

CR 2020/4 - IFM Australian infrastructure wholesale funds - capital reallocation



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Class Ruling

IFM Australian infrastructure wholesale funds – capital reallocation

Relying on this Ruling

This publication (excluding appendix) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

Further, if we think that this Ruling disadvantages you, we may apply the law in a way that is more favourable to you.

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What this Ruling is about

1. This Ruling sets out the tax consequences for unitholders of Industry Funds Management (IFM) Australian Infrastructure Wholesale Funds following the capital reallocation by IFM Fiduciary Pty Ltd (WUT A Trustee) as trustee for IFM Australian Infrastructure Wholesale Fund A (WUTA) and IFM Fiduciary No. 2 Pty Ltd (WUT B Trustee) as trustee of the IFM Australian Wholesale Fund B (WUT B) (each a Wholesale Fund and together the Wholesale Funds).
2. Full details of this capital reallocation are set out in paragraphs 14 to 45 of this Ruling.
3. All legislative references are to provisions of the *Income Tax Assessment Act 1997* unless otherwise indicated.

Who this Ruling applies to

4. This Ruling applies to you if you:
 - were registered on the Wholesale Funds' unit register on the record date for the return of capital
 - hold your units in the Wholesale Funds on capital account for income tax purposes, and

- are not subject to the taxation of financial arrangements rules in Division 230 in relation to the scheme outlined in paragraphs 14 to 45 of this Ruling.

Note: Division 230 will not apply to individuals, unless they have made an election for it to apply.

When this Ruling applies

5. This Ruling applies from 1 July 2019 to 30 June 2020.

Ruling

WUT A capital distribution amount

6. There will be no determined member component in respect of the WUT A capital distribution amount for the purposes of Subdivision 276-C.
7. The WUT A capital distribution amount will be an Attribution Managed Investment Trust (AMIT) cost base reduction amount for the purposes of section 104-107D.
8. In the event that the AMIT cost base net amount exceeds the cost base of a WUT A unit, CGT event E10 in section 104-107A will be triggered such that a capital gain equal to that excess will arise.
9. This capital gain will be disregarded pursuant to section 855-10 if you are a non-resident and the WUT A unit is not taxable Australian property.

Variation of WUT A's and WUT B's trust deeds

10. The variation of WUT A's and WUT B's trust deeds did not result in:
- CGT event A1 (subsection 104-10(1))
 - CGT event C2 (subsection 104-25(1))
 - CGT event E1 (section 104-55), or
 - CGT event E2 (section 104-60).
11. Further, the variation of WUT A's and WUT B's trust deeds did not result in CGT event D1 (subsection 104-35(1)) or CGT event H2 (subsection 104-155(1)) happening pursuant to subsection 102-25(1).

WUT B cost base and reduced cost base

12. The cost base and reduced cost base of your WUT B unit will increase by the amount of the WUT B contribution pursuant to subsection 110-25(5).

Value shifting

13. The capital reallocation will not result in either a direct value shift (Division 725) or an indirect value shift (Division 727).

Scheme

14. The following description of the scheme is based on information provided by the applicant. If the scheme is not carried out as described, this Ruling cannot be relied upon.

IFM Investors Pty Ltd

15. IFM Investors Pty Ltd (IFM Investors) is a global investment manager with more than \$140 billion under management across infrastructure, debt investments, listed equities and private equity assets as at 30 June 2019.

16. IFM Investors was established over 20 years ago and is owned by various superannuation funds.

17. IFM Investors was appointed by the respective trustees of each Wholesale Fund to provide various services to the Wholesale Funds.

Wholesale Funds

18. The Wholesale Funds were established in 2012 and invest in core infrastructure assets in the Australian market. The assets of the Wholesale Funds are primarily concentrated in New South Wales, Victoria and Queensland. The portfolio includes investments in subsectors such as airports, seaports, and electricity transmission and distribution.

19. The investors in the Wholesale Funds consist largely of institutional investors, including Australian superannuation funds.

