LCR 2020/2 - Non-concessional MIT income

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Non-concessional MIT income

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This publication 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 in good faith, 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 addresses Schedules 1 and 5 to the *Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Act 2019* (the Act). The Schedules to this Act amend various provisions of other Acts[1] to improve the integrity of the income tax law for arrangements involving stapled structures, and to limit tax concessions for foreign investors in a managed investment trust (MIT). The amendments increase the MIT withholding rate on fund payments, to the extent they are attributable to non-concessional MIT income (NCMI), to 30%.

2. This Ruling covers the key aspects of NCMI, with particular focus on MIT cross staple arrangement income. It covers:

- determining when an amount derived, received or made by a MIT is attributable to NCMI
- the meaning of 'cross staple arrangement' for the purposes of determining MIT cross staple arrangement income
- the scope and application of exceptions to MIT cross staple arrangement income
- the interpretation of the terms 'facility' and 'economic infrastructure facility'
- integrity rules, particularly in respect of economic infrastructure facilities where the income is attributable to rent from land investment
- the meaning of MIT trading trust income, MIT residential housing income and MIT agricultural income, and
- transitional provisions, which allow pre-existing MIT withholding rates to apply for certain periods of time.

Date of effect

3. This Ruling applies effective from 1 July 2019 for those who rely on it in good faith. The Act applies to a fund payment made by a MIT in relation to an income year if the:

- fund payment is made on or after 1 July 2019, and

[1] Including the *Income Tax Assessment Act 1936* (ITAA 1936), the *Income Tax Assessment Act 1997* (ITAA 1997) and the *Taxation Administration Act 1953* (TAA). All legislative references in this Ruling are to Schedule 1 to the TAA unless otherwise indicated.

- income year is the 2019–20 income year or a later income year.

Outline of the law

4. MIT withholding tax applies to fund payments made by a withholding MIT to foreign residents.[2] For recipients in an exchange of information country, the rate of MIT withholding tax is generally 15%. Under the amendments to the law pursuant to the Act, the MIT withholding tax rate becomes 30% to the extent that the fund payment is attributable to NCMI.

5. An amount will be NCMI if it is any of the following:

- MIT cross staple arrangement income
- MIT trading trust income
- MIT agricultural income, or
- MIT residential housing income.

6. Transitional rules may apply to fund payments that are attributable to existing and sufficiently committed investments. If the transitional rules apply, the concessional MIT withholding tax rate of 15% will continue to apply for the relevant transitional periods.

NCMI provisions apply only to MITs

7. The NCMI provisions apply to amounts included in the assessable income of a MIT.[3] That is, the trust must be a MIT, as defined in section 275-10 of the ITAA 1997.

8. One of the requirements for a trust to qualify as a MIT in relation to an income year is that the trust must not be a trading trust for the purposes of Division 6C of Part III of the ITAA 1936 or otherwise carry on a trading business, or control, or be able to control, directly or indirectly, the affairs or operations of another person in respect of the carrying on by that other person of a trading business within the meaning of Division 6C.[4]

9. A trading business means a business that does not consist wholly of 'eligible investment business', as defined in section 102M of the ITAA 1936.

10. The NCMI provisions do not affect the ordinary operation of Division 6C for the purpose of determining whether a trust is a MIT. Nor do they affect other legislative provisions and common law principles that would ordinarily apply to a trust and the characterisation of the income of the trust. If the trust is not a MIT because it carries on a business that is not limited to 'eligible investment business', the NCMI provisions have no application.

Investing in land within the meaning of section 102M

11. It is expected that many trust structures to which the potential application of the Act is being considered may involve investments in land. For present purposes, under section 102M of the ITAA 1936, an investment in land constitutes an 'eligible investment business' only if it is for the purpose, or primarily for the purpose, of deriving rent (primary purpose test).[5] In this regard:

- The term 'land' includes an interest in land and fixtures on land.[6]

[2] Division 840 of the ITAA 1997. The fund payment may be received directly or indirectly from the withholding MIT.
[3] Section 12-435, paragraphs 12-437(1)(a), 12-446(1)(a), 12-448(1)(a) and 12-450(1)(a).
[4] Subsection 275-10(4) and paragraphs 275-10(3)(b) and 275-45(1)(b) of the ITAA 1997.
[5] Paragraph (a) of the definition of 'eligible investment business' in section 102M of the ITAA 1936.
[6] Section 102M of the ITAA 1936.

- An investment in land is taken to include investments in certain moveable property.[7]
- The safe harbour allowance in subsection 102MB(2) of the ITAA 1936 for certain non-rental income from investments in land applies when determining whether the primary purpose test is satisfied.
- The 2% safe harbour allowance at the whole of trust level in section 102MC of the ITAA 1936 applies to effectively disregard minor breaches in determining whether a trust is carrying on a trading business.

12. Therefore, where a trust holds an interest in land, a threshold question before considering the application of the NCMI provisions is whether the trustee holds the asset for the purpose, or primarily for the purpose, of deriving rent. If this is not satisfied, the NCMI provisions have no application. The fact that the NCMI provisions may apply to amounts in the assessable income of a MIT attributable to cross staple arrangements in respect of land, residential housing or agricultural land, does not remove the requirement for the trustee to satisfy the primary purpose test in relation to such assets.

13. The purpose must be determined having regard to all the relevant facts and circumstances. In determining whether the trustee is investing in land for the purpose, or primarily for the purpose, of deriving rent, regard should be had to several factors including:

- the trust's investment strategy
- the length of time the interest in land is, objectively assessed, intended to be held for (assessed initially and continually), as well as the time such interest is actually held and any strategy for its disposal
- the actions taken by the trustee to make the land available for leasing by prospective tenants
- the terms of the lease
- any other arrangements entered into or activities undertaken by the trustee (including in relation to any development of the land, its management, and other incidental activities)
- features of the land affecting its suitability for long-term rental or its potential for profit on sale, and
- projected rental yield and capital growth.

14. No one factor is determinative and all the relevant facts and circumstances must be weighed to determine whether the primary purpose test is satisfied. Furthermore, as the test is an annual test[8], changes in facts and circumstances over time must be considered to determine whether the trustee's purpose has also changed.

15. Where a residential dwelling asset is used to provide affordable housing[9], the rental return on the residential dwelling asset may be below the market rate (for example, if below market rent is charged), and it may be more difficult to demonstrate that the projected rental yield for the property will significantly outweigh the projected capital growth.

[7] Subsection 102MB(1) of the ITAA 1936.

[8] Section 102N of the ITAA 1936 refers to a trust being a trading trust 'in relation to a year of income'. Similarly, the definition of a 'managed investment trust' in section 275-10 of the ITAA 1997 applies 'in relation to an income year'.

[9] **Note:** An amount included in the assessable income of a MIT is 'MIT residential housing income' and therefore NCMI to the extent it is attributable to a residential dwelling asset. However, an amount is not MIT residential housing income to the extent it is referable to the use of the residential dwelling asset to provide affordable housing. Refer to paragraph 333 of this Ruling.

16. However, this would not in itself necessarily cause the trustee to fail the primary purpose test, provided the other facts and circumstances clearly support a long-term rental purpose. An example of this is where the trustee enters into a long-term arrangement with an eligible community housing provider under which an eligible community housing provider exclusively manages the tenancy or prospective tenancy of the residential dwelling asset. Such an arrangement would be relevant in determining whether the below-market rental yield is consistent with the requisite purpose.

17. The meaning of 'rent' is discussed further in the consideration of third-party rent as an exception to MIT cross staple arrangement income in paragraph 52 of this Ruling.

'Attributable to' NCMI

18. The higher rate of withholding at 30% applies to the extent a fund payment made by a withholding MIT to a non-resident is 'attributable to' NCMI.[10] Similarly, under each of the tests of NCMI, it is necessary to consider what certain amounts included in the assessable income of a MIT are 'attributable to'.[11]

19. The High Court considered the phrase 'attributable to', as used in former section 160ZK(5) of the ITAA 1936, in *Commissioner of Taxation (Cth) v Sun Alliance Investments Pty Limited (in liquidation)*[12]:

> It is the concept of causation, rather than source, with which s 160ZK(5) is concerned. In determining whether the plaintiff's loss of employment was "attributable to" the provisions of the *Local Government Act* 1972 (UK), Donaldson J in *Walsh v Rother District Council* said:
>
> > "[T]hese are plain English words involving some causal connection between the loss of employment and that to which the loss is said to be attributable. However, this connection need not be that of a sole, dominant, direct or proximate cause and effect. A contributory causal connection is quite sufficient."
>
> Nothing, either in the text of s 160ZK(5) or in its objects as expressed in the Explanatory Memorandum on the Bill for the Amending Act, indicates that a narrower meaning should be presently ascribed to that phrase.

20. Consistent with judicial consideration of the phrase 'attributable to' in other contexts, its use in the NCMI provisions should also be interpreted broadly. A broad interpretation is supported by both the text of the provisions[13] and the Revised Explanatory Memorandum to the Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2019 (Explanatory Memorandum).[14]

21. For example, in relation to MIT residential housing income, where a MIT receives a distribution from another trust holding residential housing, some or all of that distribution may be attributable to a residential dwelling asset. This will be the case even if the MIT only has an indirect, non-controlling interest in the trust (for example, through one or more sub-trusts). What is relevant to the question of attribution is that, in this example, the residential housing has that causal nexus to the distribution.

22. Attribution is necessarily a matter of reasonable judgment. However, it is observed that the Act does not permit streaming of NCMI and income that is not NCMI between beneficiaries.

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[10] Subparagraph 12-385(3)(a)(iii).
[11] Refer to sections 12-437, 12-446 12-448 and 12-450.
[12] [2005] HCA 70 at [80].
[13] For example, subsection 12-450(2) expressly states that the MIT does not need to hold the residential dwelling asset itself.
[14] For example, refer to paragraphs 1.235 to 1.237 of the Explanatory Memorandum, including an example in which income from a synthetic exposure to residential dwelling assets is MIT residential housing income.

The allocation of expenses to income that is, or is attributable to, NCMI

23. As a general rule, the Commissioner expects general trust expenses to be allocated to income that is, or is attributable to, NCMI on a fair and reasonable basis.[15] Expenses that are directly incurred in relation to the derivation of NCMI may be applied against NCMI. However, where expenditure is incurred that relates partially to the derivation of NCMI, or cannot be identified as exclusively relating to the derivation of NCMI, the Commissioner expects that such expenditure will be apportioned between amounts relevantly NCMI and other income on a fair and reasonable basis. References to NCMI in this context include income that would ultimately give rise to NCMI.[16]

24. If the relevant entity is an attribution managed investment trust, Subdivision 276-E of the ITAA 1997 will apply to prescribe a methodology for the allocation of expenses across components of trust income. Law Companion Ruling LCR 2015/8 *Attribution Managed Investment Trusts: the rules for working out trust components – allocation of deductions* provides further guidance in relation to the application of Subdivision 276-E of the ITAA 1997.

MIT cross staple arrangement income

25. Broadly speaking, a MIT will have an amount of MIT cross staple arrangement income if the amount it derives, receives or makes is from, or is attributable to, a cross staple arrangement between an operating entity and an asset entity.[17]

Cross staple arrangement

26. An asset entity is a trust or partnership that only derives income from eligible investment business within the meaning of Division 6C of Part III of the ITAA 1936. In addition, an asset entity cannot control, or be able to control, directly, or indirectly, the affairs or operations of another person in respect of the carrying on of a trading business.[18] Broadly, eligible investment business is limited to investments of a passive nature such as investing in land for the purpose of deriving rent or investing in shares or financial instruments.

27. Broadly, any trust, partnership or company that is not an asset entity is an operating entity.[19] Accordingly, any such entity that derives income from, controls or could control a trading business within the meaning of Division 6C of Part III of the ITAA 1936 is an operating entity.

28. A cross staple arrangement is an arrangement that is entered into by two or more entities (arrangement entities) where:

- at least one of the entities is an asset entity
- at least one of the entities is an operating entity – that is, not an asset entity, and

[15] It is noted that the High Court in *Ronpibon Tin NL v Commissioner of Taxation (Cth)* [1949] HCA 15 also prescribed a 'fair and reasonable' basis for allocating expenditure (which served multiple objects indifferently), against assessable income and exempt income.
[16] For example, income of an asset entity (that is not a MIT) in relation to a cross staple arrangement that will ultimately be reflected in a fund payment.
[17] Section 12-437.
[18] Subsections 12-436(1) and (3); the definition of 'asset entity' in subsection 995-1(1) of the ITAA 1997.
[19] Subsections 12-436(2) and (3); the definition of 'operating entity' in subsection 995-1(1) of the ITAA 1997.

- one or more other entities (external entities) each hold a total participation interest in each of the arrangement entities, and the sum of the total participation interests held by the external entities in the arrangement entities is 80% or more (common participation interest test).[20]

29. Each of the asset and operating entities that entered into a cross staple arrangement are termed 'stapled entities' in relation to the cross staple arrangement.[21] While the external entities are relevant to determine the existence of a cross staple arrangement, they are not themselves stapled entities in relation to the cross staple arrangement.

Meaning of 'arrangement'

30. 'Arrangement' is defined in subsection 995-1(1) of the ITAA 1997 to include any arrangement, agreement, understanding, promise or undertaking, whether express or implied, and whether or not enforceable (or intended to be enforceable) by legal proceedings. Accordingly, it is not necessary for an arrangement to be written or legally binding. However, it does require a consensus between the parties.[22]

31. Notably, it is not necessary for the ownership interests of the asset entity and the operating entity to be stapled securities, in order for a cross staple arrangement to exist. Stapled securities are securities that are contractually bound together so that they cannot be bought or sold separately.

32. It follows that any arrangement between an asset entity and operating entity with sufficient common ownership can be a cross staple arrangement including, for example:

- a lease of land and/or fixtures, and
- financial arrangements (for example, a loan or total return swap). However, while a loan can be a cross staple arrangement, interest income is specifically excluded from the definition of MIT cross staple arrangement income.[23]

33. In most cases, the rights and obligations arising under a particular contractual agreement between the parties, such as a lease agreement, will be the relevant cross staple arrangement in relation to an amount of cross staple arrangement income. However, the relevant arrangement may extend beyond the legal form of a particular arrangement if any other arrangement or understanding (such as a guarantee) gives rise to an amount derived, received or made by the asset entity from the operating entity.

34. In identifying an arrangement for the purposes of whether a cross staple arrangement exists, regard should be had to matters such as:

- the nature of any rights and/or obligations
- any terms and conditions (including those relating to any payment or other consideration for them)
- the circumstances surrounding their creation and their proposed exercise or performance (including what can reasonably be seen as the purposes of one or more of the entities involved)
- whether any of the rights and obligations, or interests in the arrangement entities, can be dealt with separately or must be dealt with together

[20] Subsection 12-436(4); the definition of 'cross staple arrangement' in subsection 995-1(1) of the ITAA 1997.
[21] Subsection 12-436(8).
[22] *Commissioner of Taxation (Cth) v Lutovi Investments Pty Ltd* [1978] HCA 55, per Gibbs and Mason JJ.
[23] Paragraphs 12-405(1)(b) and 12-437(1)(c).

- normal commercial understandings and practices in relation to them (including whether they are regarded commercially as separate things or as a group or series that forms a whole), and
- the objects of these measures.[24]

35. Regard should be had to all of the matters referred to in paragraph 34 of this Ruling, although in a particular case, it may be that one matter is more influential than others.

Total participation interest in arrangement entities

36. Two separate rules apply in determining the total participation interests of an external entity in each arrangement entity:

- In working out the sum of total participation interests held by external entities in each arrangement entity, a particular direct or indirect participation interest held in the arrangement entity is taken into account only once (double-counting rule).[25]
- Only the lowest common ownership percentage (effectively, the lowest participation interest that the external entity has in any arrangement entity) is taken into account (lowest common ownership rule).[26]

37. The double-counting rule prevents the double counting of participation interests held by different external entities, such as ultimate and intermediate holding companies, in the same underlying entity. However, it does not specify which particular participation interests should be taken into account and which ones should be disregarded, where two or more participation interests would otherwise be counted more than once.

38. The total participation interest of each external entity in the arrangement entities must be calculated in turn. The order in which each external entity calculates its total participation interest in the arrangement entities effectively dictates which particular participation interests are taken into account and which ones are disregarded under the double-counting rule. This is because the double-counting rule does not apply to the first external entity (test entity 1) to calculate its total participation interest in the arrangement entities. An external entity (test entity 2, for example a subsidiary of test entity 1) that subsequently calculates its total participation interest in the arrangement entities must apply the double-counting rule to disregard any participation interest already taken into account by test entity 1.

