



Australian Government

The Board of Taxation

REVIEW OF THE TAX TREATMENT OF BARE TRUSTS AND SIMILAR ARRANGEMENTS

A Report to the Minister for Revenue
and Financial Services

the **board** of **taxation**
www.taxboard.gov.au

The Board of Taxation
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the **board** of **taxation**

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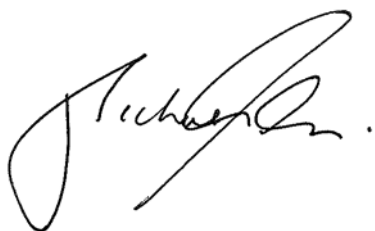
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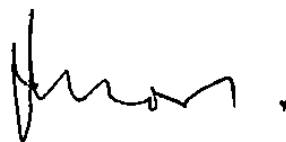
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1. FOREWORD

- 1.1 The Board of Taxation (Board) is pleased to submit this report to the Minister for Revenue and Financial Services following its self-initiated review of the tax arrangements applying to bare trusts and similar arrangements.
- 1.2 The Board has made a number of recommendations seeking to increase certainty in the use of bare trusts. Bare trusts are widely used structures. For example, Australia's licensed custodians currently hold almost \$4.5 trillion in assets via bare trusts and similar arrangements.
- 1.3 The Board established a Working Group of John Emerson AM (Chair), Dr Mark Pizzacalla and Karen Payne to conduct the review. The Working Group was assisted by officials from the Department of the Treasury (Treasury) and the Australian Taxation Office (ATO). The Board would like to express its appreciation for the assistance provided by these officials.
- 1.4 The Working Group held discussions with a range of stakeholders including industry bodies, accounting and legal practitioners, and representatives of the financial sector. The Board would like to thank all of those who so readily contributed information and time to assist in conducting this review.
- 1.5 The ex officio members of the Board - the Secretary of the Treasury, John Fraser, the Commissioner of Taxation, Chris Jordan AO, and the First Parliamentary Counsel, Peter Quiggin PSM - have reserved their final views on the recommendations for advice to Government.



Michael Andrew AO
Chair, Board of Taxation



John Emerson AM
Chair of the Board's Working Group
Deputy Chair, Board of Taxation

2. EXECUTIVE SUMMARY AND RECOMMENDATIONS

EXECUTIVE SUMMARY

- 2.1 The Board has reviewed the tax arrangements applying to bare trusts and similar arrangements. Bare trusts and similar arrangements are used widely in society by individuals, domestic and multinational businesses, and charities with almost \$4.5 trillion in assets held via these arrangements by licensed custodians alone.
- 2.2 The Board considered whether, and how, to legislate in respect of the current widespread practice of disregarding or looking through these trusts for income tax purposes. The practice appears not to be supported by Division 6 of Part III of the *Income Tax Assessment Act 1936* for most types of bare trusts, and is only maintained by an ongoing administrative approach from the Commissioner of Taxation that may change should developments in law, such as a court decision, make it no longer tenable.
- 2.3 The Board recommends that, given the magnitude of subject arrangements and ongoing uncertainty, it is now appropriate to legislate to enable certain bare trusts and arrangements with similar characteristics, to be looked through for most income tax purposes. Where the terms of the trust are in substance equivalent to direct ownership of the assets by the beneficiary, the tax consequences should be analogous. This would require a person to furnish their income tax return as though any income, gains and losses, were made or derived personally.
- 2.4 The Board recommends that the reform be achieved through a characteristics based approach, where trusts exhibiting certain characteristics would qualify for look through treatment.
- 2.5 To legislate this approach, the Board recommends that the following guiding principles be adopted throughout the policy and law design process:
 - (a) qualifying trusts are looked through for most income tax purposes (subject to certain exclusions);
 - (b) qualifying trusts all exhibit the same core characteristics; and
 - (c) qualifying trusts may have certain specific features that, while potentially conflicting with the core characteristics, do not disqualify them from the look through approach.
- 2.6 While the Board has outlined a number of suggested core characteristics and disregarded features, the Board considers that consultation is appropriate to finalise the core characteristics and disregarded features.

- 2.7 To the extent possible, the Board considers that the current legislated income tax treatment of specific types of bare trusts (such as the CGT absolute entitlement and instalment trust provisions) should be aligned to the recommended approach. However, the Board does not recommend that goods and services tax (GST), and certain withholding taxes and reporting obligations that arise in different policy contexts be covered.
- 2.8 The Board recommends that, in order to improve the implementation of this reform, the ATO provide contemporaneous guidance in the form of a Law Companion Guideline in accordance with current ATO practice.
- 2.9 The Board considers that the recommendations in this report should also assist the Australian financial services industry as it looks to grow in the Asia region in the coming years. As the upcoming introduction of Corporate and Limited Partnership Collective Investment Vehicles will rely on custodians and depositories to facilitate investment, providing certainty for the underlying tax treatment should address the risks inherent in the current practice for potential domestic and international investors.

LIST OF BOARD RECOMMENDATIONS

RECOMMENDATION 1

The Board recommends that the Government legislate to provide a look through approach for bare trusts and similar arrangements for certain income tax purposes.

RECOMMENDATION 2

The Board recommends that a characteristics based approach be used to describe the trusts that will be subject to a look through approach.

RECOMMENDATION 3

The Board recommends that a similar approach to sections 106-50 and 235-820 be used for legislating the income tax consequences of the look through approach for qualifying trusts.

RECOMMENDATION 4

The Board recommends that, subject to further consultation, the core characteristics used to identify qualifying trusts subject to the recommended approach be the following:

- (a) the trustee has no, or only minor, active duties or powers;
- (b) the beneficiaries are entitled to the benefit of all of the assets and income of the trust; and
- (c) each beneficiary can demand the trustee transfer trust assets to that beneficiary or at their direction.

RECOMMENDATION 5

The Board recommends that, subject to further consultation and consideration, certain features be disregarded when considering whether a trust qualifies for the recommended reform.

RECOMMENDATION 6

The Board recommends that a legislative instrument making power be included in the legislation.

RECOMMENDATION 7

The Board recommends that the ATO provide contemporaneous guidance in the form of a *Law Companion Guideline*.

RECOMMENDATION 8

The Board recommends that there be exclusions from the look through treatment for certain purposes and that further consultation be undertaken to identify any other purposes that should be excluded.

3. BARE TRUSTS AND LOOK THROUGH TREATMENT

BACKGROUND

- 3.1 In 2016, the Board of Taxation (Board) considered whether particular areas of trust taxation could benefit from reform.
- 3.2 The Board has previously reviewed the taxation of trusts on a number of occasions. Reviews have included issues such as the taxation of discretionary trusts, managed investment trusts (MIT) and collective investment vehicles (CIV).¹
- 3.3 The Board carried out many consultations during the above reviews on the types of trusts operating in Australia. The Board was informed that a wide variety of assets are held on many different types of trusts, including bare trusts where assets are held by trustees with limited active duties or powers.
- 3.4 In the MIT review of 2009, the Board recommended that certain managed funds be subject to a separate attribution based model of taxation (the attribution MIT regime). The attribution MIT regime allows the trustee of a qualifying pooled investment trust to directly attribute the taxable income of the trust to investors (the beneficiaries of the trust) with flow through of character.
- 3.5 The Board also recommended in its MIT review that a wider review of trust taxation be undertaken.²
- 3.6 Complementing this recommendation of a wider review, the Board considered the tax treatment of bare trusts and financial service arrangements known as investor directed portfolio services (IDPS).

