

Ruling Compendium – TD 2015/10

This is a compendium of responses to the issues raised by external parties to draft Taxation Determination TD 2014/D20 *Income tax: will paragraph 974-80(1)(d) of the Income Tax Assessment Act 1997 be satisfied merely because a company has issued a debt interest to a listed property trust within the same stapled property group?*

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

Issue No.	Issue raised	ATO Response/Action taken
1	Associate test At paragraph 4, it is explained that for the purposes of the Example it is assumed that Y Co sufficiently influences the Property Trust for the purposes of the definition of 'associate' in section 318 of the <i>Income Tax Assessment Act 1936</i> (ITAA 1936). The test of sufficient influence in the definition of 'associate' in section 318 of the ITAA 1936 is in fact a very high threshold and should not be assumed to occur between entities within a stapled group simply because they are stapled. If 'sufficient influence' is simply assumed to occur in the context of a published Taxation Determination on section 974-80 of the <i>Income Tax Assessment Act 1997</i> (ITAA 1997), it could lead to an inappropriate inference that 'sufficient influence' is a low threshold that should be presumed to take place within a stapled group. ...paragraph 4 should simply assume that Y Co and the Property Trust are assumed to be 'connected entities', rather than simply assuming that one entity sufficiently	Noted. The Commissioner has made the following change to paragraph 4 of Example 1 in the Final Taxation Determination: 4. Y Co is a company. Its activities mainly comprise property development and management of the properties owned by Property Trust. Property Trust pays to Y Co a monthly fee for the management services (at market rate). It is assumed, for the purposes of this example, that Property Trust is a 'connected entity' of Y Co as defined in subsection 995-1(1) of the ITAA 1997. The Commissioner does not agree that an inappropriate inference can be drawn from the example that the 'sufficient influence' test in section 318 of the ITAA 1936 has a low threshold such that it can be assumed to take place within a stapled group. Notwithstanding, we have made the change suggested, but we note that in all cases that the Commissioner has seen a listed property trust stapled to a company was only a connected entity of the company because it was an associate of the company under section 318; and the listed property trust was sufficiently influenced by the company (or vice versa). For completeness, in Draft Taxation Ruling TR 2012/D5 <i>Income tax: debt and equity interests: when is a public unit trust in a stapled group a connected entity of a company for the purposes of paragraph 974-80(1)(b)</i>

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	influences the other.	<i>of the Income Tax Assessment Act 1997</i> (Withdrawn), the Commissioner explained that the mere fact that units in a public unit trust were stapled to shares in a company and the two entities were part of the same economic group would not of itself, be sufficient for a conclusion that a company sufficiently influences a public unit trust (or vice versa). However, those factors together with other substantive evidence in the terms of any agreements or constituent documents, as well as the role of the trust as financier for the company may lead to a conclusion that the company sufficiently influences the trust. The Commissioner maintains the views expressed in the TR 2012/D5W (which will be replaced by a Law Administration Practice Statement).
1(a)	Paragraph 4 Paragraph 4 of the ruling reads...the sentence currently describes Y Co as ‘an associated company which ... is assumed [to be] ... an ‘associate’’. It would be clearer to remove the reference to ‘an associated company’ from this sentence, as it is unnecessary and could be confusing for some readers. Recommendation: Amend the first sentence in paragraph 4 to read as follows: <i>Y Co is a company which, it is assumed for the purposes of this example, ‘sufficiently influences’ Property Trust for the purposes of the definition of an ‘associate’ in section 318 of the ITAA 1936.</i>	Refer to the changes to paragraph 4 of the Example in the final Determination. The Commissioner has amended this paragraph to refer to a ‘connected entity’ as defined in subsection 995-1(1) of the ITAA 1997.
2	There is a slight difference in the wording used in the proposed binding parts of the draft Determination at paragraphs 10 and 14 – which question whether the trust distributions are ‘indirectly a return’ from the company – whereas the proposed non-binding paragraphs 21 to 23 express the issue as being	Noted. However, the Commissioner considers that the wording of the paragraphs 10 and 14 of the draft Determination appropriately reflects paragraph 974-80(1)(d) of the ITAA 1997 and the subject of the Determination. The wording of these paragraphs has been retained in the final Determination.

