LCG 2015/15A1 - Addendum - 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

Addendum

Draft Law Companion Guideline

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*

This Addendum amends Draft Law Companion Guideline LCG 2015/D15 to finalise it following the *Tax Laws Amendment (New Tax System for Managed Investment Trusts) Act 2016* receiving royal assent on 5 May 2016.

LCG 2015/D15 is amended as follows:

1. Page status (all pages)

At the top of all pages; insert:

Page status: **legally binding**

2. First page header and all footers

Omit 'Draft Law Companion Guideline LCG 2015/D15'; substitute 'Law Companion Guideline LCG 2015/15'.

3. Preamble

Omit the preamble; substitute:

Relying on this Guideline

This Guideline describes how the Commissioner applies 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.

4. Table of contents

Omit:

Insert:

5. Paragraph 1

(a) Omit all occurrences of 'draft' from the paragraph (including heading).

(b) After '*Income Tax Assessment Act 1999'*; insert '(ITAA 1997).

(c) Omit footnote 1; substitute:

[1] All legislative references in this Guideline are to the ITAA 1997, unless otherwise indicated.

6. Footnote 5

Omit subparagraph; substitute sub-paragraph

7. Paragraph 4

Omit the first sentence (excluding the dot points); substitute:

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:

8. Paragraph 5

Omit 'the Bill being introduced into Parliament'; substitute '3 December 2015[5A]

[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.'*

9. Paragraph 6

(a) In the first sentence, omit 'the Bill'; substitute 'the Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015'.

(b) Omit the third sentence; substitute '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.'

10. Paragraph 7

Omit 'draft'.

11. Footnote 7

Omit '276-615(1)'; substitute '275-615(1)'.

12. Paragraph 9

Omit the second dot point; substitute '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'.

13. Paragraph 14

Omit 'Under the definition of'; substitute 'then what would otherwise be the amount of non-arm's length income'.

14. Paragraph 16

Omit the paragraph; substitute '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]'.

[10A] Section 995-1.

15. Paragraph 18

(a) Omit the first sentence (excluding footnote 11); substitute '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).

[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*

(b) Omit the last sentence of the third dot point.

16. Footnote 12

Omit '2009 ATC 20-151'; substitute '2010 ATC 20-224; (2010) 81 ATR 180'

17. Paragraph 21

Omit 'Paragraph'; substitute 'For a MIT to have non-arm's length income, paragraph'

18. Paragraph 23

After *same*, insert [14A].

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

19. Paragraph 28

After 'uncontrolled' transactions, insert [14B].

[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.

20. Paragraph 31

After the last sentence, insert [14C].

[14C] In similar circumstances, this may also be an appropriate consideration in respect of dealings between non-arm's length parties.

21. Paragraph 34

Omit 'the circumstances of'.

22. Paragraph 35

After (30%), insert [14D].

[14D] Subsection 12(10) *Income Tax Rates Act 1986.*

23. Paragraph 38

After the first sentence, insert [14E].

[14E] Subsection 12(10) *Income Tax Rates Act 1986.*

24. Paragraph 50

After the paragraph, insert:

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.

25. Paragraph 51

(a) In the heading, omit 'Unified'; substitute 'Integrated'.

(b) Omit the paragraph; substitute '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.'

26. Paragraph 52

(a) In the first sentence, after 'joint'; insert 'or integrated'.

(b) After the fifth dot point, insert

- 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)

(c) In the third last doing point, after 'joint'; insert 'or integrated'.

(d) After the paragraph, insert

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.

27. Paragraph 53

Omit the paragraph; substitute

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.

28. Paragraph 54

Omit the paragraph; substitute '*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.*'

29. Paragraph 55

In the first dot point, after (the Land Trust), insert 'that is a MIT,'.

30. Paragraph 56

Omit ‘a company (the Operating Company)’; substitute ‘the Operating Company’.

31. Paragraph 61

Omit the paragraph; substitute

> 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.*

32. Paragraph 62

Omit ‘draft’.

33. Footnote 16

Omit ‘in’; substitute ‘of’.

34. Footnote 17

After ‘of’; insert ‘Schedule 1 to’.

35. Paragraph 65

After ‘284-224 of’; insert ‘Schedule 1 to’.

After the paragraph, insert:

Commissioner of Taxation
5 May 2016

36. Paragraph 66

Omit the paragraph, including heading.

37. Legislative references

Omit

ITAA 1997 275–610(1)(c)(i)

ITAA 1997 276–615(1)

ITAA 1997 276–615(5)

Insert:

ITAA 1997 275–615(1)
Tax Laws Amendment (New Tax System for Managed Investment Trusts) Act 2016

38. Other references

(a) Before the table row, insert:

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*

(b) Omit ‘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’.*

39. ATO references

Omit the references.

This Addendum applies on and from 5 May 2016.

Commissioner of Taxation
5 May 2016

ATO references	
ATOlaw topic(s)	Income tax ~~ Trusts ~~ Other