Infrastructure Partnerships Australia | ABN 54 050 036 041
8th Floor | 8-10 Loftus Street | Sydney NSW 2000
PO Box R1804 | Royal Exchange NSW 1225
T +61 2 9240 2050 | **F** +61 2 9240 2055
E contact@infrastructure.org.au | **www.infrastructure.org.au**

INFRASTRUCTURE
PARTNERSHIPS
AUSTRALIA
BUILDING AUSTRALIA TOGETHER

1 May 2015

General Manager
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir/Madam,

Re: Infrastructure Partnerships Australia submission to a new tax system for Managed Investment Trusts – Exposure Draft and Explanatory Material

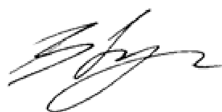
Infrastructure Partnerships Australia (IPA) welcomes the opportunity to provide this response to the exposure draft legislation and explanatory material for the new Managed Investment Trusts (MITs) tax system.

In broad terms, the exposure draft legislation and explanatory material document is a welcome policy reform measure that, when introduced, will strengthen Australia's international competitiveness. MITs are used extensively for infrastructure investment and, as such, our members have a keen interest in the progress and form of the measure.

While we support the policy direction taken, there are a number of issues with the current form of the measures contained in the draft legislation that would benefit from clarification or amendment to further strengthen certainty for those international and domestic firms involved with the MIT regime. A list of these issues follows over the page. In this context, we are happy to assist further as the measures proceed.

If you wish to discuss this response, please contact our Policy Officer, Nick Hudson, on (02) 9240 2066 or at nick.hudson@infrastructure.org.au

Yours sincerely,



BRENDAN LYON
Chief Executive Officer

A NEW TAX SYSTEM FOR MANAGED INVESTMENT TRUSTS – EXPOSURE DRAFT LEGISLATION – CONCERNS FOR THE INFRASTRUCTURE SECTOR

Start Date

IPA would like Treasury to confirm the start date and option for early adoption of the new MIT tax system - specifically that the regime will start from July 1st 2016 with the option to elect for it to apply from July 1st 2015. This is in addition to informing stakeholders of the expected passage of legislation date, and whether this will occur before the opt-in decision can be made on 30th June 2015. IPA is supportive of the above elective opt in and start dates.

The introduction of the new MIT subclass, the attribution MIT (AMIT), is a welcome reform, and we seek clarification from Treasury as to whether there is to be a once-only election opportunity to opt into the AMIT regime for current MITs which are eligible to become AMITs. IPA understands there will be a limited time frame for MITs to opt into the regime, and we submit that the AMIT regime should remain available for existing trusts for an indefinite period.

This is because IPA understands one of the objectives of the AMIT regime is to increase efficiency in the tax system through lowering compliance costs. MITs have limited budget capacity for expenditure on professional services such as tax and legal advice, so spreading the costs over time would help smooth the effects of the provisions.

Gateway into MIT/AMIT Regime

As mentioned above, IPA welcomes the introduction of the new AMIT subclass. These new entities can be entered into when extra tests are met in addition to the rules noted in the new MIT definition. To qualify into the AMIT regime, the following principal additional requirement must be satisfied:

> *"…the interests of the members of the trust need to be clearly defined (in accordance with section 276-15) at all times during which the trust is in existence in the income year (see Subdivision 276-A)".*

IPA contends the gateway into the MIT and AMIT regime needs clarifying and is too restrictive. Greater clarity is required with respect to the clearly defined rights test and how the rights of each unitholder cannot be materially diminished.

Furthermore, under *Widely held requirements—ordinary case,* one of the requirements for MIT qualification is that a limited partnership must not be a member.

The policy outcome of the proposed paragraph in 275-15(4)(k) may not eventuate where a limited partnership is the investor. A characteristic of limited partnerships (which are common international investment entities) is that the general partner holds some commercial interest in the assets of the partnership. If the limited partnership members are entities listed in 275-15 (a) to (j) then a small holding by the general partner should not preclude limited partnerships from 275-15(4)(k). IPA recommends the legislation should explicitly address the exclusion of the general partner's interest in the entity.