1 The Board of Taxation, *'Taxation of Discretionary Trusts'* November 2002; *'Review of tax arrangements applying to managed investment trusts'* August 2009 (MIT review); *'Design of an Investment Manager Regime as it relates to foreign managed funds: A report to the Assistant Treasurer'* August 2011 (IMR foreign managed funds review); *'Review of tax arrangements applying to collective investment vehicles'* December 2011 (CIV review). The Board also reviewed trust taxation in: The Board of Taxation *'Post implementation review of Division 7A of Part III of the Income Tax Assessment Act 1936'* November 2014.

2 The Board of Taxation, *'Review of tax arrangements applying to managed investment trusts'* August 2009, Recommendation 48.

- 3.7 The Board identified that bare trusts (and IDPS and similar arrangements used in the financial services industry) should not be subject to tax under the attribution MIT regime as the Board understood these types of trusts to be very limited in scope, and therefore very different to managed funds.³
- 3.8 Further, the Board questioned whether bare trusts should be subject to Division 6 of the *Income Tax Assessment Act 1936* (ITAA 1936). The Board also noted there was no express legislative backing to look through trusts in which beneficiaries have an absolute entitlement to the assets as against the trustee from the application of Division 6, while noting that such arrangements are widespread throughout the financial services industry.
- 3.9 In light of these considerations, the Board recommended that IDPS and similar bare trust type arrangements “should be excluded from taxation under Division 6 generally.”⁴
- 3.10 In its response, the then Government:
- (a) agreed with the Board’s recommendation that bare trust type arrangements not be subject to the attribution MIT regime; and
 - (b) deferred the Board’s recommendation of a wider review of trust taxation and that bare trust type arrangements be excluded from Division 6 of the ITAA 1936.⁵
- 3.11 The then Government subsequently undertook a wider review of trust taxation in 2011 and 2012;⁶ however, this review did not progress to the point of law change. Specifically, for present purposes, progress was not made on the Board’s recommendations regarding bare trusts.
- 3.12 In 2016, the Government enacted the attribution MIT regime.⁷ While the regime is opt-in, the Board understands that most bare trusts and similar arrangements will be ineligible.

3 The Board of Taxation, ‘*Review of tax arrangements applying to managed investment trusts*’ August 2009. For more information, see The Board of Taxation, ‘*Review of tax arrangements applying to managed investment trusts – discussion paper*’ October 2008, paragraphs 11.13 – 11.21.

4 The Board of Taxation, ‘*Review of tax arrangements applying to managed investment trusts*’ August 2009, Recommendation 48.

5 Assistant Treasurer Senator Nick Sherry Press Release ‘*New Tax System for Managed Investment Trusts*’ 7 May 2010.

6 Department of the Treasury, ‘*Modernising the Taxation of Trust Income – Options for Reform*’ 21 November 2011, <<http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2011/modernising-trust-income-tax>>.

7 *Tax Laws Amendment (A New Tax System for Managed Investment Trusts) Act 2016*.

- 3.13 The general taxpayer practice of looking through bare trusts and similar arrangements (including certain traditional custodial and nominee arrangements) for income tax purposes continues today.
- 3.14 The value of total assets under custody for Australian investors continues to grow and is currently over \$3 trillion (or twice the total market value of the ASX 200) for the licensed custodial services sector alone, which also holds over \$1.32 trillion of assets under custody for foreign investors.⁸
- 3.15 The Board considers that, given the developments in taxpayer practice and trust taxation, it is now timely to revisit the tax treatment of bare trusts.

ISSUES CONSIDERED BY THE BOARD

- 3.16 In this report, the Board identifies trusts that it suggests should be disregarded for income tax purposes (commonly known as the 'look through' approach). The Board has also considered how far this look through treatment should extend (for example, what carve-outs from such general treatment might need to apply to address the fact that a trustee may have withholding or reporting obligations).
- 3.17 The Board has considered three approaches to identify those trusts:
- (a) a 'no definition' approach – to use the term 'bare trust' without definition and rely on extrinsic materials and judicial decisions;
 - (b) a 'list' based approach – to list the types of trusts to be looked through; and
 - (c) a 'characteristics' based approach – to describe the characteristics of the types of trusts to be looked through.

ISSUES NOT CONSIDERED BY THE BOARD

- 3.18 This report is limited to the specific issues under consideration regarding look through treatment in the context of bare trusts and similar arrangements. It does not cover other issues relating to Division 6.

8 Australian Custodial Services Association, 'Custody sector hits \$3 trillion milestone – ACSA statistics now available' 1 March 2017 <<http://acsa.com.au/news/333382/Custody-sector-hits-3-trillion-milestone---ACSA-Statistics-Now-Available.htm>> and 'Australian Assets Under Custody for Foreign Clients' <<http://acsa.com.au/?page=AUSSubCustody>>.

4. BARE TRUSTS: TAXPAYER PRACTICE AND THE NEED FOR REFORM

BACKGROUND: WHAT IS A BARE TRUST?

- 4.1 A trust relationship can take many forms. Essentially, a trust involves a trustee and beneficiary, trust property, and an obligation to deal with the property in a certain manner for the benefit of the beneficiary.⁹
- 4.2 The main provisions affecting trusts subject to this report are in Division 6 (as modified by Subdivisions 115-C and 207-B of the *Income Tax Assessment Act 1997* (ITAA 1997) respectively for capital gains and franked distributions). Among other things, Division 6 provides for beneficiaries to be liable to tax on a share of the net income of the trust (effectively the trust's taxable income) by reference to the share of the income of the trust to which they are presently entitled. Losses of a trust are not capable of being applied by beneficiaries against other income or gains; losses (subject to certain integrity measures) can only be applied against assessable income of the trust in determining its net income. Put simply, losses are "trapped" in the trust to be carried forward unless and until they can be recouped by the trust. Trustees are also required to comply with a variety of compliance measures including reporting and withholding requirements. In some instances trustees are taxed.
- 4.3 'Bare trust' is a term normally used to describe trust relationships where the trustee has no, or few, active duties other than to transfer the trust property to the beneficiary upon direction.¹⁰

⁹ See Jacob's Law of Trusts (7th edition, 2006) JD Heydon and M J Leeming, LexisNexis Butterworths, Sydney. It is acknowledged that this definition does not apply to all types of trusts (for example, charitable trusts).

¹⁰ Jacob's Law of Trusts, p.48. See also *Herdegen v Federal Commissioner of Taxation* (1988) 84 ALR 271, 281.