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	whether the stapled group investors receive '<u>in substance equity</u> returns' from the company. Given the intention of section 974-80 of the ITAA 1997, the latter expression seems to better support the objectives of section 974-80 as a whole. Accordingly taxpayers are likely to be assisted if similar language to that used in paragraphs 21 to 23 (that is that an important issue for consideration is whether the stapled group investors receive 'in substance equity returns' from the company) were also to be used in the binding part of the Determination when it is finalised.	
3	Paragraphs 23 and 24 of the draft Determination mention that it is relevant that the interest on the cross-staple loan 'is a potential source of funds for LPT distributions'. The Professional Bodies are somewhat concerned by the use of the word 'potential' in this context, as it could unduly narrow the practical usefulness of the finalised Determination. This is because a trustee is usually compelled by the trust deed to distribute all of its net income for an income year to its unit holders. Therefore, to the extent that the interest income derived by the trust from the cross-staple loan is not offset by expenses, the net interest income is not merely 'potentially' distributable – instead the trust deed would usually compel those funds to be distributed. Accordingly, premising the finalised Determination on the interest income being merely a 'potential' source of trust distributions may not be helpful to taxpayers. We submit that the reference to the interest as a 'potential source of funds for LPT distributions' be	The Commissioner does not consider that the reference to the interest on the cross-staple loan being 'a potential source of funds for LPT distributions' in paragraphs 23 and 24 of the draft Determination detracts from the focus on the main point that the connection between the interest income and the trust distributions will be weakened for the purposes of paragraph 974-80(1)(d) of the ITAA 1997 if the trust distributions are funded by numerous sources of income, rather than consisting exclusively of interest income from the stapled company. The Commissioner understands that a trustee of a LPT is 'usually compelled by the trust deed to distribute all of its net income for an income year to its unit holders' only to the extent that there is such income. That is, net income will be gross income derived by the trust less expenses incurred for that income year. This means that any income that the trust derives (including the interest income on a cross-staple loan) will at the time of derivation only potentially be distributable to the unit holders (because it could be completely offset by the trust's expenses, and so there will be no net income which the trustee will be compelled to distribute). The tests for characterising an interest in Division 974 of the ITAA 1997 are applied at the time the relevant scheme giving rise to the interest comes into

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	omitted, with the focus instead being placed on what appears to be the real point that the ATO seeks to make at paragraphs 23 and 24, namely that the connection between the interest income and the trust distributions will be weakened for the purposes of paragraph 974-80(1)(d) of the ITAA 1997 if the trust distributions are funded by numerous sources of income, rather than consisting exclusively of interest income from the stapled company.	existence. Paragraph 974-80(1)(d) tests whether 'there is a scheme, or a series of schemes, designed to operate so that the return to the connected entity <i>is to be used to fund</i> (directly or indirectly) a return to another person' [emphasis added]. The section has a prospective application as it looks at whether the relevant return is to be used to fund a return to the ultimate recipient. Given that at the test time, it can only be definitively said that the trustee will derive income from a number of sources and the net income will be gross income derived reduced by any trust expenses it is in our view apt to say that the interest income is a potential source of trust distributions. The Commissioner therefore considers that the wording of paragraphs 23 and 24 in the Explanation of the draft Determination adequately explains the point the ATO seeks to make. This wording is retained in the final Determination.
4	The examples in the Ruling assume that Y Co's activities 'mainly comprise property development and management'. However, the explanation in the Appendix focuses more on 'property management'. It would be preferable for the Appendix to be aligned with the Ruling, so there is no confusion caused. Recommendation: Amend paragraph 16 as follows: <i>A common business structure in the Australian property sector is that of a stapled group (property stapled group). Generally, this business structure combines a listed property trust (LPT) with a property management and/or development company (PMC). The LPT owns a portfolio of properties while the PMC manages and/ or develops the properties. The shares in the PMC are stapled to the units in the LPT. While the securities are on issue they cannot be sold or otherwise dealt with separately. The stapled securities can be traded on the Australian Stock Exchange.</i>	Noted. For consistency with the examples, paragraph 16 of the Draft Taxation Determination has in the Final Taxation Determination been amended as follows: <i>16. A common business structure in the Australian property sector is that of a stapled group (property stapled group). Generally, this business structure combines a listed property trust (LPT) with a property management and development company (PMC). The LPT owns a portfolio of properties while the PMC manages and may also develop the properties. The shares in the PMC are stapled to the units in the LPT. While the securities are on issue they cannot be sold or otherwise dealt with separately. The stapled securities can be traded on the Australian Stock Exchange.</i>