Furthermore, IPA submits there are excessive restrictions for AMIT qualification and the reasons behind such restrictions are not clear. Under section 276-10(c) the exposure draft states, amongst other conditions, how an AMIT is defined:

> *"if the trust is a managed investment trust in relation to the income year solely because of section 275-40—the only member of the trust is a managed investment trust"*

The reasons for not permitting an MIT to be an AMIT in cases where other qualified widely held entities are the only members are not apparent. An example is that of a superannuation fund that meet the requirements to be considered a qualified widely held entity.

Relaxing the aforementioned requirements for eligibility into the AMIT regime, through providing a more suitable threshold and clarifying sections, would lead to greater certainty and efficiency of the MIT/AMIT regime.

Statutory amendment to prevent adverse income tax and capital gains tax consequences resulting from amendments to trust deeds to comply with AMIT regime

It is strongly submitted that a statutory amendment to the capital gains tax provisions and income tax provisions be made to make it clear that amendments to trust deeds and other constituent documents will not give rise to CGT or other income tax consequences, including for example a resettlement of the trust.

The reference in paragraphs 2.42 to 2.44 in the exposure draft explanatory memorandum providing some comfort on this issue is not preferred tax policy and should be readily implemented by a short statutory amendment, particularly to the CGT provisions of the Income Tax Assessment Act 1997.

Further, the purported reliance on an ATO tax determination, TD 2012/21, as referred to in the explanatory memorandum is again not preferred tax policy implementation.

Arm's Length Rule

IPA submits that the arm's length rule needs adjusting to apply only to non-arm's length income from sub-trusts.

Section 276-670 is set by reference to the non-arm's length income of the AMIT. This can contain a distribution from a sub-trust. However where a sub-trust has non-arm's length expenses that are paid at lower than the market rates, then the distribution to the AMIT will be higher than normal circumstance, and this excess could be non-arm's length income.

This is because the current goal of the arm's length test is to capture non-arm's length income derived by AMITs. Consequently, the income of the AMIT from a sub-trust or partnership should only have the arm's length rule applied to income in the hands of sub-trusts or partnerships.

Another concern for the infrastructure sector is the arm's length rule and its application to debt interests. Treasury should clarify that the arm's length rule does not apply to the size but rather to the return on the loan.

This discrepancy arises where the Explanatory Material in paragraph 5.54 states that the arm's length rule is not concerned with the quantity of a debt interest. However, this is not consistent with the Exposure Draft. Clarifying and aligning the Exposure Draft with the Explanatory Material will remove uncertainty for the infrastructure sector.

Moreover IPA contends that the length of the transitional period for the arm's length rule is short compared with other transitional rules. The consequence of this is that MITs may have insufficient time to discontinue or revise non-arm's length arrangements that involve third parties without incurring costs or obtaining critical third party approvals that may never be forthcoming.

Ideally, for existing MITs that opt in to the AMIT regime, existing arrangements should be "grand fathered" from the arm's length rule.

Alternatively, the transition period should be extended to 5 years from the start of the first year of income of being an AMIT (this will cater for MITs that have substituted accounting periods and give them the same length of transition period as other taxpayers).

Ultimately a longer transition period will lead to lower compliance costs. This is because rather than having to review all of the existing arrangements, an AMIT can review only long-term arrangements. This will ensure new arrangements meet arm's length criteria. Many infrastructure projects are held via MITs. The main source of income for such MITs is rental income from an operating entity which could be a related party. To provide certainty for investors, and minimise compliance costs, it is suggested that the safe harbour rules also

apply to such "cross staple" leases. IPA would be happy to work with Treasury to come up with an appropriate safe harbour regime for such assets.

Public Trading Trusts and franked dividends

Due to amendments to Division 6C, where a Public Trading Trust (PTT) is no longer a PTT from 1st July 2015, it can no longer pay a franked dividend.

This change is contrary to the overall objective of the new MIT/AMIT regime as it will inadvertently lead to the double taxation of profits. This will occur through the distributions from the PTT, which have already been subject to company taxation, being assessed as unitholders' unfranked dividends under section 102T(11) and 102T(12) of the *Income Tax Assessment Act 1936*.

The legislation would benefit from two alternative amendments. The first could be for distributions to be franked with the franking credits that were generated when the trust was a Division 6C trust, or alternatively for the distributions to be treated as exempt income that is not tax deferred income.