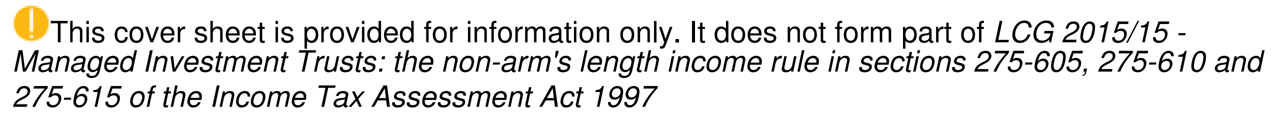
LCG 2015/15 - Managed Investment Trusts: the non-arm's length income rule in sections 275-605, 275-610 and 275-615 of the Income Tax Assessment Act 1997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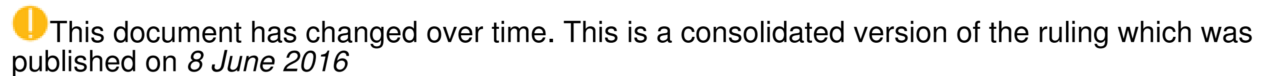
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Managed Investment Trusts: the non-arm's length income rule in sections 275-605, 275-610 and 275-615 of the *Income Tax Assessment Act 1997*

Relying on this Guideline

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

This Guideline describes how the Commissioner will apply the law as amended by the *Tax Laws Amendment (New Tax System for Managed Investment Trusts) Act 2016*.

If you rely on this Guideline in good faith, you will not have to pay any underpaid tax, penalties or interest in respect of matters it covers if it does not correctly state how a relevant provision applies to you.

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What this Guideline is about

1. The non-arm's length income rule (NALIR) relevant to managed investment trusts (MITs) is contained in sections 275-605, 275-610 and 275-615 of the *Income Tax Assessment Act 1997* (ITAA 1997)[1] Together, these sections set out the circumstances in which the Commissioner may make a determination that a MIT has an amount of non-arm's length income for an income year, and the effect of such a determination.

2. The NALIR applies to all MITs[2] including attribution managed investment trusts (AMITs[3]).

Disregarded transactions

3. Transactions between a MIT and another MIT are disregarded because MITs are subject to both the Eligible Investment Business rules[4] and the NALIR. Also, distributions from a corporate tax entity to a MIT are disregarded because they would already have been subject to taxation at the corporate rate.[5]

Date of effect

4. This Guideline is a public ruling, effective for those who rely on it in good faith in respect of assessments for income years starting on or after:

- 1 July 2016, or
- if the trustee has made an irrevocable choice to apply the new tax system for its 2015-16 income year which starts on or after 1 July 2015 – 1 July 2015.

[1] All legislative references in this Guideline are to the ITAA 1997 unless otherwise indicated.
[2] As defined in section 275-10.
[3] An AMIT is a managed investment trust that has elected in to the attribution regime for the taxation of MITs contained in Division 276.
[4] Contained in Division 6C of Part III of the *Income Tax Assessment Act 1936* (ITAA 1936).
[5] See paragraphs 275-615(1)(c) and subparagraph 275-610(1)(c)(i).

5. However, it will not apply to non-arm's length income derived before the start of the 2018-19 income year from a scheme that the MIT became a party to prior to 3 December 2015.[5A]

Background

6. As the Explanatory Memorandum to the Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015 explains, the NALIR stemmed from a Board of Taxation recommendation aimed at preventing arrangements intended to circumvent the Eligible Investment Business rules[6] through non-arm's length dealings between a MIT and a trading entity. The concern was that the income of the trading business, which should generally have been taxed at the 30% corporate rate, would instead be subject to lower taxation in the hands of MIT investors (for example, 15% for fund payments made to non-resident investors in Exchange of Information countries). The NALIR was intended to remove the incentive for trading entities to shift profits to MITs through non-arm's length activity with active businesses (particularly related parties), by subjecting the non-arm's length income of the MIT to taxation at the corporate tax rate.