20. As at April 2019, the Wholesale Funds had 36 investors. No single investor holds more than 30% of the issued units.

Fund structure

21. The Wholesale Funds are wholesale unit trusts.

22. WUT A is a managed investment trust (MIT) and a withholding MIT, and elected to be an AMIT from 1 July 2017.

23. WUT A is a flow-through trust for Australian tax purposes.

24. WUT B is a 'trading trust' but is not a 'public unit trust' and is therefore also a flow-through trust.

25. The income of WUT B is taxed under Division 6 of the *Income Tax Assessment Act 1936* (ITAA 1936).

26. The Wholesale Funds are governed by separate trust deeds, which contain similar provisions.

Stapled units

27. WUT A units and WUT B units are stapled in a ratio of 99 WUT A units to 1 WUT B unit (the Staple Ratio), to form stapled securities.

28. The effect of the stapling means that 99 WUT A units and 1 WUT B unit must be dealt with as a single investment unit, although each unit is a separate asset for tax purposes. This means that, if a unitholder wishes to redeem or transfer a WUT B unit, then

it will also be required to redeem or transfer the corresponding 99 WUT A units stapled to the WUT B unit.

Loan arrangements

29. A master loan facility has been entered into between the trustees of WUT A and WUT B, which facilitates the flow of funds between WUT A and WUT B (the Loan Facility Agreement).

30. Under the Loan Facility Agreement, either trustee can request a drawdown of funds from the other trustee to satisfy the financial obligations of the Wholesale Funds.

31. As at 30 June 2019, the aggregate balance of loans owing by WUT B to WUT A was approximately \$519 million.

The WUT A and WUT B trust deeds

32. The existing units in WUT A and WUT B are paid up.

Liability of unitholders

33. Clause 32 of each of the respective trust deeds of WUT A and WUT B (both dated 27 June 2012) provide that:

The liability of each Unitholder is limited to the amount paid, or the value of assets transferred to the Trustee, by way of application money for Units. Recourse of the Trustee and Fund creditors shall be limited to Trust Property.

Amendments

34. The procedure for amending the trust deeds is set out in clause 35 of each of the trust deeds, which provide that:

The Trustee may, by supplemental deed, make any amendment of, addition to, or deletion from the provisions of this deed provided that:

- (a) the amendment is not prohibited by Relevant Law; and
- (b) where, in the opinion of the Trustee, the rights of Unitholders may be adversely affected by any amendment, addition or deletion, the Trustee may only make the amendment, addition or deletion:
 - i. if Unitholders by Special Resolution consent to the amendment, addition or deletion; or
 - ii. Unitholders unanimously consent in writing to the amendment, addition or deletion.

35. Both the trust deeds were amended by inserting clauses which broadly:

- allowed the payment of a capital reallocation amount by WUT A to unitholders to be applied by direction as a contribution of capital to WUT B
- increased the liability of each unitholder in respect of each WUT B unit by the contribution amount, and
- permitted implementation of the proposed capital reallocation.

The capital reallocation

36. On 13 December 2019, the capital reallocation was implemented as follows:

- The WUT A Trustee directed the WUT A capital reduction to be made to each WUT A unitholder in the amount of approximately \$0.20 per unit. There were 3,805,427,239 WUT A units on issue on 13 September 2019. The aggregate capital reduction was \$730 million (WUT A capital reduction amount).
- The WUT A capital reduction amount was debited to the contributed equity of WUT A and did not include any part of the income of WUT A.
- When the WUT A capital reduction was distributed to WUT A unitholders, the amount of the WUT A capital reduction was paid at the direction of each unitholder as an additional capital contribution in respect of each WUT B unit (WUT B contribution) to offset the increased liability to contribute to the trust capital of WUT B.
- The WUT B contribution was approximately \$19 per unit. There were 38,438,659 WUT B units on issue on 13 September 2019. The aggregate capital contribution was the same as the WUT A capital reduction amount; that is, \$730 million (WUT B contribution amount).
- WUT B used the WUT B contribution amount to repay all of its loans owed to WUT A. The excess of the WUT B contribution amount over the aggregate balance of loans owed to WUT A (approximately \$211 million) was lent by WUT B to WUT A on arm's length terms.

37. To give effect to the capital reallocation, amendments to the trust deed of WUT A and WUT B was made. These amendments were approved by resolution of the unit holders of WUT A and WUT B on 28 November 2019.