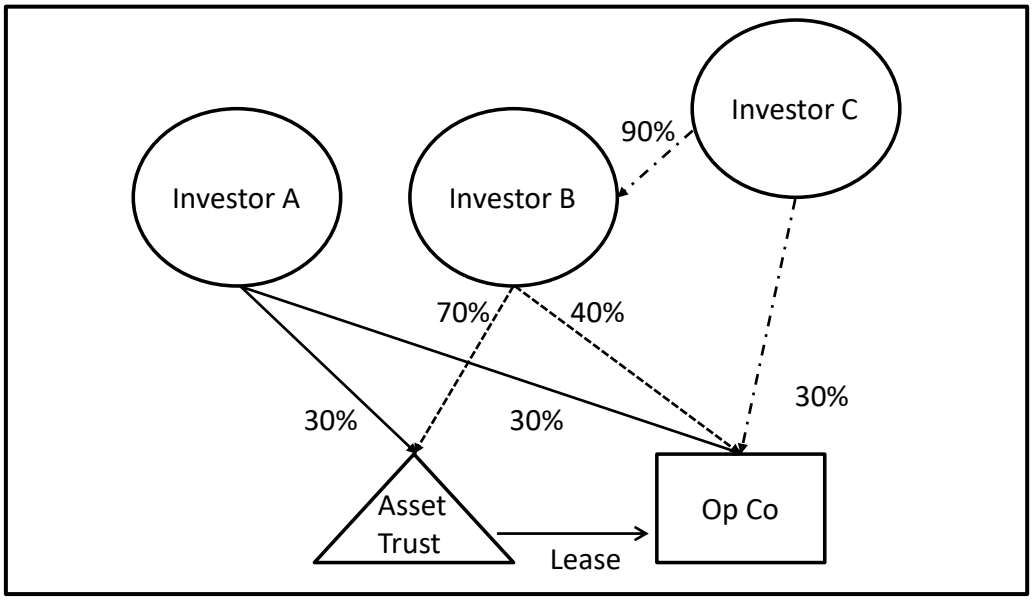
39. The Act does not specify which rule should be applied before the other. The lowest common ownership rule only applies where an external entity holds a total participation interest in two or more arrangement entities and there is a difference in the participation interests held in at least two arrangement entities.[27] It follows that the double-counting rule should apply before the lowest common ownership rule, since the double-counting rule can affect an accurate determination of the *prima facie* total participation interest of the external entity in an arrangement entity. Further, that the double-counting rule precedes the lowest common ownership rule in the Act is also consistent with the principle that statutory provisions should be read and applied sequentially.[28]

[24] Refer also to the meaning of 'arrangement' for the purposes of Division 230 as discussed in paragraphs 14 to 21 of Taxation Ruling TR 2012/4 *Income tax: the operation of subsection 230-55(4) of the Income tax Assessment Act 1997 (ITAA 1997) in determining what is an 'arrangement' for the purposes of the taxation of financial arrangements under Division 230 of the ITAA 1997*.
[25] Subsection 12-436(5). Also refer to paragraph 1.45 of the Explanatory Memorandum.
[26] Subsections 12-436(6) and (7). Also refer to paragraph 1.47 of the Explanatory Memorandum.
[27] Paragraph 12-436(6)(a).
[28] Refer to *Patman v Fletcher's Fotographics Pty Ltd* (1984) 6 IR 471 at [474].

Example 1 – cross staple arrangement

40. *Asset Trust is an asset entity and Op Co is an operating entity. Op Co enters into a lease over land held by Asset Trust. Investor A, Investor B and Investor C are external entities as they are not parties to the arrangement. Assume that:*

- *Investor A holds a 30% direct interest in Asset Trust and a 30% direct interest in Op Co*
- *Investor B holds a 70% direct interest in Asset Trust and a 40% direct interest in Op Co*
- *Investor C holds a 90% direct interest in Investor B and a 30% direct interest in Op Co*



41. *Prima facie, before applying the double-counting and the lowest common ownership rules:*

- *Investor A has a total participation interest of 30% in each of Asset Trust and Op Co. Neither the double-counting rule nor lowest common ownership rule impacts Investor A.*
- *Investor B has a total participation interest in Asset Trust of 70% and a total participation interest in Op Co of 40%.*
- *Investor C has a total participation interest in Asset Trust of 63% (90% × 70% held via Investor B) and a total participation interest in Op Co of 66% (that is, the sum of its 30% direct interest plus 36% (90% × 40%) indirect interest via Investor B).*

42. *Investor C calculates its total participation interest in the arrangement entities ahead of Investor B, and Investor B's total participation interest in Asset Trust is reduced by 63% (that is, Investor C's indirect participation interest in Asset Trust held via Investor B) under the double-counting rule. Applying the lowest common ownership rule, Investor C has a 63% total participation interest in each arrangement entity. Accordingly, Investor B would have a total participation interest in Asset Trust of 7% and, applying the lowest common ownership rule, Investor B will have a total participation interest in each arrangement entity of 4%.*[29] *On this approach, the sum of the total participation interests held by the external entities in each arrangement entity is 97% (that is, the sum of Investor*

[29] Investor B's interest in Op Co will be 40% less Investor C's interest of 36% (90% × 40%) = 4%.

A's 30%, Investor B's 4% and Investor C's 63%). It follows that the lease entered into between Asset Trust and Op Co is a cross staple arrangement.[30]

When an amount derived, received or made by a MIT is attributable to a cross staple arrangement

43. A MIT can have an amount of cross staple arrangement income, subject to certain exceptions, where the MIT is:

- a party to the cross staple arrangement in relation to the income year and derives, receives or makes the relevant amount from an operating entity, or
- not a party to the cross staple arrangement in relation to the income year but an amount is included in its assessable income that is attributable to the arrangement.

44. Where the MIT is a party to the cross staple arrangement, an amount is MIT cross staple arrangement income if the relevant amount is derived, received or made by the MIT directly (for example, an amount of cross staple rent derived by the MIT from an operating entity under a lease).

45. Where the MIT is not a direct party to the cross staple arrangement, an amount will only be MIT cross staple arrangement income if it is attributable to the cross staple amount derived, received or made by the asset entity from the operating entity.

46. In practice, a MIT that is not a direct party to the cross staple arrangement will be able to identify an amount attributable to a cross staple arrangement if it is notified accordingly by the entity making the payment to the MIT. The entity making the payment may be the asset entity or an entity interposed between the asset entity and the MIT (an interposed entity). Similarly, an interposed entity will be able to identify an amount attributable to a cross staple arrangement if it is notified accordingly by the entity making the payment.

47. The Commissioner appreciates that MITs that are multiple distributions removed from the source of the MIT cross staple arrangement income may be at an information disadvantage when it comes to reporting the extent to which amounts are NCMI. To that end, the Commissioner expects that participants in chains of distributions will share all necessary information to enable all beneficiaries to accurately report NCMI.

48. A MIT that is a withholding MIT may also be required to notify specified details relating to fund payments (or the information must be made available) to certain recipients of such payments, including the extent (if any) to which the payment is, or is attributable to, NCMI.[31] Similar notification obligations apply to custodians and certain other entities in receipt of such payments.[32]

Exceptions to MIT cross staple arrangement income

49. There are five circumstances in which an amount that is attributable to a cross staple arrangement will *not* be MIT cross staple arrangement income of a MIT:

- the third-party rent exception[33]
- the *de minimis* exception[34]
- the approved economic infrastructure facility exception[35]

[30] Subsection 12-436(4); the definition of 'cross staple arrangement' in subsection 995-1(1) of the ITAA 1997.
[31] Paragraph 12-395(3)(ab).
[32] Paragraphs 12-395(3)(ab) and 12-395(6)(ab).
[33] Subsection 12-437(3).
[34] Subsection 12-437(4).

- the capital gains exception[36], and
- the transitional rules.[37]

The third-party rent exception

50. An amount included in the assessable income of a MIT that is attributable to a cross staple arrangement will not be MIT cross staple arrangement income to the extent it represents third-party (that is, derived from an entity that is not a stapled entity) rent from land investment.

51. 'Rent from land investment' contemplates that 'rent' is derived or received, and that the rent is from investment in 'Division 6C land'.[38]

52. The Commissioner considers that 'rent' in this context takes a traditional meaning, being payments made for periodic use of land under a lease of land.[39] Payments under a lease of land (rent) are contrasted with payments in respect of land use under an agreement which is not a lease (for present purposes, referred to as a licence).

53. The term 'Division 6C land' refers to land within the meaning of Division 6C of Part III of the ITAA 1936. This includes an investment in land contemplated under subsection 102MB(1), that is, investments in a narrow class of moveable property. Accordingly, 'rent from land investment' under the Act extends beyond the common law notion of land, to that contemplated under Division 6C.

54. It is a necessary requirement that the arrangement between the operating entity and the third party (to which the cross staple amount is attributable) can properly be characterised as a lease (or sub-lease) in order for there to be rent. In turn, only that component of the payment properly characterised as rent from land investment will qualify for the carve-out.

Payment under a lease

55. At common law[40], a lease is an interest in land, which is for a fixed or ascertainable term and confers on the grantee the right of exclusive possession over the land.[41] By contrast, a licence is a personal, contractual right of the grantee against the grantor, effectively amounting to permission to do something that would otherwise not be permissible.

56. This distinction carries practical legal consequences, as a tenant's possession can be protected by equitable remedies against third parties such as ejectment, trespass and nuisance, whereas a licensee is limited to action personally against the licensor under contract law.[42]

57. Whether a grant of a right to use land will be characterised as a lease depends on whether, in substance (discerned objectively), the grant confers on the recipient a right of

[35] Subsection 12-437(5).
[36] Subsection 12-437(7).
[37] Section 12-440.
[38] Refer to the definition of 'rent from land investment' in subsection 995-1(1) of the ITAA 1997.
[39] *Commissioner of Stamp Duties (NSW) v JV (Crows Nest) Pty Ltd* (1986) 7 NSWLR 529; 86 ATC 4740 at [4742] and [4747]; *Commissioner of Stamp Duties (NSW) v Commonwealth Funds Management Limited* (1995) 38 NSWLR 173 ; 95 ATC 4756 at [4762].
[40] Various state statutes may alter the common law test for what constitutes a lease in particular contexts (for example, residential tenancies). The Commissioner considers that the relevant test for the application of the third-party rent rule is the common law test.
[41] *Radaich v Smith* [1959] HCA 45 (*Radaich*).
[42] *Living and Leisure Australia Ltd (ACN 107 863 445) v Commissioner of State Revenue* [2018] VSCA 237 (*Living and Leisure*). An application for special leave to appeal against this judgment was refused on 22 March 2019 [2019] HCATrans 56.

exclusive possession.[43] The terminology adopted by the parties in an instrument is a relevant consideration, but is not determinative.

58. Exclusive possession is both an entitlement to, and control by, a person over a defined area of land to the exclusion of others. As articulated in *Lewis v Bell*[44], exclusive possession means the tenant has the general right to exclude others, including the landlord, from the premises.

59. 'Possession' connotes a high degree of intentional control over the thing possessed.[45] In the context of land, the closer the tenant has to an unfettered right to use the land as their own, the more likely the arrangement will be a lease. Conversely, the more restricted the tenant's use of the land (for example, restrictions on nature of use, subleasing, assignment, access) the more likely the grant does not amount to a lease.

60. The adjective 'exclusive' serves merely to emphasise its centrality to the concept of possession; that the tenant be able to exclude any person, including the landlord, from the possessed premises.[46] The grantee must be able to '… exclude any and everyone from the land for any reason or no reason'.[47] This right encompasses the covenant of quiet enjoyment, being the landlord's obligation not to interfere with the tenant's exercise of their right to exclusive possession of the leased premises.

61. The concept of physical control, which is relevant to both aspects of exclusive possession, was considered in *Powell v McFarlane*[48], where Slade J stated:

> The question what acts constitute a sufficient degree of exclusive physical control must depend on the circumstances, in particular the nature of the land and the manner in which land of that nature is commonly used or enjoyed.
>
> …
>
> Everything must depend on the particular circumstances, but broadly, I think what must be shown as constituting factual possession is that the alleged possessor has been dealing with the land in question as an occupying owner might have been expected to deal with it and that no one else has done so.

62. As such, the physical characteristics of the area possessed and the expected intended use of the land, the substance of the rights granted and the extent of any reservations will all, to a greater or lesser extent, be relevant to whether the arrangement is characterised as a lease or a licence.

63. In determining whether exclusive possession has been conferred, the terms of the instrument must be read in the context of the nature of the premises and the use to which the premises are put.[49] No single attribute is likely to be determinative of the character of the agreement.

Physical characteristics

64. Certain innate physical characteristics of the land that is subject to the agreement may indicate that the land is more, or less, likely to be the subject of a lease. For example, premises that are self-contained, lockable and have physical barriers (such as walls) excluding access, more self-evidently give a tenant an ability to exercise exclusive possession than, say, if a tenant were to lease an unconfined part of a large open public space. A grant over an extremely small parcel of land, a grant where the predominant use will be of land shared with other grantees, or a grant over an area which does not readily

[43] *Radaich*.
[44] (1985) 1 NSWLR 731, Supreme Court of NSW – Court of Appeal, per Mahoney JA at [733].
[45] *Queensland v Congoo* [2015] HCA 17 at [161], per Gageler J.
[46] In *Western Australia v Ward* [2002] HCA 28 at [503], McHugh J considered that the adjective 'exclusive' does not add to an understanding of the concept of possession, as exclusivity is central to the concept.
[47] *Western Australia v Brown* [2014] HCA 8 at [52].
[48] (1979) 38 P & CR 452.
[49] *Goldsworthy Mining Ltd v Commissioner of Taxation (Cth)* [1973] HCA 7, per Mason J.

present any effective separation of the premises that would allow a putative tenant to exercise their right to exclude others from the land, is less clearly a grant of exclusive possession.

65. This is not to say that a tenant's capacity to physically exclude is a necessary precondition for a lease. The intended use by the grantee and any particular custom will be relevant. For example, an unfenced front yard of a tenant's commercial or residential property is clearly able to be leased as part of the premises, as both the intended use and social custom would contemplate third parties having a right to access the building entry for certain purposes.

66. Where the subject land is a large, multi-faceted area, the physical characteristics of the parts of the land most critical to the intended use, and whether those parts are able to be exclusively possessed, will carry the greatest weight in determining whether there has been a grant of exclusive possession.[50]

67. Where the landlord or another third party controls the ultimate access to and from the relevant area, this is one factor that may suggest that it is less likely that the grant will amount to exclusive possession.[51]

Example 2 – licence arrangement

68. *Storage OpTrust leases a storage warehouse from a MIT to which it is stapled, Storage HoldTrust. Storage OpTrust conducts a storage business offering lockable storage units inside the warehouse for periodic use (described as a lease) by third-party customers. Subject to certain exceptions, customers may access their personal property in the storage unit under the agreement and during nominated open hours. Storage OpTrust reserves control and ultimate access to the warehouse, and has the ability to relocate the personal property of customers to a different storage unit at any time. Storage OpTrust also provides and controls amenities including all lighting and climate control.*

69. *The arrangement between Storage OpTrust and its customers is properly characterised as a licence. Periodic payments under the arrangements that are on-paid to Storage HoldTrust are not third-party rent and are therefore not exempted from characterisation as NCMI when distributed to non-resident unitholders.*

Terms of the agreement

70. Although the nomenclature adopted will not be determinative of the character of the instrument as a lease or licence, if the instrument adopts the language of a lease, by expressly granting 'exclusive possession' or 'quiet enjoyment' to a putative tenant, this may indicate that the parties themselves intended that the grantee is a tenant under a lease. The subjective intent of the parties is relevant to the ultimate characterisation.

71. Certain other aspects of the agreement that may be relevant to its characterisation as a lease or otherwise include:

- the specificity (or otherwise) of the premises – a precisely defined piece of land is more amenable to a grant of a lease than an area not fixed to a precise location within a property or where the landlord can readily substitute alternatives
- the assignability (or otherwise) of the grant – an assignable grant is more likely to be a lease than a grant that is personal to the grantee and cannot be assigned, as it more closely connects the grant to the land rather than the parties

[50] *Living and Leisure*.
[51] *John Fuller and Sons Limited v Brooks* [1950] NZLR 94.

- the determinability (or otherwise) of the agreement – the easier it is for one or both parties to determine or cancel the grant, the more likely the grant is a licence, as agreed tenure is an important aspect of a lease
- provision for the abatement (or otherwise) of rent payable under the grant – a rent abatement clause may relieve a tenant from paying rent (or makes a tenant entitled to recover rent) if there is a material impediment to the exercise of exclusive possession. An arrangement with such a provision tends towards being a lease.

72. A tenant under a head lease may, if the lease permits, grant a sub-lease over the land which it leases from the landlord. However, a licensee of land cannot grant a sub-lease of land to a sub-tenant.[52]

Reservations from the grant

73. In most, if not all circumstances, leases and licences will contain reservations from the grant. Whether reservations from the grant have the result that the grant does not confer exclusive possession on a putative tenant will depend on the nature of those reservations in the context of the land itself and the intended usage. Specifically, regard will be had to whether the particular reservation is inconsistent with a right of exclusive possession.[53]

74. For example, it is common for a landlord to reserve for themselves a right to enter leased premises periodically (on notice) to inspect the premises. Although such a right might be said to derogate from the grant of exclusive possession, it is a function of the landlord's reversionary interest in the premises and is not so fundamentally incompatible with a right of exclusive possession that it results in the tenants not having such possession.[54] By contrast, an unfettered right for a landlord to enter without reason would be inconsistent with a grant of exclusive possession.

75. Whether such a particular reservation is ultimately inconsistent with the grant of exclusive possession will be influenced by the nature of the land and its agreed use.

76. In *Living and Leisure,* purported leases were granted under the *Alpine Resorts Act 1983* (Vic) over two Victorian ski fields which contained reservations in favour of the general public over vast sections of the subject land. The question was whether a reservation allowing freedom of public access to the land (subject to the condition that it does not unreasonably interfere with the conduct of the tenant's business) precluded the grant from being a lease. A majority of the Supreme Court of Victoria – Court of Appeal concluded that the tenant exclusively possessed the key parts of the premises relevant to the conduct of the business, such that the reservation from the grant in favour of the general public did not preclude a finding that the agreement conferred exclusive possession.

Example 3 – hotel operation and whether rent

77. *Hotel Trust and Hotel OpCo are stapled entities. Hotel Trust owns a building which it leases to Hotel OpCo to operate as a hotel. Hotel OpCo, in turn, grants temporary accommodation rights to third-party customers to occupy one of the rooms in the hotel for payment calculated based on the number of nights of occupation. Although no other customer or guest can access the customer's room, Hotel OpCo retains the right to enter the room for a variety of purposes, including the servicing and cleaning of the room. Hotel OpCo covenants only to enter where there is a genuine need, and to minimise inconvenience to guests when entering the room.*

[52] The common law principle of *nemo dat quod non habet*.
[53] *Living and Leisure*.
[54] *Living and Leisure* at [92], per Niall JA.