Commissioner's determination

7. For the NALIR to apply, the Commissioner must have made a written determination under section 275-615 (described in this Guideline as a 'NALI determination').

8. Under subsections 275-605(1) and (2), the trustee of a MIT is liable to pay income tax at the rate of 30% on the amount worked out under subsection 275-605(5) if the Commissioner makes a NALI determination that specifies an amount of non-arm's length income for the MIT for an income year.

9. The Commissioner may make a NALI determination when satisfied that[7]:

- an amount of 'non-arm's length income' for the MIT is included in:
  - one or more trust components for the income year (for AMITs), or
  - its net income for the income year (for other MITs)
- the MIT is a 'party to the scheme' in respect of which the parties were not dealing with each other at arm's length, and
- a party to the scheme is not a MIT.

10. If a taxpayer affected by a determination is dissatisfied, they can object to it under the rules in Part IVC to the *Taxation Administration Act 1953* (TAA 1953).[8]

Non-arm's length income

11. 'Non-arm's length income' is defined in section 295-550 (non-arm's length income of a superannuation fund), and section 275-610.

12. For a MIT, subsection 275-610(1) specifies that an amount of ordinary or statutory income is non-arm's length income of a MIT in relation to an income year if:

- it is derived from a 'scheme' and the parties to the scheme were not dealing with each other at 'arm's length' in relation to it (paragraph (1)(a)), and
- the amount exceeds the amount that the entity might have been expected to derive if the parties had been dealing with each other at arm's length in relation to the scheme (paragraph (1)(b)), and

[5A] The date the Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015 was introduced into the House of Representatives: section 275-605 *Income Tax (Transitional Provisions) Act 1997.*
[6] Contained in Division 6C of Part III of the ITAA 1936.
[7] Subsection 275-615(1).
[8] Subsection 275-615(5).

- the amount is not:
  - a distribution from a corporate tax entity
  - a distribution from a trust that is not a party to the scheme, nor
  - a return on a debt interest covered by the safe-harbour in subsection 275-610(2) (paragraph (1)(c)).

Distributions from subsidiary trusts

13. If a MIT receives income by distribution from a subsidiary trust that is a party to the scheme, it is considered non-arm's length income of the MIT only if it would have been non-arm's length income of the subsidiary trust, if it had itself been a MIT.[9] This rule means, for example, that increased distributions of income to the MIT resulting from lower deductible expenses at the subsidiary trust level are not treated as non-arm's length income of the MIT receiving the distribution.

14. If a MIT receives a distribution (or share of net income) from a subsidiary trust which is more than would be expected from an arm's length dealing (the non-arm's length distribution) and also a distribution (or share of net income) from another trust that is less than it would have been but for the non-arm's length distribution (the second distribution), then what would otherwise be the amount of non-arm's length income is reduced.[10] The reduction will occur to the extent it is reasonable to conclude that the second distribution would have been higher but for the non-arm's length distribution. This ensures that transactions between a MIT and subsidiary trusts, which result in no net overall non-arm's length income, are not subject to the NALIR.

Not dealing at arm's length

15. The phrase 'non-arm's length' refers both to the relationship between the parties to a scheme, and the amount of income that the MIT derives from the scheme.

16. In determining whether parties are dealing at 'arm's length', any connection between the parties and any other relevant circumstances need to be considered.[10A]

17. The phrase 'not dealing at arm's length' is not defined for section 275-610, but its meaning has been considered in the context of section 295-550. Section 295-550 sets out the circumstances when an amount of ordinary or statutory income of a complying superannuation fund, approved deposit fund or pooled superannuation trust is non-arm's length income of that fund.

