26 February 2016

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

Dear Committee Secretary

RE : ECONOMICS LEGISLATION COMMITTEE INQUIRY – ATTRIBUTION MANAGED INVESTMENT TRUST REGIME

The Financial Services Council (FSC) has over 115 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, licensed trustee companies and public trustees. The industry is responsible for investing more than $2.6 trillion on behalf of 11.5 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world. The Financial Services Council promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

The FSC represents over 70 asset management companies that are seeking taxation certainty for tens of thousands of investors through this regime. The introduction of the new taxation regime for Managed Investment Trusts ("MIT Regime") is a critical step in modernising Australia's unit trusts and the regime will assist Australian in becoming globally competitive in funds management.

We fully support passage of the regime as it is currently formulated as soon as possible.

Treasury has engaged in significant industry consultation on the regime's design over the past two years. There has been an open and honest consultation with industry stakeholders and the regime is now workable and effective. We believe the legislation that has been presented to Parliament is a good compromise between the industry desire for simplicity versus the complexity of integrity measures to ensure compliance.

The original intention of the MIT Regime was to reflect the fluid and imprecise nature of the interaction between trusts, tax law and accounting principles. The current legislation codifies existing administrative practices and achieves this aim.

In particular, the MIT Regime provides certainty of treatment for MITs in the critical areas of:

- Eligibility for treatment as a fixed trust;
- Workable solution to dealing with 'unders and overs';
- Cost base adjustments; and
- Certainty of character retention.

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We are very concerned that any changes proposed by Parliament will not have the benefit of consultation between key users of the regime, Treasury or the ATO, and may result in adverse and unintended consequences.

We note that the legislation is detailed and for that reason we understand that there universal support amongst stakeholders that a post-implementation review be undertaken within 18-24 months of passage. This will allow a formal mechanism for review of any unintended consequences that may arise as industry moves into the implementation phase. We strongly urge the Committee make a recommendation to this effect.

Our comments on the legislation and questions raised by this inquiry are outlined in Appendix A.

The FSC would be pleased to attend any hearings the Committee may see fit to conduct. Please do not hesitate to contact me on .

Yours sincerely

CARLA HOORWEG
Senior Policy Manager – Investment, Global Markets & Tax

Appendix A

General comments

This legislation is supported by both the Property Council of Australia (PCA) and the FSC in its current form and has been developed after extensive discussion and consultation with the major stakeholders over hundreds of hours. These stakeholders included the Treasury, the Australian Tax Office, PCA, FSC and Australian Custodial Services Association.

Potential Impact of Amendments on Timing and Implementation

Immediate enactment of this legislation is critical to the effective commencement of the new regime.

Industry has been waiting for this regime for many years. The Board of Taxation first reviewed the taxation arrangements applying to Managed Investment Trusts in 2008. On 7 May 2010, the then Assistant Treasurer, Nick Sherry, announced the release of the Board of Taxation's report and the Government's intention to put the new regime in place by 1 July 2011.

We have serious concerns regarding the impact on the industry of further delays to the passage of these bills as a result of parliamentary amendments. Implementation plans will be affected if the legislation is amended.

There are a number of steps that businesses must complete before trusts are able to enter the regime. Once the legislation is passed, managed fund trustees must consider whether entry into the regime is in the best interest of unitholders as a whole. Funds must then amend their product disclosure statements to reflect the impact of the new rules on investors and make the necessary system and business process changes.

Delays at this point will jeopardise the ability of industry to implement the regime for a 1 July 2016 start date and will completely rule out the ability of funds to enter the regime early (from 1 July 2015).

Need for post-implementation review

We believe the most appropriate solution at this point is for the issues raised through this inquiry to be monitored closely by Treasury and the ATO during implementation and addressed during a post-implementation review.

The legislation is complicated. We believe it is essential for a post-implementation review to deal with any anomalies that may arise once the regime is in operation.

Concerns raised through this Inquiry

We understand that concerns have been raised in relation to:

1. custodial liability for withholding tax on deemed fund payments where insufficient cash distributions have been made; and

2. hypothetical tax avoidance scenarios flowing from the multi-class provisions.

Our comments on these two issues are set out below.

1. Custodial liability for withholding tax

ACSA has raised issues in relation withholding tax liabilities for non-resident investors which may fall to custodians as a result of the MIT Regime.

