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

Email: trust_rewrite@treasury.gov.au

Dear Sir \ Madam,

**CONSULTATION PAPER: MODERNISING THE TAXATION OF TRUST INCOME –
OPTIONS FOR REFORM**

The Association of Superannuation Funds of Australia (ASFA) would like to provide this submission in response to the call for comments on the above discussion paper.

About ASFA

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. We focus on the issues that affect the entire superannuation industry. Our membership, which includes corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider membership, represent over 90% of the 12 million Australians with superannuation.

Comments about the Consultation Paper

ASFA supports the proposed review of the current trust rules in its intention to reduce complexity and uncertainty around their application. ASFA also supports the consultation arrangements as outlined as this is a complex area of taxation law with a myriad of arrangements with the potential to be affected by any change.

ASFA also supports this being a comprehensive review and notes that, as such, it may be a lengthy process and there may be a need for transitional provisions as law changes are implemented.

However, because the proposed changes are geared towards changing the taxation of trusts in general, ASFA seeks to draw attention to the need to ensure that the taxation arrangements for superannuation funds are not inadvertently affected by any changes made to the provisions of Division 6 of Part III of the *Income Tax Assessment Act 1936*.

ASFA considers it very important that any proposed amendments to the legislation are prepared with a view to maintaining the current rules for the tax treatment of investments held through trusts by superannuation funds, and that these rules are as clear and consistent as possible.

Importantly, ASFA considers that the current, distinct, taxation regime for superannuation trusts that are regulated superannuation funds should be retained.

Current Arrangements for Superannuation Funds

Superannuation funds are themselves trusts which are subject to special taxation regime which taxes ordinary income and certain capital gains at special rates. ASFA strongly supports the retention of these arrangements.

ASFA's interest in this issue is that in addition to being a trust, Superannuation funds typically hold investments in a range of trusts with the following being the most typical types:

- Trusts listed on the Australian stock exchange
- Special purpose investment vehicles
- Unlisted trusts

Trusts listed on the Australian stock exchange

The listed Australian trusts held directly by superannuation funds are typically Managed Investment Trusts (MITs).

These trusts are fixed unitised trusts, and the fund's share of the taxable and non-taxable income is calculated on a proportionate basis, that is, based on the number of units the fund holds. All taxable income from these trusts is included on a present entitlement basis in the assessable income of the unit holder.

It is ASFA's understanding that the current MIT taxation rules are likely to apply to all of these investments. However, in the event that they do not and the provisions of Division 6 apply, it is important that the new legislation updating the trust income tax provisions in Division 6 allows current industry practice to continue. This should include the flow through of all taxable income components.

We are of the view that the most consistent way to treat the investment trusts which are held by superannuation funds would be to apply the MIT regime equally to these trusts, and would support such a reform.

Special Purpose Investment Vehicles (SPVs)

Superannuation funds may hold international private equity, infrastructure and property investments through wholly owned special purpose investment trusts. These investments, termed Special Purpose Vehicles (SPVs), are structured in this way to minimise foreign reporting requirements, and to operate without taxation leakage.

These trusts are also fixed unitised trusts, and their taxable income is generally accrued in a fund's tax return on a present entitlement basis using the rules under Division 6.

ASFA considers it important that any new legislation updating the trust income tax provisions of Division 6 continues to allow the taxable income of SPV trusts for any year of income to flow through and be taxed in the hands of the superannuation fund. This should include the flow through of all taxable income components.

Again, we would support the application of the MIT regime to these trusts.

Unlisted Trusts

Superannuation funds may hold unlisted Australian trusts directly or indirectly through SPVs. These trusts may or may not be Managed Investment Trusts.

These unlisted trusts are also fixed unitised trusts, and a superannuation fund's share of the taxable and non-taxable income is usually calculated on a proportionate basis, that is, based on the number of units the fund holds. Superannuation funds include all taxable income from these trusts on a present entitlement basis.

Where the MIT rules do not apply, it is important that the new legislation updating the trust income tax provisions in Division 6 continues to allow current industry practice. This should include the flow through of all taxable income components. Again, we would support the equal application of the MIT regime to these trusts.

In summary, ASFA submits that each of the above types of trusts should be taxed in the future in the same way as at present.

Specific issues

Distributions

ASFA considers that distributions and their components should continue to be calculated based on the number of units the superannuation fund holds - that is, a 'cents per unit' or unit days basis calculation - rather than on the total units.

The provisions of the current 'present entitlement' regime should continue to apply, to enable funds to recognise distribution entitlements in their tax return and thus avoid the trust's trustee paying tax at top marginal rates on that income.

Character flow-through

ASFA considers that the provisions permitting income character flow-through should continue to apply to the treatment of all types of trust income by superannuation funds.

Character flow-through is essential because it allows the fund to match that trust income with its own. For example, it allows funds to offset capital gains from trusts against its own capital gains, and to benefit from franking credits or foreign taxes paid.

Submission

ASFA submits that the present rules applying to the tax treatment of trust income by superannuation funds, under the MIT regime, and Division 6 of Part III of the *Income Tax Assessment Act 1936* where the MIT regime does not apply, are appropriate, and should be retained. The superannuation industry considers it essential to ensure that these arrangements continue to apply and are not inadvertently affected by the proposed updating and rewriting of Division 6 into the *Income Tax Assessment Act 1997*.

Two approaches could be taken to ensuring this:

- ASFA's preferred, and we believe the cleanest, approach would be to apply the MIT regime equally to the Special Purpose Vehicles, listed trusts and unlisted trusts, held directly and indirectly, by superannuation funds. This approach would ensure that all trusts that superannuation funds invested in were dealt with in the same way, rather than in two ways as at present, and the ensuing consistency would lessen the potential for error in their treatment. If this approach were taken, superannuation funds would no longer need to use the relevant rules under Division 6.

- The alternate approach would be to ensure that the key issues set out in this submission are taken into consideration so as to ensure that the updated and rewritten provisions do not alter the rules currently used by superannuation funds for the taxation of their trust income under Division 6.

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If you have any queries or comments regarding the contents of our submission, please contact our principal policy adviser, Robert Hodge on (02) 8079 - 0806 or via e-mail to rhodge@superannuation.asn.au.

Yours sincerely
Margaret Stewart



General Manager, Policy and Industry Practice