18. TR 2006/7[10B] sets out, among other things, when the Commissioner considers that parties are not dealing with each other at arm's length for former section 273 of the ITAA 1936 (the precursor to section 295-550).[11] Consistent with our approach to section 295-550, the Commissioner will be guided by the following principles in relation to the NALIR:

- Parties are dealing with each other at arm's length in relation to a transaction if the independent minds and wills of the parties are applied to the transaction and their dealing is a matter of real bargaining. Conversely, if this is not the case, the parties are not dealing with each other at arm's length in relation to the transaction.

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[9] Subsections 275-610(3) and (4).
[10] Subsections 275-610(5) and (6).
[10A] Section 995-1.
[10B] Taxation Ruling TR 2006/7 *Income tax: special income derived by a complying superannuation fund, a complying approved deposit fund or a pooled superannuation trust in relation to the year of income*
[11] Section 273 referred to 'special income' rather than 'non-arm's length income' but this is largely just a difference in terminology.

- If the relationship of the parties is such that one party has the ability to influence or control the other, this will suggest that the parties may not be dealing at arm's length, but it will not be determinative of this conclusion.
- Parties that are not at arm's length can deal with each other at arm's length in relation to a transaction and parties that are at arm's length can deal with each other in a way that is not at arm's length.

19. The decision of Dowsett J in *Federal Commissioner of Taxation v. AXA Asia Pacific Holdings Ltd*[12] also provides a useful summary of the relevant principles:

- in determining whether parties have dealt with each other at arm's length in a particular transaction, one may have regard to the relationship between them
- one must also examine the circumstances of the transaction and the context in which it occurred
- one should do so with a view to determining whether or not the parties have conducted the transaction in a way which one would expect of parties dealing at arm's length in such a transaction
- relevant factors which may emerge include existing mutual duties, liabilities, obligations, cross-ownership of assets, or identity of interests which might enable either party to influence or control the other, or induce either party to serve a common interest and so modify the terms on which strangers would deal
- where the parties are not in an arm's length relationship, one may infer that they did not deal with each other at arm's length, and that the resultant transaction is not at arm's length
- however related parties may, in some circumstances, so conduct a dealing as to displace any inference based on the relationship, and
- unrelated parties may, on occasions, deal with each other in such a way that the resultant transaction may not properly be considered to be at arm's length.

20. In that case Edmonds and Gordon JJ, further stated that[13]:

> Any assessment of whether parties were dealing at arm's length involves 'an assessment [of] whether in respect of that dealing they dealt with each other as arm's length parties would normally do, so that the outcome of their dealing is a matter of real bargaining'...

The amount that the entity might have been expected to derive if those parties had been dealing with each other at arm's length in relation to the scheme

21. For a MIT to have non-arm's length income paragraph 275-610(1)(b) requires that the amount of the ordinary or statutory income that is derived be more than the amount that the entity might have been expected to derive if the parties had been dealing with each other at arm's length under the 'scheme'.

22. The Full Federal Court in *Allen & Anor v. Federal Commissioner of Taxation* observed that this test requires a comparison between a hypothetical arm's length dealing, and what actually occurred.[14] The Court also explained that the 'hypothetical situation' the 'actual dealing' is to be compared with is that which 'might have been expected to apply if the parties to the arrangement had been dealing at arm's length'.

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[12] (2010) 189 FCR 204; [2010] FCAFC 134; 2010 ATC 20-224; (2010) 81 ATR 180 at [26].
[13] At [105].
[14] (2011) 195 FCR 416; [2011] FCAFC 118; 2011 ATC 20-277. Note that this observation related to former paragraph 273(7)(b) of the ITAA 1936 – the predecessor of paragraph 295-550(5)(b).

23. However, in the case of paragraph 275-610(1)(b), additional textual considerations are relevant to interpreting the paragraph. In particular, on the plain words of the provision it is clear that what is contemplated is a comparison between the results of the scheme referred to in paragraph 275-610(1)(a) and what would have happened if the parties had been dealing with each other at arm's length in relation to that *same*[14A] scheme.

