LCG 2015/D7 - Attribution Managed Investment Trusts: attribution on a 'fair and reasonable' basis

Draft Law Companion Guideline

LCG 2015/D7

Attribution Managed Investment Trusts: attribution on a 'fair and reasonable' basis

Relying on this draft Guideline

This draft Law Companion Guideline describes how the Commissioner proposes to apply the law in Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015 when it comes into effect. If you rely on this draft Guideline in good faith before it is finalised, and the law is enacted as introduced, 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 draft Guideline is about

1. This draft Guideline explains the meaning of attribution on a 'fair and reasonable' basis as that term is used in Division 276 of the *Income Tax Assessment Act 1997*[1] (the attribution regime for Managed Investment Trusts (MITs)).

2. It discusses the meaning of 'fair and reasonable attribution', with examples.

[1] All legislative references in this draft Guideline are to the *Income Tax Assessment Act 1997* as proposed to be amended by the Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015, unless context otherwise dictates.

Date of effect

3. It is proposed that this draft Guideline will be finalised as a public ruling, effective for those who rely on it in good faith from when the Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015 (the Bill) comes into effect. If the Bill is enacted as introduced, this will be 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.

Fair and reasonable attribution

4. Under subsection 276-210(2), a member's 'member component' of a character in respect of an income year is so much of the 'determined trust component' of that character as is attributable to that member worked out according to the attribution rules in subsections 276-210(3) and (4).

5. Those rules require the trustee of an attribution MIT (AMIT[2]) to attribute amounts relating to income and tax offsets to members on a *fair and reasonable basis,* consistent with its constituent documents. The constituent documents include the trust constitution or deed and any supporting documentation (such as a product disclosure statement or other document that sets out the terms of the members' interests).[3] There is no requirement that the constituent documents refer to Division 276 or otherwise to attribution for tax purposes.

6. Provided the trustee has attributed amounts on a fair and reasonable basis, the provisions will be satisfied. It does not matter that there may be a basis of attribution that might be regarded as more fair and reasonable in the circumstances.

What is 'fair and reasonable'?

7. Whether an attribution decision is *fair and reasonable* depends on the facts and circumstances of each trust, independently of the practices of other trusts.

8. The Commissioner considers that an attribution is fair and reasonable when:

- the decision is consistent with the AMIT constituent documents[4], and
- it does not involve streaming amounts of a particular character because of the tax characteristics of the member.[5]

9. The attribution system does not require the trustee to have regard to the amount of any actual distributions when determining the attribution amounts. However, depending on the nature of the trust, it may be fair and reasonable for the trustee to take actual distributions into account and to seek to align attributed tax amounts to actual distributed cash, so long as the requirements in subsections 276-210(3) (consistency with trust constituent documents) and 276-210(4) (no tax based streaming) are met.

10. As the attribution system applies to members *in respect* of a year of income, it does not require that determined trust components be attributed only to members who were members during the relevant income year. Depending on the AMIT's constituent documents, an attribution may be fair and reasonable where amounts are attributed to a person who was not a member during the income year but was a member on the relevant distribution record date.

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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] Explanatory Memorandum to the Bill at paragraph 2.20.

[4] Subsection 276-210(3).

[5] Subsection 276-210(4).

11. An amount will not fail to be worked out on a fair and reasonable basis merely because one of the conditions in subsections 276-210(5), (6) or (7) apply. Broadly, those conditions are that an amount attributed to a member reflects:

- the fact that the trustee has directed an amount arising from the sale of assets to the member in order to fund a redemption of their interests in the AMIT
- an amount of an under or over in relation to a base year where the member was not a member of the AMIT, and
- an amount of a capital gain or capital loss made by the AMIT trustee in an income year at a time the member was not a member in respect of the income year.