CURRENT BARE TRUST TAX TREATMENT

- 4.4 The Board understands it is common current taxpayer practice for bare trusts and trusts that are similarly limited in scope, not to be recognised for income tax purposes (except in the context of certain withholding tax and special trustee assessment and reporting obligations discussed in later Chapters); that is, a bare trust is generally looked through (or disregarded). Beneficiaries are taken to derive income and incur losses directly as though no trust exists. This practice can also result in the trustee not complying with the administrative and compliance obligations that falls on other trustees.
- 4.5 This practice appears not to be supported by Division 6. No distinction is expressed in that Division between bare trusts and other trusts.
- 4.6 Some issues relating to the tax treatment of bare trusts and similar trusts were ventilated in the Federal Court in *Colonial First State Investments Limited v Commissioner of Taxation* [2011] FCA 16 (*Colonial*). The decision involved a series of complex custodian arrangements involving multiple trusts. The court allowed a look through approach for the purposes of satisfying the 'present entitlement' requirement test in Division 6. While this aspect of the decision was limited to clarifying how custodial trusts may operate in chains of trusts, it caused uncertainty as to the tax treatment of other bare trusts and similar arrangements.
- 4.7 However, in *Howard v Federal Commissioner of Taxation* [2012] FCAFC 149 (*Howard*) the Full Federal Court decided that interposed trusts within a chain cannot be ignored. In this case, a look through approach was not accepted as the 'reality' of the case was that there were multiple trusts subject to Division 6 through which a distribution flowed.¹¹
- 4.8 Following *Colonial*, the Commissioner issued a Decision Impact Statement (DIS). The Commissioner accepted the decision in *Colonial* for taxpayers in analogous circumstances, but reiterated his view that all other trusts (including bare trusts, custodians and nominees) are recognised for income tax purposes and not looked through.¹²

11 Australian Taxation Office, Decision Impact Statement on *Howard v Commissioner of Taxation* [2012] FCAFC 149, 14 August 2014 <http://law.atolaw/view.htm?locid='LIT/ICD/M115of2012'&PiT=99991231235958>>.

12 Australian Taxation Office, Decision Impact Statement on *Colonial First State Investments Limited v Commissioner of Taxation* [2011], 30 June 2011 <https://www.ato.gov.au/law/view/document?Docid=LIT/ICD/NSD1190of2009/00001>.

- 4.9 In order to generally not disturb the current practice pending the outcome of the 2011 trust taxation reforms then being considered by the Government, the Commissioner stated his 'administrative practice' as follows:

"[N]otwithstanding his view on this issue, the Commissioner will not generally seek to disturb the current practice (as described above) while [[2011] trust taxation] reform options are being considered. However, if the Commissioner is asked or required to state his view formally, then he will do so as he understands the law to operate (namely that Division 6 of Part III of the ITAA 1936 applies in determining who is taxed on the income of all bare trusts and in what amount - aside from cases with facts materially the same as those in Colonial First State). Examples of circumstances in which the Commissioner would be obliged to state and apply his view of the law as he understands it to operate include: the provision of a private or public ruling; putting arguments and submissions to the Tribunal or a Court in a litigation matter; and responding to issues raised at an ATO consultation forum, such as the National Tax Liaison Group (NTLG) or one of its Sub-groups.

The Commissioner will review this approach in the event that amendments have not been made to the law (addressing whether Division 6 applies to bare trusts) by 1 July 2014, which is the proposed date for enactment of the reforms referred to in the previous paragraph (see Modernising the taxation of trust income - consultation strategy)."¹³

- 4.10 In 2014, the Commissioner confirmed that while *Howard* supports the Commissioner's view of Division 6, he would maintain the administrative practice in the *Colonial DIS* pending further consultation.¹⁴

UNCERTAINTY

- 4.11 The Board is concerned that the general taxpayer practice appears not to be supported at law. Further, while the Commissioner's administrative practice expressed above is relied upon by many taxpayers, there are differing opinions as to the scope of the practice (and the type of arrangements that fall within it). These ongoing concerns give rise to uncertain outcomes.

¹³ Ibid.

¹⁴ Australian Taxation Office, Decision Impact Statement on *Howard v Commissioner of Taxation* [2012] FCAFC, 14 August 2014 <<https://www.ato.gov.au/law/view/document?LocID=%22LIT%2FICD%2FM115of2012%22&PiT=99991231235958>>. The High Court refused special leave on 8 November 2013: *Howard v Commissioner of Taxation* [2014] HCA Trans 268.

4.12 Stakeholders have drawn the attention of the Board to the use of bare trusts and similar arrangements in a wide variety of settings. Arrangements commonly looked through in practice for income tax purposes include those where:

- (a) assets are held by custodians, depositories and nominees for individuals or 'entities' such as unincorporated joint ventures, partnerships, companies, trusts, and unincorporated non-profit associations;
- (b) amounts are held by estate agents, solicitors and accountants for clients pending completion of a sale or occurrence of another event;
- (c) assets are held under:
 - (i) resulting trusts;
 - (ii) IDPS and other financial services platforms;
 - (iii) arrangements involving instalment warrants or instalment receipts (legislatively recognised in 2015);¹⁵ and
 - (iv) arrangements involving CHESS depository receipts (such as CHESS Depository Interests and CHESS Units of Foreign Security, collectively referred to as CDIs).

4.13 While the current administrative practice of the Commissioner is not to disturb the taxpayer practice of looking through bare trusts, the uncertainty inherent in this practice has various repercussions, for example:

- (a) it is undesirable that, in order to avoid disrupting longstanding industry practice, the Commissioner administers the law in a way that is without legislative support and is unable to issue legally binding rulings supporting the practice;
- (b) the Commissioner's current practice may be required to change as a result of a court decision in relation to a taxation matter (or non-taxation matter where the Commissioner is not a party) or if the Commissioner is compelled to issue a legally binding ruling. These events may make the Commissioner's approach untenable;
- (c) international and domestic investors may be reticent about entering into Australian custodial, depository and nominee services if they are aware of the uncertain tax treatment;

¹⁵ Subdivision 235-I of the ITAA 1997.