78. *The third-party customers of Hotel OpCo do not have exclusive possession of their rooms. On that basis, they are not common law tenants and amounts paid by guests to occupy the hotel are not rent. To the extent amounts paid by Hotel OpCo to Hotel Asset Trust are attributable to receipts from guests, the amounts will be MIT cross staple arrangement income and therefore NCMI.*

Intended use

79. The purpose for which the premises are intended to be used is an influential factor in the characterisation of a grant. Specifically, courts will consider whether, objectively, a tenant would ordinarily require exclusive possession of the premises in order to properly utilise the premises in the contemplated manner.[55]

80. In *Radaich*, a document purporting to grant a licence over premises to operate a milk bar was found to have conferred exclusive possession. Central to the reasoning of the High Court was that, in order to effectively conduct the business of a milk bar on the premises, the tenants required exclusive possession, and that the premises in question were a 'lock-up shop' which enabled the tenant to so exclude the public.

Payment 'for' the use of the land

81. The payment under a lease will only qualify as rent to the extent it genuinely reflects a payment for the periodic use of the relevant land subject to a lease. Where a bundle of rights and benefits are conferred on a lessee of land in return for a single periodic payment, only that part of the payment that is properly referable to the third party's lease of land will be attributable to rent from land investment and avoid ultimate characterisation as NCMI.

82. The Commissioner considers that regard needs to be had to both the quantum of payment relative to the arm's length value and the method by which the purported rent is calculated. Third-party receipts which are described as 'rent' but far exceed what might be the arm's length price invite questions as to whether part of the payment in fact relates to some other benefit conferred on the tenant.[56]

83. When considering the calculation methodology, while the Commissioner accepts that an incidental turnover component of a calculated periodic payment under a lease will not preclude a conclusion that the payment is rent, the more the calculation reflects something other than the arm's length value of the periodic right to use the land, the more likely some, or all, of the cross staple payment is not attributable to third-party rent. For example, purported rent which is a share of business profits, or is otherwise entirely exposed to the risks of the business, is unlikely to be characterised (either wholly, or in part) as rent.

84. Where the land has, or will have, assets attached to it that are central to the intended use of the land, and which:

- are properly characterised as chattels, and
- do not meet the definition of 'moveable property' in subsection 102MB(1) of the ITAA 1936

then payments under an agreement are not rent, even if so described, to the extent that they are properly referable to those assets.

85. The Commissioner also considers that payments or transfers of value received under an arrangement made in substitution for, as opposed to in satisfaction of, the payment of rent are not properly attributable to rent from third parties. For example, if the

[55] *Radaich*.
[56] See, for example, *Commissioner of Taxation v Star City Pty Limited* [2009] FCAFC 19.

third party issued equity or some other financing instrument to the landlord in substitution of the present and future covenant to pay rent, the value of that instrument, as well as returns on that instrument will not be rent. Conversely, where a particular periodic rent obligation can be satisfied by a means other than payment of cash specifically provided for under the lease agreement that payment in kind may still be rent.

86. If the payments under the arrangements are partly rent and partly for something else (for example, a licence), a reasonable basis of apportionment of income must be applied to identify the MIT cross staple arrangement income component.

87. For example, if the relevant operating entity is deriving both licence fees and rent from third parties, and incurring expenditure referable to both, the Commissioner would regard as unreasonable a method that allocates all of the relevant operating entity's expenses to the licence fee component (thereby reducing the proportion of the ultimate amount characterised as MIT cross staple arrangement income). However, the Commissioner will generally regard as reasonable a method that reduces each revenue stream proportionately, for example, the approach set out in Example 1.6 in the Explanatory Memorandum.

The de minimis exception

88. An amount that is attributable to a cross staple arrangement will not be MIT cross staple arrangement income to the extent that the *de minimis* exception in section 12-438 applies.[57]

89. Whether *the de minimis* exception applies is worked out at the asset entity level. If the asset entity is not a MIT, the asset entity is treated as a MIT for the income year for the purpose of working out whether the exception applies.[58] If the exception applies where the asset entity is not a MIT, the relevant cross staple arrangement income will not be MIT cross staple arrangement income even if it is ultimately distributed to a MIT. It follows that a distribution of such income does not need to be identified as MIT cross staple arrangement income.

90. The *de minimis* exception applies to an amount of MIT cross staple arrangement income for the income year of an asset entity (in relation to a cross staple arrangement) where the MIT cross staple arrangement income of the asset entity for the previous income year does not exceed 5% of its assessable income (excluding net capital gains) for the previous income year.[59]

91. The MIT cross staple arrangement income of the asset entity for the previous income year includes any amounts derived or received from other entities, but disregards the:

- *de minimis* exception[60], and
- approved economic infrastructure exemption.[61]

92. Other categories of NCMI that are not MIT cross staple arrangement income (that is, MIT trading trust income, MIT agricultural income or MIT residential housing income) included in the assessable income of the asset trust do not count towards the numerator in calculating the 5% *de minimis* threshold. Similarly, other cross staple payments received by the asset entity that do not otherwise give rise to MIT cross staple arrangement income[62] do not count towards the numerator in calculating the 5% *de minimis* threshold.

[57] Subsection 12-437(4).
[58] Subsection 12-438(6).
[59] Subsections 12-438(1), (3) and (4).
[60] Subsection 12-438(2).
[61] Subsection 12-438(2).
[62] For example, interest income.

93. If the asset entity did not exist in the previous income year, it must work out whether the *de minimis* exception applies based on reasonable estimates of MIT cross staple arrangement income, assessable income and total assessable income for the current income year.[63]

Example 4 – *de minimis* exception

94. *Hold Trust is a MIT that owns all of the units in Asset Trust. Asset Trust (which is not a MIT) and Op Co are parties to a lease agreement. Accordingly, Asset Trust is an asset entity and Op Co is an operating entity in relation to a cross staple arrangement. Asset Trust did not exist in the previous income year.*

95. *In the first three months of the 2019–20 income year, Asset Trust receives $50,000 in cross staple rental income from Op Co under the lease agreement. This amount will be MIT cross staple arrangement income unless the de minimis exception applies (that is, none of the other exceptions to MIT cross staple arrangement income in section 12-437 apply).*

96. *In the first three months of the 2019–20 income year, Asset Trust has $1 million assessable income (disregarding capital gains). At the end of the first three months of the 2019–20 income year, Asset Trust makes a $1.05 million trust distribution to Hold Trust.*

97. *At the time that Asset Trust makes a trust distribution to Hold Trust, a reasonable estimate of Asset Trust's:*

- *MIT cross staple arrangement income for the current income year is $200,000, and*
- *total assessable income for the current income year is $4 million.*

98. *Based on these reasonable estimates, the percentage of MIT cross staple arrangement income for Asset Trust is 5% of its total assessable income. Accordingly, the de minimis exception applies so that the $50,000 in cross staple rental income of Asset Trust is not MIT cross staple arrangement income. It follows that Asset Trust is not required to identify any amount of the trust distribution as NCMI (assuming the amount is not, or not attributable to, another class of NCMI) in its distribution statement to Hold Trust for the end of the first three months of the 2019–20 income year.*

The capital gains exception

99. An amount is not MIT cross staple arrangement income to the extent it is attributable to a capital gain made by an asset entity, where:

- an operating entity acquires an asset from the asset entity, and
- both entities are stapled entities in relation to a cross staple arrangement – that is, the asset entity and an operating entity are parties to a cross staple arrangement.[64]

100. This exception can apply regardless of which CGT event gives rise to the capital gain of the asset entity. For example, a capital gain made by an asset entity on the grant of a lease (CGT event F1) or the grant of a long-term lease (CGT event F2) can also qualify for the exception, provided all the other requirements are met.

101. If the calculation of the capital gain derives from amounts which do not reflect arm's length dealings between the operating entity and the asset entity, the Commissioner would consider whether specific provisions in the law, including the capital gains tax market value

[63] Subsection 12-438(5).
[64] Subsections 12-436(8), 12-437(6) and (7).

substitution, MIT non-arm's length income or general anti-avoidance provisions, would apply.

Integrity of the rules

102. The Act reflects the Government's intention to address the integrity of the Australian tax system in respect of the use of stapled structures and access to tax concessions for foreign investors.[65] The Commissioner may consider the application of the general anti-avoidance provisions of Part IVA of the ITAA 1936 to arrangements that are directed at obtaining a tax benefit from structuring around the operation of the Act. This includes, but is not limited to, schemes that, in an artificial or in a contrived manner, involve:

- the structuring of an arrangement to avoid the 80% common participation interest test
- restructure of ownership or interests in the arrangement entities to avoid the 80% common participation interest test, or
- a restructure of an existing arrangement to attract the operation of one or more of the specific exceptions covered in section 12-437.

MIT cross staple arrangement income – transitional rules

103. The transitional rules apply in relation to MIT cross staple arrangement income that is attributable to a facility that existed or was sufficiently committed to prior to 27 March 2018.

104. The transitional rules also apply to subsequent expansions and enhancements where assets are added to or an existing facility is otherwise improved or extended, provided the investment did not bring into existence a new, separate facility.[66]

105. If the transitional rules apply, the general existing MIT withholding rate of 15% will apply broadly from the facility's relevant start date for a period of seven years, or 15 years if the facility is an economic infrastructure facility. The transitional rules will apply if, *inter alia*, one of the following alternative threshold tests are met:

- an investment is approved by an Australian government agency (first alternative threshold test)[67], or
- there is a pre-existing or sufficiently committed investment (second alternative threshold test).[68]

106. The transitional rules may provide the following transitional benefits:

- amounts of rent from land investment[69] may be excluded from MIT cross staple arrangement income if the requirements in subsection 12-440(3) are satisfied[70], subject to the integrity rules[71], and
- an operating entity may be entitled to a deduction for an amount of rent from land investment if the requirements in section 25-120 of the ITAA 1997 are satisfied.[72]

[65] Paragraph 1.15 of the Explanatory Memorandum.
[66] Paragraph 1.111 of the Explanatory Memorandum.
[67] Subsection 12-440(1).
[68] Subsection 12-440(2).
[69] As defined in subsection 995-1(1) of the ITAA 1997.
[70] Subsection 12-440(3). Note also paragraph 1.121 of the Explanatory Memorandum.
[71] Sections 12-441 to 12-445.
[72] Note also paragraphs 1.123 to 1.127 of the Explanatory Memorandum.

First alternative threshold test – where an investment is approved

107. The first alternative threshold test is in subsection 12-440(1), which states:

> This section applies if:
>
> (a) before 27 March 2018, an Australian government agency:
>
> (i) decided to approve the acquisition, creation or lease of a facility; and
>
> (ii) publicly announced that decision; and
>
> (iii) took significant preparatory steps to implement that decision; and
>
> (b) either:
>
> (i) a cross staple arrangement was entered into in relation to the facility before 27 March 2018; or
>
> (ii) it was reasonable on 27 March 2018 to conclude that a cross staple arrangement will be entered into in relation to the facility; and
>
> (c) all the entities that are stapled entities in relation to the cross staple arrangement already existed before 27 March 2018; and
>
> (d) each entity that is a stapled entity in relation to the cross staple arrangement has made a choice in accordance with subsection (5).

Approval requirement

108. The first requirement comprises three elements, each of which must be satisfied in relation to an Australian government agency, dealt with in paragraphs 109 to 112 of this Ruling.

Australian government agency or authority of the Commonwealth or of a state or territory

109. An Australian government agency is defined in subsection 995-1(1) of the ITAA 1997 as:

> (a) the Commonwealth, a State or a Territory; or
>
> (b) an authority of the Commonwealth or of a State or a Territory.

110. 'Authority' is not defined but has been considered in numerous cases, whether as authority, or public authority.[73] There is no universal test for what is an 'authority'.[74] The question will be one of fact and degree.[75]

111. The Commissioner considers that in context, for a body to be an authority of a Territory, State or of the Commonwealth, the body must be an authority in the ordinary sense of the word established by the cases.[76] It must perform a traditional or inalienable function of government and have governmental authority for doing so.[77] The body must also be an agency or instrument of government set up to exercise control or execute a function in the public interest. It must be an instrument of government existing to achieve a government purpose.[78]

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[73] *Western Australian Turf Club v Commissioner of Taxation (Cth)* [1978] HCA 13, per Barwick CJ. The addition of 'public' in 'public authority' does not add much, but emphases the public nature of the activity.
[74] *Commissioner of Taxation v Bank of Western Australia Ltd* [1995] FCA 1028 (*Bank of WA*), per Hill J.
[75] *Bank of WA*, per Hill J; *Western Australian Turf Club v Commissioner of Taxation (Cth)* [1978] HCA 13.
[76] *Bank of WA*, per Hill J at [429] – [430].
[77] *Renmark Hotel Inc v Commissioner of Taxation* [1949] HCA 7; *General Steel Industries Inc v Commissioner for Railways* [1964] HCA 69; and *Re Anti-Cancer Council (Vic); State Public Services Federation, Ex p* [1992] HCA 53.
[78] *Committee of Direction of Fruit Marketing v Australian Postal Commission* [1980] HCA 23, per Gibbs J.

112. It follows that a local government, or any other agency established for a government purpose with the relevant authority to approve the relevant investment, would meet the requirement.

Element 1 – decided to approve the acquisition, creation or lease of a facility

113. Firstly, an Australian government agency must have decided to approve the acquisition, creation or lease of a facility. That decision to approve must be under and in accordance with a relevant power.

114. 'Approve' takes its ordinary meaning, judicially considered to be 'to confirm authoritatively; to sanction to pronounce to be good; commend'.[79]

115. The approval must be in context, that is, the facility must be something that requires an approval or permission process resulting in a decision to approve or reject, and the approver's approval is ultimately determinative of whether the project can, or cannot, proceed.

116. A preliminary, in-principle, contingent or mere statement of approval will not be sufficient to constitute a decision to approve. The decision-making process giving rise to the decision must have concluded in all material respects. This will be a question of fact and degree to be examined in all of the circumstances. The decision must also be validly made by the decision maker.

117. An advisory body which provides advice or makes recommendations to a decision maker will not satisfy the requirement, even if that advisory body is a government department or agency and the decision maker is a Minister who customarily relies on such advice. The relevant decision in such a situation is the Minister's decision. Likewise, an approval that an investment is not contrary to the national interest, or satisfies certain environmental criteria is not a relevant approval, as it will not ultimately allow the construction and eventual operation of the facility. Such an approval is merely a necessary, but not sufficient, condition in certain instances.

Acquisition, creation or lease of a facility

118. The first element of the first alternative threshold test also requires that the decision to approve be for the acquisition, creation or lease of a facility. That facility must be sufficiently identifiable at the relevant date. What relevantly constitutes the Commissioner's view on what is the *acquisition, creation or lease* of a facility is dealt with in paragraph 147 of this Ruling.

119. The Commissioner's view on what constitutes a facility is dealt with in paragraphs 152 to 203 of this Ruling, and what constitutes an economic infrastructure facility in paragraphs 204 to 229 of this Ruling.

Element 2 – publicly announced

120. The second element is that the decision to approve must be publicly announced by the Australian government agency that made the decision.[80] 'Announced' is not defined, but what will be a relevant announcement will be very much a product of the facts and circumstances.

121. In context, the requirement to publicly announce should be taken as a requirement to be made known publicly. The Commissioner expects that an announcement will follow and provide evidence of the relevant decision. An announcement of indication of policy intention or goals will not be sufficient.

[79] *McDonalds System of Australia Pty Ltd v McWilliams Wines Pty Ltd* [1979] FCA 142.
[80] Subparagraph 12-440(1)(a)(ii).

122. Where the Australian government agency is under an obligation to publish the decision, for example by way of notice in the Government Notices Gazette or broadly circulated newspaper, and has in fact published the decision, the Commissioner will accept the published notice as evidence of the announcement.

Element 3 – significant preparatory steps

123. The third element[81] requires that significant preparatory steps be taken by the Australian government agency to implement the decision.

124. The term 'significant preparatory steps' is not defined. The Commissioner considers that, having regard to the context, the phrase directs attention to objectively determinable steps that contribute, in a significant and practical way, to the relevant acquisition, creation or lease of the facility. Those steps will necessarily be preparatory or introductory in nature, however, investigatory steps or those to determine the feasibility of the proposed facility will generally be insufficient.

125. What is significant in the circumstances will be a question of fact and degree, dependent on the nature of the decision and what steps might reasonably be expected to be undertaken by the approver to implement the decision. Where only very limited further action is required from the approver to implement the decision, a material, but small step, such as publication of the decision, may be sufficiently significant. In context, where substantial further actions are required to implement the decision, publication is very unlikely to be regarded as 'significant'.

126. The Commissioner considers that steps prior to the decision to approve the acquisition, construction or lease of a facility could have the necessary character as preparatory to the implementation of the decision, but only if those steps are not more properly characterised as preparatory to the making of the decision.

A cross staple arrangement was entered into in relation to the facility

127. The second requirement of the first alternative threshold test requires a cross staple arrangement in relation to the facility.[82] The second requirement contains two alternative limbs, where either:

- a cross staple arrangement was entered into in relation to the facility before 27 March 2018[83], or
- it was reasonable on 27 March 2018 to conclude that a cross staple arrangement will be entered into in relation to the facility.[84]

128. The first alternative limb requires that a cross staple arrangement was entered into prior to 27 March 2018. This is expected to be a question of fact. It will also be a question of fact and degree as to whether any arrangement will have the necessary nexus to the facility.