24. Accordingly, in applying paragraph 275-610(1)(b), the specific terms of the arrangement and circumstances of parties must be taken into account in making the comparison required by the provision. For example, matters such as relevant guarantees in place, the level of capitalisation of the relevant entities, the nature of the assets held by each, the size of borrowings, and other features will be relevant in this context.

Example 1

25. *Trust A (a MIT) and Company B are head entities of a stapled group. Company C, an entity owned jointly by Trust A and Company B, is the financing entity for the stapled group. All entities in the stapled group have entered into a facility agreement with Company C. Under the facility, each member of the stapled group must provide guarantees to, or for the benefit of, creditors of Company C. Trust A sells an asset and loans the proceeds to Company C under the facility agreement.*

26. *In considering the application of the NALIR to the returns on the loan from Trust A to Company C, the terms of the facility agreement are taken into account, including any security that is provided by entities within the stapled group.*

27. The evidence of what might reasonably have been expected if dealings had been truly independent could include:

- the prices charged in comparable transactions in comparable circumstances between parties dealing with each other on an arm's length basis
  - (a) by the taxpayer with independent parties, and/or
  - (b) between independent parties, or
- whether the context and conduct of bargaining between the relevant parties is consistent with the conduct and consideration that would be arrived at by arm's length parties.

28. Industry practice between third parties, indices or benchmark asset returns may be a useful starting point. However, consistent with the practice employed in international transfer pricing, where 'uncontrolled' transactions[14B] are used as the basis for setting or reviewing whether income received by a MIT is arm's length under section 275-610, adjustments may be required to ensure that these measures are appropriately comparable with the specific facts and circumstances of each case.

29. Further, while evidence of real bargaining and conduct between the parties may support a conclusion of arm's length arrangements between the MIT and its related parties, these things may not be determinative. Additional analysis of what arm's length parties would do may be required to support the approach taken.

[14A] Without ruling out the possibility that the income of the MIT might, under the hypothetical situation, have been less.

[14B] Consistent with TR 97/20 Income tax: arm's length transfer pricing methodologies for international dealings, 'uncontrolled transactions' are transactions or arrangements between independent enterprises that are dealing wholly independently with each other.

Unrelated parties

30. Arm's length parties may deal in a way that may be considered to be not at arm's length, if the circumstances and the outcome are not considered to be a matter of real bargaining.

31. In determining whether unrelated parties are dealing with each other at arm's length, the relevant scheme is the entire arrangement between the parties. If the dealings between unrelated parties comprise a number of elements or transactions, and the pricing of one element takes the pricing of a different element into account, it is appropriate to consider this when we are determining whether the parties were dealing with each other at arm's length.[14C]

'Scheme' and 'party to the scheme'

32. Subsection 275-610(1) requires that the non-arm's length income be derived from a 'scheme', the parties to which were not dealing with each other at arm's length. The definition of 'scheme' in section 995-1 is broad enough to encompass any arrangement that results in an amount of ordinary or statutory income of the MIT being more than it would have been, had the parties been dealing at arm's length.

33. However, to make a NALI determination, the Commissioner must be satisfied that:

- an amount of non-arm's length income is reflected in the MITs 'trust component' or 'net income', and
- the MIT is a 'party' to the relevant scheme from which that non-arm's income was derived.

34. For the NALIR to apply, therefore, there must be some involvement, knowledge, understanding or acquiescence by the MIT in the arrangement that resulted in the non-arm's length income of the trust that was ultimately derived by the MIT.

Effect of a determination under section 275-615

35. Under subsection 275-605(2), where the Commissioner has made a NALI determination, the trustee of the MIT is liable to pay income tax at the rate declared by the Parliament (30%)[14D] on the amount calculated under subsection 275-605(5).

36. The amount calculated under subsection (5) is essentially the amount of non-arm's length income included in the trust component or net income of the MIT that exceeds what would have been derived had the parties been dealing at arm's length, reduced by deductions that are attributable only to the amount of that excess income.

