

# Treasury Discussion Paper Managed Investment Trusts - Capital Gains Tax Election

ASFA Submission

July 2009

Association of Superannuation Funds of Australia

ASFA Secretariat  
Level 6  
66 Clarence Street  
Sydney NSW 2000

PO Box 1485  
Sydney NSW 1005  
Ph: +61 2 9264 9300  
Fax: +61 2 9264 8824

Outside Sydney  
1800 812 798

Website: [www.superannuation.asn.au](http://www.superannuation.asn.au)

The Association of Superannuation Funds of Australia Limited ABN 29 002 786 290 ACN 002 786 290

**Please Note:**

This background paper provides general information and is not intended as advice specific for any individual superannuation fund or investment manager's portfolio. Although verification of the accuracy of the information contained in this paper has taken place, liability is not accepted for any errors or omissions that may have occurred.

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10 July 2009

General Manager  
Business Tax Division  
The Treasury  
Langton Crescent  
Parkes ACT 2600

Dear Mr Cicchini,

**Re: Treasury Discussion Paper  
Managed Investment Trusts – election to allow Capital Gains Tax to be  
the primary code for disposals of shares, units and real property**

The Association of Superannuation Funds of Australia (ASFA) is a non-profit, non-political national organisation whose mission is to protect, promote and advance the interests of Australia's superannuation funds, their trustees and their members. Our members include corporate, public sector, industry and retail superannuation funds plus service providers who provide professional services to SMSFs, account for more than 5.7 million member accounts and over 80% of superannuation savings.

ASFA welcomes the opportunity to respond to the discussion paper and to contribute to the development of an outcome that will provide investors in managed investment trusts with certainty as to the treatment of gains accruing on their investments.

**Background**

In August 2008, ASFA raised the issue of the appropriate tax treatment of gains in managed investment trusts with the Assistant Treasurer as it had come to our attention that the Australian Taxation Office (ATO) was considering the following question:

Income Tax: does it follow that merely from the fact that an investment has been made by a trustee, including the trustee of a managed investment fund, that any gain or loss from the investment will be on capital account?

ASFA's concern was that the mere fact that the question was being asked indicated that there exists within the ATO a view that either in all cases or in a broad range of situations a managed investment trust is not entitled to treat gains and losses on capital account.

Should such a view prevail, ASFA was concerned that it would have the effect of removing access to the concessional tax treatment of certain capital gains for investments made by superannuation funds through a managed investment trust.

In submissions made at that time, ASFA noted that the tax treatment applicable to a managed investment trust ("MIT") must be determined by the application of ordinary tax principles (that is, the "CGT as primary code" rule applicable to superannuation funds in section 295-85 of the Income Tax Assessment Act 1997, as amended ("ITAA97"), does not apply).

However, ASFA noted that, if CGT treatment were not available within all or particular MITs, this would seriously impair competitive neutrality between larger superannuation funds (which are able to appoint investment managers through direct mandates) and smaller and medium-sized funds (which may only be able to obtain exposure to certain asset classes through MITs). In ASFA's view, there are no sound policy grounds for imposing less favourable tax treatment on investments made by superannuation funds (or other investors) when made through an MIT than those applying when they invest directly or make use of a Pooled Superannuation Trust assuming that the MIT undertakes those investment activities in the same manner as the superannuation entity would have.

In response to the concerns raised by ASFA and more broadly in relation to potential changes in long-standing treatment of MITs by the ATO, the Government announced in the 2009 budget that it would allow MITs to make an irrevocable election to treat gains and losses on disposal of eligible investments in shares, units in unit trusts and real property on capital account for taxation purposes.

ASFA welcomes and supports these measures. In the comments below, ASFA notes certain issues associated with the measures of particular relevance to the superannuation industry.

### **Comments on the Discussion Paper**

#### *The MIT is an eligible Australian MIT*

While welcoming the Government's announcement, ASFA is concerned at the potentially narrow definition of an eligible Australian MIT proposed in the Discussion Paper.

One of the conditions for the application of the measures is that the MIT is an eligible Australian MIT, which requires:

- The MIT to have a relevant connection with Australian;
- The MIT to be either listed or widely held (including through certain tracing rules); and
- The MIT is a "managed investment scheme" operated by a "financial services licensee", with both these terms being as defined in the Corporations Act.

