



# ***LCG 2015/D5 - Attribution Managed Investment Trusts: choice to treat separate classes as separate AMITs***

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 This document has changed over time. This is a consolidated version of the ruling which was published on *3 December 2015*



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## Attribution Managed Investment Trusts: choice to treat separate classes as separate AMITs

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### 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. Section 276-20 of the *Income Tax Assessment Act 1997* (ITAA 1997)<sup>1</sup> allows the trustee of a multi-class AMIT<sup>2</sup> to make a choice that each of the classes of membership interests will be treated as a separate AMIT for the purpose of applying Division 276 (other than for the purposes of Subdivision 276-A which deals with what an AMIT is).<sup>3</sup> Section 276-20 is referred to in this draft Guideline as ‘the separate class rule’.

2. This draft Guideline explains the circumstances in which an AMIT can make the choice to apply the separate class rule and the tax effects of making that choice.

### **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.

### **Background: section 276-20**

4. The separate class rule makes it possible for the trustee of a multi-class AMIT that meets the test in subsection 276-20(1) to apply the AMIT rules (including the attribution rules) on a class-by-class basis as though each class was a separate AMIT. This in turn facilitates the attribution of tax amounts between members of the AMIT according to their interests in the trust.

5. Treating a separate class of membership interests as a separate AMIT has the effect that the tax attributes of assets supporting a particular class can be ‘ring fenced’ to those interests, rather than being ‘spread’ over the AMIT as a whole. The rule can also result in significant cost savings. For example, a master fund does not need to set up separate trusts to be taxed as if separate trusts had been created.

6. The Explanatory Memorandum to the Bill explains the broad effect of the rule as follows:

- 2.34 If the trustee of an attribution MIT makes a choice to apply the attribution regime separately to each class of membership interests, the attribution regime will apply separately to each class of membership interests of the attribution MIT. However, for the purpose of determining whether a managed investment trust qualifies as an attribution MIT<sup>4</sup>, an attribution MIT with multiple classes will continue to be treated as a single entity...

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<sup>1</sup> All legislative references in this draft Guideline are to the ITAA 1997 as proposed to be amended by the Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015, unless context otherwise dictates.

<sup>2</sup> An attribution MIT (AMIT) is a managed investment trust (MIT) that has elected in to the attribution regime for the taxation of MITs contained in Division 276.

<sup>3</sup> From this point on, references to or discussions on the application of section 276-20 exclude Subdivision 276-A.

<sup>4</sup> Subdivision 276-A.

- 2.35 If the trustee of an attribution MIT makes a choice to apply the attribution regime separately to each class of membership interests, each class will effectively be treated as a separate trust with separate trust property. Therefore, the trustee will effectively need to work out the taxable income for an income year separately for each class.
- 2.36 To facilitate this, the assessable income, exempt income, non-assessable non-exempt income, tax losses, net capital losses and other similar amounts of the attribution MIT for an income year must be allocated between each class on a fair and reasonable basis...
- 2.37 In this regard, to the extent that assets and expenditure relate solely to a particular class of membership interests, the assessable income and deductions and other trust attributes relating to that class will need to be identified by reference to the assets supporting that class. In addition, transactions and events involving those assets (including intra-entity dealings within the actual attribution MIT involving the deemed separate attribution MITs) will need to be recognised for tax purposes as though the class was in fact a separate entity.
- 2.38 To the extent that assets and expenditure relate to more than one class of membership interests, the related assessable income and deductions must be allocated to each class on a fair and reasonable basis.

### **When a choice can be made**

7. Subsection 276-20(1) sets out when the separate class rule will apply to an AMIT. The AMIT must have made a choice for the rule to apply.<sup>5</sup> However, that choice can only have been made if:

- (a) the membership interests of the AMIT for an income year are divided into classes<sup>6</sup>
- (b) the rights arising from each of those membership interests in a particular class are the same as the rights arising from every other of those interests in that class<sup>7</sup>, and
- (c) each of those membership interests in a particular class is distinct from each of those membership interests in another class.<sup>8</sup>

### **No requirement for each class to qualify as an AMIT on a stand-alone basis**

8. It is not necessary that each class separately meet the test for being an AMIT as a condition to a choice being made under section 276-20. Where a MIT is eligible to be an AMIT and the trustee chooses for the MIT to be an AMIT, the whole MIT will be an AMIT including all of its classes. A MIT must qualify and choose to be an AMIT before it can choose to apply the separate class rule.