129. The second alternative limb is relevant if no cross staple arrangement was entered into before 27 March 2018. An investment in relation to a facility may still satisfy the transitional rules if it was reasonable, on 27 March 2018, to conclude that a cross staple arrangement will be entered into in relation to the facility.[85]

130. Whether something may reasonably be concluded is a question of an objective standard of the reasonable bystander.[86] This will require objective evidence that the cross

[81] Subparagraph 12-440(1)(a)(iii).
[82] Paragraph 12-440(1)(b).
[83] Subparagraph 12-440(b)(i).
[84] Subparagraph 12-440(b)(ii).
[85] Subparagraph 12-440(1)(b)(ii).
[86] *Lee v R* [2007] NSWCCA 71; *Leask v Commonwealth* [1996] HCA 29.

staple arrangement structure was intended at that date. That evidence must also be contemporaneous; *ex post facto* recollections from key personnel or directors in the absence of documentary records made prior to 27 March 2018 will not be sufficient. Further, evidence that a stapled structure was suggested, contemplated, speculated about or tentatively agreed to will not be sufficient.

131. The cross staple arrangement identified by paragraph 12-440(1)(b) must be the cross staple arrangement in relation to the facility. It must be that facility for which the cross staple arrangement received the approval in relation to its acquisition, creation or lease.

132. The phrase 'in relation to' is of wide meaning and directs the reader's attention back to the object of the provision[87], indicating a connection or association (direct or indirect) between two subject matters.[88] Construing the phrase in context, although the words are of wide import, the Commissioner expects this requirement will be satisfied where it is reasonably evident that the stapled entities each have or will have an interest in the same facility, and that the operating entity will derive its interest from the asset entity.

133. The 'relationship', in context, must be sufficiently broad to accommodate yet-to-be constructed facilities. However, the facility must at least be objectively identifiable and definable at the relevant time. The arrangement will not be 'in relation to a facility' where the stapled entities' relationship with the facility is tenuous or unclear, or where the entities do not have the relationship with the facility as identified before 27 March 2018.

All the entities that are stapled entities in relation to the cross staple arrangement already existed before 27 March 2018

134. The third requirement of the first alternative threshold test is that each entity that is a stapled entity must exist before 27 March 2018.[89] The entities must have been properly constituted, and registered (if required), prior to 27 March 2018.

Each entity has made a choice in accordance with subsection 12-440(5)

135. The final requirement to satisfy the first alternative threshold test of the transitional rule is that each entity that is a stapled entity must make a choice in accordance with subsection 12-440(5). The choice:

- must be made by the entity in the approved form[90] and no later than 30 June 2019, or at such later time as is allowed by the Commissioner
- must be given by the entity to the Commissioner within 60 days after the entity makes the choice, and
- is irrevocable.

136. The choice must be made separately by each of the entities who are the parties to the cross staple arrangement giving rise to rent from land investment. This will generally be the operating entity which incurs the rent and the asset entity which derives the rent.[91] Thus, if the stapled entities comprise of one operating entity and one asset entity, the Commissioner must receive two separate, validly completed approved forms within 60

[87] *Pearce, J.J. (as the nominated person of the representative class of vendor shareholders of Sayani Pty Ltd) v. Commissioner of Taxation* [1988] FCA 771; refer also *Hatfield, S.B. v. Health Insurance Commission* [1987] FCA 462.
[88] *HP Mercantile Pty Limited v Commissioner of Taxation* [2005] FCAFC 126, per Hill J; *Amrit, L.N. v Parnell, J* [1986] FCA 89*; O'Grady v Northern Queensland Co Ltd* [1990] HCA 16, per McHugh J.
[89] Paragraph 12-440(1)(c).
[90] Refer to *Stapled groups – choice to apply transitional provisions* on **ato.gov.au** for more information.
[91] Paragraph 1.116 of the Explanatory Memorandum.

days after making the choice under subsection 12-440(5) in order for the transitional provisions to apply.[92]

137. Even if the choice is made by the required time, unless the choice forms are given to the Commissioner in the required time, the transitional rules cannot apply.

Second alternative threshold test – pre-existing investments

138. The second alternative threshold test for the transitional rules to apply is where a contract or investment in relation to a facility has been entered into before 27 March 2018 in accordance with subsection 12-440(2).

139. Subsection 12-440(2) states:

> This section also applies if:
>
> (a) any of the following applies:
>
> (i) an entity entered into a contract before 27 March 2018 for the acquisition, creation or lease of a facility;
>
> (ii) an entity owns, or is the lessee of, a facility at a time before 27 March 2018; and
>
> (b) either:
>
> (i) a cross staple arrangement was entered into in relation to the facility before 27 March 2018; or
>
> (ii) it was reasonable on 27 March 2018 to conclude that a cross staple arrangement will be entered into in relation to the facility; and
>
> (c) all the entities that are stapled entities in relation to the cross staple arrangement already existed before 27 March 2018; and
>
> (d) each entity that is a stapled entity in relation to the cross staple arrangement has made a choice in accordance with subsection (5).

Requirement for existing commitment before 27 March 2018

140. The first requirement of the second alternative threshold test of the MIT cross staple arrangement income transitional rules is satisfied if one of two alternative limbs is met.

Contract for the acquisition, creation or lease of a facility

141. The first alternative limb is that an entity must have, before 27 March 2018, entered into a contract for the acquisition, creation or lease of a facility. That entity must be one of the entities referred to in paragraphs 12-440(2)(c) and (d).

142. A contract will come into existence in accordance with the ordinary law of contract. Steps taken up to, but not including, the formation of a contract will not be sufficient.

143. The contract must be for the acquisition, creation or lease of the facility. In the context of a payment, that payment cannot be described as a consideration 'for' anything but that which is given in exchange for it.[93] A contract will be 'for' the acquisition, creation or lease of a facility when the object of the contract is one of those things, and nothing preparatory or contingent.

144. Hence, a conditional right to acquire an option or a contract for an option as, opposed to an obligation to acquire the facility will be too remote.[94] The Explanatory

[92] Refer paragraphs 12-440(1)(d) and (2)(d).
[93] *Berry v Commissioner of Taxation* [1953] HCA 70, per Kitto J.
[94] *Fowler v Commissioner of Taxation* [2013] FCAFC 69.

Memorandum sets out an example of a contract for a call option and explains that the contract is for the option, not the facility.[95]

145. A contract to acquire or lease land will not be a contract for the acquisition or lease of a facility, as land is not a facility in and of itself.[96]

146. The Explanatory Memorandum does not provide guidance on what is meant by 'acquisition, creation of lease of a facility'. However, it is clear that each of these terms is taken in isolation and does not form a composite phrase.

Acquisition, creation or lease

147. For the purposes of the MIT cross staple arrangement income transitional rules, the Commissioner's views are as follows:

An entity will have entered into a contract for the:	**where:**
acquisition of the facility	the facility is in existence and the entity enters into a contract for the freehold title to the facility. This would not include a contract granting a call option over the facility[97], or for something else preparatory or contingent in relation to the facility.
creation of the facility	the facility is identifiable in one or more contracts for the construction of that facility. The contract could not be said to be for anything preparatory or contingent to the construction. For example, where a contract is for preliminary works or the partial construction of the facility, such as preliminary earthworks, this will not be sufficient. Given the exemption ultimately relates to cross-staple rent, it is expected that the entity hold title or lease of the land upon which the facility is to be constructed in order that it be able to be the subject of a lease/sub-lease.
lease of a facility	the entity enters into a binding agreement which is properly characterised as a lease agreement. The agreement is not for an option or anything else preparatory or contingent to a lease and is properly described as a lease for the facility itself. A licence to access will not be sufficient, for example where access is permitted under statutory licence to install and maintain telecommunications facilities under the *Telecommunications Act 1997*. The lease will generally relate to an existing facility, but a present lease of a yet-to-be-constructed facility may satisfy the requirement, provided the lease is not contingent or conditional, the facility is sufficiently identifiable such that it can be said that the lease is *for* the facility and not land on which a facility will be constructed at some time in the future.

[95] Example 1.11 of the Explanatory Memorandum.
[96] Paragraph 1.114 of the Explanatory Memorandum.
[97] Example 1.11 of the Explanatory Memorandum.

Owns or leases a facility

148. The second alternative limb of the first requirement is that an entity must own or be the lessee of a facility at a time before 27 March 2018.

Cross staple arrangements

149. The second requirement of the second alternative threshold test in paragraph 12-440(2)(b) relates to a cross staple arrangement in relation the facility. This requirement is identical in formulation to that in paragraph 12-440(1)(b), discussed in paragraphs 127 to 133 of this Ruling.

All the entities that are stapled entities in relation to the cross staple arrangement already existed before 27 March 2018

150. The third requirement in the second alternative threshold test, in paragraph 12-440(2)(c), requires that each entity that is a stapled entity in relation to the cross staple arrangement to exist before 27 March 2018. This requirement is identical in formulation to that in paragraph 12-440(1)(c), discussed in paragraph 134 of this Ruling.

Each entity has made a choice in accordance with subsection 12-440(5)

151. The final requirement to satisfy the second alternative threshold test of the transitional rules is that each entity must make a choice in accordance with subsection 12-440(5). Paragraphs 135 to 137 of this Ruling deal with this requirement.

Facility

152. The concept of 'facility' is a key element of the MIT cross staple arrangement income transitional rules. The word 'facility' is not defined in the Act.

153. The *Macquarie Dictionary* online[98] definition of 'facility' relevantly includes (emphasis added):

> 8**. a building or complex of buildings, designed for a specific purpose**, as for the holding of sporting contests, launching of rockets, etc.

154. The *New Oxford American Dictionary*[99] defines 'facility' relevantly as:

> a place, amenity, or piece of equipment provided for a particular purpose: cooking facilities | facilities for picnicking, camping, and hiking | a manufacturing facility.

155. Other definitions of 'facility' indicate that the word has a broad and varied meaning, depending on the context in which it is used. In context, the ordinary meaning of the word indicates a connection, both physical and functional, of assets coming together for a particular purpose. While the identification of what is a 'facility' depends on the level of abstraction in which it is approached, the Commissioner considers that given the breadth of the ordinary meaning of the word 'facility', it is necessary to consider the context of the amendments, the Act and extrinsic materials.[100]

156. The word facility is central to identifying the parameters of what amounts fall within or outside the ambit of the transitional rules. It is only amounts of rent from land

[98] Macmillan Publishers Australia, *The Macquarie Dictionary* online, www.macquariedictionary.com.au, viewed 18 August 2020.
[99] Oxford Dictionaries, 2015, *New Oxford American Dictionary*, 3rd edn, Oxford University Press.
[100] Refer also to comments in *Hutchison 3G Australia Pty Ltd v Director of Housing & Anor* [2004] VSCA 99, per Morris AJA.

investment[101] which relate to that identified facility that may qualify for transitional treatment.[102]

157. From time-to-time, where there is an existing facility, additional works may be carried out, with the following possible outcomes:

- Subsequent works expand and or create additional assets to alter that facility, whereby those expansions or alterations may still form part of the existing facility. In such cases, the transitional rules will apply to the expanded or altered facility.
- Subsequent works which expand, create additional assets or alter a facility, its capabilities or functions, are of such an extent and character that they do not form part of the existing facility. In such cases, the related amounts attributable to such expansions or alterations do not qualify for transitional treatment.
- It is also possible that subsequent works which expand, create additional assets or alter a facility, its capabilities or functions, are of such an extent and character that the existing facility ceases to exist. In such cases the facility will cease to qualify for transitional treatment.

158. The effect of expansions or alterations on the existing facility is to be determined having regard to the specific facts and circumstances of each case.

159. Broadly, the NCMI provisions dealing with MIT cross staple arrangement income have a focus on investment in the property and infrastructure markets. As such, the Commissioner will approach the identification of a relevant facility from a high-level understanding of the real property assets and with reference to the necessary connection between, and function of, the assets said to comprise the facility.

160. Determining those assets which comprise a relevant facility does not mean in all cases that the intricacies of how every individual asset relates must be scrutinised. However, that identification should be performed at a sufficient level to identify and describe the nature and connection between such assets, including purpose or function.

161. Importantly, the Commissioner considers that the approach in identifying a facility is not performed by identifying which assets comprise the operation of an integrated business.

What assets form part of a facility?

162. There are no statutory rules which govern what assets form part of a facility. The Commissioner considers that the starting point is the ordinary meaning of the word to identify those assets in accordance with the principles stated in this ruling. The commentary in the Explanatory Memorandum may assist with the identification of a facility, however it is not a substitute for the interpretation of the word in the context that it appears in the law. The Explanatory Memorandum describes a facility as 'a collection of assets that are connected and together perform a particular function such as, for example, an infrastructure facility or a property facility.'[103]

163. At a broad level, the Commissioner considers that for the purposes of the Act, the word 'facility' contemplates a tangible asset or group of assets having a physical connection with land. That the transitional rules[104] and approved economic infrastructure facility exception[105] apply to amounts of 'rent from land investment' is consistent with this

[101] That are included in the assessable income of a managed investment trust.
[102] Refer to paragraphs 232 to 236 of this Ruling for the Commissioner's view on when an amount relates to the facility.
[103] Paragraph 1.117 of the Explanatory Memorandum.
[104] Section 12-440.
[105] Subsection 12-437(5) and section 12-439.

view. However, the Commissioner considers that taxpayers should bear in mind that what might fall within the meaning of the term 'facility' will not necessarily align with the use of assets that will satisfy the eligible investment business requirements in Division 6C of Part III to the ITAA 1936. Separate regard must be had to those requirements. Further, land, without more, cannot be a facility.[106]

164. Assets which constitute 'moveable property' as contemplated under subsection 102MB(1) of the ITAA 1936 may not necessarily be excluded from forming part of a facility. This is because the transitional rules apply to a facility and recognise that it is amounts of 'rent from land investment' that relate to the facility which qualify for transitional treatment, with that term being defined by reference to 'Division 6C land'. 'Division 6C land' can include something that qualifies as an investment in land under subsection 102MB(1) of the ITAA 1936.[107] However, whether an asset which is moveable property forms part of a facility should be determined having regard to the principles in this Ruling.

165. Both the ordinary meaning of the word, and the Explanatory Memorandum indicate that 'facility' has both a connective and a functional essence. In most cases, a facility will comprise of a number of physically connected or proximate assets which possess some unifying function, whereby the assets can be identified as an integrated whole. The existence of a commonality in function across a group of assets will tend to indicate that such assets form part of the same facility. Where the degree of connection or alignment of function is tenuous, this may indicate that the relevant assets do not form part of the same facility.

166. Hence, physical and functional connection are both major considerations in determining which assets form part of the same facility.[108] Both physical and functional connection should be considered in conjunction, and the weighting of each would depend on the facts and circumstances of the relevant case.

167. While the absence, or low degree, of either physical or functional connection does not necessarily mean that the relevant assets are not part of the same facility, it may be an indicator of such a conclusion. However, it may be that assets having a low degree of functional connection but high degree of physical connection, or conversely a low degree of physical connection but high degree of functional connection, form part of the same facility. For instance, assets which are not physically connected, but are adjacent to each other, may be part of the same facility where there is a strong functional connection, but would not be part of the same facility where they are entirely functionally separate. Assets physically subsumed within a broader facility may be part of the facility even where they retain some functional independence.

168. Where a tangible asset or group of assets are solely used for operating or maintaining a facility, this would be a factor that is suggestive, but not conclusive, that the asset or group of assets is part of the same facility.

169. There may be relevant considerations beyond those physical and functional connections that support the identification of a relevant facility. Factors identified in paragraph 1.118 in the Explanatory Memorandum may also be relevant in determining what assets form part of the same facility.

170. No factor considered in isolation is determinative (including degree of physical or functional connection), and a consideration of all the facts and circumstances must be undertaken. Factors beyond physical and functional connection are more likely to be relevant in circumstances where an assessment of physical and functional connection is not overly influential. These factors include those specified in the Explanatory Memorandum as mentioned in paragraphs 171 to 203 of this Ruling.

[106] Paragraph 1.114 of the Explanatory Memorandum.
[107] Subsection 12-448(5).
[108] This is evident from the factors listed in the Explanatory Memorandum at paragraph 1.118.

Whether assets give rise to the same or separate revenue streams

171. The presence of separately identifiable revenue streams may be a factor, unlikely to be determinative by itself, indicative of separate facilities.

172. There is a level of abstraction that can be applied to the concept of a 'revenue stream'. For example:

- An airport might have numerous revenue streams, including fees for airplane parking, retail space, access to maintenance and aircraft services and landing fees.
- A stretch of tollway between toll gantries and entrance/exit ramps might have numerous revenue streams. One 3km section might generate discrete revenue and incur direct expenditure, for example on maintenance, allocated against the identifiable revenue stream. Another stretch of the tollway may generate a separate revenue stream, however this does not necessarily mean it constitutes a separate facility.
- Multiple facilities may result in a single revenue stream. An example of this might be a telecommunications network resulting in revenue from telephone contracts for the provision of communications services. A mobile telephone network may be made up of discrete facilities, for wireless and fixed line communications.

The legal rights of the parties in respect of the relevant assets

173. The following may be suggestive of a continuity and expansion of a currently identifiable facility:

- **scope of any existing and proposed lease agreement** – where an existing lease of a facility provides rights for, or commitment to, the construction of additional assets.
- **the applicable regulatory framework** – where additional assets are put to a purpose in aid of or are similar in function to, existing assets comprising the currently identifiable facility, and all the assets are subject to a specific regulatory regime.
- **any applicable licence or concession arrangements** – where the rights in relation to the operation of a facility granted by a relevant Australian government agency are contingent upon, for example, a licence which requires the service delivery to a set standard and to designated or mandated geographical areas.

Whether the financial viability of assets existing at transition time are dependent on expansions or enhancements occurring after the transition time

174. The more dependent the existing facility is on such expansions or enhancements, the more likely the expansion is part of the same facility.