Commercial rationale for undertaking the capital reallocation

38. The Loan Facility Agreement is used to enable money to flow between the Wholesale Funds to meet the financial obligations of each fund. Due to the Staple Ratio between the Wholesale Funds, WUT B has historically been allocated a smaller portion of total capital contributions into the Wholesale Funds relative to WUT A. As a result of the Staple Ratio and the value of investments made by WUT A and WUT B over time, WUT B has had to make substantial borrowings under the Loan Facility Agreement to fund its operational activities.

39. The borrowing by WUT B from the Loan Facility Agreement has increased its gearing level to approximately 70%, which may have impacted its future investment plans.

40. Further, the loan balances were depressing the value of WUT B as compared to WUT A, so additional capital raisings would not resolve the issue given the stapling ratio between the Wholesale Funds. Any capital raisings would see more capital being distributed to WUT A over WUT B.

41. The Wholesale Funds wished to reduce WUT B's gearing to a more appropriate level and to have the capital amounts better reflect the value of the underlying investments. In that regard, prior to the capital reallocation the relative net tangible asset value (NTA) of WUT A and WUT B excluding the impact of loans between WUT A and WUT B was approximately 87.5:12.5 as compared to a relative contributed equity amount of 99:1. It was considered that WUT A was capitalised in excess of its needs. The capital reallocation sought to address this imbalance.

42. The reason for undertaking the capital reallocation was to ensure that WUT B did not need to issue new units to raise additional trust capital and to avoid the complexity that would result from the need to de-staple, amend the Staple Ratio or undertake a unit consolidation, and re-staple.

Other relevant information

43. Prior to the capital reallocation WUT A comprised approximately 99.9% of the NTA of the stapled group. WUT B comprised approximately 0.1% of the NTA of the stapled group. As outlined in paragraphs 38 to 42, disregarding the impact of cross-staple loans, the NTA split was approximately 87.5 WUT A and 12.5 WUT B.

44. Following the capital reallocation, WUT A comprised approximately 85% and WUT B 15% of the NTA of the stapled group.

45. There is no expectation that WUT B will make a capital return in the short term following the capital reallocation (although consistent with past practice, small returns of capital might be paid if WUT B receives a return of capital from an investment and returns of capital might also be paid if WUT B disposes of an investment, although no disposals are currently expected in the short term).

Commissioner of Taxation

15 January 2020

Appendix – Explanation

ⓘ *This Explanation is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

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WUT A capital distribution amount

46. The WUT A capital distribution amount, consisting of \$730 million in total, was a return of capital debited to the contributed equity account of WUT A. The return of capital will not form a part of the AMIT's trust component for an income year as defined in subsection 276-260(2). No amount will be attributed to a unitholder in respect of the WUT A capital distribution. Accordingly, there will be no determined member component in respect of the WUT A capital distribution amount for the purposes of Subdivision 276-D.

47. The term 'AMIT cost base reduction amount' is defined in section 104-107D. Section 104-107D will be satisfied when the WUT A capital distribution amount is provided by the trustee of WUT A to the unitholders and the criteria for CGT event E10 are satisfied. The WUT A capital distribution amount will be an AMIT cost base reduction amount.

48. Where the AMIT cost base net amount of the income year exceeds the cost base or reduced cost base of the interest, the unitholder will make a capital gain equal to the excess pursuant to CGT event E10 in section 104-107A.

49. However, section 855-10 has the effect that a capital gain made by a unitholder from CGT event E10 is disregarded if the unitholder is a non-resident just before the CGT event and the WUT A unit is not taxable Australian property.

Variation of the WUT A and WUT B trust deeds

50. In Taxation Determination TD 2012/21 *Income tax: does CGT event E1 or E2 in sections 104-55 or 104-60 of the Income Tax Assessment Act 1997 happen if the terms of a trust are changed pursuant to a valid exercise of a power contained within the trust's constituent document, or varied with the approval of a relevant court?* the Commissioner states at paragraph 1 that in circumstances where the terms of a trust are changed pursuant to a valid exercise of a power contained within the trust's constituent document, CGT events E1 and E2 do not happen unless:

- the change causes the existing trust to terminate and a new trust to arise for trust law purposes, or
- the effect of the change is such as to lead to a particular asset being subject to a separate charter of rights and obligations such as to give rise to the conclusion that that asset has been settled on terms of a different trust.

