LCG 2015/11 - Attribution Managed Investment Trusts: annual cost base adjustments for units in an AMIT and associated transitional rules

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Law Companion Guideline
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Attribution Managed Investment Trusts: annual cost base adjustments for units in an AMIT and associated transitional rules

Relying on this Guideline

This publication is a public ruling for the purposes of the *Taxation Administration Act 1953*.

This Guideline describes how the Commissioner applies the law as amended the *Tax Laws Amendment (New Tax System for Managed Investment Trusts) Act 2016*.

If you rely on this Guideline in good faith, you will not have to pay any underpaid tax, penalties or interest in respect of matters it covers if it does not correctly state how a relevant provision applies to you.

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What this Guideline is about

1. This Guideline explains the rules for adjusting the cost base of interests in attribution managed investment trusts (AMITs),[1] associated transitional rules, and the tax treatment of so-called tax deferred distributions.

Date of effect

2. This Guideline is a public ruling, effective for those who rely on it in good faith in respect of relevant payments made on or after 1 July 2011 from a trust that becomes an AMIT and for assessments for income years starting on or after:

- 1 July 2016, or
- if the trustee has made an irrevocable choice to apply the new tax system for its 2015-16 income year which starts on or after 1 July 2015 – 1 July 2015.

Background

CGT event E10

3. CGT event E4 applies when payments in respect of certain trust interests are made in circumstances where those payments are not otherwise assessable.[2] CGT event E4 does not apply in respect of interests in AMITs[3], instead, CGT event E10 applies.[4] Sections 104-107B to 104-107E, which relate to CGT event E10, provide for both downwards and upwards adjustments to the cost base of interests in AMITs. This is in contrast to CGT event E4, which only provides for downwards adjustments to the cost base of the trust interests in respect of which it applies.

4. Special rules also clarify the tax treatment of so-called tax deferred distributions (TDDs) paid by AMITs[5], and deal with adjustments to the tax cost of interests in an AMIT where those interests are held on revenue account.[6]

5. This Guideline discusses CGT event E10 and these rules, as well as the transitional rules for working out under CGT event E4 the 'non-assessable parts' of trust payments made on or after 1 July 2011.[7]

6. This Guideline also discusses the restriction under the transitional rules on the Commissioner's power to amend assessments relating to trust payments made before 1 July 2011.[8]

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[1] An AMIT is a managed investment trust that has elected in to the attribution regime for the taxation of MITs contained in Division 276 of the *Income Tax Assessment Act 1997* (ITAA 1997). All legislative references in this Guideline are to the ITAA 1997 unless otherwise indicated.
[2] Section 104-70.
[3] Subsection 104-70(1A).
[4] Section 104-107A.
[5] Section 104-107F.
[6] Sections 104-107G and 104-107H.
[7] Section 276-750 of the *Income Tax (Transitional Provisions) Act 1997* (IT(TP)A 1997).
[8] Section 276-755 of the IT(TP)A 1997.

Explanation

7. Formerly, CGT event E4 applied to MITs in the same way it applied to other trusts. Broadly, CGT event E4 happens when a trustee makes a payment to a member in respect of their unit or relevant interest in the trust, and some or all of the payment is not included in the member's assessable income. In this situation, the cost base of the member's unit or interest may be adjusted downwards. If the adjustment exceeds the cost base, the member makes a capital gain equal to the excess. A member cannot make a capital loss from a cost base adjustment.

8. Notably, CGT event E4 allows only downwards cost base adjustments. Because attribution of an amount can take place independently of actual payment of that amount under the attribution regime for AMITs, if CGT event E4 were to apply to interests in AMITs, there would be a risk of double taxation.

9. For example, amounts might be attributed to a member for tax purposes but not actually paid to that member before the member disposes of their interest in the AMIT. In effect, without an upwards cost base adjustment, the undistributed but taxed amount may otherwise also form part of the member's capital gain or reduce the member's capital loss on any disposal of that interest prior to payment or actual distribution in respect of the attributed amounts.

10. By contrast to CGT event E4, sections104-107B to 104-107E allow both downwards *and* upwards cost base adjustments for units and interests in an AMIT. By allowing for adjustments in both directions, the rules minimise potential tax distortions that might otherwise arise on the sale of a member's units or interests in an AMIT.

11. CGT event E10 downwards adjustments reflect, broadly speaking, actual payments received by the member.[9] Upwards adjustments are, broadly speaking, equal to the sum of amounts included in the member's assessable income (or otherwise as a relevant capital gain[10]) and non-assessable non-exempt income in respect of the AMIT.[11]

12. The downwards and upwards adjustments are netted off against each year to arrive at a net cost base adjustment amount, which is the amount by which the cost base of the member's interest in the AMIT is adjusted.

