.

As MIT status will be determined on a year by year basis, this may create significant compliance issues. For example, gains and losses will need to be tracked and attributed to periods when the MIT was or was not an eligible MIT. The Taxation Institute submits that these issues need to be specifically dealt

with in the design and implementation of this measure. Further, the Taxation Institute recommends that the CGT Election be structured as a "once and for all election". That is, if a MIT is eligible and makes the CGT Election, the election will remain in force even if the MIT no longer satisfies the criteria to be an eligible MIT. The Taxation Institute considers that this approach would effectively deal with the compliance costs and the integrity issues associated with MITs manipulating the CGT Election (ie by coming in and out of the regime depending on which approach is more beneficial).

The relevant requirements of the Corporations Act are that at the time the first fund payment is made, the relevant trust must be a "managed investment scheme" (as defined in the Corporations Act) operated by a "financial services licensee" (as defined in the Corporations Act) whose licence covers operating such a scheme.

The Discussion Paper does not make any proposals which would resolve the uncertainty about the status of unregistered managed investment schemes nor the different kinds of financial services licences that can be issued. Nor does it address the common situation of a licence held by a person other than the trustee where the trustee is simply an authorised user of the licence. The Taxation Institute submits that these issues need to be specifically dealt with in the design and implementation of this measure. Further, the Taxation Institute considers that it would be inappropriate to exclude unregistered schemes as this would exclude many wholesale funds, which clearly should be within the scope of the measures.

The requirement to be "widely held" will be satisfied if at least one member of the MIT is a complying superannuation fund with at least 50 members. However, it is not proposed that the definition of "widely held" will include MITs which have at least one member being a life insurance company. The Taxation Institute considers that it is incongruous to provide that a MIT will be considered to be widely held if it has at least one member that is a superannuation fund (with at least 50 members) but a MIT will not be considered to be widely held if it has at least one member that is a life insurance company. Accordingly, the Taxation Institute considers that a MIT should be considered to be widely held if it has at least one member that is a life insurance company.

The foreign resident exemption from the definition of "widely held" MITs is inconsistent with the current policy position to attract foreign residents to invest in Australian funds. Accordingly, the Taxation Institute considers that this exemption should be reconsidered.

On a broader level, the Taxation Institute considers that further consideration should be given to expanding the CGT Election to other collective investment vehicles not just MITs (eg listed investment companies and venture capital limited partnerships) and those trusts that are subject to regulatory regimes other than the Corporations Act (eg those regulated by the superannuation and life insurance regimes).

2. Eligible assets

The Discussion Paper proposes that eligible assets exclude those assets that are financial arrangements which are subject to the TOFA regime. The Taxation Institute does not support this limitation of eligible assets. Such a limitation will undermine the competitiveness of MITs (ie why would investors invest in MITs if they can invest in a superfund which is taxed in a more beneficial manner under the TOFA provisions).

The Discussion Paper indicates that trading stock will not be an eligible asset. The carve-out for trading stock may undermine the purpose of the proposed measure as it will leave open the characterisation debate (ie capital versus revenue) in relation to gains and losses on realisation of the portfolio investments of MITs. In particular, as the current superannuation rules (refer s 295-85) exclude the operation of trading stock, it would be incongruous to retain such a rule as it would cause a dichotomy between direct and indirect investment by superannuation funds. Accordingly, the Taxation Institute recommends expanding the category of eligible assets to include trading stock.

3. Eligible disposals

The Discussion Paper provides that capital treatment can be elected where the disposal of the eligible asset constitutes a CGT event arising from the disposal or other realisation of ownership of the asset for the purposes of the CGT provisions.

It appears that this statement is intended to further limit the scope of the CGT Election. If it is intended as a further limitation, this may mean that the capital/revenue characterisation of gains and losses in relation to certain transactions which relate to those assets and give rise to a CGT event under the CGT regime which is not strictly a "disposal or other realisation of ownership" of the asset will remain an issue (eg premiums received on the grant of a lease, payments for entering restrictive covenants, amounts received for granting an option over an asset and payments where the underlying share or units remain on issue such as a reduction of capital). Further information needs to be provided in relation to any such limitations to enable a fuller consideration.

The Taxation Institute considers that the concept of an "eligible disposal" should be expanded to an "eligible event" which should include all CGT events and, if appropriate, certain CGT events can be carved out. This would be consistent with the approach in the superannuation rules (refer s 295-85 of the *Income Tax Assessment Act 1997*).

4. Election and application date

The Taxation Institute considers that there should be a legislative prohibition on the Commissioner amending prior year tax returns in respect of gains or losses which have previously been treated as capital gains and losses where a MIT makes a CGT Election.

As elections for existing MITs will be backdated to eligible disposals from 1 July 2008, taxpayers with assessments covering a period which ends after 30 June 2008, should be entitled to amend their tax returns in respect of this period regardless of whether capital and losses were previously treated as revenue gains and losses. This will include those MITs with a substituted accounting period and cover assessments raised prior to the enactment of the legislation to implement this regime.

The existing rules governing amended assessments should apply to gains and losses treated as revenue gains and losses in respect of disposals by MITs prior to 1 July 2008. Therefore, generally, taxpayers should not be entitled to amend their returns to change gains and losses that were previously characterised as revenue gains and losses to capital gains and losses. However, there should be a specific provision that allows taxpayers to amend their returns for periods prior to 1 July 2008 where taxpayers have adopted a view that their gains and losses are on revenue account based on an ATO position or ATO information.

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If you require any further information or assistance in respect of our submission, please contact Joan Roberts on 03 9611 0178 or the Taxation Institute's Senior Tax Counsel, Dr Michael Dirkis, on 02 8223 0011.

Yours sincerely

Joan Roberts
President