

# ***CR 2011/8 - Income tax: proposed return of capital: Burwood Property Syndicate***

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## Class Ruling

### Income tax: proposed return of capital: Burwood Property Syndicate

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#### **ⓘ This publication provides you with the following level of protection:**

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

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

## What this Ruling is about

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1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

#### **Relevant provision(s)**

2. The relevant provisions dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- Division 104 of the ITAA 1997;
- section 110-25 of the ITAA 1997;
- section 112-20 of the ITAA 1997;
- section 112-25 of the ITAA 1997; and
- Division 727 of the ITAA 1997.

All subsequent legislative references in this Ruling are to the ITAA 1997 unless otherwise stated.

**Class of entities**

3. The class of entities to which this Ruling applies is the holders of units (Syndicate Unitholders) in the Burwood Property Trust (Syndicate) who:

- (a) are registered as Syndicate Unitholders on the Record Date of 1 February 2011, being the date for determining entitlements under the proposed return of capital as described in paragraph 24 of this Ruling.
- (b) hold their units in the Syndicate (Syndicate Units) on capital account; and
- (c) are not subject to the taxation of financial arrangements rules in Division 230 in relation to gains and losses on their Syndicate Units.

(Note – Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them.)

**Qualifications**

4. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 9 to 27 of this Ruling.

6. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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## Date of effect

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8. This Ruling applies from 31 December 2010 to 30 June 2011. The Ruling continues to apply after 30 June 2011 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

## Scheme

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9. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them form part of and are to be read with the description:

- application for Class Ruling dated 10 September 2010 lodged by WHK Horwath on behalf of APGF Management Limited (Applicant); and
- correspondence from the Applicant dated 20 October 2010 and 28 October 2010.

10. The Syndicate is a registered Managed Investment Scheme (MIS) under section 601ED of the *Corporations Act 2001*.

11. APGF Management Limited is the Syndicate's responsible entity, as defined by section 9 of the *Corporations Act 2001*.

12. The Syndicate is a unit trust for income tax purposes and all Syndicate Units were issued after 19 September 1985.

13. The Syndicate's property consists of cash and non-residential real property acquired with the proceeds of contributions raised from Syndicate Unitholders and other institutional borrowings.

14. The Syndicate derives net rental income which is and has been the source of the annual distributions to the Syndicate Unitholders. The Syndicate may also make a profit or loss in the future from the eventual sale of the real property.

15. In respect of the Syndicate no entity, or no entity and its associates between them, has the right to receive at least 40% of any distribution of trust income, or trust capital, as beneficiaries of the Syndicate.

### Overview of the Stapling Scheme

16. The Syndicate and ten other MIS (Participating Entities) propose undertaking an economic amalgamation through stapling their units to facilitate refinancing of their collective debts.

17. The proposed Stapling Scheme will involve a number of key steps.

**Step 1**

18. The Syndicate Unitholders will vote on two resolutions, requiring 75% of votes cast to firstly give general approval to the proposed Stapling Scheme and to secondly approve specific amendments to the Syndicate's Constitution which are necessary to implement the other steps in the proposed Stapling Scheme.

**Step 2**

19. The Syndicate Units of foreign resident Syndicate Unitholders (excluding New Zealand residents) will be transferred to a nominee for sale.

**Steps 3 and 4**

20. A significant number of Syndicate Units are owned by Investor Trusts. The Investor Trusts will be wound up following an *in specie* distribution of each Investor Trust's Syndicate Units to the members of the relevant Investor Trust.

**Step 5**

21. The Syndicate will split the 4,490,000 units that it has on issue so that it will then have 107,196,828 units on issue. There will be no change in the percentage of beneficial ownership by the respective Syndicate Unitholders.

22. At that time, the Syndicate and the Participating Entities will each have 107,196,828 units on issue.

**Step 6**

23. The Syndicate will make a 'Stapling Distribution' on 1 February 2011 to the Syndicate Unitholders.

24. The Syndicate will return an estimated \$1,685,358 of the \$4,490,000 capital originally subscribed for. This represents an estimated return of capital of \$0.015 for each of the 107,196,828 Syndicate Units on issue at the time of the Stapling Distribution.

25. APGF Management Limited will automatically apply the Stapling Distribution to subscribe for units under the proposed Stapling Scheme so that each Syndicate Unitholder will then also own an identical number of units in each of the Participating Entities.

