

Trusted since 1888

Equity Trustees Limited
ABN 46 004 031 298
AFS Licence No 240975
RSE Licence No L0003094

Level 2, 575 Bourke Street
Melbourne Victoria 3000
GPO Box 2307
Melbourne Vic 3001
Telephone (61 3) 8623 5000
Facsimile (61 3) 8623 5200
Email equity@eqt.com.au
Website www.eqt.com.au

Monday, November 15, 2010

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

By email: SBTR@treasury.gov.au

Dear Mr Cicchini

A new tax system for managed investment trusts (MITs)

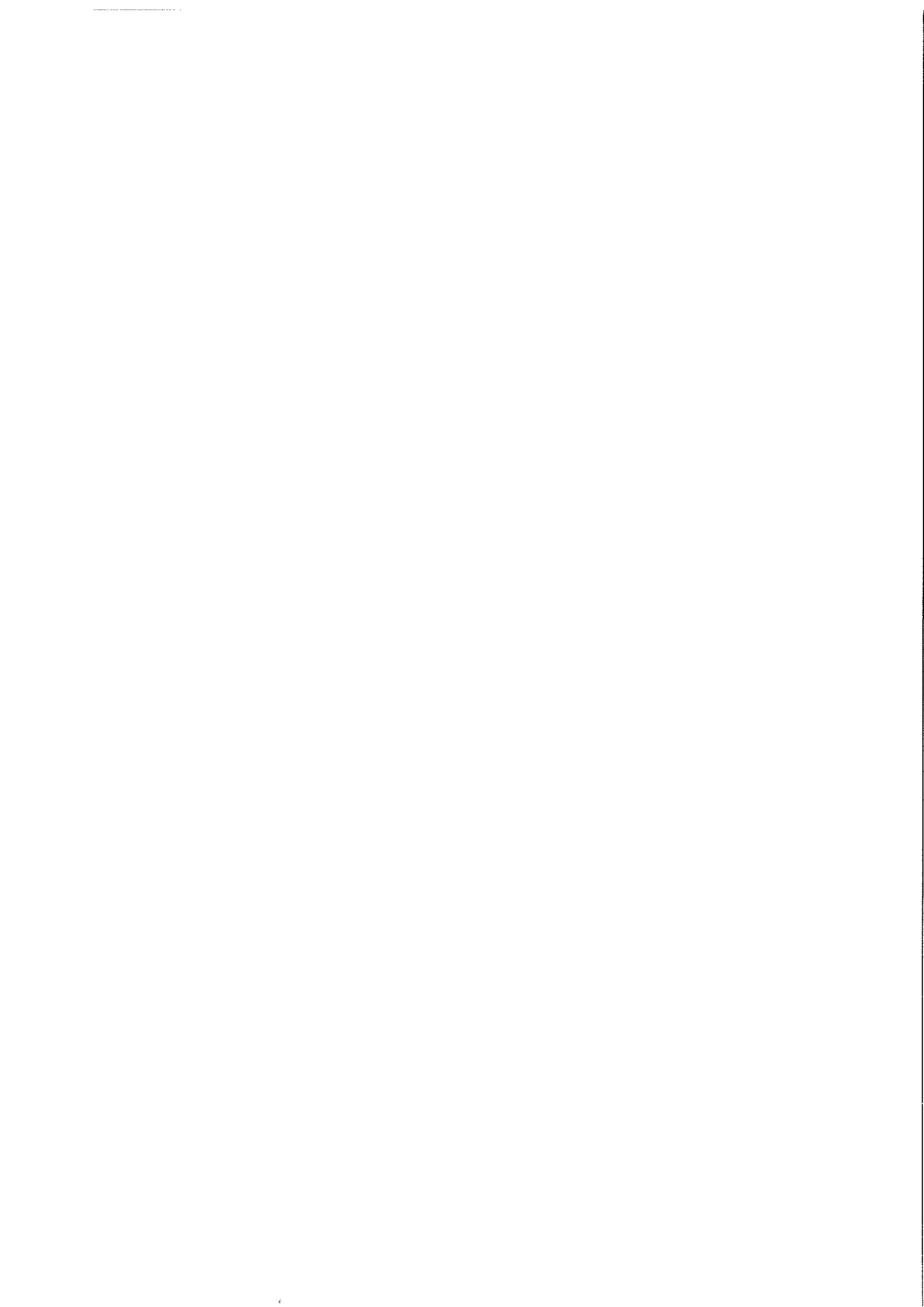
Equity Trustees Limited (EQT) is one of Australia's oldest fund managers and acts as Responsible Entity for over 130 internally and externally managed funds, providing services for 41 fund managers (refer Appendix 1) who collectively represent funds under management in Australia of approximately \$15bn directly and over \$150bn sourced in Australia and in excess of A\$5,000 bn world wide.