Streaming because of tax characteristics

12. The attribution will not be considered to involve streaming based on the tax characteristics of a member merely because the attribution reflects the member's economic interest in underlying assets of the AMIT. This will be the case even where the member has interests in a class of units that provide the type of returns that would mean that investors with a particular tax profile would be more likely to invest in that class than other investors.

Example 1: attribution to a class reflecting interests in the assets of the class

13. *An AMIT has a number of classes of units on issue. Each class of units is supported by different assets. Class C units are supported by assets that return foreign source income, non-TAP capital gains and interest. The Class C unit holders are entitled to share proportionately in the income and capital of the class. Because of the nature of the returns payable on the Class C units, foreign resident investors hold Class C units in preference to other classes. The trustee of the AMIT attributes to the Class C members in accordance with their rights and entitlements to the income and capital of the class. The attribution does not involve streaming based on tax characteristics.*

Examples of attributions that may be fair and reasonable

14. The following examples demonstrate that attribution on a fair and reasonable basis does not necessarily require equal or proportionate attribution. However, while the trustee may choose one of a range of methods, it is essential that the attribution accord with the trust's constituent documents.

Example 2: attribution to an outgoing member

15. *A significant member of an AMIT redeems its interests. To restore liquidity, the AMIT must sell trust property. If permitted by the trust constituent documents, streaming the disposal gains to that significant outgoing member would be considered fair and reasonable. This kind of attribution is permitted by subsection 276-210(5). The trustee may also attribute an amount of income relating to the period up to the date of redemption (or some other fair and reasonable amount of income determined consistent with the constituent documents) as a component of the redemption proceeds.*

Example 3: attribution to redeeming member based on length of membership period

16. *A redeeming member has held an interest in the AMIT during the year for less than 12 months. The AMIT attributes a non-discount capital gain to that member. In this case, attributing 'short term' gains of the trust to 'short term' investors, if consistent with the AMIT's constituent documents, would be considered fair and reasonable. This does not mean, however, that other methods of attributing capital gains would not be fair and reasonable. For example, attribution of capital gains on a proportional basis without regard to the length of holding of membership interests could also be fair and reasonable.*

Example 4: attribution calculations based on 'as at' and 'year to date' methods

17. *Under the* ***As At approach****: components are generally 'locked-in' for the interim period in which they are distributed and are not subject to revision after year end when the full year components have been calculated. Components such as capital gains, may be 'held back' until the net position for the full year is known.*

18. *Under the* ***Year to Date approach****: tax components shown in the AMIT member annual statement issued to members are based on the calculation of trust components for the full tax year. Tax components stated in interim distribution statements are subject to restatement to reflect the calculation of components for the full tax year.*

19. *Both of these methods if consistent with the constituent documents of the AMIT are fair and reasonable methods of making an attribution of determined trust components to members under section 276-210.*

Example 5: attribution reflects tax directly attributable to member

20. *An AMIT invests in a US Real Estate Investment Trust (REIT). The AMIT has a member that has an indirect interest in the US REIT of 10% or more. The US withholding tax paid in respect of distributions to the AMIT is directly attributable to the member. The trustee may reduce the attribution to the member to reflect the US withholding tax. This would represent a fair and reasonable basis of attribution.*

Your comments

21. You are invited to comment on this Draft Law Companion Guideline including the proposed date of effect. Please forward your comments to the contact officer by the due date.

Due date:	**Friday, 15th January 2016**
Contact officer:	**David White**
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Address:	**Australian Taxation Office GPO Box 9977 Melbourne VIC 3001**

References

ATOlaw topic(s)	Income tax ~~ Trusts ~~ Other
Legislative references	ITAA 1997 ITAA 1997 Div 276 ITAA 1997 276-210 ITAA 1997 276-210(2) ITAA 1997 276-210(3) ITAA 1997 276-210(4) ITAA 1997 276-210(5) ITAA 1997 276-210(6) ITAA 1997 276-210(7)
Other references	Explanatory Memorandum to Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015
ATO references	