Attributable only to non-arm's length income

37. A deduction is attributable only to the amount of the non-arm's length income if the only reason for the deductible expense being incurred was to derive the non-arm's length income.

Interaction with Division 6C

38. If the NALIR applies, the non-arm's length amount of income is subject to taxation at the corporate rate.[14E] A determination under section 275-615 does not of itself result in the MIT being taken to have carried on a trading business for the purposes of section 102M of the ITAA 1936.

[14C] In similar circumstances, this may also be an appropriate consideration in respect of dealings between non-arm's length parties.
[14D] Subsection 12(10) *Income Tax Rates Act 1986.*
[14E] Subsection 12(10) *Income Tax Rates Act 1986.*

39. However, the circumstances which cause the NALIR to apply to the MIT might also be relevant to determining that the trust is not carrying on eligible investment business.

Finance arrangements and NALIR

NALIR does not apply to the quantum of a debt

40. The NALIR is concerned with the non-arm's length ordinary or statutory income of a MIT reflected in the MIT's 'trust component' or 'net income'. It follows that, to the extent that it applies to a debt interest of the MIT, the NALIR looks at the amount of return derived by the MIT, and not the quantum of the debt. However, the quantum of the debt may influence an analysis of whether the interest returns were arm's length returns.

Back to back loans

41. If a MIT borrows funds from an independent third party and on-lends to a related party at the same interest rate, the interest paid from the related party to the MIT would usually be considered arm's length income for the purpose of the NALIR. It would also be expected that in most cases, directly relevant interest deductions would offset the amount of interest such that there is no excess income for the rule to apply to.

Example 2

42. *Trust X (a MIT) and Company Y are head entities of a stapled group. Trust A borrows $50 million from an external bank at an interest rate of BBSW plus a basis points margin. Trust A on-lends the $50 million to Company B, with an interest rate of BBSW plus the same basis point margin.*

43. *Trust A receives no excess income from the return on the loan from Trust A to Company B. The interest income derived by Trust A is reduced by the directly related interest payments to the external bank.*

Loans at weighted average cost of debt

44. Usually, where a MIT group finance entity borrows from third party lenders, lends to entities within the stapled group at the weighted average cost of external debt (on a stand-alone or whole of group basis), and any intragroup lending back to the finance entity is also at this rate, the amount of interest received on such loans would be considered arm's length income. This is because overall, the interest received will equate to the external borrowing cost. In determining the weighted average cost of external debt, related costs and gains attributable to currency and/or interest rates may be taken into account. Differences between the terms of the internal loans and the terms of the external loans will not usually affect this outcome.

Interaction with transfer pricing

45. The objective of the NALIR is to remove the incentive for MITs to shift profits from the active businesses of a related party, through non-arm's length activity. This is a different objective from the transfer pricing provisions in Subdivision 815-B. Consistent with the different objectives, it is not intended that a MIT must satisfy the transfer pricing requirements to be dealing at arm's length for the purpose of the NALIR. However, if the MIT can demonstrate that a transfer pricing benefit does not arise under the transfer pricing provisions, this is generally sufficient to establish arm's length dealing for the purpose of the NALIR.

Where no comparable exists

46. Difficulties in establishing that the income derived by a MIT is a result of arm's length dealing may arise where there are no equivalent transactions or benchmarks that can be used for the purposes of the hypothetical arm's length comparison, or that data cannot be readily adjusted for comparability purposes. These difficulties are particularly acute, for example, in transactions involving unique assets, or highly integrated arrangements, such as infrastructure staples.

47. In these situations, for the purposes of the NALIR, you can rely on an accepted arm's length pricing methodology, such as those used in transfer pricing. The Organisation for Economic Co-Operation and Development's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines) have been developed to assist tax administrations and multinational enterprises deal with cross-border transfer pricing. These continue to provide relevant guidance, adapted as appropriate for Subdivision 275-L.