9. Because the separate class rule is specifically stated not to modify the operation of Subdivision 276-A, once a multi-class MIT satisfies the test for being an AMIT the tests do not need to be reapplied to the separate classes as a precondition for the separate class rule to apply. For example, the classes do not individually need to satisfy a widely held test.

### **Choice to apply the separate class rule is irrevocable**

10. Once a choice has been made, it cannot be revoked. The separate class rule applies in the year the choice is made and all following years.<sup>9</sup>

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<sup>5</sup> Paragraph 276-20(1)(d).

<sup>6</sup> Paragraph 276-20(1)(a).

<sup>7</sup> Paragraph 276-20(1)(b).

<sup>8</sup> Paragraph 276-20(1)(c).

<sup>9</sup> Subsections 276-20(4) and (5).

## Variation in class rights after election

11. As the election under paragraph 276-20(1)(d) is irrevocable, if class rights are varied after an election has been made and the variation is sufficient to create two separate classes, then each class will be treated as a separate AMIT under the separate class rule.

## Separate 'classes' of 'interests in income and capital'

12. As explained in paragraph 7 of this draft Guideline, in order for the trustee of an AMIT to be able to apply the separate class rule, membership interests of the AMIT must be divided into distinct classes and the rights attaching to each membership interest in a particular class must be the same.

13. Subsection 995-1(1) specifies that a 'class' of membership interests in a trust exists if the interests have the same, or substantially the same, rights. One class of interest will be distinct from another class if the terms relating to the class of interest provide interest holders of the first class with rights to the income and/or capital of the AMIT that are not substantially the same as those obtained by the holders of interests in the second class.

14. The Explanatory Memorandum to the Bill explains that:

2.30 The question as to whether an attribution MIT has more than one class of membership interests is one of fact. In this regard, the membership interests in a trust will form a class if they have the same, or substantially the same, rights.

2.31 An attribution MIT may have more than one class of membership interests if, for example, different members have exposure to different groups of assets of the attribution MIT. As a result, the tax attributes of a particular class of assets can effectively be ring-fenced to a particular class of membership interests. In this regard, it is possible for a class to have just one member.

15. The rights arising from membership interests in an AMIT would typically be expected to include rights to the income and/or capital of the trust. The trust's records will evidence what the income and capital of the AMIT is. An interest of a member need not be to both the income and capital of the AMIT in order for the election to apply the separate class rule to be made. For example, a particular class of interest may provide the interest holder with rights in relation to the income of the trust only while a different class may provide rights in relation to the capital of the trust only.

## Classes of separate or pooled assets

16. While section 276-20 requires that the rights attaching to interests within a class be the same and distinct from those attaching to interests in other classes, it does not require that each separate class be supported by separately identified assets. Any one class of interest may be supported either solely by segregated assets, solely by pooled assets, or by a mixture of both, provided that the interests of the class in the income and/or capital of the AMIT is distinct from the interests of other classes in income and/or capital.

### **Example 1: pooled assets**

17. *The XYZ Fund is a listed MIT and an AMIT. It invests in global equities.*

18. *The membership interests of the XYZ Fund have been divided into two classes – the AUD Class (denominated in Australian dollars) and the NZD Class (denominated in New Zealand dollars):*

- *Members of the AUD Class have an interest in the income and capital arising from the AUD Class's share of the global equity investments of the trust. The AUD Class's share of the investments is determined by the proportion of the net asset value (NAV) held by AUD Class members in the trust on 30 June, being the last day of the income year. The interests of each member in the AUD Class are the same as those of every other member of the AUD Class.*

- *Members of the NZD Class have an interest in the income and capital arising from the NZD Class's share of the global equity investments of the trust and an AUD/NZD hedging contract. The NZD Class's share of the investments is determined by the proportion of the NAV held by NZD Class members in the trust on the last day of the income year. The interests of each member in the NZD Class are the same as every other member of the NZD Class.*

19. *The XYZ Fund has made the choice under section 276-20 to apply the attribution regime separately to each class. The XYZ Fund is eligible to make the choice because it meets the conditions in paragraphs 276-20(1)(a) to (c). Although the XYZ Fund is a pooled fund and so does not have specific assets that can be identified as belonging separately to each class (the hedge contract excepted), the conditions are still met because the interests of members in the AUD Class are distinct from the interests of the members in the NZD Class.*

### **Making of choice**

20. A trustee who makes a choice to apply the separate class rule should make a record of that choice identifying the AMIT to which the choice applies and the year of income in which the choice was made. The choice applies to the income year in which the choice was made and to every subsequent income year.

