


TD 2009/14EC - Compendium

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Ruling Compendium – Taxation Determination TD 2009/14

This is a compendium of responses to the issues raised by external parties to draft TD 2008/D6: Income tax: is a taxpayer entitled to an income tax deduction under subsection 70B(2) of the *Income Tax Assessment Act 1936* where a Stapled Security of the kind described in Taxpayer Alert TA 2008/1 is sold at a loss or upon the occurrence of an Assignment Event?

This compendium of comments has been edited to maintain the anonymity of entities that commented on the draft ruling.

Summary of issues raised and responses

| Issue No. | Issue raised | Tax Office Response/Action taken |
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| 1 | The ATO's characterisation of the stapled security of the kind described in the draft TD as a single instrument is not contemplated in the income tax law. For example, the related scheme provisions in Division 974 of the <i>Income Tax Assessment Act 1997</i> (ITAA 1997) supports the view that the two instruments comprising a Stapled Security have separate legal form and character for tax purposes. | The Commissioner agrees that generally the components of a stapled security are to be regarded as separate instruments in legal form and character for taxation purposes. However, the Stapled Security considered in this Determination has peculiar features which result in the two instruments not being separate and distinct. Accordingly, the Stapled Security has been characterised as a single instrument for tax purposes. |
| 1.1 | The ATO characterisation of the Stapled Security as a single instrument ignores the legal form of the two instruments. In particular, the view ignores the fact that the Notes and the Preference Shares each represent separate rights and obligation and Holders are entitled to enforce their rights in their separate capacities. The Commissioner's argument that three separate documents with different parties comprises a single contract ignores the privity of contract doctrine: refer to Barwick CJ's comments in <i>Coulls v Bagot's Executor and Trustee Co Ltd</i> (1967) 119 CLR 460 (at 478). | The Commissioner does not agree with the contention that when an Investor acquires a Stapled Security of the kind described in this Determination, the Investor is acquiring two separate, distinct and transferable legal instruments that simply must be traded together. The Stapled Security is offered to subscribers on the terms set out in the Prospectus and that is, as a single instrument. The Note is inextricably bound with the Preference Share when it is stapled; it is not distinct and will not exist separately from the Preference Share. |

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| 1.1 cont | <p>There is no principle at law that supports the proposition that acquiring two instruments under one document (that is, the Prospectus) can change the legal form or character of those instruments at law. See the recent stamp duty case of <i>Westpac Custodian Nominees Ltd v Commissioner of State Revenue</i> [2008] WASCA 18 where the court held that while the practical effect of stapling is to enable two instruments that would otherwise be traded separately to be traded together, the legal form or character of the instruments comprising the stapled security at law is not changed by the stapling (that is, the underlying instruments continue to have separate form and character at law).</p> | <p>The Commissioner does not accept the argument that there cannot be a single contract. The Commissioner's view that the Stapled Security is acquired under a single contract is not predicated on the view that the three documents combine to form the single contract. Rather, a new and distinct contract is created between the Investor and the Company (as well as the subsidiary, if a subsidiary of the Company issues the Note) when the Investor accepts the Company's offer to acquire the Stapled Securities and agrees to be bound by the terms in the Prospectus. The rights and obligations under the contract are described in the Prospectus and the contract specifically includes rights and obligations that were also created under the Note Deed Poll, the Note Terms and the Preference Share Terms, and any other relevant document(s). Privity of contract is maintained as all of the entities that can sue on the contract are parties to it and are bound by its terms.</p> <p><i>Westpac Custodian Nominees Ltd v Commissioner of State Revenue</i> found that for <i>Stamp Act 1921</i> (WA) purposes, a security need not be quoted as a stand alone security, rather it can be quoted jointly with another security. The case briefly looked at the meaning of 'security', but only for Western Australian stamp duty law purposes, which defines 'security' differently. This is not relevant for providing a case law view for Commonwealth income tax legislation. Furthermore, the stapled security considered by the Western Australian Court was not the same as the ones covered by this Determination.</p> |