175. Whether the financial viability of assets that existed at the transition time are dependent on expansions or enhancements occurring after the transition time is a question of fact and degree. Objective and contemporaneous evidence should exist (prior to 27 March 2018) to support this. This would include, but not be limited to, evidence of:

- the final investment decision
- committed funds and financing arrangements
- financial modelling

- business plans, and
- tenders.

Example 5 – depot servicing a toll road

176. *A depot is constructed after 27 March 2018 to hold equipment and to base staff to operate and maintain an existing stretch of toll road. The depot itself is physically below the road by being situated under a freeway off-ramp which is on land leased by the Operating Entity from the Asset Entity.*

177. *The depot is utilised by Operating Entity to carry out support work to ensure the safe and smooth operation of the toll road under its licence in relation to the delivery of the services provided by the toll road. The depot is used from time to time to store equipment and provide a permanent base for maintenance staff who conduct work exclusively for and on the toll road, including the removal of hazards from the road.*

178. *The depot does not give rise to a revenue stream. Asset Trust charges rent to Operating Entity pursuant to a lease calculated by reference to the total value of assets that are the subject of the cross staple arrangement (which includes the value of the depot). The depot is conveniently collocated for access to and on leased land occupied by the toll road.*

179. *The existing toll road and the depot are subject to the same regulatory regime in the sense that the depot is reasonably required for Operating Entity to meet its obligations to maintain the toll road.*

180. *The depot is considered to be an enhancement to, and part of, the existing toll road facility for the following reasons (none of which are determinative by themselves):*

- *The depot is physically below the assets forming a broader facility, being the toll road. The depot is so close to the toll road as to occupy the same land.*
- *Services provided from the depot maintain the toll road, to ensure the safe and effective operation of the toll road. The depot's sole function is to operate and maintain the toll road. It does not serve any other purpose or function. The efficient day-to-day operation of the toll road is directly dependent on the services provided by the depot.*
- *Operating Entity does not receive a separate revenue stream in respect of the depot.*
- *Operating Entity has a legal obligation to ensure the toll road is fit for purpose and maintained at a certain standard. The functions provided by the depot are inextricably linked with such maintenance standards.*

181. *Hence, although the new depot could be a facility in its own right, it may be considered here to form part of the toll road facility.*

Alternative facts to example

182. *The depot assets include some limited warehouse space which houses vehicles and equipment to maintain the toll road, with the majority of warehouse space utilised to service buses operated by the local council. It also includes office space whereby general administrative functions for Operating Entity are carried out.*

183. *The depot is not something which performs the same function as the toll road – being the facilitation of road transport for toll paying motorists. Further, the function of the depot here mainly involves things separate to maintaining the toll road. Notwithstanding the proximity to the toll road, the degree of functional integration of the depot is low, and on*

balance this would not give rise to a sufficient connection for the depot to form part of the toll road facility.

Example 6 – land held in abeyance pending new construction

184. *Asset Trust holds land on which an existing shopping centre facility is situated, which it leases to Operating Entity. Asset Trust acquires an additional parcel of land in anticipation of an expansion of the shopping centre to expand the retail space and car parking amenities. Due to regulatory approvals, including design, the construction and connection of the extension to the existing shopping centre will not occur for a number of years. The vacant land is leased to Operating Entity.*

185. *Under the lease the additional land requires a recalculation of the consideration as the rent that Asset Trust charges to Operating Entity is calculated by reference to the value of assets that are the subject of the cross staple lease (which includes the value of the vacant land).*

186. *The acquisition of the vacant land is not an enhancement to the existing shopping centre facility, or any facility, as it is merely vacant land. The extension and additional car parking amenities may, depending on the facts and circumstances, following completion, become assets forming part of the existing facility. However, until such time as the expansion on the vacant land is completed it could not be said to be integrated into an existing facility, irrespective of whether they later, in fact, form part of the existing facility. This conclusion applies irrespective of when the land was acquired.*

Example 7 – creation of a new facility (that replaces an existing facility)

187. *Asset Trust holds a small existing factory facility for manufacturing. Operating Entity wants to leverage new opportunities by converting its manufacturing business into a retail shopping centre (retail facility) to take advantage of encroaching urbanisation.*

188. *The construction of the retail facility is a new facility which replaces part of the existing facility, while maintaining a number of warehouses for storage. The retail shopping centre and the factory are not linked, functionally, or in any way other than occupying the same land. Indeed, the shopping centre facility physically replaces the existing factory facility. Further, while there may be a single revenue stream, it could not be said to be a continuation of the revenue stream from manufacturing, as the manufacturing facility will cease to operate.*

189. *Given these facts, the retail facility will be an entirely new facility.*

Example 8 – change of purpose of facility (same assets but different use)

190. *Asset Trust holds a lease to a port and subleases it to Operating Entity. Operating Entity uses it for the purpose of operating a business for the loading and unloading of freight. The port includes storage for bulk dry commodities, a small terminal building, internal roads and access ways. Incentivised by the State government, Operating Entity reviews its business and decides to repurpose the freight port into a cruise ship port for the landing and disembarkation of passengers.*

191. *There are some alterations to existing structures and surfaces, but they are relatively minor in the context of the port as a whole. Safety barriers and signage are erected in accordance with safety regulations.*

192. *As a consequence of the repurposing of the port facility:*

- *there remains a single, albeit different, revenue stream*
- *there has been no significant change to the physical composition of the port, and*

- *the purpose and function of the port remains one of transportation.*

193. *While use may have a bearing on the identification of a facility, in this case, without more, the application of the existing assets and facilities to a cruise ship port will not give rise to a new facility. This is because the identification of a facility should not be altered merely because of a change in usage, where the assets comprising a facility lend themselves to multiple uses.*

Example 9 – integrated network not a single facility

194. *Asset Trust holds a number of land assets which include warehouses and distribution centres which it leases to Operating Entity. Operating Entity uses its rights to the land to conduct a logistics business to provide services for the delivery of goods between locations (logistics network). The logistics network includes:*

- *warehousing and distribution assets in discrete, albeit strategic, geographic locations*
- *integrated IT systems to facilitate the network's operation, and*
- *vehicles for the transport of goods.*

195. *A facility must have a relevant connection to, and include an interest in, the land on which it is situated. Despite the functional integration of the warehousing provided by the business conducted by Operating Entity, the warehouses and distribution centres will not constitute a single facility. This is because:*

- *The discrete warehouses/distribution centres are remote from one another, often by hundreds, if not thousands of kilometres.*
- *Each discrete warehouse/distribution centre performs the same function yet operates wholly independently of another warehouse/distribution centre.*
- *The level of functional integration is provided by assets and systems which are not connected with land, i.e vehicles and IT systems.*
- *The functional integration is at a business level, not at a level of a collection of assets coming together to perform a particular function.*
- *There are no overarching regulatory regime or obligations on the operator of the business to maintain or expand the services provided.*

Example 10 – airport facility

196. *An airport is a facility for the aerial transportation of people and cargo. An airport facilitates the loading and unloading of passengers and cargo onto or from aircraft, and the taking off and landing of aircraft. The functional relevance of particular assets to the function of the airport, and the physical integration with assets having a direct functional relevance to the airport, are major considerations in identifying the composition of the facility.*

197. *The aprons, runways, taxiways, control towers, terminals, air-bridges, and cargo bays serve the central function of facilitating the take-off and landing of aircraft and loading and unloading passengers and cargo onto or from aircraft. They are all physically integrated – all are necessary to be in the location that they are, connected to each other, to facilitate the core function of an airport. Therefore, they will form part of the same (airport) facility.*

198. *The hangars and storage for airport equipment located on or around the core parts of an airport, while not facilitating aerial transportation themselves, form part of the airport facility by reason of their direct functional relevance to the operation of the aircraft which land at or take off from the airport They do not serve any other purpose.*

199. *Shops, hotels, and business premises (for example of airlines) that are located on the airport site, but outside terminal buildings, have only indirect relevance to the function of an airport. They do not pertain to the aerial transportation of people and cargo, and only provide a complementary function to the core function of the airport. The main function of such assets does not change whether they are located at the airport site or at another location. Accordingly, they are not part of the same (airport) facility.*

200. *A luggage shop, for example, has the same functional relevance (that is, the sale of luggage items) whether it is located at an airport or in a suburban shopping centre. The fact that passengers use luggage is irrelevant and does not mean there exists the necessary connection to aerial transportation – function must be looked at in the context of the physical facility itself (here, the airport). However, if the luggage shop is located inside an asset of the facility such as a terminal building, it cannot be distinguished as physically separate. Therefore, it is part of the same facility, because it is part of the same asset (that is, the terminal building) that is necessarily part of the airport facility.*

201. *A business park (which comprises buildings used for general business purposes such as offices or conference rooms) does not form part of the airport facility even though it is located on the airport site. It does not relate to the aerial transportation of people and cargo, but rather provides a complementary function to the core function of the airport. That a business park may be located the same distance as, for example a hangar, to the terminal, does not impact on the conclusion. Its existence on an airport site is due to the benefits associated with geographic proximity to, rather than being relevant to the function of, the airport.*

202. *Assets which facilitate transport to and from the airport may or may not be part of the airport facility, depending on an examination of all the facts and circumstances. This would include whether they are physically part of, connected or proximate to, the assets comprising the airport facility; the time they are created; and the degree of their functional relevance to and degree of dependence on the airport.*

203. *Roads, car parks, taxi ranks, bus stations and railway stations are therefore more likely to be part of the same airport facility where they: are physically integrated with airport terminals or are in close proximity to them; were built at or around the same time as the rest of the airport; and are utilised exclusively by individuals to get to and from the airport.*

Economic infrastructure facilities

204. Economic infrastructure facilities are a subset of facilities. What constitutes an 'economic infrastructure facility' is relevant to:

- the application of the approved economic infrastructure facility exception to MIT cross staple arrangement income[109],
- the application of a 15-year period to which the transitional provisions for the MIT cross staple arrangement apply, and
- in respect of both those items, integrity rules that limit the quantum of 'excepted MIT CSA income'[110], that can be excluded from being NCMI.

205. Common to the application of the provisions in respect of each of the items in paragraph 204 of this Ruling is the existence of rent from land investment.

[109] This exception is provided in subsection 12-437(5) for approvals under section 12-439, with one of the conditions being that the relevant facility (or improvement to a facility) must be approved by the Treasurer for the purposes of that provision. In considering whether to exercise the discretion conferred by section 12-439 to approve a facility (or improvement to a facility), the Treasurer must be satisfied, amongst other things, that the facility is an economic infrastructure facility, refer to paragraph 12-439(4)(a).

[110] As defined in section 12-442.

206. Economic infrastructure facility is defined in subsection 12-439(5) as:

> An **economic infrastructure facility** is a facility that is any of the following:
>
> (a) transport infrastructure;
>
> (b) energy infrastructure;
>
> (c) communications infrastructure;
>
> (d) water infrastructure.

207. 'Infrastructure' is not defined in the TAA. The *Macquarie Dictionary online*[111] defines infrastructure as:

> *noun* **1.** the basic framework or underlying foundation (as of an organisation or a system).
>
> **2.** the roads, railways, schools, and other capital equipment which comprise such an underlying system within a country or region: **MPs had called for the government to spend its share on country roads and telecommunications infrastructure.* – AAP NEWS, 2000.
>
> **3.** the buildings or permanent installations associated with any organisation, operation, etc.

208. It should not be assumed that merely because an asset, or collection of assets form part of an identified facility, that all assets forming part of the facility in its widest or greatest possible abstraction in aggregate will constitute a single economic infrastructure facility. Regard must still be had to the all the relevant facts and circumstances pertinent to the identification of a 'facility' and 'economic infrastructure facility'.

209. In context, the term 'economic infrastructure facility' connotes an enduring facility that supports or enables economic activity and improves national productivity.[112] The Commissioner considers that these are key attributes and will be particularly helpful in identifying an economic infrastructure facility. The specified categories of economic infrastructure facility in subsection 12-439(5) should therefore be construed in that context.

210. The Explanatory Memorandum provides some specific examples of a collection of assets which may, or may not be economic infrastructure facilities[113], including the following:

	Economic infrastructure facility?
Toll road networks	Yes
Ports	Yes
Mining operation	No
Water facility built for use by a single commercial business	No

211. It should also be noted, in a similar vein to the comments in paragraph 163 of this Ruling, that a facility which is an economic infrastructure facility will not necessarily align with the use of assets that will satisfy the eligible investment business requirements in Division 6C of Part III to the ITAA 1936.

Transport infrastructure

212. The first category of economic infrastructure facility is 'transport infrastructure'. 'Transport infrastructure' is not defined, and the ordinary meaning of the phrase has a generality about it.[114]

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[111] Macmillan Publishers Australia, *The Macquarie Dictionary* online, www.macquariedictionary.com.au, viewed 19 August 2020.
[112] Paragraph 1.80 of the Explanatory Memorandum.
[113] Refer to paragraphs 1.80 and 1.81 of the Explanatory Memorandum.
[114] *Red Hill Iron Ltd v API Management Pty Ltd* [2012] WASC 323 at [201], per Beech J.

213. Some guidance may be provided in the capital allowances provisions. Subsection 40-870(1) of the ITAA 1997 defines 'transport facility' and includes a 'railway, a road, a pipe-line, a port facility or other facility for ships, or another facility that is used primarily and principally for transport … [of minerals or quarry materials]'.

214. In *Queensland Rail v Commissioner of Taxation*[115], Dowsett J considered that '… the words "in rail transport" mean *'in a system or means of transportation or conveyance of people or goods by rail*'. Such a system must inevitably involve loading and unloading activities and maintenance activities'.

215. The Commissioner considers that 'transport infrastructure', as used in the definition of economic infrastructure facility, could be any infrastructure (which is relevantly a facility) to transport people or things from one place to another and would necessarily include fixtures for the loading and unloading of passengers and goods. It would include, generally speaking, roads, airports and ports, noting that a general description does not necessarily assist in identifying the facility and regard must always be had to the ordinary meaning of the term in context. It would not include infrastructure or facilities to store or hold people or things[116], including for the conveyance itself (for example, the vehicles that operate on transport infrastructure).

216. It would not be sufficient that there be some transportation within a facility, for example, a:

- conveyor belt within a factory
- milk pipeline within a dairy, or
- conveyor of ore from pit to the run of mine stockpile.

Energy infrastructure

217. The second category of economic infrastructure facility is 'energy infrastructure'. 'Energy infrastructure' is not defined and will take its ordinary meaning in the context of a facility that is a piece of infrastructure as commonly understood.

218. Provided they are themselves a relevant facility, the Commissioner considers that the ordinary meaning of energy infrastructure could include:

- a bio diesel plant
- gas infrastructure, including for the transport and storage of gas, and
- electricity distribution networks and generation plants, including renewable energy generation and storage.

Communications infrastructure

219. The third category of economic infrastructure facility is 'communications infrastructure'. 'Communications infrastructure' is not defined.

220. The Commissioner considers that communications infrastructure is infrastructure which provides, for example, communications, radio, mobile telephone, internet – whether cables, transmission towers or smaller component transmission facilities.

221. A facility will only be communications infrastructure where it includes the actual means of communication as a central part of the facility. For instance, a business which makes available mobile phone towers and other elevated sites for third-party telecommunications operators to install their equipment will not be investing in a relevant communications facility.

[115] [2006] FCA 816 at [44].
[116] *Canwan Coals Pty Ltd v Commissioner of Taxation* [1974] 1 NSWLR 728.

Water infrastructure

222. The fourth category of economic infrastructure facility is 'water infrastructure'. 'Water infrastructure' is not defined.

223. Water infrastructure could be broadly described as including assets and facilities for the extraction, storage, processing and transportation of water, including water piping, dams and bores. For example, a desalination plant that is constructed to address issues of water supply for public consumption, would be considered to be water infrastructure.

224. It is clear however that a water facility built for use by a single commercial business, or ordinary domestic or commercial water piping, would not be sufficient and is not intended to be construed relevantly as 'water infrastructure'. Such assets do not exist to improve national productivity.

225. Where water infrastructure is installed in a location where an operator requires a licence to extract water from a particular body of water, the intangible water licence will not form part of the water infrastructure facility despite being a necessary precondition for the function of the business.

Economic infrastructure facility examples

226. When identifying an economic infrastructure facility, regard must be had to the categories of infrastructure within the definition in subsection 12-439(5), as discussed in paragraphs 204 to 225 of this Ruling. Assets which do not form part of the relevant four categories of infrastructure are unlikely to comprise part of an economic infrastructure facility because they do not meet the requirements of the definition. That is to say, the existence of an economic infrastructure facility asset does not mean that other assets and facilities which are complementary will be 'coloured' by that piece of infrastructure, such that they become, for example, transport infrastructure (under paragraph 12-439(5)(a)). However, this does not mean that an asset will necessarily be disaggregated merely because a part of it serves a function merely incidental to, for example transport.

227. Examples of whether or not there is an economic infrastructure facility include:

- A mine with a water facility, for example being a dewatering system for the removal of ground water from the mine site will not be an economic infrastructure facility.
- A power station may be an economic infrastructure facility (as energy infrastructure). However, administration buildings housing various administrative functions, only some of which pertain to the power station, are neither an economic infrastructure facility, nor part of the power station facility. This can be contrasted with an operating control room which is not necessarily connected to the power station but is in close proximity and solely used for the operation of the power station.

Example 11 – airport – economic infrastructure facility

228. *Further to Example 10 of this Ruling, the airport facility may be viewed an economic infrastructure facility on the basis that it is transport infrastructure.*[117] *It operates to facilitate the transport of people or things from one place to another. It is an enduring facility; supports economic activity by providing employment and improving transport links; and improves national productivity as its existence enables the facilitation of domestic and international tourism, business and trade.*

[117] Subsection 12-439(5).