- (d) conversely, international and domestic investors may not be aware of the uncertainty – for example, a Product Disclosure Statement may be issued without addressing the uncertainty. This means that investors are not alerted to the issue and attendant risks;
- (e) trustees may administer the same types of bare trusts in different ways. One trustee may, in accordance with the Commissioner’s technical view, treat the trust as subject to Division 6 and so lodge income tax returns and decline to pass through revenue losses to beneficiaries. Another may rely on the Commissioner’s practice in the DISs for the *Colonial* and *Howard* decisions so as to not lodge returns and to allow revenue losses to be passed through to beneficiaries. The second trustee will have reduced compliance costs and beneficiaries of the second trust will potentially benefit from loss flow through;
- (f) the approach of accountants and auditors to bare trusts varies, and determining or advising on whether assets are held on bare trust is relevant for tax purposes when preparing and auditing financial reports. For example, an auditor may decline to approve accounts prepared on a look through basis;
- (g) if the nominee arrangements (generally bare trusts) used by the Australian Securities Exchange Limited (ASX) to operate markets of CDIs (which, by their nature, require a nominee to hold the underlying securities and the investor to have an equitable interest) were recognised as trusts subject to Division 6, the inability to pass through losses would impact the use of these markets;
- (h) the lack of legal authority for the administrative concession may present challenges for the proposal to introduce new Collective Investment Vehicles (CIVs) to attract foreign retail investors in Australian pooled investment vehicles. These vehicles will likely require the use of custodians (or similar services called ‘depositories’) as is common global practice. When using a custodian to hold the vehicle’s assets, the marketing and disclosure products provided to retail customers both in Australia and overseas will not be capable of assuring the legal position of the bare or custodial trusts regarding income tax including whether customers can access losses. This may impact Australia’s international competitiveness;
- (i) the use of licensed custodians to hold investments of superannuation funds, life insurance companies and managed investment schemes (including MITs and AMITs) is extremely widespread and is an essential feature of the regulatory and governance framework of the Australian financial services sector. The taxation rules applying to these financial services entities (for example, the specific tax regime of life insurance companies) can often only apply as intended if these investments are effectively treated as though they were directly held.

4.14 Further to subparagraph (b) above, since the Board's 2009 recommendations there have been a number of judicial developments in this area. The following cases since *Colonial* and *Howard* are also relevant to the treatment of bare trusts and similar arrangements:

- (a) *Oswal v Commissioner of Taxation* [2013] FCA 745;
- (b) *Kafataris v Deputy Commissioner of Taxation* [2015] FCA 874;
- (c) *Taras Nominees Pty Ltd as Trustee for the Burnley Street Trust v Commissioner of Taxation* [2015] FCAFC 4; and
- (d) *White Rock Properties Pty Ltd v Commissioner of State Revenue* [2015] VSCA 77.

4.15 These cases reviewed aspects of the equitable obligations relating to bare trusts. While each case turned on its facts, all potentially impact the Commissioner's ability to maintain the administrative concession. These cases suggest that courts maintain a narrow view of the characteristics of a bare trust (in particular, *Oswal* and *Kafataris*).¹⁶ This has increased the importance of addressing this uncertainty.

4.16 The Board received general strong agreement from stakeholders that legislative reform is needed to address the uncertainty as a matter of priority.

4.17 The Board believes that it is appropriate that legislation now be passed to authorise taxpayer practice to the extent elaborated below.

RECOMMENDATION 1
The Board recommends that the Government legislate to provide a look through approach for bare trusts and similar arrangements for certain income tax purposes.

¹⁶ These cases also address the related concept of absolute entitlement as against the trustee: section 106-50 of the ITAA 1997.

5. OPTIONS FOR REFORM

POTENTIAL LEGISLATIVE APPROACHES FOR REFORM

- 5.1 The Board considered different legislative approaches that could be used to enact a look through approach, including:
- (a) a no definition approach: the use of an undefined term;
 - (b) a 'list' based approach: to list those types of trusts to be looked through; and
 - (c) a 'characteristics' based approach: the use of characteristics to describe the types of trusts to be looked through.

NO DEFINITION APPROACH

- 5.2 It was canvassed during consultation whether a look through approach using an undefined term such as 'bare trust' should be adopted. This term would rely on extrinsic materials and judicial guidance for interpretation of the term in its context (being the purpose of this reform, namely, to look through the trust for income tax purposes). Leaving a relevant term undefined is prima facie simple and, in the right circumstances, reduces the complexity and length of legislation.
- 5.3 The Board considered the effectiveness of this approach in the 'absolute entitlement' CGT provisions that provide similar treatment for certain trust arrangements.
- 5.4 Section 106-50 of the ITAA 1997 provides that a beneficiary will be treated for CGT purposes as if it owns a CGT asset to which it is absolutely entitled as against the trustee. There is no definition of 'absolute entitlement' in ITAA 1936 or ITAA 1997.
- 5.5 Draft Taxation Ruling TR 2004/D25 examines this concept in the context of its origins in the rule in *Saunders v Vautier* (1841) 49 ER 282. The Commissioner's view is that absolute entitlement to an asset as against a trustee is the ability of a beneficiary to call for a trust asset to be transferred to them or at their direction where the beneficiary has a vested and indefeasible interest in the entire asset.¹⁷

¹⁷ Draft Taxation Ruling TR 2004/D25 *Income Tax: capital gains: meaning of the words 'absolutely entitled to a CGT asset as against the trustee of a trust' as used in Parts 3-1 and 3-3 of the Income Tax Assessment Act 1997*, paragraph 10. This approach was endorsed by Lindgren J in *Kafataris v Deputy Commissioner of Taxation* [2008] FCA 1454.

- 5.6 The Board understands that the Commissioner has not finalised this ruling in the 13 years since it was issued due to uncertainty in the law regarding the circumstances in which absolute entitlement can arise. This uncertainty seems to have become more acute in recent times.¹⁸ Further, there are questions about whether absolute entitlement can exist in situations involving multiple beneficiaries and how the concept applies in the context of fungible assets.¹⁹
- 5.7 Stakeholders emphasised that bare trusts take a variety of forms in industry and can be difficult to describe.²⁰ While the term ‘bare trust’ has been adopted in some circumstances by certain States,²¹ the Board notes that it is common for States not to use the term and rather to describe the characteristics that are most important for particular treatment to be available.²²
- 5.8 During consultation, stakeholders considered that the current problems with the Commissioner’s administrative practice would persist for the vast majority of trusts if this approach was adopted due to uncertainty as to what was meant by bare trusts and similar arrangements. The Board agrees with this view. Further, given the Board’s recommendation extends beyond what judicial precedent suggests a bare trust to be, it is unlikely that legislating an income tax look through treatment targeted to apply to bare trusts and similar arrangements will provide the result intended.
- 5.9 While having no definition might seem simple, the Board considers the potential adverse consequences of unexpected results warrant a greater level of certainty be provided.
- 5.10 Throughout the Board’s consultation, the use of a ‘no definition’ approach attracted the least support.

18 For example, see the decision of Edmonds J in *Oswal v Commissioner of Taxation* [2013 FCA 745] which on one reading might suggest the circumstances in which absolute entitlement can arise are much narrower than might previously have been understood (and certainly narrower than the ruling would suggest).

19 Draft Taxation Ruling TR 2004/D25 *Income Tax: capital gains: meaning of the words ‘absolutely entitled to a CGT asset as against the trustee of a trust’ as used in Parts 3-1 and 3-3 of the Income Tax Assessment Act 1997*, paragraphs 23 – 24.

20 It was submitted to the Board that this was among the reasons for the term not being adopted for CGT purposes in section 106-50.

21 For example, section 157C of the *Duties Act 1997* (NSW).

22 For example, section 35 of the *Duties Act 2000* (Vic), examined in *White Rock Properties Pty Ltd v Commissioner of State Revenue* [2015] VSCA 77.