51. The variation of the terms of WUT A and WUT B trust deeds were valid amendments to the trusts, which did not cause the existing trusts to terminate and new trusts to arise, nor lead to any asset being subject to a separate charter of rights and obligations. Accordingly, CGT event E1 and E2 did not happen on variation of the WUT A and WUT B trust deeds.

52. CGT event A1 happens if there is a change in the ownership of a CGT asset (section 104-10). The variation of the terms of the units of WUT A and WUT B to increase the liability of a unit holder to contribute trust capital did not cause any change in the units of both WUT A and WUT B, therefore CGT event A1 did not happen.

53. CGT event C2 happens if the units are redeemed or cancelled (section 104-25). The amendments of the WUT A and WUT B Trust Deed did not cause any units to end, therefore CGT event C2 did not happen.

54. If more than one CGT event could apply to your transaction or circumstances, the most relevant CGT event applies (subsection 102-25(1)). The most specific CGT event in this situation is CGT event E10 for the unit holders; therefore CGT event D1 and CGT event H2 will not apply.

WUT B cost base and reduced cost base

55. Subsection 110-25(5) provides:

The fourth element is capital expenditure you incurred:

- (a) the purpose or the expected effect of which is to increase or preserve the asset's value; or
- (b) that relates to installing or moving the asset.

The expenditure can include giving property: see section 103-5.

56. No new WUT B units were issued. WUT B credited the WUT B contribution amount to contributed equity in its accounts. In these circumstances, it is expected that the WUT B contribution amount increased the cost base and reduced cost base of each unit in WUT B.

Value shifting

57. Direct value shifting rules apply if, under a scheme, value is shifted from equity or loan interests in a company or trust to other equity or loan interests in the same company or trust (subsection 725-145(1)). A direct value shift may result from issuing new shares or trust units at a discount, buying back shares at less than market value or changing the voting rights attached to shares.

58. A direct value shift did not occur because neither WUT A nor WUT B issued additional units; therefore subsection 725-145(2) is not satisfied.

59. Further, the WUT A capital return which decreased the market value of the units in WUT A, did not also increase the market value of the units in WUT A, and the WUT B capital contribution which increased the market value of units in WUT B did not also decrease the market value of any other equity interests (that is, units) in WUT B. Therefore subsection 725-145(3) is not satisfied.

60. Indirect value shifting rules apply where there is an unequal exchange of economic benefits between two entities – the losing entity and gaining entity (subsection 727-150(3)).

61. WUT A and WUT B did not provide each other with any economic benefits. Rather, WUT A provided an economic benefit to unitholders, and unitholders provided an economic benefit to WUT B. Accordingly, subsection 727-150(3) is not satisfied.

62. Furthermore, WUT B using the WUT B contribution amount to repay its loan owing to WUT A, did not result in an indirect value shift. The value of WUT B will be unchanged because of the repayment as the market value of its assets and liabilities should be reduced by equal amounts.

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TD 2012/21

Legislative references:

- | | |
|------------------------|-------------------------------|
| - ITAA 1936 Div 6 | - ITAA 1997 110-25 |
| - ITAA 1997 102-25(1) | - ITAA 1997 110-25(5) |
| - ITAA 1997 103-5 | - ITAA 1997 Div 230 |
| - ITAA 1997 104-10 | - ITAA 1997 Subdivision 276-C |
| - ITAA 1997 104-10 (1) | - ITAA 1997 Subdivision 276-D |
| - ITAA 1997 104-25 (1) | - ITAA 1997 276-260(2) |
| - ITAA 1997 104-55 | - ITAA 1997 Div 725 |
| - ITAA 1997 104-60 | - ITAA 1997 725-145(1) |
| - ITAA 1997 104-107A | - ITAA 1997 725-145(2) |
| - ITAA 1997 104-107D | - ITAA 1997 725-145(3) |
| | - ITAA 1997 Div 727 |
| | - ITAA 1997 727-150(3) |
| | - ITAA 1997 Div 855 |
| | - ITAA 1997 855-10 |
| | - TAA 1953 |

ATO references

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