21. The way in which the AMIT prepares its income tax return evidences the making of that choice.

### **Effects of the choice**

22. Where the AMIT has made a choice, subsection 276-20(2) specifies that each class of membership interests in the AMIT is treated as a separate AMIT for the purpose of applying Division 276.

23. Division 276 includes the rules relating to:

- the treatment of an AMIT as a fixed trust (Subdivision 276-B)
- the determination of trust components of an AMIT, including the allocation of deductions (Subdivision 276-E)
- the determination of member components of an AMIT (Subdivision 276-D)
- the taxation of member components of an AMIT (Subdivision 276-C)
- the treatment of unders and overs (Subdivision 276-F), and
- trustee shortfall taxation (Subdivision 276-G).

24. For example, treatment of each class as a separate AMIT implies treatment of each class of membership interests as a separate trust that is a fixed trust under section 276-55.

### **Trust level effects**

25. When classes of membership interests are first recognised as separate AMITs, as part of the process of identifying the classes' initial tax positions as separate deemed AMITs, the trustee must allocate tax items being carried forward at the whole of trust level (such as tax losses and net capital losses) across the classes. This must be done on a fair and reasonable basis. Other tax attributes should, similarly, be initially allocated on a fair and reasonable basis, with regard to the nature of the assets supporting the respective classes.

26. On an ongoing basis, the broad effect of the separate class rule is that the AMIT must work out the determined trust components<sup>10</sup> for each class as though it were a separate AMIT. This requires the trustee first to allocate the assessable income, exempt income, non-assessable non-exempt income, tax losses, net capital losses and other similar amounts (for example, expenses and credits) of the trust across the classes on a fair and reasonable basis. In addition, any such tax amounts deemed to have arisen out of inter-class dealings (see paragraph 36 of this draft Guideline) will need to be recognised by the relevant class to which they relate.

27. Once this has been done for each class, and considering the character of the income and nature of the expenses attributable to that class, the trustee must work out the class's determined trust components. In so doing, the AMIT must apply deductions attributable to that class against the characters of assessable income attributable to the class on a fair and reasonable basis, consistent with the principles in section 276-270.

28. In working out each class's determined trust components, the unders and overs<sup>11</sup> provisions also need to be separately applied to that class, again consistent with the class being treated as though it were a separate AMIT.

29. As the trust components and 'member components'<sup>12</sup> of each class are determined separately, a particular class may have an overall tax loss for an income year while other classes are tax positive. The result will be that the class in a loss position will have nil trust and member components while another class will have positive trust components attributed to members of that class. As each class is treated as a separate AMIT, tax losses of a particular class are quarantined and carried forward in that class.

#### **Schedule 2F to the *Income Tax Assessment Act 1936***

30. As the separate class rule requires that the trust components of each class of membership interest be worked out on the basis that each class is a separate trust, it follows that rules, such as the trust loss rules in Schedule 2F to the *Income Tax Assessment Act 1936* (ITAA 1936) are also applied separately to each class.

31. Subsection 272-105(1) in Schedule 2F states that an AMIT, including classes treated separately under the separate class rule, is a 'widely held unit trust' for the purpose of applying the trust loss rules.

32. Moreover, the rules are applied on the basis that each class is treated for the purposes of ITAA 1936 as a fixed trust, because the fixed trust deeming rule in section 276-55 also applies to each class treated as a separate AMIT.

#### **TOFA elections**

33. There is no requirement that a TOFA election made by an AMIT trustee for the entire trust also be made for each separate class deemed to be a separate AMIT.

#### **No requirement to lodge multiple tax returns or AIIRs**

34. The separate class rule does not extend the separate entity treatment for individual classes to the other administrative requirements that apply to trusts, such as the requirement to lodge a return or Business Activity Statement, appoint a public officer, apply for a separate TFN, or lodge an Annual Investment Income Report (AIIR).