‘LIST’ BASED APPROACH

- 5.11 A list based approach has been used in a number of contexts throughout the ITAA 1936 and ITAA 1997. A recent example is found in one aspect of the managed investment trust regime,²³ and many stakeholders in consultation were aware of that approach.
- 5.12 This approach can satisfy certain policy aims. For example, where the policy is required to be static and only specific types of entities known at a point in time are within its scope.
- 5.13 The Board has considered the merits of this approach. A list approach, stating the types of trusts that would qualify, will not confine the look through approach just to those trusts as they are understood at the time of enactment. For example, trusts in IDPS may be entered into on different terms to reflect market conditions and customer needs, and some stakeholders observed that these terms may be structured so that they go beyond any view of a bare trust (or even any similarity to a bare trust). The names attributed by taxpayers to trusts may then be misappropriated to create inappropriate tax outcomes – such a foreseeable and avoidable consequence outweighs any certainty that may be provided in the short term.
- 5.14 Further, while a list may be easier to create at the time of enactment, it lacks flexibility as new types of trusts may be designed that should qualify for look through treatment.²⁴
- 5.15 The Board considers that any approach which may foreseeably require ongoing monitoring and potential legislation to update is unattractive.
- 5.16 Accordingly, the Board considers that this approach does not provide an effective solution.

‘CHARACTERISTICS’ BASED APPROACH

- 5.17 The Board also raised in consultation adopting a ‘characteristics’ based approach. A term, such as ‘bare trust’, could be defined by describing the core characteristics of the trusts that the Board considers to be in scope.

23 Subsection 275-20(4) of the ITAA 1997 which contains an extensive list of entities the presence of which as a member of a managed fund can assist the fund to meet the required ‘widely held test’.

24 There are concerns in other areas of tax law that have adopted this approach such as the public trading trust provisions of Division 6C Part III of the ITAA 1936. The difficulty of drafting provisions that can keep pace with evolving industry practices and instruments without monitoring and updating has been observed. As a result, there is often significant lag before any legislative update being made, if it indeed occurs at all.

- 5.18 Where sufficiently robust characteristics are used, stakeholders preferred a characteristics based approach on the basis that it provides greater certainty and allows for such trust arrangements and products to evolve over time. Stakeholders observed that such an approach, accompanied by guidance from the ATO on existing arrangements, was the preferable option.
- 5.19 The Board considers that a characteristics based approach should be adopted.²⁵
- 5.20 The Board's identifies the principles that underpin this approach in the following Chapter.

RECOMMENDATION 2

The Board recommends that a characteristics based approach be used to describe the trusts that will be subject to a look through approach.

²⁵ The Board observes that the approach in subsection 235-830(1) of the ITAA 1997 provides an illustration of a characteristics based approach that identifies the types of arrangements that qualify and the relevant tax consequences. These provisions were designed for limited purposes and are not suited to the practice the Board recommends be legislated.

6. THE CHARACTERISTICS BASED APPROACH

BARE TRUSTS AND OTHER EXTENDED TRUST ARRANGEMENTS

- 6.1 This chapter expands upon the Board's preferred characteristics based approach, and outlines its view on the core characteristics that should be considered for adoption.
- 6.2 The consultations the Board has undertaken has led it to the view that the look through approach should apply to bare trusts, as well as being extended to some other similar trust arrangements.
- 6.3 The legislative design should articulate the characteristics that allow identification of arrangements sufficiently clearly to minimise uncertainties and potential for dispute without the articulation being overly prescriptive or rigid.
- 6.4 As a guide to the following sections, the Board considers the following coherent principles encapsulate the recommended characteristics based approach:
- (a) qualifying trusts are looked through for most income tax purposes (subject to certain exclusions);
 - (b) qualifying trusts all exhibit the same core characteristics; and
 - (c) qualifying trusts may exhibit certain specific features that, while potentially conflicting with the core characteristics, do not disqualify them from the look through approach.

INCOME TAX CONSEQUENCES FOR QUALIFYING TRUSTS

- 6.5 The Board's recommendation to look through qualifying trusts for income tax purposes has the predominant consequence that an asset of the trust is deemed to be an asset of the beneficiary (for example, in relation to income, capital gains or losses).

- 6.6 This is achieved elsewhere in the ITAA 1997. For example, the CGT absolute entitlement provisions emphasised provide:

*“(1) For the purposes of [CGT], from just after the time you become absolutely entitled to a CGT asset as against the trustee of a trust (disregarding any legal disability), **the asset is treated as being your asset (instead of the asset of the trust).**”*

*(2) This Part [**applies**] to an act done in relation to the asset by the trustee as if the act had been done by you (instead of the trustee).”²⁶*

- 6.7 The Board considers this provision appropriately identifies the relevant consequences of ownership and actions, namely, that these should be those of the beneficiary instead of the trustee.

- 6.8 Another example of look through treatment is the instalment trust provisions. The relevant provisions emphasised provide:

*“(1) If an entity (the investor) has a beneficial interest in an *instalment trust asset under an * instalment trust, **the asset is treated as being the investor's asset (instead of being an asset of the trust).**”*

*(2) **An act done in relation to an * instalment trust asset of an *instalment trust by the trustee of the trust is treated as if the act had been done by the investor (instead of by the trustee).**”*

*(3) The investor is treated as having the *instalment trust asset in the same circumstances as the investor actually has the interest in the *instalment trust.*

(4) Without limiting subsection (3), the circumstances include:

(a) whether the interest is held on capital account or on revenue account;

and

(b) whether the interest is held as a joint tenant or tenant in common.”²⁷

- 6.9 The Board observes that these provisions use similar mechanisms to look through instalment trusts and align the relevant income tax consequences (the Board notes those phrases with an emphasis added). This deeming applies to the extent that, for example, a disposal of an asset held in an instalment trust would be taken to be a disposal of the beneficiary. The disposal of the interest in the trust should, to the extent possible, have an analogous tax treatment to the disposal of the underlying asset.

²⁶ Section 106-50 of the *Income Tax Assessment Act 1997*.

²⁷ Section 235-820 of the *Income Tax Assessment Act 1997*.

- 6.10 The Board recommends a similar approach using coherent principles to impute the relevant consequences to the beneficiary.

RECOMMENDATION 3

The Board recommends that a similar approach to sections 106-50 and 235-820 be used for legislating the income tax consequences of the look through approach for qualifying trusts.

WHAT ARE THE RELEVANT CHARACTERISTICS?

- 6.11 The Board considers that core characteristics exist in the bare trusts and similar trust arrangements intended by the Board to be subject to the look through approach.
- 6.12 The Board considers it is appropriate to base the core characteristics upon traditional bare trust characteristics.
- 6.13 Importantly, the Board notes that there are a number of common features (whether pursuant to the trust's terms or by statute) that, when strictly interpreted, may mean a trust is not a bare trust. The Board considers that some of these features should be disregarded for the purposes of qualifying for look through treatment as the Board considers there to be minimal risk inherent in these features when considering the interests of a beneficiary in the trust's assets. That is, while these features may result in a trust not being a traditional bare trust, the trust should receive analogous tax treatment. These disregarded features are in the next section (starting at paragraph 6.26).
- 6.14 The Board considers that the following characteristics should be the core characteristics for the purposes of the recommended reform:
- (a) the trustee has no, or only minor, active duties or powers;
 - (b) the beneficiaries are entitled to the benefit of all of the assets and income²⁸ of the trust; and
 - (c) each beneficiary can demand the trustee transfer trust assets to that beneficiary or at their direction.