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| 1.2 | <p>The ATO view that the Note is no longer capable of separate existence once the stapling has occurred is wrong because:</p> <ul style="list-style-type: none"> • It ignores the legal form of the Notes and the separate rights and obligations which exist under the Note. • The stapling of the instruments is merely a way of packaging them for commercial reasons (ie. to satisfy tier 1 requirements and obtain a deduction in NZ for amounts paid in respect of the Note). The stapling is not permanent and does not affect the character of the Note and Preference Shares themselves. • The Notes do not cease to exist on assignment. • In cases where the issuer of the Note and the issuer of the Preference Shares are different legal entities, the effect of the Note being assigned upon the occurrence of an Assignment Event is to terminate the debtor-creditor relationship that previously existed between the Investor (as a holder of the Note) and the issuer of the Note and to create a new debtor-creditor relationship between the Company (that issues the Preference Shares) and the issuer of the Note. | <p>It is not agreed that the Tax Office's view that, once stapled, the Note is no longer capable of separate existence is wrong. Once stapled, the note will not continue to exist separately to the Preference Share.</p> <ul style="list-style-type: none"> • The Tax Office's view does not ignore the legal form of the Notes and the separate rights and obligations which exist under the Note. It is acknowledged that prior to stapling separate rights and obligations exist under the Note. The Tax Office's view is that the Stapled Security acquired by the Investor is one instrument. Under the terms of the Stapled Security contract, the investor acquires a preference share with additional rights and obligations all of which are set out in the Note Terms and the other relevant transaction documents. • The stapling is not merely a means by which the instruments are packaged. While the stapling is not permanent, when the Stapled Security is de-stapled, the Note will cease to exist upon assignment to the Company. It is legal nonsense for an entity to owe a debt to itself. Even when the Note is assigned to a subsidiary of the Company, the Note is not traded separately. • It is not agreed that a debtor-creditor relationship exists after the stapling. All of the periodic returns on the Note are contingent and the Investor has no rights to sue for unpaid amounts. The Investor is also not entitled to a return of the face value of the Note. The promisor (the Company) has absolute discretion whether or not to pay amounts to the promisee (the Investor). In other words, the Company is under no obligation to make those payments: any obligation that exists would be illusory. See <i>Placer Development Ltd v. Commonwealth</i> (1969) 121 CLR 353. <p>Action taken for issue 1: This contention has been addressed in the Alternative Arguments section of this Determination.</p> |

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| 2.1 | <p>Legal characterisation: the Note component of a Stapled Security is a ‘security’ for the purposes of section 70B of the <i>Income Tax Assessment Act 1936 (ITAA 1936)</i>¹</p> <p><i>Meaning of debenture</i></p> <p>The Note is a debenture for the purposes of the <i>Corporations Act 2001</i> and is sufficient as evidence of a debt obligation by the Note issuer.</p> <p>The Explanatory Memorandum that introduced the definition of ‘debenture’ indicated that ‘[t]he definition...is in line with the definition used in the Companies Acts’, which, at that time, was ‘documentary evidence of a debt’. At the time the statutory meaning was aligned with the meaning at common law which was that a debenture was ‘documentary evidence of a debt’. Section 9 of the Corporations Act now defines debenture of a body to mean:</p> <p style="padding-left: 40px;">a chose in action that includes an undertaking by the body to repay a debt as money deposited with or lent to the body. The chose in action may (but need not) include a charge over property to the body to secure payment of the money.</p> <p>The ambulatory approach to statutory construction should be adopted such that the meaning of ‘debenture’ in the Income Tax Act should align with meaning of debenture in section 9.</p> | <p>The Commissioner’s considered view is that the Note, assuming it was an instrument separate and distinct from the preference share, is not a ‘security’ for the purposes of section 70B. It is not agreed that it falls within the meaning of debenture for the reasons given in the alternative view in the draft Determination, TD 2008/D6.</p> <p>Even on the basis that an ambulatory approach to statutory construction should be adopted such that the meaning of ‘debenture’ in the Tax Act should be aligned with the current definition of ‘debenture’ in the Corporations Act, the Note would not fall within the definition of ‘debenture’ in the Corporations Act. The Note does not acknowledge a debt or an absolute promise to pay a sum to the Investors. Payments under the terms of the Note are contingent on the Company having distributable profits, and the face value of the Note is never payable to the Investors. Even upon the winding up of the Company, the face value of the Note is payable to the Company as Assignee rather than to the Investor. Therefore, whilst on its face the Note in the Stapled Security is covered by the definition of ‘debenture’ in subsection 6(1), it is the Commissioner’s view that ‘Note’ is an incorrect label for the instrument.</p> <p>This Determination does acknowledge that before the Note is stapled to the Preference Share, it would be a ‘note’ under the ordinary meaning of the term.</p> |

¹ All legislative references are to the ITAA 1936 unless otherwise indicated.