EQT recently assisted Treasury and the Minister with amendments to fix the MIT changes in May/June this year. With this in mind, EQT welcomes the opportunity to comment on the Discussion Paper regarding the "Implementation of a new tax system for managed investment trusts" released by the Treasury on 18 October 2010.

The establishment of a new tax regime for MITs is a positive development to bring the tax rules into line with developments in the investment management market since the existing rules were enacted. To assist Treasury in these endeavours, EQT has some specific comments on the Discussion Paper.

1. Definition of an MIT - the number of approved entities in section 12-402(3) is too narrowly defined

"Consultation Question 1" in the Discussion Paper concerns whether the Division 275 definition of a MIT (for the purposes of the capital account election) is also an appropriate definition of a MIT for the purposes of the new tax system for MITs. In paragraph 18 of the Discussion Paper it is suggested that this would be appropriate, and "For this not to occur there would need to be clear reason(s) why a particular feature of the proposed new tax system was unsuitable for a trust that met the Division 275 requirements but not the



existing MIT definition in section 12-400" of Schedule 1 to the Taxation Administration Act 1953.

EQT agrees that the definition of a MIT for the purposes of Division 275 provides an appropriate framework for defining a MIT under the new tax system. Division 275 sensibly expands the section 12-400 MIT definition to include limited categories of other trusts which are in substance widely held.

However, paragraph 19 of the Discussion Paper notes that Investor Director Portfolio Services (IDPS) will not be subject to the MIT tax system, as the tax consequences from these investments are generally assessed to the investor.

Equally, where an IDPS is a unitholder in a trust, the IDPS will typically represent a substantial number of underlying investors. However, it is generally difficult in practice for a trustee of the trust to obtain underlying ownership details from an IDPS operator. This means that where a substantial percentage of the registered unitholders of a trust are held through IDPS operators, it may be difficult to establish that the trust satisfies the MIT definition even though it is clearly widely held.

Section 12-402(3) of the section 12-400 MIT definition sets out a list of "widely held" entities. If these entities are unitholders of a particular trust, they may assist that trust in satisfying the widely held requirements in the section 12-400 MIT definition, and enable the trust to qualify as a MIT. Subsection 12-402(3)(i) which provides:

"an entity of a kind similar to an entity mentioned in the preceding paragraphs of this subsection as specified in the regulations"

allows for additional types of entities to be specified in the regulations as widely held.

EQT submits that IDPS arrangements should be included in the definition of MIT in section 12-400. Alternatively, an IDPS could be deemed to be an entity and specified in the regulations as widely held. This will ensure that trusts which should clearly be MITs (as they are widely held) are included in both the capital account provisions in Division 275 and the new tax system for MITs.

2. Income Funds

"Consultation Question 2" concerns whether certain types of MITs should automatically satisfy the clearly defined rights requirements in situations where rules already operate to prohibit a MIT from acting in a manner inconsistent with the core rules, and in which situations should these tests apply.

Some investors, particularly those in retirement, are interested in investing in products that will provide them with a relatively stable income flow from which to meet day to day living expenses. Income funds are an example of one product offered by the industry to meet the requirements of such investors.

An income fund may, for example, invest in fixed interest securities or bonds. The objective of the fund is to distribute regular income payments received on these investments (ie interest) to investors. It is important that these returns not be diminished by losses on these investments.

To achieve this objective, the trustee of a fund may determine distributable income to be equal to coupon income less expenses for the distribution period. In periods where there are losses on investments this may result in distributable income exceeding the tax net income for the period.

In most circumstances, the excess of distributions over the tax net income will constitute a "tax deferred" distribution – resulting in complex cost base adjustments to the investors' units. This complexity of tax treatment is often confusing for retail investors, many of whom are retirees who prefer to focus on day to day living rather than taxation complexity.

This complexity could be removed by allowing a trustee to treat the whole of the distribution (including the excess over the tax net income) as a distribution of income of the trust and wholly assessable income to the investor.

Paragraph 33 of the Discussion Paper suggests that there be a requirement that beneficiaries' interests be "fixed" and that this might potentially not be the case where the trustee has "a power to characterise receipts or expenses as income or capital."

EQT submits that a beneficiaries' interest in a trust should be regarded as "fixed" where the trustee has a power to determine the income of the trust in **excess** of the tax net income of the trust (in accordance with the Constitution of the trust). This is particularly so when the manner in which the trust will operate is clearly described in the Constitution and offering document (eg Product Disclosure Statement or Information Memorandum) for the trust.

Where such a power is exercised the trustee should also be allowed to treat the excess of the distributable income over the tax net income of the trust as a taxable (rather than tax deferred) distribution. Such a measure is expected to be revenue neutral (at worst) or revenue positive (at best) but would eliminate significant tax complexity for investors.

3. Multi-Class Trusts

"Consultation Question 6" in the Discussion Paper concerns whether compliance issues would be raised by a requirement under the attribution method that tax losses in respect of one class of unitholders cannot be used to reduce the tax income of another class of unitholders.