28 A useful example of this concept is the following subsection in the Land Tax Management Act 1956 (NSW) that the income criteria is satisfied if: "the trust deed specifically provides that the beneficiaries of the trust: (i) are presently entitled to the income of the trust, subject only to payment of proper expenses by and of the trustee relating to the administration of the trust, and (ii) are presently entitled to the capital of the trust, and may require the trustee to wind up the trust and distribute the trust property or the net proceeds of the trust property."

6.15 While the Board expects that these characteristics may be further refined and ultimately finalised through the policy and law design process, in consultation with stakeholders, the Board recommends that the above characteristics form the basis for determining the types of trusts that qualify for the recommended approach.

RECOMMENDATION 4

The Board recommends that, subject to further consultation, the core characteristics used to identify qualifying trusts subject to the recommended approach be the following:

- (a) the trustee has no, or only minor, active duties or powers;
- (b) the beneficiaries are entitled to the benefit of all of the assets and income of the trust; and
- (c) each beneficiary can demand the trustee transfer trust assets to that beneficiary or at their direction.

Active duties or powers

6.16 The term 'active duties' has been judicially considered in the context of bare trusts.²⁹ Generally speaking, active duties are any duties other than those which exist by reason only as a result of the office of trustee and the holding of legal title.³⁰

6.17 A passive holding with no or minor active duties commonly imposes the following obligations on the trustee, namely, to:

- (a) hold trust assets in its custody;
- (b) transfer the trust assets as directed by the beneficiaries; and
- (c) provide information and documents to the beneficiaries regarding the income of the trust and trust property.

6.18 The Board anticipates that other permissible minor active duties and powers will be identified during further consultation.

²⁹ *Herdegen v Federal Commissioner of Taxation* (1988) 84 ALR 271. For further analysis, see Taxation Ruling TR 2004/D25 *Income tax: capital gains: meaning of the words 'absolutely entitled to a CGT asset as against the trustee of a trust' as used in Parts 3-1 and 3-3 of the Income Tax Assessment Act 1997.*

³⁰ *CGU Insurance Limited v One.Tel Limited* (2010) 242 CLR 174 at 183.

6.19 However, the characteristic that the Board considers should be present in all circumstances is the absence, or minimal nature, of active duties or powers of the trustee (excluding those duties and powers outlined below as ‘disregarded features’).³¹

Right to demand trust property

6.20 This characteristic draws upon the concept of absolute entitlement to an asset as against the trustee and the requirement that a beneficiary or beneficiaries have a vested and indefeasible interest in the trust property.³²

6.21 However, the Board considers that importing the same requirement may impose too strict a requirement on the terms of qualifying trusts. While each beneficiary ought to be entitled to demand the trustee convey trust property to the beneficiary or at their direction (subject to the disregarded characteristics), it may be reasonable for such a requirement to be limited, as follows:

- (a) the trustee may convey trust property or, if the trust property is fungible, assets substantially the same as trust property; or
- (b) the trustee may convey cash in substitution for trust property for qualifying types of trust property (for example, listed securities).

Providing for multiple or joint beneficiaries

6.22 The Board considers that limiting access to this reform to trusts with a single beneficiary would inappropriately restrict the measure. Further, it would likely provide no greater certainty than the existing law that the Board has recommended be amended. The Board has considered:

- (a) trusts where the asset is held for multiple beneficiaries; and
- (b) trusts where a pool of assets is held on separate trusts for a number of beneficiaries.

6.23 Where a trust exists for the benefit of multiple beneficiaries, whether holding as joint tenants or as tenants in common, that trust should qualify under the proposed reform if the proportionate interest of each beneficiary in the asset is clearly identified.³³

31 A recent example of an active duty, in the context of a purported bare trust, was the duty to perform the actions of a lessor under a lease: *Kafataris v Deputy Commissioner of Taxation* [2015] FCA 874.

32 TR 2004/D25.

33 Section 108-7 of the ITAA 1997 deals with joint tenancy for CGT purposes. Any assets held on revenue account would likely be treated analogously under the Board’s recommended approach.

- 6.24 Where a number of beneficiaries are entitled to a proportionate interest in a pool of underlying fungible or suitably interchangeable assets, the reform should also apply to those trusts. For example, this may apply where a custodian maintains separate client accounts in respect of a single fungible pool of securities in an “omnibus account”. Their respective proportionate interests in the pool of fungible assets should be clear, and each beneficiary’s interest must be in all of the income and capital of the assets allocated to their client account. For example, a trust where a beneficiary merely had an interest in the income of the pool would not qualify.
- 6.25 Therefore, the Board considers that the core characteristic for beneficiaries to be entitled to the benefit of all of the assets and income of the trust includes that:
- (a) each beneficiary must be entitled to all of the income attributable to the proportionate interest of that beneficiary in the assets as identified; and
 - (b) the beneficiaries are entitled to the benefit of all of the income, including income that is not distributed but rather continues to be held by the trustee.

WHAT FEATURES SHOULD BE DISREGARDED?

- 6.26 The Board understands that certain features are commonly present in trusts that would, without more, mean that even traditional bare trusts would find it difficult to qualify for any legislated look through approach that the Board has considered in this report.³⁴
- 6.27 The features of concern are not minor active duties or powers as described in the core characteristics. However, the Board does not consider these features should disqualify trusts from qualifying.
- 6.28 The Board recommends that this issue be addressed by explicitly disregarding certain types of duties or powers of the trustee when considering whether the above core characteristics are satisfied.

³⁴ For example, see the analysis by Edmonds J in *Oswal v Deputy Commissioner of Taxation* [2013] FCA 745 at [74]–[76] [regarding the inability of a beneficiary to satisfy absolute entitlement where the trustee has a statutory power of sale (section 28 of the *Trustee’s Act 1962* (WA))]. This is relevant to the bare trust analysis given the similarity of the concepts.

6.29 The Board considers that further consultation should be undertaken to develop this recommendation and a method to implement it. To assist this process, the Board considers the following types of reasonable duties or powers should qualify as disregarded features:

- (a) the right of a trustee to a lien over trust property;
- (b) the ability of the trustee to be indemnified out of trust property;
- (c) the inability of the trustee to accept a direction from, or to transfer an asset to, a beneficiary who is under a legal disability;
- (d) a limited power of sale by the trustee (including a legislative power of sale);³⁵
- (e) the inability of the trustee to transfer an asset to a beneficiary due to the operation of law (eg, legal impediments under foreign securities law that do not allow a depository to transfer a foreign security to a CDI holder);
- (f) an obligation on the trustee to make reasonable efforts to recover income or payments;
- (g) an obligation on the trustee to institute or defend legal proceedings in connection with the trust property as instructed by the beneficiary; and
- (h) a power or duty of the trustee to attend and vote at meetings etc. of members of companies or unitholders of trusts in which the trustee holds an interest for the beneficiary as instructed by the beneficiary.