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<sup>10</sup> See section 276-255

<sup>11</sup> See Subdivision 276-F

<sup>12</sup> See section 276-210

## Classes with separately identified assets

35. If a trustee chooses to treat each class of membership interests as a separate AMIT, each class is treated as having separate trust property to the extent that the property can be separately identified for each class.

36. Where there are separately identifiable assets, the assessable income, allowable deductions and other tax attributes for each class need to be determined by reference to the assets supporting that class. To do otherwise would be inconsistent with the rule in subsection 276-20(3). In addition, transactions and events involving those separately identified assets (including the transfer of separately identifiable assets between the deemed separate AMITs) are treated as though they were transactions between separate entities for income tax.

### Example 2: separately identified assets

37. In July 2018, AMIT X acquires a parcel of shares for \$10,000. The shares are held in a separately identified portfolio solely supporting membership entitlements in respect of Class A units. In June 2019 the share parcel is transferred to a separate portfolio supporting Class B units, with a compensating cash transfer of \$18,000 to the assets supporting the Class A units. The trustee has made an election under section 276-20 to treat Classes A and B as separate AMITs.

- Class A is taken to have realised a taxable gain as though it had sold the shares to a separate entity in June 2019 for \$18,000.
- For the purposes of working out any gain or loss on a subsequent sale or transfer of the shares, and for the purposes of CGT and the imputation holding period rules, Class B is treated as though it acquired the shares as a separate entity for \$18,000 in June 2019.

## Classes with an interest in pooled assets

38. Where the trust is a pooled fund, each class's share of the trust's pooled assets should be determined on a reasonable basis. Any gain or loss (for example, a currency hedging gain or loss) specifically attributable to that class should be allocated to it. More broadly, the assessable income and allowable deductions of the trusts must be allocated across the classes, taking each class's appropriate share of the trust pooled assets into account. The allocation of pooled (non-class specific) gains and expenses should also be done on a fair and reasonable basis and consistent with the fund's constituent documents.

### Example 3: interests in pooled assets

39. Assume the same facts as in Example 1.

40. The XYZ Fund prepares two separate calculations of attributable income for the 2014-2015 income year – one for the AUD Class and one for the NZD Class.

41. At the end of the 2014-2015 income year:

- members of the AUD Class held 65% of the total NAV in the XYZ Fund, and
- members of the NZD Class held 35% of the total NAV in the XYZ Fund.

42. The calculation by the trustee of the AUD Class's determined trust components includes a proportion of the trust's total assessable income and allowable deductions based on the proportion of units held by AUD Class members, that is 65%. The same principle applies for the NZD Class. Any assessable income and allowable deductions directly arising from the relevant hedging contract are recognised in calculating the NZD Class's trust components.

43. It is not necessary to track actual gains or attributable gains or losses arising from any change in the overall interest of members of the AUD Class and the NZD Class in the pooled



assets due to changes in the relative interests of members for each class over the year (for example, arising as a result of the issue or redemption of units in one class).

44. The calculation for the NZD Class shows a tax loss. As the NZD Class is effectively treated as a separate AMIT, the loss cannot be offset against the AUD Class and is carried forward to be offset against the taxable income for the NZD Class in future years.

45. XYZ Fund performs separate calculations for the AUD and NZD Classes for the purposes of the one tax return. As the NZD Class has a tax loss, it is treated as having a nil taxable income.

46. XYZ Fund will complete one AMIT tax return. A separate AMIT Schedule for the AUD Class and NZD Class would be included in the return. Accordingly, the NZD Class tax loss would be disclosed in the NZD Class schedule.

### **Member level effects**

47. The determined member components of classes treated as separate AMITs are determined using the rules applying to AMITs generally. This includes the requirements of section 276-210 that attribution must be fair and reasonable<sup>13</sup>, and not involve streaming to members based on tax characteristics.<sup>14</sup>

48. Similarly, the rules relating to AMMA statements apply to each separate deemed AMIT: each member of an individual class must be given an AMMA statement for the income year setting out their member components arising from the attribution of the trust components related to that class.

### **Example 4: different fees**

49. X AMIT has made a choice to apply the separate class rule. As regards one of the classes of membership interests, some holders are charged retail rate management fees while others are charged management fees at a lower wholesale rate. Assume the following facts for the 2018-2019 income year.

- The wholesale and retail unit holders have equal entitlements to a total income of a single character of \$12 million.
- Overall expenses (apart from fees) are also charged equally, but because of the differential fee structure, the total fees charged to the retail unit holders are \$1.5 million, whereas the total charged to the wholesale unit holders are \$1 million.
- The total trust component for the deemed separate AMIT is therefore \$9.5 million, being \$12 million assessable income less \$2.5 million allowable deductions.

50. The trustee attributes \$5 million of this amount (\$6 million less \$1 million) to the wholesale unit holders, and \$4.5 million (\$6 million less \$1.5 million) to the retail unit holders. This is a fair and reasonable attribution reflecting the underlying entitlements of the unit holders. In particular, it is fair and reasonable to take into account the different fee structures attaching to interests within the one class when attributing trust amounts among the membership interests of that class.

### **Example 5: election to treat as separate AMITs**

51. Y AMIT has two classes of membership interests supported by underlying investments in equities. The trustee has elected to treat the two classes as separate AMITs. The A Class is mainly held by foreign investors who face low treaty rates of Australian dividend withholding tax. The B Class is mainly held by Australian residents.

<sup>13</sup> See Draft Law Companion Guideline LCG 2015/D7 *Attribution Managed Investment Trusts: attribution on a 'fair and reasonable' basis*,

<sup>14</sup> See subsections 276-210(3) and (4).

- **No streaming mischief** would arise if the investment strategy of the MIT for the A Class involved investing in a separate portfolio of stocks whose price reflected low levels of franked dividends, and that strategy took into account the limited value of franking credits as a low rate of withholding tax applies for the non-resident A Class interest holders. Here, the tax and economic attributes of the assets supporting the A Class are aligned. The Commissioner accepts there is no streaming mischief merely because investors choose to invest in trust interests supported by assets which suit their personal tax profile.
- **A streaming mischief** would arise if the A and B Classes were supported by a common pool of stocks, but franked distributions were selectively allocated to the B Class because of their higher value to residents. Here, there has been an artificial divergence between the common interest in the underlying investments, and the selective allocation of the tax attributes they give rise to. More generally, the Commissioner's view is that a streaming mischief arises, and, consistent with (but not reliant on) the rule in subsection 276-210(4), by selectively directing attributes from a pool of assets between classes with a common economic exposure to those assets, the allocation of the assessable income of the MIT between its classes cannot be said to have been done on a fair and reasonable basis for the purposes of subsection 276-20(3). The deemed B Class AMIT will have understated its income from other sources (and overstated its franked distribution income) in its determined trust components.

## AMIT withholding

52. Where the separate class rule applies, the AMIT withholding rules apply separately to each class of membership interests. This is because the tax consequences to members under the rules in Subdivision 276-C, and the withholding provisions for AMITs in Division 12A of Schedule 1 to the *Taxation Administration Act 1953* (TAA 1953), rely on the determined member components of an AMIT (which must be worked out separately for each class) for their operation.

53. However, in applying those rules, it is sufficient if the AMIT as a whole qualifies as a 'withholding MIT' for the purpose of section 12-383 in Schedule 1 to the TAA 1953. It is not necessary for each class to separately establish that they would individually qualify.

## Your comments

54. 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, 15<sup>th</sup> January 2016

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## References

ATOlaw topic(s)	Income tax ~~ Trusts ~~ Other
Legislative references	ITAA 1997 ITAA 1997 Div 276 ITAA 1997 Subdiv 276-A ITAA 1997 Subdiv 276-B ITAA 1997 Subdiv 276-C ITAA 1997 Subdiv 276-D ITAA 1997 Subdiv 276-E ITAA 1997 Subdiv 276-F ITAA 1997 Subdiv 276-G ITAA 1997 276-20 ITAA 1997 276-20(1) ITAA 1997 276-20(1)(a) ITAA 1997 276-20(1)(b) ITAA 1997 276-20(1)(c) ITAA 1997 276-20(1)(d) ITAA 1997 276-20(2) ITAA 1997 276-20(3) ITAA 1997 276-20(4) ITAA 1997 276-20(5) ITAA 1997 276-55 ITAA 1997 276-210 ITAA 1997 276-270 ITAA 1997 995-1(1) ITAA 1936 ITAA 1936 Sch 2F ITAA 1936 272-105(1) TAA 1953 TAA 1953 Sch 1 Div 12A TAA 1953 Sch 1 12-383
Other references	<a href="#">Explanatory Memorandum</a> to Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015
ATO references	