48. The OECD Guidelines recognise a number of methods for arm's length pricing in addition to the 'comparable uncontrolled pricing' method. These include the resale price method and the cost plus method, as well as profit based methodologies such as the Transactional Net Margin Method (TNMM) and profit-split methods. Application of a method or combination of methods will depend on the facts and circumstances of the case.

49. Critical to the application of any method will be its ability to identify, directly or indirectly, prices and/or profit outcomes under the scheme that are consistent with an arm's length result, having regard to all the facts and circumstances of the arrangement. The relevant consideration for a determination under the NALIR should extend not only to analysis of a comparison price (by reference to other arm's length pricing methods) but also be able to be reconciled to commercially realistic outcomes for the parties involved, having regard to their facts and circumstances. These outcomes should reflect those expected from real bargaining between the parties and conduct of independent parties engaged in a similar transaction seeking to protect and optimise their own economic interest.

50. A fundamental part of any transfer pricing analysis is an analysis of the facts and circumstances of the entire arrangement and the real value chain of the business. Relevant factors of comparability that direct an analysis of the entire arrangement are set out in the OECD Guidelines.

Application of NALIR to a lease

50A. In order to determine an arm's length rental return, taxpayers should adopt OECD recognised transfer pricing methods. For example, rents or yields on comparable commercial real estate, say, in terms of $/m2 or as a per annum percentage of the market value of the property (adjusted as appropriate), may provide market evidence of the arm's length pricing adopted between independent enterprises. Taxpayers can also evaluate the reasonableness of a rental by examining whether a particular rental amount leaves a commercially realistic profit outcome for each of the parties in all their circumstances over the life of the lease, while recognising that many factors unrelated to the rental may affect profits in individual years.

50B. The selection of a transfer pricing method always aims at finding the most appropriate method for a particular case. Each OECD method has its own strengths and weaknesses, information requirements and relevant comparables which need to be considered, and no one method is suitable in every situation.

50C. Taxpayers could also apply methods not described by the OECD ('other methods'), unless the OECD methods are more appropriate to the facts and circumstances of the case. For instance, taxpayers may consider applying finance theory or other techniques to estimate an appropriate arm's length rental rate.

Integrated business arrangements

51. The way in which a particular OECD methodology applies to an arrangement can depend on whether the arrangement is a joint or integrated business or whether the company (or trading entity) is simply providing services to another entity. In the analysis of a joint or integrated business, the Commissioner looks beyond the contract between the MIT and the company (or other trading entity) to consider all the facts and circumstances of the arrangement.

52. Indicators of a joint or integrated business could include, among other things, that they:

- are regulated as a single business
- have stapled securities: these indicate that an independent trust and independent company have agreed to operate the business together (that is, both sides are unlikely to agree to stapling their securities if the entities can be operated separately)
- have central management of the overall business
- have the same shareholders
- were purchased together, with contracts for sale/lease executed together
- have integrated value (for example, where the company (or other trading entity) has bought into the joint or integrated business as a whole or its financials recognise goodwill of the business)
- have assets that, in practice, operate together in a highly integrated manner
- are financed based on joint or integrated business revenues, covenants, guarantees or implicit support
- raise and use financing together, and
- are recognised by key suppliers or customers as joint business, for example, key customers are concerned with the reliability of trust assets.

52A. On the other hand, there may be instances where the company and the MIT are not operated jointly, for example, the company is a service provider to the MIT, as indicated by:

- separate management and financing
- assets of the company are limited to the assets it requires to provide the services it supplies, that is, they don't include goodwill of the entire business of both entities, but can include goodwill attributable to the limited activities of the company
- funding levels of the company are consistent with the capital structure and asset base of an independent service provider, and
- responsibilities for the upkeep/maintenance of assets are allocated to the owners of the assets – for example, a motel owner has to maintain the motel's property, plant and equipment to a certain standard, but the motel is operated (bookings, cleaning, marketing et al) by a third party who simply pays rent to the landlord.