6.30 While the disregarded features will require further consultation and consideration during the policy and law design process to ensure that they do not lead to inappropriate or unintended outcomes, it is the Board's view that the principle of disregarding certain features is the most effective way to ensure the reform is accurately targeted and effectively implemented.

RECOMMENDATION 5

The Board recommends that, subject to further consultation and consideration, certain features be disregarded when considering whether a trust qualifies for the recommended reform.

³⁵ The Board considers that such a power of sale must be limited to ensure that reasonable endeavours are taken to seek direction from the beneficiary as to the appropriate assets to sell.

LIMITED LEGISLATIVE INSTRUMENT MAKING POWER

- 6.31 The Board considers a characteristics based approach provides a robust legislative framework. However, the Board notes the complex nature of trust law has led to complex interaction issues in tax legislation, including the current uncertainty this review seeks to address.
- 6.32 Accordingly, the Board suggests a limited legislative instrument making power be included in the legislation.
- 6.33 While the scope of such a power should be subject to further consultation, the Board suggests this power might allow the Commissioner to clarify the operation of the core characteristics or to specify that a certain feature be disregarded, but only where doing so is consistent with the core characteristics.
- 6.34 This should increase the robustness of this approach to adapt to developments in the law and taxpayer practice.

RECOMMENDATION 6

The Board recommends that a legislative instrument making power be included in the legislation.

'CHARACTERISTICS' BASED APPROACH – ATO GUIDANCE

- 6.35 Some stakeholders stated it was important that guidance material is provided by the ATO in connection with the reform.
- 6.36 Stakeholders noted that the ATO's new public ruling product called the '*Law Companion Guideline*', generally issued when a bill is tabled in Parliament, should assist in providing immediate certainty as to the types of trust arrangements the ATO considers fall within the scope of the reform.³⁶
- 6.37 The Board agrees with this view. The ability of the ATO to provide contemporaneous and binding advice significantly enhances certainty and minimises the potential for disruption throughout the legislative reform process. It is also noted that the binding nature of a public ruling arguably provides a greater level of legal protection (for example, from a change of view by the Commissioner) than extrinsic materials such as Explanatory Memoranda. The ATO undertakes consultation with stakeholders as a matter of course when preparing advice of this nature.

³⁶ Australian Taxation Office Law Companion Guideline LCG 2015/1.

- 6.38 The Board notes that the process of withdrawal, substitution or updating public rulings is less resource and time intensive than updating via the legislative process. The ability for advice to be updated in a timely manner is an extremely valuable tool of tax administration.
- 6.39 Stakeholders suggested including examples of trust clauses would greatly assist advisers and taxpayers to understand the effect of the legislation.

RECOMMENDATION 7

The Board recommends that the ATO provide contemporaneous guidance in the form of a *Law Companion Guideline*.

TAX SYSTEM INTEGRITY AND REPORTING

- 6.40 The Board considers that the consequences outlined above should apply for most income tax purposes; however, it is appropriate to consider whether certain exclusions are appropriate to maintain the integrity and proper administration of the tax system. During consultation there was broad agreement that a number of exclusions that are not currently looked through by the Commissioner's administrative practice be maintained.
- 6.41 The Board recommends that the following exclusions from the look through approach be adopted:
- (a) Obligations to withhold MIT withholding tax in respect of fund payments to foreign residents under Subdivision 12-H of Schedule 1 to the *Tax Administration Act 1953* (TAA 1953), either as a "custodian" or "other entity" under s 12-390.
 - (b) Related notice and reporting requirements under s 12-395.
 - (c) Obligations to withhold amounts where a TFN or ABN is not quoted under Subdivision 12-E of Schedule 1 to the TAA 1953.
 - (d) Obligations to withhold amounts from dividend, interest and royalty payments in respect of foreign residents under Subdivision 12-F of Schedule 1 to the TAA 1953.
 - (e) Income tax liabilities and associated income tax return lodgement requirements pursuant to subsections 98(3) and (4) of the *Income Tax Assessment Act 1936* (ITAA 1936) when a trustee holds assets in trust for a foreign resident or beneficiary under a legal disability.

- (f) Obligations to pay amounts in respect of another entity's tax obligations; for example, pursuant to a notice under section 255 of the ITAA 1936, a 'Mareva' injunction, or under CGT foreign resident withholding provisions.
- (g) Any tax reporting obligations; for example, in respect of the annual investment income report (AIIR).

6.42 The Board recognises that further exclusions may be identified during consultation.

RECOMMENDATION 8

The Board recommends that there be exclusions from the look through treatment for certain purposes and that further consultation be undertaken to identify any other purposes that should be excluded.

7. OTHER RELEVANT CONSIDERATIONS FOR THE LOOK THROUGH APPROACH

CONSIDERING SPECIFIC TYPES OF TRUSTS

- 7.1 During consultation, stakeholders brought to the Board's attention many types of trusts and considered whether they fall within the Commissioner's administrative practice.
- 7.2 The Board has reflected on this consultation, and provides a number of observations regarding common types of trusts in the context of the look through approach.
- 7.3 *Custodial and depository trusts*: these trusts are commonly considered bare trusts in the custodial and depository industry and are widely used.³⁷ The Board understands that most trust instruments establishing custodial or depository trusts are of limited scope, often referring to simply holding the assets in custody, and sometimes the provision of minor administrative services.³⁸ As noted in Chapter 4 (in particular paragraph 4.12), depending on the particular terms and conditions of specific arrangements, custodial trusts are commonly ignored for income tax purposes given their bare trust like nature. They are generally expected to be within the core characteristics discussed in Chapter 6.
- 7.4 *Chess Depository Interests*: as noted in paragraph 4.12, CDIs are commonly accounted for on a look through basis. The Board understands that this is an appropriate reflection of the terms of the trust arrangements and generally within the Commissioner's administrative concession. However, the Board notes that subsections 124-780(6) and 124-781(5) of the ITAA 1997 (scrip-for-scrip roll-over) specifically deem holders of Chess Units of Foreign Security (a type of CDI) to be holding the underlying membership interests. The existence of these provisions lends weight to the Board's view (supported by the Commissioner's administrative practice) that bare trusts should be looked through for income tax purposes. It is arguable that their existence increases the desirability for certainty for CDIs as the authority for the current practice is potentially contradicted by these provisions. The Board also understands that a depository holding foreign securities may be legally impeded (under either domestic or foreign laws) from

37 For example, see the Australian Securities and Investments Commission Report 291 (2012) '*Custodial and depository services in Australia*' or the Australian Custodial Services Association website <http://www.acsa.com.au>.

38 Australian Securities and Investments Commission Regulatory Guide RG 148 '*Platforms that are managed investment schemes and nominee and custody services*' December 2016.

transferring those securities to the CDI holder; however, the Board considers that any such legal impediment should be disregarded for the purposes of the CDI qualifying for the recommended look through approach.