The AMIT cost base adjustments rules

13. In summary, the AMIT cost base adjustment rules work as follows:

- Under section 104-107B, a member makes an annual adjustment to the cost base of their unit or interest in an AMIT. The adjustment is to be made just before the end of the income year, or just before the time of a relevant CGT event.
- Under section 104-107D, the cost base of a member's interest or unit in an AMIT is effectively *reduced* by the *AMIT cost base reduction amount* for the income year, being the total of:
  - (a) money, and the market value of any property, attributable to the interest or unit, that they start to have a right to receive in that year, and
  - (b) the amounts of all tax offsets attributable to the member's interests or units.

[9] Section 104-107D.
[10] Discount capital gains attributed to the member from an AMIT are grossed up to double the amount of the discounted capital gain, before the member then applies their own discount (if any) to that gain.
[11] Section 104-107E.

- Under section 104-107E, the cost base is effectively *increased* by the *AMIT cost base increase amount* for the income year, being the total of:
  - (a) amounts included in the member's assessable income or non-assessable non-exempt income (including amounts included because of section 276-80) that are attributable to the unit or interest, other than any amount in respect of the AMIT's net capital gain (the 'first amount'), and
  - (b) the amount of the member's determined member component of a character relating to capital gains[11A] (the 'second amount').
- The amount by which the cost base is actually adjusted under section 104-107B is the net difference between the AMIT cost base reduction amount and the AMIT cost base increase amount. This is called the *AMIT cost base net amount*, and it is worked out under section 104-107C.
- If the cost base is reduced to nil, any further negative net amount results in a capital gain under the new CGT event E10.[12]

Clarification of treatment of tax deferred distributions (TDDs) paid by AMITs

14. Historically, there has been some uncertainty about the tax treatment of trust distributions not included in assessable income under Division 6 of Part III of the *Income Tax Assessment Act 1936* (that is, TDDs). Depending on the circumstances, such amounts may arguably be ordinary income in the hands of the member or form part of the non-assessable part of a payment giving rise to cost base adjustments under CGT event E4.

15. Section 104-107F addresses this uncertainty for AMIT distributions. Generally, distributions which give rise to an AMIT cost base reduction amount under section 104-107D will not be included in the member's assessable income under provisions such as section 6-5 (ordinary income), section 15-15 (profit-making undertaking or plans) and section 6-10 (statutory income).[13] However, such distributions can give rise to net capital gains under section 102-5 or revenue gains under section 104-107H.

16. To further address the historical uncertainty about the treatment of TDDs, section 276-750 of the IT(TP)A 1997 allows these new rules to be applied retrospectively from 1 July 2011, but only for identifying when amounts are non-assessable under CGT event E4 (see further paragraphs 19 to 22 of this Guideline).

AMIT interests or units held as revenue assets

17. Corresponding with sections 104-107B (which provides for annual cost base adjustments for capital gains tax purposes) and 104-107A (which provides for a capital gain to arise if the relevant cost base would otherwise be reduced below nil), sections 104-107G and 104-107H deal with adjustments to the tax cost of interests held on revenue account and the inclusion of an amount in assessable income where that cost would otherwise be reduced below nil. As with the AMIT cost base adjustment rules, the tax cost of the interest may increase or decrease[14] and, where the reduction exceeds the tax cost, the excess is included in the member's assessable income.[15]

[11A] Including any relevant discount component: subsection 276-85(4).
[12] Section 104-107A.
[13] Some amounts are excluded from this treatment for example, amounts relating to remuneration for providing finance, services or goods.
[14] Section 104-107G.
[15] Subsection 104-107H(2).

Subdivision 276-U Transitional rules for becoming an AMIT

18. Two transitional rules for TDDs have been inserted into the IT(TP)A 1997. These rules clarify the extent to which trust distributions (payments) will be treated as non-assessable amounts for the purposes of CGT event E4.

Payments on or after 1 July 2011: section 276-750

19. For most payments made by a trust on or after 1 July 2011, but before the trust became an AMIT, sections 104-107F, 104-107G and related provisions apply to work out the non-assessable part for CGT event E4 purposes.[16] These sections do not, however, apply to payments already included as assessable income in the income tax return lodged for the income year the payment was made.

20. This rule is designed to ensure that TDDs are taken into account under the relevant cost base adjustment rules, rather than being taxed as ordinary income at the time of the distribution, unless the member has already returned the distribution as assessable.

21. Even though the rule enables both section 104-107F *and* section 104-107G (which relates to revenue assets) to apply retrospectively, on its terms the rule applies only for working out:

- whether CGT event E4 happens in relation to a payment, and
- the amount of a non-assessable part under section 104-70.

22. The rule does not, therefore, retrospectively codify an approach for working out *revenue* gains and losses from relevant interests in MITs. Nonetheless, the Commissioner recognises the consistency these provisions themselves (and the inclusion of them both in the transitional rules) require between CGT event E4 non-assessable amounts and the treatment of these amounts in working out revenue gains and losses. For instance, if the retrospective application of section 104-107F ensures that a particular distribution in respect of an interest in a MIT that is a revenue asset is treated as non-assessable for CGT event E4, it should similarly be treated as an adjustment to the cost (sometimes referred to as 'tax-deferred') for the purpose of calculating the revenue gain or loss on that asset, rather than being assessable up front.

Payments before 1 July 2011: section 276-755

23. Section 276-755 of the IT(TP)A 1997 limits the Commissioner's power to amend assessments in particular circumstances. For payments made before 1 July 2011 by a trustee of a trust which becomes an AMIT, the Commissioner cannot amend an assessment to increase an entity's assessable income if the Commissioner could not amend the assessment in that way had sections 104-107F, 104-107G, 104-107H and related provisions applied when the payment was made.

24. However, when pre 1 July 2011 payments have not been returned by the taxpayer as income, the Commissioner considers that they must be:

- taken into account as non-assessable amounts for CGT event E4, and
- included in any revenue gains or losses from the relevant trust interests,

either on disposal or at an earlier time when the cost of the interests has been recouped.

25. The Commissioner regards situations where amounts paid before 1 July 2011 are not returned as assessable income, **or** included when working out later capital or revenue gains or losses, as a high compliance risk.

[16] See subsections 276-750(2) and (3) of the IT(TP)A 1997.

26. The approach to TDDs in sections 276-750 and 276-755 of the IT(TP)A 1997 is consistent with the Commissioner's compliance approach at the time that ATO ID 2011/58 was withdrawn.[17]

27. On this basis, sections 276-750 and 276-755 of the IT(TP)A 1997 effectively confirm the Commissioner's current administrative approach to TDDs generally, and not just those paid by trustees of trusts which become AMITs.

Example: Prior distributions to revenue account unitholder

28. *Prior to a MIT becoming an AMIT (but after 1 July 2011), it made distributions to its unit holders in excess of the amounts dealt with under Division 6 of the Income Tax Assessment Act 1936. The distributions were not paid as remuneration or as consideration for any finance, services, goods or property provided to the MIT.*

29. *Some such distributions were paid to X Co, who held and continues to hold its interest in the MIT as a revenue asset.*

30. *The MIT has since become an AMIT.*

31. *The following consequences arise:*

- *Under subsections 104-107F(2) and (3), insofar as it is relevant for working out the 'non-assessable amount' of the distribution for CGT event E4 purposes, no part of the distributions are assessable as ordinary or statutory income.*
- *The Commissioner accepts that the amounts would instead be treated on a 'tax deferred basis', resulting in the cost of the interest in the MIT being adjusted.*
- *As X Co's interest in the MIT is a revenue asset, a gain or loss (taking the adjusted cost into account) would generally arise on realisation (with the CGT anti-overlap provisions applying as appropriate).*
- *However, if X Co had already returned the amounts as assessable income in the years they were distributed, no adjustments would be made to the cost of its interest in the MIT in respect of the distributions.*

Commissioner of Taxation
5 May 2016

[17] See New taxation system for managed investment trusts – the Commissioner's compliance approach.

References

ATOlaw topic(s)	Income tax ~~ Trusts ~~ Other Income tax ~~ Capital gains tax ~~ CGT events ~~ CGT events E1 to E10 – trusts
Legislative references	ITAA 1997 ITAA 1997 6-5 ITAA 1997 6-10 ITAA 1997 15-15 ITAA 1997 102-5 ITAA 1997 104–70 ITAA 1997 104–70(1A) ITAA 1997 104–107A ITAA 1997 104–107F ITAA 1997 104–107F(2) ITAA 1997 104–107F(3) ITAA 1997 104–107G ITAA 1997 104–107H ITAA 1997 104–107H(2) ITAA 1997 104–107B ITAA 1997 104–107C ITAA 1997 104–107D ITAA 1997 104–107E ITAA 1997 Div 276 ITAA 1997 276–80 ITAA 1936 ITAA 1936 Pt III Div 6 IT(TP)A 1997 IT(TP)A 1997 Subdiv 276–U IT(TP)A 1997 276–750 IT(TP)A 1997 276–750(2) IT(TP)A 1997 276–750(3) IT(TP)A 1997 276–755 Tax Laws Amendment (New Tax System for Managed Investment Trusts) Act 2016
Other references	ATO ID 2011/58