229. *The assets in Example 10 of this Ruling which do not comprise the airport facility (for example, the business park assets) cannot by definition form part of the airport economic infrastructure facility, as they do not form part of the airport facility. Also, the business park and the individual assets comprising the business park could not be considered as an economic infrastructure facility in their own right, as they do not satisfy one of the four categories mentioned in subsection 12-439(5). They do not involve the transport of people or things from one place to another, so would not be considered to fall in the 'transport infrastructure' category.*

Amount will not be MIT cross staple arrangement income

230. If either of the alternative threshold tests is satisfied, an amount derived, received or made by the MIT will not be MIT cross staple arrangement income of the MIT if it satisfies subsection 12-440(3), which states:

> An amount included in the assessable income for an income year of a managed investment trust is *not* ***MIT cross staple arrangement income*** of the managed investment trust if:
>
> (a) the amount is, or is attributable to, an amount derived received or made from another entity (the ***second entity***); and
>
> (b) the amount relates to the facility; and
>
> (c) the second entity is a stapled entity in relation to the cross staple arrangement; and
>
> (d) either:
>
> (i) if subparagraph 12-437(2)(a)(i) applies – the amount is rent from land investment paid from an *operating entity in relation to the cross staple arrangement to the managed investment trust; or
>
> (ii) if subparagraph 12-437(2)(a)(ii) applies – the amount is attributable to rent from land investment paid from an operating entity in relation to the cross staple arrangement to an *asset entity in relation to the cross staple arrangement; and
>
> (e) the time when the amount was derived, received or made by the managed investment trust meets the requirements in subsection (4).

231. Hence, the amount included in the assessable income of the MIT must be derived, received or made directly or indirectly from the operating entity that is a stapled entity in relation to the cross stapled arrangement. Only that proportion which is or is attributable to rent from land investment will satisfy the transitional rules[118], and only during the relevant transition period.[119]

Amount must relate to the facility

232. The second limb to the exception from MIT cross staple arrangement income in subsection 12-440(3) is that the amount of rent from land investment must relate to the facility. Where an amount is targeted at two or more objects, for example the facility and vacant land adjacent to the facility, the Commissioner expects an apportionment.

233. Critically, if there is no facility in existence, such that it has yet to be created, no amount could be said to relate to the facility.

234. An amount in respect of vacant land, whether or not set aside for future expansions of a facility, cannot be said to relate to the facility. Further, if it is intended to expand or improve an existing facility, until such time as the expansion or improvement is completed and integrated into the existing facility, then amounts in respect of the

[118] Paragraph 12-440(3)(d).
[119] Paragraph 12-440(3)(e).

uncompleted proportion cannot be said to be in relation to the existing facility. Accordingly, an apportionment of the amounts that relate to the existing facility will be required.

235. Hence, an amount cannot relate to something that is not part of the relevant facility. This would include amounts paid in relation to:

- land which is not part of the facility, including adjacent land
- assets, including chattels, which do not form part of the facility
- licences and other rights
- services provided with or within the facility, or
- a lease premium.

236. The Commissioner would expect a common sense, reasonable approach to attribution and apportionment in determining what amounts relate to the facility.[120] Where an insignificant proportion of the land is not occupied by the facility as defined and payments under a lease are not properly referable to items other than the land and facility, the rent can be taken to relate to the facility.

Rent from land investment

237. The amount qualifying for treatment under the transitional rules must be attributable to rent from land investment. The Commissioner discusses 'rent from land investment' in the context of the third-party rent exception from MIT cross staple arrangement income commencing at paragraph 51 of this Ruling.

Deduction for operating entity

238. If the transitional rules apply in relation to a cross staple arrangement, the operating entity may claim a deduction for an amount of rent from land investment derived or received by the asset entity if the requirements in section 25-120 of the ITAA 1997 are satisfied.

239. The general anti-avoidance rule in the income tax law (Part IVA of the ITAA 1936) applies only if a taxpayer has obtained a tax benefit in connection with a scheme. The allowance of a deduction to a taxpayer that is attributable to a choice is not a tax benefit for the purposes of Part IVA.[121] This is provided that the relevant scheme was not entered into or carried out for the purpose of creating the affairs that enabled such a choice to be made.[122]

240. Consequently, if a choice is made under subsection 12-440(5) to apply the transitional rules[123], then for the purposes of the general anti-avoidance provisions, the operating entity will not be taken to have obtained a tax benefit in relation to the deduction for the cross staple rent payment to the asset entity.[124] The exercising of a choice under the transitional provisions does not however preclude the potential application of the general anti-avoidance provisions to any other identifiable tax benefits associated with the use of a stapled structure.

241. Paragraph 25-120(2)(d) of the ITAA 1997 limits the quantum of the deductions for payments that give rise to excepted MIT CSA income of the asset entity. Excepted MIT

[120] *Ronpibon Tin NL v Commissioner of Taxation (Cth)* [1949] HCA 15.
[121] Refer subparagraph 177C(2)(b)(i) of the ITAA 1936, paragraph 69 of Law Administration Practice Statement PS LA 2005/24 *Application of General Anti-Avoidance Rules* and paragraph 1.125 of the Explanatory Memorandum.
[122] Subparagraph 177C(2)(b)(ii) of the ITAA 1936.
[123] This assumes the relevant requirements of section 12-440 have been satisfied.
[124] Paragraph 1.126 of the Explanatory Memorandum.

CSA income broadly covers income that would otherwise be MIT cross staple arrangement income, but for the application of either the:

- approved economic infrastructure facility exception, or
- MIT cross staple arrangement income transitional provisions.[125]

242. Deductions that give rise to other forms of income of an asset entity are not affected by this choice.[126]

Timing requirements

243. For MIT cross staple arrangement income, the applicable transitional rule period depends on whether or not the facility is an 'economic infrastructure facility'. The time requirements of subsection 12-440(4) are:

- where the facility to which the cross staple arrangement relates is **not** an economic infrastructure facility – before 1 July 2031 and before the later of[127]
  - 1 July 2026, and
  - the end of the period of 7 years beginning on the earliest day on which an asset being part of that facility is first put to use for the purpose of producing assessable income, or
- where the facility to which the cross staple arrangement relates is an economic infrastructure facility – before 1 July 2039, and before the later of
  - 1 July 2034, and
  - the end of the period of 15 years beginning on the earliest day on which an asset being part of that facility is first put to use for the purpose of producing assessable income.

An asset that is part of the facility is first put to use for the purpose of producing assessable income

244. The transitional period starts when an asset which is part of the facility is first put to use for the purpose of producing assessable income.[128]

245. Whether an asset being part of the facility has been put to use for the purpose of producing assessable income will be a question of fact and degree. For an asset being part of a facility to be put to use, the facility must first be in existence.

246. Notably, use of the asset need not directly generate or produce the income, but an income-producing purpose must be attributable to that asset.

What is an asset that is part of a facility?

247. 'Asset' in this context is not defined, hence it takes its ordinary meaning as informed by its context. The Commissioner considers that the relevant asset must be a tangible asset that is part of the facility, and its use is in furtherance of the facility performing the function originally intended.

[125] Sections 12-440 and 12-442.
[126] Paragraph 1.127 of the Explanatory Memorandum.
[127] Paragraph 12-440(4)(a).
[128] Subsection 12-440(4).

248. Subparagraphs 12-440(4)(a)(ii) and (b)(ii) focus on an asset that is part of the facility. The Commissioner considers that before an asset can be part of a facility, that facility must first be completed.

249. A facility identified for the purposes of the transitional rules may take some time to complete. However, in certain circumstances it may be possible to conceive of a facility in stages. That is, a relevant 'facility' for the purposes of the Act may exist following completion of a certain stage, notwithstanding that the facility approved and contracted for is incomplete. That facility may comprise one or more assets, which is put to use to produce assessable income. Hence, the transitional period commences on the day that the relevant operating entity uses the asset comprising that facility for the purpose of producing assessable income.

Example 12 – facility forming part of a later completed facility

250. *Asset Entity enters into a contract for the construction of a shopping centre before 27 March 2018. All other elements to access the transitional measure are satisfied. The shopping centre consists of a number of 'wings' (six in total) which in total will take 10 years to construct. However, the shopping centre will be constructed in stages and the first two wings will be operational (capable of performing the function of a shopping centre in themselves) in two years. Upon completion of the two wings there exists a relevant facility, notwithstanding that the facility for which the relevant construction contract was entered into is incomplete.*

First put to use

251. If a facility that qualifies under the MIT cross staple arrangement income transitional rules is an existing facility that is already in use and is currently producing income, the transitional rules apply to an amount that is derived, received or made before 1 July 2026, or if the facility is an economic infrastructure facility before 1 July 2034.[129]

252. If the facility that qualifies under the MIT cross staple arrangement income transitional rules is currently being constructed, or construction of the facility has not yet commenced, the transitional rules will apply to an amount that is derived, received or made after a time that an asset that is part of the facility is first put to use and starts producing assessable income and ceases in accordance with the timing requirements in subsection 12-440(4).[130]

253. Whether an asset forming part of a facility is put to use for the purpose of producing assessable income will be a question of fact and degree. 'Use' is not defined but has been described as being of wide import.[131] The ordinary meaning of 'put to use' implies something more than just merely being available for use and suggests some activity with respect to the asset. That asset must also first exist.[132]

254. In respect of land, 'use' has regard to the purpose to which the land is put.[133] Land requires some physical use, such as 'putting' the land to use'[134], 'making the land 'serve' some purpose'[135] or devoting the land to a particular purpose.[136] While 'use' cannot be

[129] Paragraph 1.130 of the Explanatory Memorandum.
[130] Paragraph 1.131 of the Explanatory Memorandum.
[131] *Newcastle City Council v Royal Newcastle Hospital* [1957] HCA 15 (*Newcastle Council*).
[132] Paragraph 10 of Taxation Ruling IT 2658 *Income tax: use of units of industrial property for the purposes of producing assessable income*.
[133] *Commissioner of Land Tax v Christie* [1973] 2 NSWLR 526 at [533], per Bowen JA; *Educang Ltd v Brisbane City Council* [2002] QSC 374 at [29], per White J.
[134] *Commissioner of Land Tax v Christie* [1973] 2 NSWLR 526; *Leda Manorstead Pty Ltd v Chief Commissioner of State Revenue* [2011] NSWCA 366 (*Leda Manorstead*) at [21], per Allsop P.
[135] *Newcastle Council*, per Kitto and Taylor JJ.
[136] *Newcastle Council*, per Taylor J.

some notional, potential future or contemplated use, it need not be for a productive return to be present use.[137]

255. There is also an element of futurity about the expression 'used for'. In the context of earthworks on land to ultimately construct a residential development, Allsop P in *Leda Manorstead* stated:

> The fact that the land was, at that time, at the stage of earthworks does not deny the present use of the land for commercial land development. It does not matter, in my view that the residential housing estates likely to be built in due course had not yet been completed, had not yet been taken their place in a completed residential development.

256. While passive use of land may include rental to an operating entity, before an asset comprising part of the facility can be used, that facility must first be in existence. That asset must be used, although there need not be a present productive return. That facility need not be in its final approved or contracted form but must exist at some relevant level of abstraction.

For the purpose of producing assessable income

257. The phrase 'an asset that is part of a facility is first put to use for the purpose of producing assessable income' in subsection 12-440(4), requires consideration of the purpose for which the asset is put to use. This includes an enquiry into the whole of the profit-making structure. The asset used must first be part of the facility and neither the profit-making structure nor the facility need be in its ultimate or final form to satisfy the test.

258. In considering whether something is used for the purpose of producing assessable income, the Commissioner accepts that it is not necessary to establish a direct nexus between the use of the asset that is part of the facility and identifiable assessable income (or even a right to assessable income) attributable to that use.[138] The use for an income-producing purpose need not be the dominant use, nor a significant use.[139] For completeness, whether the asset is held on capital or revenue account will not preclude it from being used for the purpose of producing assessable income.

259. Hence, having regard to the facility and the business, the test will be to assess the extent to which that asset (forming part of the facility) fits into the overall business structure, organisation set up or process established for the earning of assessable income.[140] It is not relevant whether the asset is put to use by either the operating entity or the asset entity. The Commissioner would expect that, given the anticipated activities of both the operating entity and the asset entity, once completed the facility (even if not in its ultimate form) or an asset forming part thereof, will immediately be used for the purpose of producing assessable income.

260. It also follows that for the MIT cross staple arrangement income transitional rules where a facility has not yet been constructed, there may be a pre-transition period prior to the completion of the facility. If that is the case, the benefits of the MIT cross staple arrangement income transitional rules will not apply during that period.

Examples of when an asset that is part of a facility is first put to use for the purpose of producing assessable income

261. In light of the contextual understanding of 'asset', examples of the asset first being put to use will necessarily reflect the business operation or other intended use of the facility. The putting to use of the asset is likely to at least be referable to the activities of the

[137] *Leda Manorstead* at [23] per Allsop P; *Minister Administering the Crown Lands Act v NSW Aboriginal Land Council* [2008] HCA 48 at [30–32], per Kirby J, and at [73] per Hayne, Heydon, Crennan and Kiefel JJ.
[138] Paragraph 3 of IT 2658; *NT86/10511 and NT87/7495 and Commissioner of Taxation* [1989] AATA 10.
[139] Paragraph 4 of IT 2658.
[140] Refer to general principles in *Sun Newspapers Limited v Federal Commissioner of Taxation* [1938] HCA 73.

lessee of the land on which the facility is located. The first use could potentially occur before ultimate completion of the facility that is approved and contracted for. For example, where an asset that is part of a self-contained component or collection of assets that could conceptually constitute a facility in itself, notwithstanding that it is intended to be part of a larger facility that is incomplete.[141]

262. Examples where an asset that is part of a facility is first put to use for the purpose of producing assessable income (despite the project involving the construction of the facility having further stages to progress before ultimately being complete) include:

- The first stage of a multi-stage toll road is opened to the public. While the designs have been approved and contracted for which will take several years over multiple stages, the stage completed is a facility in and of itself.
- While a water desalination and storage facility is being constructed, the desalination plant is switched on and pumps water into a city reservoir while the storage catchment is still being constructed.

In what circumstance might an investment cease to qualify for the transitional rules?

263. The MIT cross staple arrangement income transitional rules are not a 'one-off' test. The stapled entities in the cross staple arrangement in respect of the relevant facility must continue to satisfy the MIT cross staple arrangement income transitional rules.

264. This is because section 12-440 applies where the requirements in either subsection (1) or (2) are satisfied and the relevant choice is made, the MIT cross staple arrangement income transitional rules may apply for the relevant period in subsection (4) to:

- exclude an amount of rent from land investment from being MIT cross staple arrangement income, and
- provide for a deduction of an amount of rent from land investment in accordance with section 25-120 of the ITAA 1997.

265. However, even if section 12-440 applies, and specifically subsections 12-440(4) and (5) are satisfied, it does not follow that the transitional rules will continue to have effect in respect of the facility and the cross staple arrangement where there is some change in circumstances.

266. The operative provisions giving effect to the transitional rules are ambulatory. Therefore, regard must be had on an ongoing basis, to the requirements of subsection 12-440(3) and section 25-120 of the ITAA 1997 in order to determine whether the MIT cross staple arrangement income transitional rules continue to apply. Hence, merely making the choice in accordance with subsection 12-440(5), and/or satisfying either subsections 12-440(1) or (2) at one point in time will not in itself qualify a cross staple arrangement for the whole transition period.

267. Subsection 12-440(3) may provide for relief from MIT cross staple arrangement income and section 25-120 of the ITAA 1997 may provide a specific deduction where section 12-440 applies. Collectively these provisions focus on:

- the cross staple arrangement
- amounts that relate to the facility, and
- rent from land investment.

268. It follows that changes to the cross staple arrangement, ceasing to have a cross staple arrangement, or alterations to the facility, such that it ceases to be the facility

[141] Refer to paragraph 249 and Example 12 of this Ruling.

identified by subsections 12-440(1) or (2), will cause the relevant entities to fail the requirements of subsection 12-440(3) and section 25-120 of the ITAA 1997.

269. The following are some examples in which the relevant entities may cease to qualify for the MIT cross staple arrangement income transitional rules:

- cessation of cross staple arrangement – there is no stapled entity, being the second entity in accordance with paragraph 12-440(3)(c), and therefore, the amount referred to in paragraph 12-440(3)(d) is not an amount derived, received or made from, or attributable to an entity which is a stapled entity. For example, this situation may have arisen because although the arrangement is not altered, a change in ownership may cause the arrangement to fail the requirements of common ownership in paragraph 12-436(4)(c)
- replacement of cross staple arrangement – a new cross staple arrangement is entered into in relation to the facility, for example a new contract is entered into between the relevant operating entity and the relevant asset entity, different to the contract which existed before 27 March 2018
- where the amount is no longer 'in relation to the facility' – required by paragraph 12-440(3)(b), for example where
  - an additional, new and separate facility is created, or
  - augmentation of the existing facility is so dramatic that a new facility is identified
- where the relevant asset entity no longer exists and is replaced
- where the amount derived is no longer attributable to rent from land investment.

Renewed, renegotiated or otherwise affected cross staple arrangements

270. As noted in paragraph 142 of this Ruling, whether a contract is entered into will be a question of contract law and will not necessarily be limited to a lease arrangement. Similarly, what is a relevant arrangement will be a question of fact and degree. Circumstances could exist in which an arrangement has so fundamentally changed as to constitute a new cross staple arrangement (so as to fall outside of transitional relief). These could include changes sufficient to result in a new contract.

271. As long as the cross staple arrangement remains the same, something more than a mere extension of rights will be required. For example, a mere rent review under an existing contract will not result in a new cross staple arrangement.