We expect that significant issues are unlikely to materialise in practice. The issue is a hypothetical scenario which would only arise where trust distributes insufficient cash to cover the withholding tax liabilities of foreign investors. Currently the proportion of foreign investors into Australian managed investment funds is very low.

Whilst the MIT Regime theoretically allows a trust to attribute a tax liability to an investor and not provide sufficient cash to cover this liability, the situation would not arise in practice. FSC members have clearly indicated that the attribution regime will not result in changes to distribution policy. This is particularly the case in retail funds, where investors must be provided with product disclosure statements under Corporations Law requirements. The commercial reality of suddenly changing distribution policy when investors are expecting income from a fund makes it highly unlikely and unpalatable for a trustee to do.

A number of potential alternative solutions were thoroughly discussed by industry participants, Treasury and the ATO but a consensus could not been reached on a workable solution, commensurate with the low likelihood of issues arising.

We believe these concerns have more than adequately been dealt with by both the legislation (through the statutory indemnity mechanism specifically provided for custodians) and by the commercial arrangements which will be entered into by issuers, custodians and non-resident investors.

The legislative approach contained in the MIT Regime seeks to minimise the administrative burden on the industry more generally in collecting amounts of tax from non-residents. It provides a balance between imposing more onerous obligations on all Australian taxpayers and collecting withholding tax from non-resident investors in a timely and effective manner.

The FSC believes it is essential that that the legislation is neither delayed nor undermined by alterations to the withholding tax mechanisms.

2. Hypothetical tax avoidance opportunities from multi-class provisions

The background to providing the multi-class functionality in the MIT Regime is that whilst it is currently possible to set up trusts with multiple classes, it is not possible to effectively operate these classes in different currencies. This is because the existing tax laws require the gains and losses from different classes within the same trust to be netted off at a whole of trust level.

This result is inconsistent with the way investment vehicles operate in other jurisdictions and a change is necessary for existing Australian funds to be able to compete in the Asia Region Funds Passport ("Passport").

The Passport will offer the ability to sell Australian managed funds into participating Asian economies by early 2017. The jurisdictions include Australia, New Zealand, Japan, South Korea, Thailand and the Philippines.

By way of example, currently it is not possible to run an Australian equities fund with an Australian dollar class and a Korean won class because any currency gains or losses made in each class must be netted off across the whole trust. This means that currently the only way to offer different currency classes is to set up a new fund for each currency, which is extremely cost prohibitive.

Allowing multi-currency class funds will result in a greater number of existing Australian MITs being able to participate in the Passport.

The purpose of the multi-class functionality in the MIT Regime is to ensure that gains and losses arising in a class are quarantined to the particular class from which they arose. Members have advised that it is quite conceivable that subclasses in this instance may not satisfy the widely held test individually but would only be able to satisfy the test at a whole of fund level.

We understand concerns have been raised about the possibility for a single large foreign investor to be the sole holder in an AMIT and use this as a vehicle for asset transactions which would be subject to a higher rate of tax if carried out directly.

This issue was considered in the consultation discussions by Treasury, the ATO and stakeholders and was not considered to be likely to occur in reality. The situation could arise under the current law, as multiple classes can already be established and the widely held test applies at the trust level.

Whilst from an examination of the taxation law one could construe a theoretical risk to the revenue, this has not become a real risk to date because the legal ownership of assets and liabilities in a trust cannot be segregated.

The AMIT changes to allow quarantining of losses to the class do not create a legal segregation of ownership between classes. Commercially this makes it quite unattractive to investors as they would then be potentially liable to creditors from another class. As a result the likelihood of a trustee setting up sub-classes which invest in completely different asset pools would be very low. We understand this is why Treasury and the ATO did not have revenue concerns in relation to the widely held test applying at the whole of trust level only, as it does under the current law.

If there are specific concerns about the ability of foreign investors to access discounted withholding tax rates through investment via the subclass of an AMIT we think this should be better targeted to the particular concern, rather than a blanket amendment that will affect a large number of trusts unnecessarily.

Further, the ATO Law Companion Guides which accompany the MIT Regime would, in our view, be the most appropriate mechanism for addressing this concern. Australia's anti-avoidance laws under Part IVA *Income Tax Assessment Act* 1936 (Cth) are some of the strongest in the world.

We understand the ATO will be closely monitoring industry's compliance with the MIT Regime and again stress the need for commitment to a post-implementation review. This would allow any specific instances of behaviour not covered by Part IVA to be addressed in a targeted manner.