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| 2.2 | <p><i>'Note' is not the correct label for the instrument in this case</i></p> <p>The Commissioner in stating that 'Note' is not the correct label is essentially arguing that the correct approach in determining the tax treatment of amounts paid in relation to the Notes is to ignore their legal form and character and the terms of their issue.</p> <p>We consider that the Commissioner's view that no debtor-creditor relationship is created because the Note issuer only has an obligation to pay returns in relation to the Note in certain circumstances is incorrect.</p> | <p>The Commissioner is not ignoring the legal form and character of the Note. Rather, he is carefully scrutinising the terms of the Stapled Security contract to properly characterise the Stapled Security. The Commissioner's characterisation is based on the terms of issue of the Stapled Security.</p> <p>The Tax Office's view, 'Note' is the incorrect label because there is no debtor-creditor relationship as one would expect if the Note was truly a note. If the Issuer had an absolute obligation to pay interest to the Investors, then the non-payment of such interest would create a debt owed by the Issuer to the Investors. However, for Stapled Securities covered by this Determination, no such debt arises. The terms of the Note provide for the payment of interest by the Issuer to the Investor unless, among other things, the Issuer has passed a Stopper Resolution which has not been rescinded. Where such a resolution has been passed and a Stopper Resolution is in place, any unpaid amount is non-cumulative and the Investors have no entitlement to sue for such amounts or force the Issuer into insolvency in respect of the unpaid amounts. No debt is therefore created from the non-payment of interest in these circumstances.</p> <p>In the case where interest has not been paid but should have been because none of the interest payment exclusion clauses apply (for example, the Issuer has no Stopper Resolution in place), the non-payment of interest will cause an Assignment Event to occur if it remains unpaid on the 21st business day after an interest payment date. This occurrence does not create any obligation for the Issuer to make a payment to the Investors. Instead, the Assignment Event will lead to the Notes being automatically assigned back to the Issuer for nil consideration and any obligation the Issuer had to make the payment being payable to the Issuer itself (or a subsidiary) as Assignee of the Note.</p> |

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| 2.2 cont | | Therefore, the Issuer has no obligation to pay an amount to the Investors and there is no money owed by the Issuer to the Investors if interest goes unpaid. No debt is owed by the Issuer to the Investors on the non-payment of interest by the Issuer to the Investors. Consequently no liability arises under the terms of the Note and the Issuer is not liable under the terms to pay any amounts to the Investors. |
| 2.3 | <p><i>While the Note has the legal form and character of a note for the purposes of the definition of security in section 159GP(1) prior to the stapling, the Note no longer meets this description after the stapling happens</i></p> <p>The Commissioner's position cited above does not correctly reflect the Note Terms:</p> <ul style="list-style-type: none"> • The terms of the Notes are not varied at any time (that is, either before or after the Assignment Event occurs, in contrast to the Commissioner's statement in paragraph 25 of TD 2008/D6). Rather the terms of the Notes are self-executing when the Irrevocable Assignment Offer is made. • The restrictions on Notes in Stapled Security arrangements are merely conditions on which the Notes are issued. (<i>Macquarie Finance Ltd v Commissioner of Taxation</i> [2005] FCAFC 205). | <p>With respect, it is considered that the Commissioner's position correctly reflects the terms of the Stapled Security. The Note Terms form part of the terms of the Stapled Security upon which the Investor acquires the Stapled Security.</p> <p>Whilst the restrictions on the Note that forms part of the Stapled Security can be said to be merely conditions on which the Note is issued, the restrictions, including the Irrevocable Assignment Offer which is embedded in the terms of the Note, are such that the Note does not create a debtor-creditor relationship. To that end, it is relevant that:</p> <ul style="list-style-type: none"> • The terms of the Note provide a conditional obligation to pay interest to the Investor, as the Issuer has full discretion to decide not to pay interest to the Investors under the terms of the agreement (by making a Resolution Stopper). • The terms of the Notes do not provide that the Issuer would have any 'debts or money claims' in respect of the Notes to the Investors. The Investors have an entitlement to interest, but this is a conditional entitlement which, if it goes unpaid, causes an Assignment Event that removes the Issuers obligation in respect of the interest payments from the Investor to itself. |

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| 2.3 cont | | <ul style="list-style-type: none"> • The terms of the Note also provide that the Issuer has no obligation to pay back the face value of the Notes to the Investors, even in the case of insolvency. The Issuer's liability in respect of the face value of the Notes is: <ul style="list-style-type: none"> - On Assignment Event, the Notes will be automatically assigned back to the Issuer for nil consideration, in which case the Issuer has no requirement to pay the Investor the face value, - On insolvency the face value and any interest due but unpaid is to be paid to the Assignee (the Issuer) and not the Investor, - On redemption the face value is paid to the Assignee (the Issuer). <p>As there is no obligation on the part of the Company to pay an amount to the Investor, the Notes do not come within paragraph (a) of the definition of 'security' in subsection 159GP(1).</p> <p>Action taken for issue 2: Changes were made following the discussion under Issue 1. No other amendments to this Determination were required in respect of these comments.</p> |
| 3 | <p>The Stapled Security is a traditional security There is no requirement in either section 26BB or section 159GP for a 'traditional security' to be a debt instrument.</p> | <p>This Determination does not say that a traditional security must be a debt instrument.</p> <p>This Determination actually states that a traditional security for the purposes of section 26BB is a security as defined in section 159GP; and in turn the definition of security covers any instrument which would normally be taken to be a security as well as some other liabilities which would not normally be characterised as a security. The point made in this Determination is that the only part of the definition of security which the Stapled Security could potentially satisfy is paragraph (d) and the Stapled Security is not covered by paragraph (d) because only instruments which are debt-like fall under paragraph (d).</p> <p>Action taken for issue 3: No amendments to this Determination were required in respect of these comments.</p> |