272. The mere renewal of a lease agreement, covering the same facility and between the same parties would not, subject to the facts and circumstances, be expected to create a new cross staple arrangement.[142] Similarly, an ordinary exercise of an option to extend the arrangement without any material change would not be expected to cause transitional relief to cease to apply.

273. Examples of characteristics that could result in a new cross staple arrangement include:

- introduction of significant assets and facilities not part of the existing facility, for example where they alter the character of the arrangement, or where they dramatically augment the earlier facility such that the original facility can no longer be identified,

[142] Paragraph 1.122 of the Explanatory Memorandum.

- amending the terms and conditions, such as altering the lease from a year on year lease to a long-term lease may be sufficient to cause a new arrangement, and
- replacing parties, such that a change in the cross staple arrangement results from the change in stapled entities to a cross staple arrangement.

274. While replacing parties to a cross staple arrangement will result in loss of transitional relief due to the cessation of the relevant arrangement which existed at 27 March 2018, the Commissioner considers that a mere change in trustee[143] will not result in a new trust, and therefore not result in a cessation of the relevant cross staple arrangement. Depending on the facts and circumstances, this could include where a custodian is replaced, or custodian arrangement terminated.

275. A material change to the facility, such that it becomes a facility different to the one that existed prior to 27 March 2018 would cause transitional relief in relation to the facility to cease.

Interaction of the various transitional rules

276. The MIT cross staple arrangement income transitional rules apply to assessable income that is attributable to existing or sufficiently committed investments.

277. Where that income is captured by more than one of the classes of NCMI, transitional relief will not apply unless the transitional rules applicable to each class of NCMI are satisfied. For example, where an arrangement gives rise to both MIT cross staple arrangement income and MIT agricultural income, then the transitional provisions relevant to each of those categories would need to be satisfied in order for transitional relief to apply.

Integrity rules – concessional cross staple rent

278. Integrity rules can apply to limit the amount of concessional cross staple rent. The integrity rules broadly take two forms:

- the 'non-arm's length income rules' (NALIR) in Division 275 of the ITAA 1997. The NALIR applies generally to MITs, and includes but is not limited to arrangements resulting in 'excepted MIT CSA income', and
- the concessional cross staple rent cap (CCSRC)[144], which applies to 'excepted MIT CSA income' in relation to economic infrastructure facilities only.

279. 'Excepted MIT CSA income' means income of a MIT that would otherwise be MIT cross staple arrangement income and therefore NCMI, but for either of the following applying:

- the approved economic infrastructure facility exception[145], or
- where the transitional MIT cross staple arrangement income rules apply.[146]

Integrity rule – non-arm's length income rule

280. In circumstances where the facility is not an economic infrastructure facility, only the NALIR will apply.[147]

[143] Section 960-100 of the ITAA 1997.
[144] Sections 12-441, 12-443 and 12-444.
[145] Refer to sections 12-437(5) and 12-442(a).
[146] Refer to sections 12-440(3) and 12-442(b).

281. If the NALIR applies, the Commissioner may make a determination to treat an amount of ordinary or statutory income as non-arm's length income, where:

- the amount is derived from a scheme the parties to which were not dealing with each other at arm's length in relation to the scheme[148], and
- that amount exceeds 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[149], and
- the amount is not a distribution listed in subparagraphs 275-610(1)(c)(i) or (iii) of the ITAA 1997.

282. If the Commissioner makes such a determination, the relevant trustee is liable to pay tax on the amount of the specified non-arm's length income at the rate of 30%.[150] If a determination is made, then the amount of net income of the MIT will be reduced and the amount will not form part of a fund payment, or be assessable to Australian investors in the trust under Division 6 of Part III of the ITAA 1936.[151]

283. The operation of the NALIR is discussed in detail in Law Companion Ruling LCR 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*. However, for the purposes of the MIT cross staple arrangement income rules, the NALIR has been modified to ensure that the Commissioner will be able to apply the non-arm's length income determination where a MIT is not a party to the scheme.[152]

Integrity rule – concessional cross staple rent cap

284. The CCSRC integrity rule operates in relation to economic infrastructure facilities and can apply in addition to the NALIR.

285. The CCSRC will cap and deny concessional transitional treatment for an amount of excessive rent. There are two broad categories of CCSRCs:

- CCSRC – Existing, which applies in relation to either an existing lease with a specified amount of, or objective method to determine the amount of, annual rent[153] (CCSRC – Existing amount and CCSRC – Existing method respectively) which was set before 27 March 2018, and
- CCSRC – General, which applies by default where the CCSRC – Existing amount and CCSRC – Existing method do not apply. The cap is calculated by way of a formula.[154]

286. The CCSRC will apply where an amount of excepted MIT CSA income is derived, received or made by a MIT for an income year under a cross staple lease entered into by the relevant asset entity and the relevant operating entity, being an amount of rent from land investment under a lease.[155] To the extent that the amount of excepted MIT CSA income of the asset entity exceeds the CCSRC, that excess will not benefit from the relevant exceptions to MIT cross staple arrangement income. This will be the case whether the asset entity is a MIT or not, as subsection 12-441(3) deems the relevant asset entity to be a MIT for the purposes of the test.[156]

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147 Subparagraph 12-441(1)(b) and paragraphs 1.132 and 1.134 of the Explanatory Memorandum.
148 Paragraph 275-610(1)(a) of the ITAA 1997.
149 Paragraph 275-610(1)(b) of the ITAA 1997.
150 Subsection 275-605(2) of the ITAA 1997 and subsection 12(10) of the *Income Tax Rates Act 1986*.
151 Subsections 275-605(3) and (4) of the ITAA 1997.
152 Subsections 275-610(1A) and 275-615(1A) of the ITAA 1997.
153 Section 12-443.
154 Section 12-444.
155 Subsection 12-441(1).
156 Subsection 12-441(2).

287. The clarification that the amount of rent from land investment must be under a lease establishes the object of the paragraph, being the cross staple lease. The cross staple lease is that entered into by the relevant asset entity and the relevant operating entity, identified in subparagraphs 12-437(2)(a) and (b) respectively. It is this cross staple arrangement and hence the cross staple lease that will be tested against the CCSRC.

CCSRC – existing lease with specific rent or established rent method

288. The CCSRC – Existing method requires a lease to be in existence before 27 March 2018 in relation to a cross staple arrangement and a facility. It applies where an amount is identified in subsection 12-441(1) as excepted MIT CSA income[157], the cross staple lease was entered into before 27 March 2018[158], and the lease and/or the associated documents specify:

- the amount of annual rent under the lease for the first year of the lease that ends after 27 March 2018[159], or
- an objective method for determining the amount of annual rent under the lease.[160] That method must be set out in the documentation prior to 27 March 2018.[161]

289. It is possible that a lease may specify an amount which satisfies paragraph 12-443(1)(c)(i) for one income year, and an objective method (for the purposes of subparagraph 12-443(1)(c)(ii)) for a different income year. In those circumstances the Commissioner considers that the CCSRC is to be worked out in accordance with the amount or method that applies for the income year as specified in the relevant lease.[162]

290. A renewal of a cross staple lease that gives rise to a new lease on or after 27 March 2018, in circumstances where this does not affect the continuation of the cross staple arrangement, would result in the cross staple lease not satisfying paragraph 12-443(1)(c). This is because it is a new lease, and not the same lease as that contemplated under paragraph 12-443(1)(c). Hence, there would be no existing amount or method specified in the lease prior to 27 March 2018, and the asset entity must apply the CCSRC – General.

CCSRC – Existing method

291. The CCSRC – Existing method will apply where, in addition to other requirements, the lease or associated documents specify an objective method for determining the annual rent under the lease.[163] Also, that method must be set out in those documents before 27 March 2018.[164] Accordingly, *ex post facto* evidence created after that date is insufficient.

292. The Explanatory Memorandum outlines the requirements to establish a relevant method[165]:

> In order to establish that there is a method that is set out in the documents, the method must be objective and sufficiently prescriptive so that the calculation of the rental charge relies upon objectively discernible information, and produces a result that would be the same for any reasonable person applying it.

[157] Paragraph 12-443(1)(a).
[158] Paragraph 12-443(1)(b).
[159] Subparagraph 12-443(1)(c)(i).
[160] Subparagraph 12-443(1)(c)(ii).
[161] Paragraph 12-443(1)(d).
[162] Subsections 12-443(2) and (3).
[163] Subparagraph 12-443(1)(c)(ii).
[164] Paragraph 12-443(1)(d).
[165] Paragraph 1.152 of the Explanatory Memorandum.

293. 'Objective method' is not defined. The ordinary meaning of 'objective' relevantly lends itself to being free from personal feelings or prejudice, or bias.[166] Having regard to the context of the provisions, the Commissioner considers that an objective method contemplates:

- The method must be capable of application without reference to discretion or judgment by the parties to the lease. There should not be the opportunity to calculate lease payments which can in any way be influenced by the lessee and/or lessor.
- Where the method consists of a number of inputs into the amount rent payable, they must all be fixed prior to 27 March 2018 and determinable with sufficient precision. By way of example, where rent is calculated by multiplying a set amount by reference to a variable factor, and that variable factor is an independent benchmark[167], this would be suggestive of an objective method.
- The method should be sufficiently prescriptive such that its application is the same, no matter who applies the method. It should produce results capable of independent reproduction. However, this does not necessarily mean that in all instances if it were hypothesised that an independent third-party lessee and lessor were to enter into the same lease agreement, the lease payments calculated under that hypothetical agreement would yield *precisely* the same value or amount as that actually calculated.

294. Methods of arriving at an amount of rent which are not objective methods include a lease clause[168]:

- permitting the asset entity the discretion to set the rent
- requiring the parties to agree on an amount of rent, and
- requiring the amount of rent to be calculated by reference to a profit margin desired by the asset entity.

295. Hence, a method that permits the parties to agree on the rent, or a component of the rent formula, will not be an objective method.

296. If an objective method is set out in the cross staple lease or associated documents, before 27 March 2018, then the CCSRC – Existing method is the amount of rent determined by that method for the income year under the method mentioned in that subparagraph.[169]

297. The Commissioner expects that taxpayers will be able to provide documentary evidence that the method existed prior to 27 March 2018 by producing the relevant lease, and any associated documents, such as transfer pricing or market rent reviews, as well as any evidence of instructions to independent valuers and/or economists where applicable. There must be a clear connection between the cross staple lease and any associated documents.

Example 13 – agreed percentage of operating margin

298. *A lease agreement is entered into between Asset Trust (the lessor) and Operating Entity (the lessee) in July 2017. The lease agreement stipulates that the lease payment*

[166] *The Macquarie Dictionary* online relevantly defines 'objective' as '*adjective* 1**.** free from personal feelings or prejudice; unbiased', Macmillan Publishers Australia, *The Macquarie Dictionary online*, www.macquariedictionary.com.au, viewed 19 August 2020.
[167] For example, consumer price index.
[168] Paragraph 1.154 of the Explanatory Memorandum.
[169] Subsection 12-443(2).

amounts are calculated by applying a formula which applies a rental yield percentage to a prescribed value of the lessor's assets, less an operating margin.

299. *The lease agreement specifies that:*

(a) the rental yield is to be determined by an independent valuer

(b) the prescribed value of the lessor's assets is its regulated asset base, determined at the beginning of each income year by the industry regulator, and

(c) the operating margin is the lessee's operating expenses multiplied by a certain percentage as agreed between the lessee and lessor.

300. *In July 2017 an independent valuer is engaged who develops and records a method that is free from bias and influence of the parties. Through the application of this method, the valuer determines the rental yield as 5% (the application and result are also recorded at that time).*

301. *Conclusion: this is not an objective method. There is a component of the formula that is subject to the discretion of the lessor/lessee, being the operating margin. This is notwithstanding there are other components of the formula that are based on objective inputs and not subject to the lessor/lessee discretion or influence (that is, the rental yield and regulated asset base set by the regulator). The result is that Asset Entity must apply the CCSRC – General for the income years corresponding to the lease where there is no amount or objective method specified.*

302. *However, if the operating margin in the formula was already specified in the lease agreement (rather than being subject to agreement by the lessee and lessor), the method in the lease agreement would be considered to be an objective method as the method would be objective in its application.*

Example 14 – market value rent – appointment of valuer

303. *A 25-year lease agreement is entered into by Asset Trust (the lessor) and Operating Entity (the lessee) in January 2018.The lease agreement specifies that rent will be calculated as being market value rent, with periodic review dates every five years. Documentation referable to the lease agreement is prepared in January 2018, which specifies that the parties must use an independent expert (valuer) to assess market value rent at commencement of the lease, as well as at each rent review date.*

304. *In January 2018, in accordance with the documented agreement, the parties obtain an independent valuation of market value rent. In coming to that valuation, and at the request of the parties to the lease, the valuer sets out a method for determining the quantum of market value rent. That method requires the independently established asset values determined by the regulator to be multiplied by the average of a benchmark of profit margins in comparable industries as the rent calculation method. The method is sufficiently prescriptive, such that the result of its application can be independently reproduced. Utilising this method, the valuer calculates the market value rent is $5 million per annum. The lessor and lessee document, in January 2018, that they agree the same method set out by the valuer to determine market rent must be used for each rent review period during the term of the lease.*

305. *Conclusion: the combination of: (a) the lease agreement; (b) the parties' agreement to use an independent expert to assess market value rent; and (c) the parties' agreement to use the method as set out in documentation by the independent expert in January 2018, constitutes an objective method. It is capable of application without input or influence by the parties to the lease. It is also capable of independent reproduction by a person possessing the requisite skills, free from bias or influence. Accordingly, the CCSRC will be the amount calculated under that method for the relevant years specified in the lease.*

Additional facts to example

306. *Assume that prior to the second review date the parties agreed to vary the rent calculation. It was agreed that the calculation of rent applying from January 2023 be based on instructions to a different independent expert, which deviate from the original method that the lessor and lessee agreed to in January 2018. This results in the relevant assets being significantly overvalued, and consequently the calculation of rent being overstated. As the lease and associated documents require the method set in January 2018 be applied to each rent review and the relevant result to each respective year of the lease, the subsequent variation does not affect the conclusion that there existed, before 27 March 2018, an objective method. Therefore, the CCSRC Existing method will continue to apply to cap the maximum amount of rent available for concessional treatment under the transitional rules. The amount of rent over the cap which is calculated under the objective method will not receive concessional treatment. The cap is calculated by working out what the rent would have been had the method applied been consistent with what the lessor and lessee agreed to in January 2018. Further, depending on the facts, the result of applying the new instructions may potentially attract the operation of the non-arm's length income rules in Division 275 of the ITAA 1997.*

CCSRC – Existing amount

307. If there is a rent amount specified for the first year of the lease ending after 27 March 2018, but no objective method is so set out, then the CCSRC – Existing amount will apply. The amount of the CCSRC – Existing amount is then determined by subsection 12-443(3), by reference to an amount specified in the lease that was agreed to before 27 March 2018. This could be where either:

- an amount is specified for a year of the lease, the CCSRC – Existing amount being that amount corresponding to the relevant income year[170], or
- an amount is not specified for the relevant year of the lease, then the CCSRC – Existing method is the amount in relation to the most recent year of the lease for which the amount was so specified, indexed according to Subdivision 960-M of the ITAA 1997.[171]

308. In identifying an amount specified and agreed for the purposes of subsection 12-443(3), the Commissioner expects contemporaneous documents evidencing that amount as being specified before 27 March 2018.[172] The amount need not be set out in the lease itself, but the documentation in relation to the amount must evidence the connection with the facility, the cross staple arrangement and relevant cross staple lease.

309. The Explanatory Memorandum provides examples of how the CCSRC – Existing amount will operate where there is a specified amount of annual rent.[173]

310. Where an income year does not align with a particular year of the lease, subsection 12-443(4) provides that the years will correspond if the years both end after a particular 27 March, but before the next 27 March.

Example 15 – existing amount

311. *Asset Trust (the lessor) and Operating Entity (the lessee) enter into a 10-year lease agreement on 1 July 2017. The lease agreement provides that:*

(a) The initial annual rent is to be as agreed by the parties.

[170] Paragraph 12-443(3)(a) and subsection 12-443(4).
[171] Paragraph 12-443(3)(b).
[172] Paragraph 12-443(3)(a).
[173] Examples 1.18 and 1.19 of the Explanatory Memorandum.

(b) The annual rent for the second to fifth years (that is, from 1 July 2018 to 30 June 2022) will be the rent from the preceding year, increased by CPI.

(c) The annual rent for the sixth year and subsequent years (that is, from 1 July 2022 onwards) is to be further agreed by the parties and subsequently indexed on the same basis for the remaining years of the lease

312. *On 1 July 2017, the lessor and lessee agree, and set out in correspondence referable to the lease, that the initial annual rent will be $5 million.*

313. *Conclusion – the relevant CCSRC will depend on the terms of the lease, as set out in section 12-443:*

(a) For the income year corresponding to the first year of the lease, ending after 27 March 2018, subparagraphs 12-443(1)(c)(i) and subsection 12-443(3) apply as the amount is specified in the lease and associated documents before 27 March 2018, in this case being $5 million. Hence the CCSRC – Existing amount will apply to 'cap' the amounts that are not treated as NCMI at $5 million for that income year.

(b) For the income years corresponding to years two through five of the lease, the parties have specified that the initial amount will be multiplied by CPI. This is an objective method as it must be applied without input or influence by the parties to the lease. Hence for those years the CCSRC – Existing method in paragraph 12-443(1)(c)(ii) and subsection 12-443(2) will apply.

(c) For the income years corresponding to year six of the lease and onward, neither an objective method, nor an amount has been specified in the lease or associated documents. Hence, regard must be had to the most recent year of the lease for which an amount was so specified.[174] *On the facts, the income year corresponding to the first year of the lease ending after 27 March 2018 is the most recent for which the lease or associated documents, prior to 27 March 2018, specified a relevant amount. Hence, paragraph 12-443(3)(b) applies to index that amount annually in accordance with Subdivision 960-M of the ITAA 1997.*

CCSRC – General

314. Where neither of the CCSRC – Existing provisions apply, then the CCSRC – General will apply. Hence, taxpayers will need to ensure that they have carefully reviewed the relevant lease and associated documents to determine whether section 12-443 applies.

315. The CCSRC – General applies to economic infrastructure facilities, whether approved by the Treasurer[175], or subject to the transitional rules.[176]

316. Paragraph 1.159 of the Explanatory Memorandum explains that the CCSRC – General:

> … broadly reflects the amount of rent that would be paid from the operating entity to the asset entity which would result in the asset entity having a current year net (taxable) income position equal to 80 per cent of the project's total notional current year taxable income.

317. There are broadly three circumstances where the CCSRC – General may apply[177]:

- cases of economic infrastructure approved by the Treasurer[178], and

[174] Paragraph 12-443(3)(b).
[175] Section 12-439.
[176] Section 12-440.
[177] Paragraphs 1.157 and 1.159 of the Explanatory Memorandum.

- an economic infrastructure facility where the transitional rules apply, but section 12-443 does not apply. That is
  - the cross staple lease and associated documents did not, before 27 March 2018, specify an objective method nor the amount of rent, or
  - where the facility and the relevant cross staple arrangement are sufficiently committed to before 27 March 2018, but no cross staple lease has been entered into in respect of the facility, whether or not it has been constructed.

318. The CCSRC – General is worked out in accordance with the steps at subsection 12-444(2), which broadly establishes an '80/20' rule. That is, broadly, to the extent that the asset entity's taxable income exceeds 80% of the total notional current year taxable income for both the asset entity and the operating entity, then that excess will not benefit from the relevant exceptions to MIT cross staple arrangement income. That notional calculation must be worked out as a 'reasonable estimate'.[179] For the purposes of working out the net or assessable income of the relevant entities, losses are to be disregarded.[180] Example 1.20 in the Explanatory Memorandum applies these steps in detail.

319. The provisions contain references to terms such as 'net income', 'tax loss', 'trust components' and 'partnership loss'. This requires the relevant entity to have regard to the income tax law to make that reasonable estimate of its income or loss for the purposes of the CCSRC – General. This includes the modification to disregard losses which would otherwise distort the application of the CCSRC – General.

320. 'Reasonable' is objective and will be determined in context. Relevantly, for the purposes of making a reasonable estimate of the relevant asset entity's and operating entity's assessable or net income for the income year, the Commissioner considers that regard should be had to all the facts and circumstances, including the object of the CCSRC – General provisions and the integrity rules.

321. A reasonable estimate should be broadly reflective of the relevant entities' notional project income for the income year.[181] It would necessarily require the relevant entities to have regard to the notional project, the current and historic income and deductions, current and expected market conditions and other relevant factors to make that reasonable estimation.

Consequences for breaching the CCSRC

322. Broadly, there are two main consequences for a MIT where the CCSRC is breached:

- to the extent that excepted MIT CSA income exceeds the CCSRC, the amount will be NCMI[182], and
- an expense allocation rule will apply.

323. Subsection 12-441(2) provides that to the extent that the amount of the relevant asset entity's excepted MIT CSA income exceeds the CCSRC for that income year, the concessions in subsections 12-437(5) and 12-440(3) do not apply. Consequently, that

[178] Section 12-439.
[179] Paragraphs 12-444(2)(a) and (b).
[180] Subsection 12-444(3).
[181] Refer to paragraph 1.159 of the Explanatory Memorandum.
[182] Subsection 12-441(2).

excess amount, to the extent it is reflected in a fund payment, is subject to withholding at a rate equal to the top corporate rate.[183]

324. Where the CCSRC is breached, a MIT, or an asset entity which is taken to be a MIT[184], is required to allocate expenses in a certain order.

325. The ordering rule applies where the asset entity in relation to a cross staple arrangement is entitled to a deduction and had derived excepted MIT CSA income (disregarding subsection 12-441(2) and section 12-445), and that amount of excepted MIT CSA income exceeds the CCSRC.

326. The amount of the deduction (identified in paragraph 12-445(1)(b)) can only be deducted against income in the following order:

- firstly, against amounts of assessable income that is excepted MIT CSA income, up to the amount of the CCSRC
- secondly, where an amount of a deduction remains after applying paragraph 12-445(2)(a), then that amount can be deducted against an amount of assessable income that is MIT cross staple arrangement income, and
- finally, if an amount of deduction remains after following paragraphs 12-445(2)(a) and (b), the amount can be deducted against other assessable income in accordance with the Act.

327. Example 1.21 of the Explanatory Memorandum provides a detailed example of the deduction ordering rule.

MIT trading trust income

328. The MIT trading trust income rules broadly ensure that distributions a MIT receives either directly or indirectly from a trading trust are treated as NCMI.

329. The rules apply if an amount is included in a MIT's assessable income for an income year which is attributable to or received from another entity.[185] The amount will be MIT trading trust income where the MIT holds a total participation interest[186] in the second entity greater than nil, and the second entity is a trading trust in relation to the income year. The rules also capture amounts from a partnership or a trust that is not a unit trust, which if they were a unit trust through the income year, would be a trading trust. However, the section will not apply where the second entity is a public trading trust.[187]

330. Amounts of assessable income excluded from the meaning of a fund payment are not captured as MIT trading trust income.[188] Also excluded are amounts attributable to a capital gain arising out of CGT events E4 or E10.[189]

MIT trading trust income – transitional provisions

331. Transitional rules may apply where MIT trading trust income is attributable to a total participation interest in a second entity that is in existence at the time of the announcement of the measure.[190] These rules maintain the general concessional 15% MIT withholding

[183] Refer to paragraph 1.164 of the Explanatory Memorandum.
[184] Subsection 12-445(3).
[185] Subsection 12-446(1).
[186] 'Total participation interest' is defined in section 960-180 of the ITAA 1997.
[187] Subsection 12-446(2).
[188] Paragraph 12-446(1)(c) and subsection 12-405(1).
[189] Broadly, these events happen where a trust or an attribution managed investment trust makes a non-assessable payment to a beneficiary or member.
[190] Section 12-447.

rate to relevant amounts[191] attributable to this interest for the transitional period. The transitional period applies to relevant income that was derived, received or made by the MIT before 1 July 2026.

332. An apportionment methodology applies to any relevant amount attributable to a trading trust where the relevant MIT's participation interest in the trading trust has increased since 27 March 2018.

MIT residential housing income

333. Under section 12-450, an amount included in the assessable income of a MIT will be MIT residential housing income to the extent that it is:

- attributable to a 'residential dwelling asset', and
- not referable to the use of the residential dwelling asset to 'provide affordable housing', as defined in section 980-5 of the ITAA 1997.

334. A 'residential dwelling asset' is defined in section 12-452. It uses the existing definition of 'dwelling' in section 118-115 of the ITAA 1997, and treats certain adjacent land and adjacent structures as though they were also a dwelling by extending the application of section 118-120 of the ITAA 1997.

335. Broadly, a residential dwelling asset is an asset that is:

- a dwelling
- taxable Australian real property, and
- residential premises but not commercial residential premises.

336. A residential dwelling asset does not however include a dwelling that is used primarily to provide:

- specialist disability accommodation[192], or
- disability accommodation of a kind prescribed in the regulations.[193]

337. The terms 'residential premises' and 'commercial residential premises' each take their meaning from the *A New Tax System (Goods and Services Tax) Act 1999*.[194]

Use of residential dwelling to provide affordable housing

338. Income attributable to a residential dwelling asset will constitute MIT residential housing income. However, such income will not constitute MIT residential housing income to the extent it is referable to the use of the residential dwelling asset to provide affordable housing.[195]

339. Broadly, a residential dwelling asset will be provided for affordable housing if it is either tenanted or available to be tenanted under the management of an eligible community housing provider and the community housing provider has issued to the owner of the asset a certificate covering the asset for the relevant period.[196] There are additional

[191] The relevant amount is identified at paragraph 12-447(1)(a). It is the amount that would be MIT trading trust income of the MIT if the section were disregarded.
[192] Within the meaning of the *National Disability Insurance Scheme (Specialist Disability Accommodation Conditions) Rule 2018*, and that dwelling is enrolled in accordance with section 6 of that Rule.
[193] As prescribed for the purposes of paragraph 12-452(1)(e).
[194] 'Residential premises' and 'commercial residential premises' are defined in subsection 995-1(1) of the ITAA by reference to the *A New Tax System (Goods and Services Tax) Act 1999*.
[195] Subsection 12-450(3).
[196] Section 980-5 of the ITAA 1997.

requirements, including that the tenants or occupants must not own a 10% or greater interest in the MIT which owns the residential dwelling asset.

Example 16 – residential apartment building

340. *The trustee of a widely-held unit trust holds land on which a residential apartment building stands. This is the only asset held in the trust. The trust's investment strategy and the offering documents provided to investors state that the trust intends to invest in residential property suitable for providing long-term rental options to tenants, with 50% of the apartments available for affordable housing. The trust is open-ended, with the offering documents stating that the property is intended to be held for at least 15 years with no ability for investors to redeem their units in that time.*

341. *As the trustee expects to provide the affordable housing to tenants at below-market rent, the forecast rental return for the property is lower than would be the case had it all been leased at market rates. The rental return is therefore not expected to significantly exceed the forecast capital growth.*

342. *The trustee enters into long-term arrangements with an eligible community housing provider who manages the tenancy and prospective tenancy for 50% of the apartments in the residential apartment building. The remaining apartments in the residential apartment building are marketed for leases at market rates. The trustee leases the apartments for terms of up to five years, with tenants having an option to renew their leases for a further three years, plus any subsequent extension as agreed between the parties.*

343. *Due to the fact that the provision of affordable housing reduces the overall rental return, the forecast figures alone might indicate that the investment in land is not held primarily for the purposes of deriving rent. However, no single factor is determinative, and it is necessary to have regard to all the facts and circumstances. In this case, the investment strategy, the expected holding period of the property, the marketing plan and lease terms indicate that the investment in land is primarily for the purpose of deriving rent. Furthermore, the long-term arrangements with the eligible community housing provider and the stated purpose of providing affordable housing provide the necessary context for establishing that the below-market rental yield is consistent with the investment in land being for the primary purpose of deriving rent.*

344. *Assuming all other requirements in section 275-10 of the ITAA 1997 are met, the trust is likely to be a MIT. Consequently, it is necessary to consider whether any amount included in its assessable income for the income year is MIT residential housing income, as defined in section 12-450.*

Example 17 – residential apartment building with retail area

345. *Expanding on Example 15 (and assuming the trust is a MIT), the trustee leases all the apartments to tenants, with 50% of the apartments used to provide affordable housing, as defined. The ground floor of the apartment building also contains a small retail/commercial area. This is leased to various tenants, who operate their respective businesses on the premises.*

346. *The trustee receives $2 million a year in total rent from the site. Of this total, 5% is rent from the commercial premises, 40% from the apartments used to provide affordable housing, and 55% from the remaining apartments.*

347. *The trustee determines that the $1.1 million it receives as rent on the apartments leased at market rates is MIT residential housing and therefore NCMI. It is income that is attributable to residential dwelling assets.*

348. *The remaining $900,000 is not NCMI as:*

- *the $800,000 received in relation to the remaining apartments is not MIT residential housing income. While attributable to a residential dwelling asset, it is referable to the use of those residential dwelling assets to provide affordable housing (as defined), and*
- *the $100,000 rent from the commercial premises is not MIT residential income, as it is not attributable to a residential dwelling asset.*

MIT residential housing income – transitional provisions

349. The rules apply to payments made from 1 July 2019 that are attributable to the 2019–20 income year or later. However, transitional rules[197] provide relief for amounts attributable to the following circumstances:

- where a MIT had direct or indirect interests in a residential dwelling asset prior to 14 September 2017[198], or
- the MIT would otherwise have qualified for transitional relief as it (or another entity from whom the MIT derived the relevant amount) had entered into a contract prior to 14 September 2017 in respect of a facility that consists of or contains a residential dwelling asset.

350. This transitional relief period is until 1 October 2027.[199]

351. An apportionment methodology applies to any relevant amount attributable to a residential dwelling asset where the relevant MIT's participation interest in the entity that holds, or contracted for the asset, has increased since 14 September 2017.

MIT agricultural income

352. An amount is MIT agricultural income under subsection 12-448(2) to the extent it is attributable to an asset that is 'Australian agricultural land for rent'. The term 'Australian agricultural land for rent' is specifically defined in subsection 12-448(3) to mean 'Division 6C land' situated in Australia that is:

- used, or could reasonably be used, for carrying on a primary production business, and
- held primarily for the purposes of deriving or receiving rent.

353. Paragraphs 356 to 358 of this Ruling set out the Commissioner's view on the first requirement – 'is used, or could reasonably be used, for carrying on a primary production business'. Whether land is held primarily for the purpose of deriving rent is considered at paragraphs 11 to 17 of this Ruling.

Carrying on a primary production business

354. Whether an activity amounts to the carrying on of a primary production business[200] is a question of fact. While each case will turn on its own particular facts, the determination of the question is generally the result of a process of weighing all the relevant indicators.

355. General guidance on what constitutes carrying on a primary production business is available in Taxation Ruling TR 97/11 *Income tax: am I carrying on a business of primary production?*

[197] Section 12-451.
[198] Specifically, prior to 4:30pm by legal time in the Australian Capital Territory, on 14 September 2017.
[199] Section 12-451(1)(c).
[200] The term 'primary production business' is defined in subsection 995-1(1) of the ITAA 1997.

Is used, or could reasonably be used

356. Under subsection 12-448(3), it is not essential that the land is actually being used by the lessee or another entity to carry on a primary production business. It is sufficient that the land 'could reasonably be used' for carrying on a primary production business.[201]

357. TR 97/11 provides general guidance on what constitutes the carrying on of a primary production business. Relevant factors in determining whether the land 'could reasonably be used' for such a business include:

- any zoning or regulatory restrictions on the use of the land – if the carrying on of primary production is expressly not allowed under the applicable zoning, then it is unlikely the land could reasonably be used to carry on a primary production business
- prior usage of the land
- characteristics of the land (for example, soil and water analyses performed and expert opinion on the suitability of the land for primary production), and
- land capacity and the scale of activity that could be conducted on the land – while a very small parcel of land may not be suitable for carrying on a primary production business, it is not necessarily the case that the land must be capable of sustaining a primary production business in isolation. For example, the characteristics of adjoining land may indicate that the land could reasonably be used for a primary production business carried on over several adjoining properties.

358. This is not an exhaustive list of the relevant factors and no single factor is determinative. All the facts of circumstances of each case must be considered and relative weight placed on the relevant factors.

Example 18 – agricultural land

359. *The trustee of a widely-held unit trust acquires agricultural land. Its investment strategy is to maximise the total return to investors over a five-year period. At the time of acquisition, the land was leased to the owner of a neighbouring property to graze cattle. The trustee retains the existing lease arrangement and renews the lease on a year by year basis. The trustee receives a moderate amount of rent from the lease. The land is located on the urban fringe, and the trustee anticipates that the area will be re-zoned in two to four years, significantly increasing its resale value. During this time, the trustee engages with the local council on the re-zoning process and undertakes some preliminary works on the property that would facilitate any future subdivision of the land.*

360. *Although the trustee leases the land and derives rent at all times, it is unlikely that the investment in the land is primarily for the purpose of deriving rent. The expected holding period is relatively short and the trustee's activities are focused on maximising the profit on sale rather than the rental return. If, having regard to all the facts and circumstances (including as relevant to the application of the safe harbour rules), the investment in land does not satisfy the primary purpose test, then the trust will not be a MIT. If the trust is not a MIT, the NCMI provisions will have no application to distributions that are attributable to the agricultural land.*

[201] The definition of 'agricultural land' in section 4 of the *Foreign Acquisitions and Takeovers Act 1975* and section 4 of the *Register of Foreign Ownership of Water or Agricultural Land Act 2015* similarly refers to land 'that is used, or that could reasonably be used, for a primary production business'.

MIT agricultural income – transitional provisions

361. The rules apply to payments made from 1 July 2019 that are attributable to the 2019–20 income year or later. However, transitional rules[202] provide relief for amounts attributable to the following circumstances:

- where a MIT had direct or indirect interests in the asset that is Australian agricultural land for rent before 27 March 2018, or
- the MIT would otherwise have qualified for transitional relief as it (or another entity from whom the MIT derived the relevant amount) had entered into a contract before 27 March 2018 for the acquisition or lease of the relevant asset.

362. This transitional relief period is until 1 July 2026.

363. An apportionment methodology applies to any relevant amount attributable to an asset that is Australian agricultural land for rent where the MIT's participation interest in the entity holding the asset has increased since 27 March 2018.

Fund payment attributable to more than one type of NCMI

364. Section 12-435 provides that NCMI comprises four discrete types of income. The Act does not provide for an ordering or hierarchy of these classes of NCMI. Where two or more apply, the withholding amount remains the same. This is so even if one of the types of NCMI may benefit from a transitional rule.

365. For example, where an amount included in the assessable income for an income year of a MIT is attributable to MIT agricultural income or MIT residential housing income, it will be NCMI regardless of whether it is excluded from MIT cross staple arrangement income.

366. Conversely, the specific exceptions to MIT cross staple arrangement income in subsections 12-437(3) to (7) do not apply in determining MIT trading trust income, MIT agricultural income or MIT residential housing income.

Commissioner of Taxation
18 November 2020

[202] Section 12-449.

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