53. Where there is a joint or integrated business, the Commissioner considers it inappropriate for the company to be treated as a standard service provider in determining an arm's length reward. Instead, it would be expected to receive a share of the overall business profits consistent with each entity's contribution. Where the joint or integrated business has been purchased, the determination of any allocation of purchase price between the entities should be supported by an appropriate valuation that takes into account the functions, assets (especially goodwill) and risks of each entity, including any unique and valuable contributions made by each entity. Any relevant 'regulatory asset base', as determined by a relevant Australian regulator, should also be considered in the valuation.

53A. One example of the application of a profit split approach that the Commissioner accepts is consistent with the OECD guidelines is set out below.

Example 3: Privatisation into a stapled structure – arm's length rental payments

54. *A Government-owned entity runs a business that the Government privatises for $1 billion. The Government privatises it as a single integrated business. The substance of the agreements between the Government and the entities reflect this reality.*

55. *The Government entity decides to dispose of the business by way of a 99-year lease. Specifically, this involves the following steps:*

- *The Government entity grants a 99-year lease over the land assets to a trust (the Land Trust) that is a MIT, and receives a lease premium in consideration.*
- *The lease premium is $700 million, and is financed by a combination of debt and equity.*
- *The Land Trust then sub-leases the land to a company (the Operating Company) on typical lease terms.*

56. *Additionally, the Government entity sells the goods and other chattels, as well as customer contracts, licenses and other intangibles to the Operating Company.*

57. *The amount paid by the Operating Company is $300 million, and is financed by a combination of debt and equity on mirror terms to the finance provided to the Land Trust.*

58. *The allocation of the total amount paid to the Government of $1 billion between the Land Trust and the Operating Company was supported with a valuation that is considered appropriate on review.*

59. *Both the Land Trust and the Operating Company have the same underlying owners, and there is, therefore, a potential that the sub-lease is not an arm's length dealing between them.*

60. *Nonetheless, the income that the Land Trust earns from the sub-lease is not considered non-arm's length income if the pricing of the lease results in the combined net present value of the Land Trust and the Operating Company being allocated between the parties in the same proportions as their relative contributions to the $1 billion purchase price (that is, 70/30).*

61. *This is on the basis that the activities of the Land Trust and the Operating Company constitute an integrated business. This profit-split approach is consistent with the OECD Guidelines.*

61A. The Commissioner may also accept using alternative profit split percentages which are consistent with the OECD guidelines and which look to the functions, assets and risks of the respective entities, provided the methodology makes appropriate adjustments for all relative factors including the relative negotiating power of the parties.

Non-integrated business arrangements

61B. As indicated above, there may be circumstances where the company is in effect merely a service provider to the MIT. In such circumstances, it would be appropriate to apply a methodology other than a profit split. The most appropriate methodology to use in these circumstances will depend on the particular facts of the arrangement.

Example 4

61C. *A property fund comprises a geographic and commercially diverse portfolio of accommodation encompassing short stay and medium term rentals across recreational, permanent residential and corporate customers.*

61D. *The properties are held by Asset MIT, which purchases and finances those assets. Asset MIT is stapled to Operating Entity. Asset MIT leases the assets to Operating Entity. Operating Entity's responsibilities are limited to the day to day management of the properties, including maintenance of the properties, customer checking and negotiation where warranted, pricing, bookings and collections.*

61E. *Under this scenario, Operating Entity may be viewed as providing routine property management services rather than viewing the activities as part of a joint or integrated business. In this instance, rental could be set so as to reward Operating Entity with a return equal to its fully absorbed costs and an arm's length profit. Asset MIT would receive rental income reflecting an arm's length cross-staple lease charge.*

Minimum documentation requirements

62. MIT trustees should keep documents to demonstrate that their dealings are at arm's length to comply with the record keeping requirements under the Act.[15] We intend to limit requirements to the minimum necessary to ensure compliance with the principles set out in this Guideline.