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| 4 | <p>Other implications</p> <p>The Commissioner's view raises uncertainty in respect of other aspects of the income tax legislation such as Division 974, section 215-10, CGT and Division 13A of the <i>Income Tax Assessment Act 1997</i> (ITAA 1997).</p> | <p>The Commissioner acknowledged that the view may in some circumstances create uncertainty in other areas of the law. Where the need arises, the Commissioner will provide guidance. For example, the Commissioner's preliminary view on the application of section 215-10 of the ITAA 1997 to the Stapled Securities of the type described in this Determination is given in Taxation Determination TD 2009/D2.</p> <p>Action taken: No amendments to this Determination were required in respect of these comments.</p> |
| 5 | <p>Statutory Interpretation</p> <p>Although the Courts have been prepared to look at the substance of a transaction when interpreting income tax legislation, we submit that the form of a transaction should still be respected.</p> <p>In <i>FCT V Broken Hill Pty Co Ltd</i> 2000 ATC 4569, Hill J stated (at 4670-4671) '...I would wish to say something about the issue of substance and form. ...it is not to be assumed that form must always prevail over substance. The law has moved somewhat from the rather rigid adherence to form to be found in cases such as <i>Inland Revenue Commissioners v Duke of Westminster</i> [1936] AC 1. This is not to say that legal rights are not important or even, in a case such as the present, determinative.'</p> | <p>The Commissioner considers that Justice Hill's comments in <i>FCT V Broken Hill Pty Co Ltd</i> 2000 ATC 4569, (at 4670-4671) support the view that form does not always prevail over substance. Indeed the label that a party attributes to a payment will not be determinative of their true nature. Here, Investors purchase a product that provides for periodic payments called 'interest' until an 'Unstapling' event happens, and then equivalent payments, called 'dividends' after that event (except where the event is in respect of conversion and redemption of the Preference Share). The substance of the Stapled Security is one asset. The legal form of the Stapled Security is one contract (refer discussion provided for Issues 1-3).</p> <p>Regarding statutory interpretation in an income tax context, in more recent times, the courts have moved to an approach where the syntax, the legislative context and the evident policy are considered in every case regardless of whether there is any ambiguity in the relevant provision. It is submitted that the Commissioner's view follows these rules of modern statutory interpretation. It takes account of both the form and substance of the Stapled Security and applies the income tax legislation to it, taking account of the words of the law, the legislative context and the evident policy of the law: see <i>CIC Insurance Ltd v. Bankstown Football Club Ltd</i> (1997) 187 CLR 384.</p> <p>Action taken: No amendments to this Determination were required in respect of these comments.</p> |

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| 6 | <p>Does the Commissioner’s analysis extend to all stapled securities?</p> <p>The Draft Determination does not make clear to what extent the Commissioner’s views represents a new approach to analysing the consequences of stapled security arrangements.</p> | <p>The Commissioner’s analysis does not extend to all stapled securities, only those that have the features described in this Determination (refer comments at Issue 1).</p> <p>Action Taken: This Determination now clarifies that the view taken is only for stapled securities that have the features described in paragraph 2.</p> |
| 7 | <p>Date of Application</p> <p>In the event that the approach set out in the Draft Determination is adopted in the final determination, we recommend that this approach be prospective only, that is, that the final determination only apply from its date of issue (or alternatively from the date of issue of the draft determination on 26 March 2008).</p> <p>The Commissioner’s proposed approach will potentially adversely impact stapled securities that have already been issued into the market. Accordingly we submit that the final determination should have prospective application only.</p> | <p>The Commissioner considers that a prospective application of the final determination is unwarranted. The Commissioner’s preliminary view has been in the public arena since the Taxpayer Alert was issued 14 January 2008.</p> <p>The view in this Determination can be either favourable (reducing the amount of tax payable on gains) or unfavourable to taxpayers depending on their circumstances. Given that it can be both favourable and unfavourable, the date of application of this Determination will not be prospective only.</p> <p>The taxation system is one of self assessment. Taxpayers must self assess their liability to tax, taking account of their income and deductions and lodging returns based on those assessments. Where they are uncertain about the taxation implications of a financial product, they may write to the Commissioner for a private ruling.</p> <p>Action Taken: The date of application in this Determination remains unchanged, that is, it applies both before and after its date of issue.</p> |