- 7.5 *Solicitor, estate agent and accountant trust accounts*: stakeholders understood that the prevailing uncertainty applies to many of these professionally regulated trusts; however, this will vary depending on the terms of the trust. Stakeholders also observed that other trusts used by solicitors, such as that described by the High Court in *Harmer v Federal Commissioner of Taxation* (1991) 173 CLR 264 (being a trust subject to a court order on particular terms), are not bare trusts and would not be in scope.

INVESTOR DIRECTED PORTFOLIO SERVICES AND SIMILAR INVESTMENT PLATFORMS

- 7.6 The Board's 2009 recommendation specifically noted that IDPS should be excluded from Division 6.³⁹ During this review, the Board has concluded that the appropriate way in which qualifying trusts should qualify for the recommended reform is through a characteristics based approach. The Board has considered the way in which trusts under IDPS and similar investment platforms may qualify below.

- 7.7 During the 2009 MIT review, the Board described typical IDPS arrangements in its 'discussion paper' as follows:

- (a) investment assets are required to be held on trust for the investor such that someone other than the investor is the legal owner;
- (b) investors are given a list of investment opportunities. Each investor has the discretion to make investment decisions and, in particular, sole discretion to decide what assets will be acquired. Further, subject to prior directions given by the IDPS (for example, minimum holding requirements), investors may direct the custodian to transfer assets or realise assets and pay over the proceeds;
- (c) the operator is able to give effect to standing directions previously given by the investor such as to rebalance the portfolio by buying and selling specified securities or realise assets to maintain an agreed minimum balance in a cash account or pay fees associated with the service; and

³⁹ The Board of Taxation, 'Review of tax arrangements applying to managed investment trusts' August 2009, Recommendation 48.

- (d) the assets in which an investor has an economic interest are held by a custodian who is not the operator. Each investor is provided with consolidated reporting about their interests in assets acquired through or held under the IDPS.⁴⁰
- 7.8 Some stakeholders take the view that the trust (or trusts) established under an IDPS between the investor (beneficiary) and the operator (trustee) relating to investments in securities (IDPS trusts) are bare trusts.⁴¹ The Board understands that many are looked through for Division 6 purposes in practice.
- 7.9 The Board notes that the governing documents of IDPS can vary. As noted at paragraph 5.13, some stakeholders mentioned that IDPS trusts may include terms that go beyond a bare trust (or even any similarity to a bare trust). Accordingly, the name or label IDPS is not a sufficient criteria for look through eligibility. This means that, while the Board expects many IDPS trusts will qualify for the recommended reform, some may not and it will depend on the precise terms of the documentation.

IDPS-like services

- 7.10 While similar to an IDPS as a platform, an IDPS-like service is a registered managed investment scheme and as such requires the trustee to act in the best interests of all unitholders.⁴² The Board considers that this obligation negates the potential for such a scheme to be a bare trust as the trustee is obliged to act otherwise than in accordance with the instructions of any one beneficiary. Therefore, the recommended reform should not apply to it.

40 The Board of Taxation, 'Review of tax arrangements applying to managed investment trusts – discussion paper' October 2008, paragraphs 11.13 – 11.21 <http://taxboard.gov.au/files/2015/07/managed_investment_trusts_discussion_paper.pdf>.

41 Many investments made through an IDPS or IDPS-like service are held by a custodian, depository or nominee on trust. These trusts are generally on the same terms to other custody arrangements and should be considered analogously.

42 Australian Securities and Investments Commission Regulatory Guide 148 *Platforms that are managed investment schemes and custody services*, December 2016, paragraphs RG 148.6 – RG 148.7 and RG 148.62. These paragraphs make clear that the operator of an IDPS-like scheme must act in the best interests of the members of the scheme pursuant to paragraph 601FC(1)(c) of the *Corporations Act 2001*.

THE ASIA REGION FUNDS PASSPORT

- 7.11 The Board understands that the current Asia Region Funds Passport (ARFP) is an initiative aimed at removing regulatory barriers for fund managers across the Asia Region. As part of this initiative, the Government is establishing two new collective investment vehicles (CIVs): a corporate CIV and a limited partnership CIV. These CIVs will be used to facilitate pooled retail investment. The Board has previously recommended the establishment of such entities.⁴³
- 7.12 The Board considers that custodial or depository services will likely be provided to the operator of these CIVs. This means that the assets of the pooled vehicles will be held on a custodial or depository trust.
- 7.13 As observed above, the Board considers that custodial or depository trusts will commonly be qualifying trusts. In order to legislate the current industry practice and provide certainty for these arrangements as they are marketed by Australian fund managers in other jurisdictions, it is appropriate to ensure that the characteristics of these trusts in any CIV regulatory infrastructure be considered with regard to the Board's recommended reform.

TAX INTERACTION ISSUES

- 7.14 The Board also notes that a number of tax interaction issues arise. The Board expects that many of these issues will be resolved during the policy and law design process; however, the Board makes the following observations.
- (a) *Subdivision 235-I of the ITAA 1997 (Instalment Trusts)*: the Instalment Trust provisions provide targeted look through treatment to trusts relating to certain financial arrangements. While the scope of these provisions is quite narrow, the Board considers that the trusts would generally be considered similar to bare trusts. The Board would recommend a consistent approach for bare trusts and instalment trusts to the extent possible.
 - (b) *CGT*: the Board has recommended that the look through treatment apply for CGT purposes to the extent possible, with consequences arising for the beneficiary not the trustee. However, the Board observes that there will be inconsistencies with the absolute entitlement provision (in section 106-50) in certain circumstances that need to be addressed; in particular, CGT E events such as E1 and E5. To the extent possible, absolute entitlement should be reconsidered with a view to aligning relevant provisions to the recommended reforms (rather than section 106-50).

⁴³ The Board of Taxation, *Review of Tax Arrangements Applying to Collective Investment Vehicles* (December 2011).

- (c) **Withholding tax:** as noted in Chapter 6, withholding tax requires different policy considerations regarding tax obligations and the identification of beneficiaries for collection purposes, given its focus on non-resident taxpayers. The Board does not consider that looking through trusts for withholding tax purposes is appropriate and therefore withholding tax is outside the scope of this measure.
- (d) **GST:** GST treatment of bare trusts was raised during consultation. While some similarities exist, the legislative context is sufficiently different (including the concept of 'enterprise') to require a different approach.⁴⁴ The Board therefore does not recommend alignment of the GST provisions.

7.15 Finally, the Board has been informed that it is common for chains of bare trusts to exist. Given the decision in *Colonial*, it might be expected that chains of bare trusts can sometimes be dealt with using equitable principles but the Board considers chains of bare trusts should qualify for the look through treatment by legislation.

⁴⁴ For examples of the GST treatment of bare trusts, see Australian Taxation Office Taxation Ruling GSTR 2008/3 Goods and Services Tax: *Dealings in real property by bare trusts*; and Taxation Ruling Financial Services: *Questions and Answers – Is an IDPS carrying on an enterprise within the meaning given by the GST Act?*.