26. The amounts to be subscribed for units in each of the Participating Entities are not intended to equate to their market value.

**Step 7**

27. APGF Management Limited (the responsible entity for all the Participating Entities) will then execute 'The Stapling Deed' such that the units in the Participating Entities will become stapled and can only be traded together as a Stapled Security.

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**Ruling**

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**Splitting of Syndicate Units**

28. No CGT event will happen when the Syndicate Units are split into a larger number of units (subsection 112-25(2)).

29. Each element of the cost base and reduced cost base of the original Syndicate Units, as at the time of splitting, is to be apportioned in a reasonable way to the corresponding elements of the cost base and reduced cost base of the new Syndicate Units held after the split (subsection 112-25(3)).

**Stapling Distribution*****Non-assessable payment***

30. The proposed Stapling Distribution of \$0.015 per unit on 1 February 2011 will not represent ordinary income under subsection 6-5(1) of the Syndicate Unitholders.

***Capital distribution***

31. CGT event E4 will happen in respect of each Syndicate Unit when the Syndicate pays the Stapling Distribution to a Syndicate Unitholder (subsection 104-70(1)).

**Acquisition of units in Participating Entities**

32. The market value substitution rule in section 112-20 will apply if the amount paid by the Syndicate Unitholders for each of their units in a Participating Entity is more than the market value of that unit at the time of acquisition. The first element of the cost base and reduced cost base of the unit in the Participating Entity will be its market value when acquired on 1 February 2011 (section 112-20).

33. If the amount paid by the Syndicate Unitholders for each of their units in a Participating Entity is less than the market value of that unit at the time of acquisition, the first element of the cost base and reduced cost base for the unit will be the money paid to acquire the unit (subsections 110-25(2) and 112-20(2)).

**Value shifting rules**

34. There will be no consequences for a Syndicate Unitholder under Division 727 from the acquisition of units in the Participating Entities.

**Execution of the Stapling Deed**

35. No CGT event in Division 104 will happen as a result of the stapling of the Syndicate Units to each unit in the Participating Entities.

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**Commissioner of Taxation**2 February 2011

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## **Appendix 1 – Explanation**

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

### **Splitting of Syndicate Units**

36. If a CGT asset is split into two or more assets and the beneficial owner of the original asset and of each new asset remains the same, the split does not result in the happening of a CGT event (subsections 112-25(1) and (2)).

37. Subsection 112-25(3) provides that each element of the cost base and reduced cost base of the original asset, as at the time of splitting, is to be apportioned in a reasonable way to the corresponding elements of the cost base and reduced cost base of the new assets held after the split.

38. Accordingly, no CGT event will happen to the Syndicate Unitholders on the splitting of their Syndicate Units.

39. Each element of the Syndicate Unitholder's cost base and reduced cost base of their original Syndicate Units, at the time of splitting, will be apportioned in a reasonable way to the corresponding elements of the cost base and reduced case base of the new split Syndicate Units.

### **Stapling Distribution**

#### ***Non-assessable payment***

40. Subsection 6-5(1) provides that a taxpayer's assessable income includes income according to ordinary concepts (ordinary income).

41. To determine whether a receipt is of an income or a capital nature, various factors may be relevant.

42. In this case, the proposed Stapling Distribution to the Syndicate Unitholders will be *corpus* and will be attributable to the contributed equity capital of the Syndicate. The contributions were received solely to establish the fund and as such are of a capital nature and not ordinary income.

43. Accordingly, the proposed Stapling Distribution will not be included under subsection 6-5(1) as ordinary income of the Syndicate Unitholder as it represents *corpus* of the fund that is attributable to amounts derived by the fund that, if derived by a taxpayer being a resident, would not have been included in the assessable income of that taxpayer.

**Capital distribution**

44. Under section 104-70, CGT event E4 happens if the trustee of a trust makes a payment to a unitholder in respect of their unit in the trust and some or all of the payment is not included in the unitholder's assessable income (non-assessable payment).

45. The consequences of CGT event E4 happening are determined on an annual basis, that is, having regard to all such CGT events that happen to a unit during an income year (subsection 104-70(3)).

46. If CGT event E4 happens during an income year, a unitholder will make a capital gain if the total value of the non-assessable payments made by the trustee during the income year in respect of a unit exceeds the cost base of the unit (subsection 104-70(4)).