EQT considers that the compliance issues raised by this can be managed. However, this question raises broader equity issues and opportunities for Australian as a financial services hub in Asia.

(a) Equity issues

Firstly, from an equity perspective it would not seem appropriate that unitholders of one class should be disadvantaged by being required to subsidise losses incurred by another class of unitholders (the example on page 19 of the Discussion Paper illustrates the disadvantage that arises to the Class B unitholders in that case). However, as all income and losses within one trust are required to be offset, that is the result that arises under current tax legislation. Accordingly, quarantining of losses within a class of units within a trust would address this equity issue.

(b) International competitiveness

In many overseas jurisdictions in Asia and Europe, it is commonplace to have multiple sub-funds within a fund, with losses quarantined within each sub-fund. This allows the establishment of funds that have:

- multiple currency sub funds within one fund for one asset class. For example, a foreign equities fund with each sub fund hedged back to a different currency eg Euros, Yen, US dollars, Australian dollars; or
- different sub funds for multiple asset classes within one fund, again hedged back to different currencies (if desired).
- Put another way the ability to do multiple tax returns in a fund ie per class and hence quarantines the FX in that class and one set of financial statements

The inclusion of multiple sub funds within one fund allows for a reduction in the total number of funds required while still catering for the full range of investor preferences. Loss quarantining within sub funds makes this possible. This reduces administration and compliance costs, and this benefit is passed on to investors.

In the Australian funds market at present, these types of structures are not possible. It is currently necessary to establish a separate trust for each investment option, to ensure that investors obtain the investment performance from their particular investment option without it being potentially diminished by losses of other investment options. The lack of quarantining of losses within a class within a trust is one of the key barriers to resolving this issue.

Accordingly, quarantining of losses within a class within trusts would make Australian funds more competitive with foreign funds. It may also provide an investment vehicle that might be capable of being marketed in the Asian region once the Asian passport concept has been progressed.

4. Amendment of Trust Constitutions to comply with new Managed Investment Trust (MIT) Regime

"Consultation Question 25" in the Discussion Paper concerns what would be appropriate rollover relief where a resettlement of a trust occurs as a result of

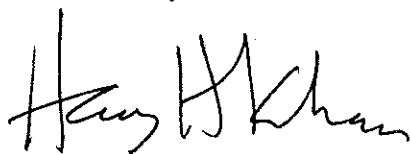
a MIT amending its constituent documents so as to be eligible for the attribution method of taxation.

EQT submits that investors should not be disadvantaged from a tax perspective from changes made to constituent documents of a trust to ensure that the trust is able to comply with particular aspects of the new tax system for MITs. Whether resettlement of a trust occurs is a question of trust law. However, should a resettlement occur it would be appropriate for rollover relief to ensure investors are not disadvantaged.

The rollover relief provided should include rollover of capital and revenue losses of the old trust to the new trust (similar to the loss rollover provisions in Division 310 of the Income Tax Assessment Act 1997, rollover of any capital or revenue gains on disposal of a unitholders' units in the old trust to their units in the new trust, and asset rollover relief so that cost bases and acquisition dates of assets of the old trust are rolled over to the new trust.

The objective of the rollover relief is to ensure that investors are in the same tax position before and after any resettlement. This is appropriate from a tax policy perspective when there has been no substantive change to the economic position of an investor in respect of their investment in the MIT.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Harvey H Kalman". The signature is written in a cursive style with a large initial "H".

Harvey H Kalman
Head of Funds Management

Appendix 1

List of Funds Managers represented by EQT in Australia, both domestic and international

1. Alpha Fund Managers
2. Amundi Asset Management
3. Armytage private Limited
4. Aurora-Sandringham
5. AV Funds (Contango, Five Oceans)
6. AXA IM and Rosenberg
7. BNP Paribas Investments Partners
8. Cohen and Steers
9. Shakespeare Property Group
10. Credit Suisse Investments Bank
11. EQT - 1888
12. Fauchier Partners
13. Fisher Francis Trees & Watts
14. GAM
15. Guild Capital Asset Management
16. Intrinsic Value Investments
17. Janus Capital Management
18. K2 Advisors
19. LaSalle Asset Management
20. Lime Street Investments Management
21. Lincoln Indicators Australia
22. Lloyd George Management
23. Longreach Capital Management
24. Martin Currie
25. Marvin & Palmer
26. Massachusetts Financial Services
27. MCG Asset Management
28. MIR Investment Management
29. Orbis Australia Investment Management
30. Orbis Investment Management
31. PanAgora Asset Management
32. PIMCO
33. Putnam Investment Management
34. RCM
35. SG Hiscock & Co
36. Standard Life Investments
37. Swita Investments Management
38. T. Rowe Price
39. Spectrum Asset Management
40. THS Partners – DonaldsonBurston
41. Tribeca Investment Management