ASFA notes that many larger Australian superannuation funds have established trusts which they either wholly own, or own in conjunction with a small number of other large Australian superannuation funds, to hold particular types of investments. The reason for such structures is typically due to the regulatory restrictions within the *Superannuation Industry (Supervision) Act* ("SIS"). For example, some foreign limited partnerships allow for the partnership to borrow, and direct investment by a superannuation fund may be held to be in breach of the general prohibition in SIS against borrowing by superannuation funds.

Based on the Discussion Paper, it would appear likely that such trusts would not be "eligible Australian MITs", as although the Australian superannuation fund will hold both an APRA and ASIC licence, the trust would not appear to be a "managed investment scheme" or be operated by a "financial services licensee" as those terms are defined in the Corporations Act.

ASFA considers that the certainty of taxation treatment provided to an Australian MIT should also be granted to trusts wholly owned by superannuation entities.

ASFA submits that the group of eligible Australian MITs that can access the election be expanded to include a wholly owned trust of a complying APRA-regulated superannuation entity (i.e. a registered registerable superannuation entity) which has more than 50 members, or a trust owned wholly by a group of such APRA-regulated superannuation funds.

Such a class of superannuation fund would meet the 'widely held' trust requirement.

Importantly, their inclusion would provide the trustees with the opportunity to remove any doubt as to the ATO's view of how the tax rules should apply to trust gains and thus would provide tax neutrality for superannuation entities between investing through a wholly owned subsidiary trust and an Australia MIT (as currently proposed).

### *Eligible Assets*

The paper lists the assets which are proposed to be subject to the new rules and seeks comment on a legislative option to implement the outcome.

ASFA's preference is for a rule equivalent to that in present section 295-85 of ITAA97. This would establish that the "primary code" for the MIT is CGT, except for specific assets (such as traditional securities, or other assets subject to the measures in the Taxation of Financial Arrangements provisions).

In ASFA's view, such an approach is preferred to a listing of specific assets to which CGT treatment would apply, as over time, the latter approach may not keep up with new types of investments that may be undertaken by MITs. For example, if section 295-85 of ITAA97 were constructed on terms that listed the specific assets to which CGT treatment applied, it is unlikely that water rights, carbon rights, or a variety of other assets that did not exist in 1988 would be covered (or that lengthy delays in obtaining amending legislation would be endured before coverage were extended to these types of assets).

ASFA also notes that the rules in section 295-85 of ITAA97 (and in the former guise within the 1936 Act) have existed for many years, and thus their operation is well understood by all relevant industry participants.

### *Other entities*

ASFA notes that both the Budget announcement and the Discussion Paper deal only with MITs at this stage.

However, ASFA also notes that many superannuation funds invest via pooled vehicles that are not MITs. In particular, listed investment companies ("LICs") have considerable popularity as vehicles to obtain exposure to certain asset classes.

ASFA would support the extension of the election available to MITs to LICs in equivalent circumstances. The present uncertainty within MITs in respect to whether particular investment strategies or levels of turnover give rise to CGT versus revenue treatment is, if anything, even greater in the case of LICs. Competitive neutrality considerations would suggest that measures should be introduced to also address this uncertainty for LICs. If this were done, it is possible that LICs may provide greater competition to MITs, and such competition should apply downwards pressure on investment management fees.

### *Application Date*

Comments were sought on whether there should be retrospective application of an election.

The current proposal arose from an industry request for certainty of treatment given the presence of an ATO view that the activities of an MIT should be recorded on revenue account. Given this, ASFA proposes that where an MIT elects for capital treatment this should be treated by the ATO as prima facie evidence that previous self assessment on a similar basis was an appropriate tax treatment of gains. That is, the Commissioner of Taxation should make a statement to the effect that previous assessments will not be disturbed.

ASFA does not consider that exercising, or not exercising, the right to elect, should confer a right on the MIT to amend prior year tax returns.

If you have any further queries, please do not hesitate to contact Robert Hodge, principal policy adviser, on 02 8079 0806 or by email: [rhodge@superannuation.asn.au](mailto:rhodge@superannuation.asn.au)

Yours sincerely

**Melinda Howes**  
Director Policy and Industry Practice