47. Where a unitholder makes a capital gain when CGT event E4 happens, the cost base and reduced cost base of the unit are reduced to nil (subsection 104-70(5)).

48. However, if the sum of the non-assessable payments is not more than the cost base of the unit, the cost base and reduced cost base are reduced by that amount. A unitholder cannot make a capital loss when CGT Event E4 happens (subsection 104-70(6)).

49. The proposed Stapling Distribution of \$0.015 per Syndicate Unit on 1 February 2011 will not be included in the assessable income of the Syndicate Unitholders.

50. As the proposed Stapling Distribution will not be included in the Syndicate Unitholder's assessable income CGT event E4 will happen when the Syndicate pays the proposed Stapling Distribution (subsection 104-70(1)).

51. Accordingly, the cost base and reduced cost base of each Syndicate Unit, which may have been adjusted by previous tax deferred distributions, will be reduced (but not below nil) by \$0.015. A Syndicate Unitholder whose cost base for the Syndicate Unit is less than \$0.015 cents will make a capital gain to the extent of the difference.

**Acquisition of units in Participating Entities**

52. Sections 110-25 and 110-55 provide that the first element of the cost base and reduced cost base of a CGT asset is the money paid or the property given in respect of its acquisition.

53. However, paragraph 112-20(1)(c) provides that the first element of the cost base and reduced cost base of a CGT asset will be its market value (at the time of acquisition) if you did not deal at arm's length with the other entity in connection with its acquisition.

54. The Syndicate will make an estimated proposed Stapling Distribution of \$0.015 in respect of each of its then issued 107,196,828 Syndicate Units, on 1 February 2011.

55. The proposed Stapling Distribution will be used to acquire an equal number of units in each of the Participating Entities. Similarly, unit holders in each of the Participating Entities will subscribe for units in the Syndicate and the other nine Participating Entities. After this process there will be commonality of ownership, as each unit holder will have the same number of units in the Syndicate, and each Participating Entity will then have 107,196,828 units on issue.

56. Whilst the proposed Stapling Distribution and the acquisition of units in the Participating Entities is not intended to change the overall market value of a Syndicate Unitholder's collective investment in the Syndicate and the Participating Entities, the acquisition of units in the Participating Entities involves non-arm's length dealing.

57. The question whether the parties are dealing with each other at arm's length is not decided by asking whether the parties were at arm's length to each other. Subsection 995-1(1) provides that in determining whether parties deal at arm's length; consider any connection between them and any other relevant circumstance.

58. The fact that there is no ownership connection between the parties is not determinative, on its own, of whether the parties deal with each other at arm's length. The question is whether the parties dealt with each other at arm's length: *The Trustee for the Estate of the late AW Furse No. 5 Will Trust v. FC of T* 91 ATC 4007 at 4014-4015; (1990) 21 ATR 1123 at 1132. This will be determined by considering the terms of the dealing and any other relevant consideration.

59. In *Granby Pty Ltd v. FC of T* 95 ATC 4240 at 4243; (1995) 30 ATR 400 at 403 Lee J stated that the provision 'dealing with each other at arm's length' invited an analysis of the manner in which the parties conduct themselves in forming the transaction. The question is whether the parties behaved in the manner in which parties at arm's length would be expected to behave in conducting their affairs and the expression means, at least, that the parties have acted severally and independently in forming their bargain.

60. Further, Lee J stated (at ATC 4244; ATR 403-404) that:

If the parties to the transaction are at arm's length it will follow, usually, that the parties will have dealt with each other at arm's length. That is, the separate minds and wills of the parties will be applied to the bargaining process whatever the outcome of the bargain may be.

61. However this will not be the case where the parties collude to achieve a particular result, or where one of the parties submits the exercise of its will to the discretion of the other. In such a case the lack of the exercise of an independent will in the formation of the transaction would indicate a lack of real bargaining.

62. In *Collis v. FC of T* 96 ATC 4831; (1996) 33 ATR 438 the Federal Court found that the parties were not dealing at arm's length because one party was indifferent to the allocation of the sale price for the parcel of land. This indifference was indicative of a submission of one party's will to the other party's wishes which demonstrated a lack of arm's length dealing.

63. The way in which the proposed Stapling Scheme will be structured and implemented evidences that the parties will not behave in the manner in which arm's length parties would be expected to behave, that is, APGF Management Limited as the responsible entity for the Syndicate and all the Participating Entities, the Syndicate Unitholders and the Participating Entities' unit holders will not act severally and independently in conducting and implementing the proposed Stapling Scheme.

64. The Syndicate Unitholders and the Participating Entities' unit holders will have no bargaining power or ability to act independently from APGF Management Limited as the responsible entity for the Syndicate and all the Participating Entities in relation to the implementation of the proposed Stapling Scheme.

65. Accordingly, if the amount paid by the Syndicate Unitholders for each of their units in a Participating Entity is more than the market value of that unit at the time of acquisition, the first element of the cost base and reduced cost base of the unit will be its market value when acquired on 1 February 2011 (subsection 112-20(2)).

66. Conversely, if the amount paid by the Syndicate Unitholders for each of their units in a Participating Entity is less than the market value of that unit at the time of acquisition, the first element of the cost base and reduced cost base of the unit will be the money paid to acquire the unit (subsections 110-25(2) and 112-20(2)).

### **Value shifting rules**

67. There is an indirect value shift if there is an unequal exchange of economic benefits between the two entities (the losing entity and gaining entity (subsection 727-150(3))) or no economic benefit is provided to the losing entity by the gaining entity in connection with the scheme.

68. There can only be consequences for an indirect value shift if the entities between which the value is shifted (the losing entity and the gaining entity) satisfy an ultimate controller test and or a common ownership nexus test at some time during the indirect value shift period defined in subsection 727-150(7) (paragraph 727-100(c) and sections 727-105 and 727-110).

69. On the basis of information provided in respect of the Syndicate and any of the Participating Entities, there is no entity that meets the ultimate controller test and or the common ownership nexus test as described in paragraph 68 of this Ruling. As a result, there are no consequences under Division 727 for any indirect value shift that occurs under the proposed Stapling Scheme.

**Execution of the Stapling Deed**

70. The effect of the stapling is to apply restrictions to the transferability of the individual units (including the Syndicate Units) that together make up each Stapled Security. Each individual unit that makes up a Stapled Security will retain its legal character without any change in beneficial ownership. There will be no variation to the rights or obligations attaching to, or to the beneficial ownership of, the individual units that make up the Stapled Security as a consequence of the stapling.

71. Therefore, no CGT event in Division 104 will happen as a consequence of the stapling of the Syndicate Units to those in the Participating Entities.

## **Appendix 2 – Detailed contents list**

72. The following is a detailed contents list for this Ruling:

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## References

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*Previous draft:*

Not previously issued as a draft

*Related Rulings/Determinations:*

TR 2006/10

*Subject references:*

- capital gains tax
- capital reductions
- capital benefit
- indirect value shifting scheme

*Legislative references:*

- ITAA 1997
- ITAA 1997 6-5(1)
- ITAA 1997 Div 104
- ITAA 1997 104-70
- ITAA 1997 104-70(1)
- ITAA 1997 104-70(3)
- ITAA 1997 104-70(4)
- ITAA 1997 104-70(5)
- ITAA 1997 104-70(6)
- ITAA 1997 110-25
- ITAA 1997 110-25(2)
- ITAA 1997 110-55
- ITAA 1997 112-20
- ITAA 1997 112-20(1)(c)
- ITAA 1997 112-20(2)

- ITAA 1997 112-25
- ITAA 1997 112-25(1)
- ITAA 1997 112-25(2)
- ITAA 1997 112-25(3)
- ITAA 1997 Div 230
- ITAA 1997 Div 727
- ITAA 1997 727-100(c)
- ITAA 1997 727-105
- ITAA 1997 727-110
- ITAA 1997 727-150(3)
- ITAA 1997 727-150(7)
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- ITAA 1997 995-1
- Corporations Act 2001 9
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- TAA 1953
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*Case references:*

- Collis v. FC of T 96 ATC 4831; (1996) 33 ATR 438
- Granby Pty Ltd v. FC of T 95 ATC 4240; (1995) 30 ATR 400
- The Trustee for the Estate of the late AW Furse No. 5 Will Trust v. FC of T 91 ATC 4007; (1990) 21 ATR 1123

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ATO references

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