63. We will seek to rely as much as possible on the documentation created in the ordinary course of the MIT's business. We consider that such documentation would include:

- details of the relevant facts and circumstances of the transactions
- details of any agreements that set out the responsibilities of the parties
- any relevant comparable transaction data, and the basis for it being considered comparable
- consideration of why a particular methodology was adopted in preference to others, and
- financial and economic analysis that supports the application of the method including any assumptions applied and cross-checks or commercial assessments.

Penalties

64. The trustee of the MIT may also be liable to an administrative penalty if the Commissioner has issued a NALI determination to the trustee.[16] The amount of the penalty will be 50% of the scheme shortfall amount or 25% of the scheme shortfall amount, if it is reasonably arguable that the adjustment does not apply.[17] The scheme shortfall amount is the total additional amount of tax that the trustee is liable to pay in accordance with Subdivision 275-L.

65. Such penalties may be reduced under section 284-224 of Schedule 1 to the TAA 1953 if the law was applied in a way that agreed with advice given by the Commissioner, general administrative practice under the law, or a statement in writing approved by the Commissioner.

Commissioner of Taxation
5 May 2016

[15] Including sections 262A(1) of the ITAA 1936 and 121-20.
[16] Section 284-145(2C) of Schedule 1 to the TAA 1953.
[17] Sections 284-155 and 284-160 of Schedule 1 to the TAA 1953.

References

ATOlaw topic(s)	Income tax ~~ Trusts ~~ Other
Legislative references	ITAA 1997 ITAA 1997 121-20 ITAA 1997 Subdiv 275–L ITAA 1997 275–10 ITAA 1997 275–605 ITAA 1997 275–605(1) ITAA 1997 275–605(2) ITAA 1997 275–605(5) ITAA 1997 275–610 ITAA 1997 275–610(1) ITAA 1997 275–610(1)(a) ITAA 1997 275–610(1)(b) ITAA 1997 275–610(1)(c) ITAA 1997 275–610(1)(c)(i) ITAA 1997 275–610(2) ITAA 1997 275–610(3) ITAA 1997 275–610(4) ITAA 1997 275–610(5) ITAA 1997 275–610(6) ITAA 1997 275–615 ITAA 1997 275–615(1) ITAA 1997 275–615(1)(c) ITAA 1997 275–615(5) ITAA 1997 Div 276 ITAA 1997 295–550 ITAA 1997 295-550(5)(b) ITAA 1997 Subdiv 815-B ITAA 1997 995–1 ITAA 1936 ITAA 1936 Pt III Div 6C ITAA 1936 102M ITAA 1936 262A(1) ITAA 1936 273 ITAA 1936 273(4) ITAA 1936 273(7)(b) TAA 1953 TAA 1953 Pt IVC TAA 1953 Sch 1 284–145(2C) TAA 1953 Sch 1 284-155 TAA 1953 Sch 1 284-160 TAA 1953 Sch 1 284–224 Tax Laws Amendment (New Tax System for Managed Investment Trusts) Act 2016
Case references	*Federal Commissioner of Taxation v. AXA Asia Pacific Holdings Ltd* (2010) 189 FCR 204; [2010] FCAFC 134; 2010 ATC 20-224; (2010) 81 ATR 180 *Allen & Anor v. Federal Commissioner of Taxation* (2011) 195 FCR 416; [2011] FCAFC 118; 2011 ATC 20-277

Related Rulings/Determinations	Taxation Ruling TR 2006/7 *Income tax: special income derived by a complying superannuation fund, a complying approved deposit fund or a pooled superannuation trust in relation to the year of income*
Other references	Explanatory Memorandum to the Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015 OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations