LCG 2015/4 - Attribution Managed Investment Trusts: 'clearly defined rights'

Australian Government
Australian Taxation Office

Law Companion Guideline
LCG 2015/4

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Attribution Managed Investment Trusts: 'clearly defined rights'

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 will apply the law as amended by 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 meaning of '*clearly defined'* membership rights to income and capital as that term is used in Division 276 of the *Income Tax Assessment Act 1997* (ITAA 1997)[1] (the attribution regime for Managed Investment Trusts (MITs)).

2. It discusses:

- the 'safe harbours' for the *clearly defined* rights test, and
- examples of the powers a trustee may have without breaching the *clearly defined* requirement.

[1] All legislative references in this Guideline are to the ITAA 1997, unless otherwise indicated.

Date of effect

3. This Guideline is a public ruling, effective for those who rely on it in good faith in respect of 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.

Clearly defined rights

4. For a MIT to qualify as an attribution MIT (AMIT)[2] in an income year, it must satisfy the requirements in section 276-10. One of these requirements is that the rights to income and capital arising from each of the membership interests in the trust must be *clearly defined* (paragraph 276-10(1)(b)).

5. The requirement for the members to have clearly defined rights in the trust for it to qualify as an AMIT is central to the attribution system of taxation applying to AMITs. The rights to income and capital arising from members' membership interests in the AMIT provide a benchmark against which to judge whether an attribution decision of the trustee is fair and reasonable.[3] The test also ensures that AMIT benefits such as deemed fixed trust treatment[4] are not available to trusts in which the trustee has significant discretionary powers.

Clearly defined rights – safe harbours

6. Without limiting the ordinary meaning of *clearly defined*, section 276-15 sets out three safe harbours. That is, the rights to income and capital arising from the membership interests of all members in a MIT will be taken to be *clearly defined* if the MIT falls within one of the following categories:

- **Corporations Act:** The trust is registered under section 601EB of the *Corporations Act 2001* (this covers the registration of a managed investment scheme).[5]
- **Single class:** There is one class of membership interests (typically units) in the trust, that is, the rights to income and capital arising from those membership interests are the same.[6]
- **Multiple class:** Disregarding the three features listed in paragraph 7 of this Guideline, there would be one class of membership interests in the trust, and the rights to income and capital arising from those interests would be the same.[7]

7. To apply the safe harbour test, a MIT with more than one class of member is treated as if it were a MIT with a single class of member where the only things distinguishing one class from another are any or all of:

- the fees and charges imposed by the trustee on the members
- the issue and redemption prices of membership interests
- the exposure of membership interests to foreign exchange gains and losses, for example, if the interests are denominated in a foreign currency or are exposed to different foreign currency hedging strategies of the MIT.

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[2] An AMIT is a managed investment trust that has elected in to the attribution regime for the taxation of MITs contained in Division 276.

[3] Law Companion Guideline LCG 2015/7 *Attribution Managed Investment Trusts: attribution on a 'fair and reasonable' basis*.

[4] Subdivision 276-B.

[5] Paragraph 276-15(1)(a).

[6] Paragraph 276-15(1)(b).

[7] Paragraph 276-15(1)(b) and subsection 276-15(2).

8. For multi-class MITs, the clearly defined rights test is applied to the MIT as a whole and not on a class by class basis. The choice for separate class treatment[8] is available only to MITs eligible to be an AMIT, after the MIT trustee has made that choice. For multi-class MITs that do not satisfy the multiple class safe harbour,[9] the MIT cannot be an AMIT if the rights to income and capital of one or more of the classes are not clearly defined.

Clearly defined rights – ordinary meaning

9. Where a MIT does not fall within one of the safe harbours, the Commissioner will have regard to the following factors, set out in the Explanatory Memorandum to the Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015, in determining whether the rights to income and capital are *clearly defined*:

- whether the constituent documents of the trust provide an objective benchmark for the trustee to attribute amounts to members annually
- whether, assuming that the trust is an AMIT 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
- whether the right of each member of the trust to the income and capital of the trust can be materially diminished or expanded through the exercise of a power or right
- whether the trustee has an obligation to treat members who hold units or interests of the same class equally and members who hold membership interests in different classes fairly, and
- whether the trustee can easily modify the rights of those membership interests to the income and capital of the trust by changing the constituent documents of the trust.

10. [Omitted.]

11. As indicated above, one of the factors the Commissioner will consider is whether the rights of each member to the income and capital of the trust can be materially diminished or expanded through the exercise of a power or right. The Commissioner accepts that due to its fiduciary obligations, a trustee of a MIT will generally not exercise a discretionary power in a manner which materially diminishes or expands the interests of the members. The Commissioner will treat the exercise of the power in this way as a mere theoretical possibility. Therefore, the Commissioner will not treat the existence of such a power as a breach of the requirement that the rights of members be clearly defined. However, if a trustee exercised a discretionary power in a manner which materially diminishes or expands the interests of members, the rights of members will cease to be clearly defined from the time the powers are exercised. It is the exercise of the discretionary power in this way that nullifies the Commissioner’s presumption that exercise of the power in such a way was a mere theoretical possibility.

Examples of powers not breaching the ‘clearly defined’ requirement

12. It is only the members’ rights to income and capital arising from membership interests which must be clearly defined.

[8] Law Companion Guideline LCG 2015/5 *Attribution Managed Investment Trusts: choice to treat separate classes as separate MITs*.
[9] See paragraph 6 of this Guideline.

13. The Commissioner accepts that the powers set out in the table below do not result in a trust breaching the clearly defined rights requirement, unless any (except for item I1)[10] are exercised in a manner which materially diminishes or expands the rights of members to income and/or capital. This is a list of examples and is not exhaustive.

Examples of trustee powers / features of trust deed consistent with the existence of clearly defined rights

	Trustee powers etc.	Notes and examples
A: Income determination		
A1.	power to determine the daily net income of the trust	Note: This power facilitates daily trust distributions. The power goes to the calculation of the income of the trust and not to the rights that a member has to that income.
A2.	power to determine whether a receipt is income or capital for trust accounting purposes	
A3.	power to determine the distributable income of the trust	Note: This power goes to the calculation of the income of the trust and not to the rights that a member has to that income.
A4.	power to determine the trust components and attribute them to members as determined member components	Note: This power goes to the calculation of trust and determined member components for the purposes of Division 276 and not to the rights that a member has to income and capital.
B: Distributions & accumulations		
B1.	power to accumulate cash	Note: The attribution system does not require the trustee to consider the cash distributed to members.
B2.	power to make distributions by way of additional membership interests, or in specie rather than in cash	See B3.
B3.	power to distribute income to outgoing members	Example: The trustee has the power to distribute amounts of income to redeeming members based on the period of time they were members. Example: The trustee has the power to include an income distribution with or as part of the redemption proceeds.

[10] As a matter of practical administration – and noting that in light of the circumstances in which the power to amend the deed may be exercised, the trustee cannot easily modify members' rights to income and capital by changing the deed (see paragraph 9 of this Guideline).

	Trustee powers etc.	Notes and examples
B4.	in working out a performance based distribution amount for a member or class of members, the trust constituent documents provide for the trustee to include the performance of a related non-MIT entity as part of the calculation formula involving no element of trustee discretion	Example: A private equity fund, comprising a Venture Capital Limited Partnership (VCLP) and a MIT, has one manager. An investment in the fund consists of an investment in both fund entities. The trust constituent documents set out a formula for the calculation of the members' distribution entitlements from the MIT. One element of that formula is based on the performance of the VCLP.
B5.	power to determine that in the period in which a membership interest is issued, in respect of that interest the member can participate in any relevant distribution for that period either fully, pro-rata based on a 'days on issue basis', or not at all	Note: This power is acceptable only if, on or before the issue date of the relevant membership interests, the trustee determines which one of the alternative bases will apply and discloses that determination to potential investors.
C: Application of amounts		
C1.	power to apply amounts otherwise owing to a member to satisfy a liability owed by the member to the trustee	Example: The trustee has the power to retain amounts otherwise payable to a member or redeem units held by the member to discharge a liability the member owes to the trustee.
C2.	power to apply a loss or expense, attributable to the member's status or behaviour, against the income or capital entitlements of that member	Example: Domestic or foreign law may impose obligations or penalties on a MIT or trustees of a MIT because of a member's residency or citizenship or something done by a member. The trustee may have a power to apply a loss or expense arising from the member's status or behaviour against the interests of the member. Example: The US withholding tax paid in respect of a member that has an indirect interest of more than 10% in a US Real Estate Investment Trust (REIT).
D: Recovery from members		
D1.	power to recover previously distributed income and capital amounts from members that were distributed based on the earlier economic performance of the MIT but are reassessed in light of later overall economic MIT performance	Example: Some MIT trustees will be empowered to make performance based payments in a year and to recover some or all of such payments (referred to as 'claw-back') if the MIT fails to meet economic benchmarks in later years.

	Trustee powers etc.	Notes and examples
D2.	the trustee may determine to recover amounts from past and present members who have previously been paid distributions in order to meet obligations owed by the trustee in respect of a particular investment	
E: New or modified membership interests		
E1.	power to issue membership interests to existing members or non-members at a discount to market value	Example: The trustee may issue units at a discount provided the offer is to all unitholders on the same pro-rata basis. Example: The trustee may issue units at a discount when a trust has liquidity issues, is restructuring or as part of a profit reinvestment program. Note: If new units are issued at a substantial discount (including situations not covered by the above examples) which materially diminishes members' rights to income and/or capital (for example, in circumstances where the size of the discount is not justifiable on commercial grounds) the AMIT would cease to satisfy the clearly defined rights test from that time.
E2.	power to issue units of a different class	Note: Acceptable use of this power would include the issue of a different class of units with a fee structure, or denominated in a particular currency, not previously offered.
E3.	power to compulsorily create interests/units	Example: A fee rebate is a mechanism used to create a differential fee structure. A trustee may implement a fee rebate by issuing additional interests to a member as if the relevant member had made a subscription at the price calculated using conventional unit pricing methods.
E4.	power to determine the Minimum Holding	Example: The trustee can hold money or property received on (a different) trust for the applicant if the payment received, or the property transferred, to the trustee is less than that required to subscribe for the Minimum Holding requirement to be a member. Note: The applicant is not a member of the MIT until the trustee accepts their application.

	Trustee powers etc.	Notes and examples
E5.	power to issue 'pro-rata units' at market value	Note: Pro-rata units typically carry an entitlement to distributions calculated on 'days basis' for the member's first distribution period. This reflects the fact that the holder was a member for only a part of that period. Units of this type are sometimes issued on a temporary basis to members of a newly formed MIT.
E6.	power to convert units to a different class	Note: Acceptable use of this power would include the conversion of units to change the fees payable by a member, to suspend a member's rights until a breach of the member's obligations has been rectified or to convert a member from units denominated in one currency to units denominated in a different currency.
E7.	power to consolidate or split units	Note: Acceptable provided done on the same basis for all units.
E8.	power to restrict the types of entities to whom units can be issued	Example: Units can only be issued to MIT eligible investors unless approval is obtained from current unitholders. This power may extend to deeming an issue in breach of restrictions that were in place at the time of issue to be void.
E9.	power to staple units in the trust to other securities	
F: Redemption		
F1.	power to refuse or delay the redemption of membership interests	Example: The trustee might refuse or delay redemption where the requests: • do not meet a minimum redemption amount prescribed • outpace the issue of new membership interests, or • cannot all be funded by the MIT.
F2.	power to compulsorily redeem membership interests for any reason at a redemption price calculated in accordance with the constituent document as if the relevant member had made a redemption request	Example: The trustee can use this power to reduce the number of units on issue.

	Trustee powers etc.	Notes and examples
F3.	power to stream capital gains (including by way of in specie distributions) to redeeming members where the trustee sells MIT assets to fund the redemption	Note: The streaming of gains in these circumstances is considered fair and reasonable for attribution purposes (subsection 276-210(5)). This applies to both mandatory and discretionary redemptions.
F4.	power to redeem units of less than a marketable/minimum parcel	
G: Forfeiture & waiver		
G1.	power to forfeit the interests of a member who is in default of its obligations as a member under the trust constituent documents	Note: Some trusts may require that members (after they have become members) contribute further capital to the trust in some circumstances. Such trusts may penalise a member in default of these obligations by forfeiture of their units. This may be conditional and may be with or without compensation to the unitholder.
G2.	the trust constituent documents provide that a member who has a carried interest entitlement may waive a distribution of carried interest in respect of the year of income. A carried interest is, broadly, a partner's entitlement to a distribution contingent on profits[11].	Example: A private equity MIT trust deed may provide for waiver of a carried interest payable in a year. The waiver might be exercised where it appears likely that all or part of a distribution may be required to be paid back in a future year of income. This might be due to the risk of the economic performance of the MIT deteriorating in the future and future performance measures for entitlement not being met. As the power is with the member and not the trustee, it does not affect the clearly defined rights that the member has in the MIT.
H: Valuation		
H1.	power to determine current unit value at any time	Note: Unit pricing is an ordinary part of the duties of a MIT trustee that must take place whenever membership interests are issued or redeemed.

[11] Carried interest is defined in section 104-255.

	Trustee powers etc.	Notes and examples
I: Member approved variations		
I1.	power to amend a deed (unregistered schemes) where amendment is in accordance with the requirements in section 601GC of the Corporations Act	Note: Trust deeds usually provide a mechanism for amending the deed. Consistent with the position pertaining to registered schemes, the Commissioner accepts that the power to amend is consistent with clearly defined rights where any amendment that might materially affect a member's rights and interests adversely can be made only with the consent of at least 75% of the votes cast by members entitled to vote or by the trustee if the change will not adversely affect members' rights.
J: Transfers		
J1.	power to refuse or delay the transfer of membership interests	Example: The transfer is not in accordance with requirements in the constitution.
J2.	power not to register a transfer where the transfer may have adverse consequences for members	Example: The trustee is not permitted to register a transfer if doing so would mean that the trust would no longer qualify as a MIT.
K: Other		
K1.	power to deem a constitution to have a clause if required under the Corporations Law or ASX Listing Rules	
K2.	power to deem a constitution not to have a clause if not permitted under the Corporations Law or ASX Listing Rules	

Commissioner of Taxation
5 May 2016

References

ATOlaw topic(s)	Income tax ~~ Trusts ~~ Other
Legislative references	ITAA 1997 ITAA 1997 104-255 ITAA 1997 Div 276 ITAA 1997 Subdiv 276-B ITAA 1997 276-10 ITAA 1997 276-10(1)(b) ITAA 1997 276-15 ITAA 1997 276-15(1)(a) ITAA 1997 276-15(1)(b) ITAA 1997 276-15(2) ITAA 1997 276-210(5) Corporations Act 2001 601EB Corporations Act 2001 601GC Tax Laws Amendment (New Tax System for Managed Investment Trusts) Act 2016
Related rulings/Determinations	Law Companion Guideline LCG 2015/5 *Managed Investment Trusts: choice to treat separate classes as separate AMITs* Law Companion Guideline LCG 2015/7 *Managed Investment Trusts: attribution on a 'fair and reasonable' basis*
Other references	Explanatory Memorandum to the Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015