ATO guidance on non-concessional MIT income

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In brief

On 26 June 2019, the Australian Taxation Office (ATO) issued guidance in the form of a draft Law Companion Ruling LCR 2019/D2 (the draft LCR) on the concept of "non-concessional MIT income" (NCMI) on which a withholding tax rate of 30 per cent applies to fund payments made by a Managed Investment Trust (MIT) from 1 July 2019 unless transitional rules apply.

The draft LCR addresses various aspects of the new stapled structure law as they relate to NCMI, including:

- MIT cross staple arrangement, including the meaning of 'arrangement' and 'facility'
- MIT cross staple arrangement income and the transitional rules
- Integrity rules, particularly in relation to concessional cross staple rent
- MIT trading trust income
- MIT residential housing income
- MIT agricultural income

Notwithstanding that the draft LCR is intended to clarify the application of the new stapled structure law, uncertainties remain and a number of new questions arise as many of the positions taken by the ATO were not expected and/or inconsistent with previous guidance. Further clarification will be required in the finalised version of the LCR.

Comments on the draft LCR are due by 9 August 2019.

In detail

From 1 July 2019, the new stapled structure rules (enacted by Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Act 2019) apply to impose a 30 per cent rate of withholding tax (rather than 15 per cent) on fund payments made by a MIT to the extent that they are attributable to NCMI, unless the transitional rules apply.

The draft LCR considers the ATO's preliminary views on various aspects concerning the new concept of NCMI. The new NCMI rules apply to any fund payment made on or after 1 July 2019 in respect of the 2019-20 or later income years.

There are a large range of issues covered by the draft LCR, we have highlighted below our key observations.

- **Definition of facility**

  The draft LCR examines the concept of "facility", and "ultimate facility" which was not previously addressed in the Explanatory Memorandum (EM) accompanying the Act. In particular, the draft LCR suggests in one of the examples that notwithstanding that assets are part of an integrated system or network, they may be discrete facilities for the purposes of the new rules. Examples in the draft LCR include a storage facility adjacent to a transport facility, a road or discrete sections of road, bridges and tunnels which are part of an integrated system network and a depot from which services are dispatched in support of another facility (such as a toll road). This distinction indicates that the Commissioner may take a narrow interpretation of what constitutes a facility.

  The Commissioner's interpretation seems to indicate that where multiple "facilities" make up an "ultimate facility", each of the facilities may be considered separately in assessing whether a facility is eligible to be an "economic infrastructure facility". The implication of this could be far reaching, and may come as an unwelcome surprise to certain taxpayers who may have anticipated the entirety of their operations to be a single facility which meets the "economic infrastructure facility" definition. This may lead to two transitional periods for the "ultimate facility" (i.e. 15 years for the economic infrastructure facility component and 7 years for other parts of the facility). This may result in an additional tax cost for certain investors and a heavy compliance burden on taxpayers to "reasonably apportion" cross staple income.

  In addition, in respect of a number of the examples in the LCR on what constitutes a facility, the Commissioner has not provided detailed facts or reasoning which makes it difficult to draw hard and fast rules from the examples. The listing of various examples where there are separate facilities without providing much in the way of supporting detail would seem to suggest the Commissioner is seeking to reserve the right to challenge the scope of a "facility" on a case by case basis.

- **Change to existing cross staple arrangements**

  The draft LCR provides guidance on when changes made to a cross staple arrangement may result in a new arrangement. The draft LCR confirms the position adopted in the EM that 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. However, surprisingly, one of the examples in the draft LCR indicates that a change in the external entities holding the stapled entities could result in a new cross staple arrangement. This seems to suggest a sell-down of interests in stapled structures by upstream investors could potentially result in a new cross staple arrangement (i.e. the transitional provisions would cease to apply to the cross staple arrangements entered into before 27 March 2018 and where a choice is made to apply the transitional rules). This is inconsistent with previous guidance and is a matter that requires urgent clarification.

- **Eligible investment business and the meaning of rent**

  Interestingly, notwithstanding that the new stapled structure law changes did not introduce a definition for “rent” or “investing in land primarily for the purpose of deriving rent”, which have long been cornerstone principles of the taxation of trusts in the context of the meaning of an “eligible investment business”, the draft LCR devotes significant attention to these matters in providing guidance on the definition of “rent from land investment”, a new concept which refers directly back to these established concepts.

  Law Companion Rulings are intended to “provide an insight into the practical implications or detail of recently enacted law”[1] and therefore the use of this LCR to express the ATO’s views of concepts which are not amended or introduced in the amending law is novel. Given the importance of these concepts, additional ATO guidance is not unwelcome, though some of the conclusions reached in the draft LCR are not necessarily consistent with industry practice.

- **First put to use**

  For facilities that qualify for transitional relief that are either currently being constructed, or have yet to be constructed, it will be necessary to determine when the 7 or 15 year transitional concession begins. The draft LCR indicates that the clock will start to run from the time of first use of some “self-contained component or collection of assets” that of themselves satisfy the definition of facility. This may occur prior to the ultimate facility being completed, which means for certain projects that are phased (or where one component of a project is brought online ahead of others), the value of the transitional concession may be diminished.

- **Concessional cross staple rent cap - objective method**

[1] Law Companion Ruling (LCR) 2015/1: Law companion ruling: purpose, nature and role in ATO’s public advice and guidance.

The draft LCR does not provide any additional guidance on what will constitute an "objective method" for determining the annual rent under the lease, and instead reproduces comments from the EM. The lack of additional guidance suggests that the ATO's preference is to ensure taxpayers seek ATO guidance on their specific rent clauses, which will allow the ATO to administer the rent cap rules on a case by case basis.

- **Concessional MIT rate unavailable for amounts not classed as 'rent', or attributable to moveable property**

  Receipts on cross-staple arrangements may only be eligible to limit designation as "MIT cross staple arrangement income" (e.g. under the transitional rules) if they meet the definition of "rent from land investment", which, in the Commissioner's view, should exclude returns on arrangements which do not provide exclusive possession.

  Additionally, in order to limit designation as "MIT cross staple arrangement income" under the transitional rules or as an economic infrastructure facility, rent must be "attributable to" a facility. Importantly, the Commissioner considers a facility does not include ancillary and peripheral assets, such as moveable property and therefore rent attributable to such assets may not fall within the transitional rules.

  Taxpayers who otherwise have an eligible investment business for Division 6C purposes may still receive income which is not "rent", or which is attributable to moveable property which is not a facility, which in either case would give rise to MIT cross staple arrangement income. Where this income exceeds the de minimis threshold of 5 per cent of net income in the prior year, this may lead to a compliance burden on taxpayers to "reasonably apportion" income from cross-staple arrangements according to whether the returns are "rent" and whether the returns are attributable to a facility.

The draft LCR does not address the other measures that have been enacted by the same package of measures, including the changes to the thin capitalisation rules, the foreign pension fund withholding tax exemption and sovereign immunity rules. The ATO has indicated that guidance in respect of the foreign pension fund withholding tax exemption and sovereign immunity will be subject to a separate LCR which is yet to be released.

The takeaway

The draft LCR provides some interesting insight into the ATO's proposed administration of the new stapled structures law. Taxpayers who have concerns in relation to any of the ATO's views as set out in the draft LCR should consider making a submission before the due date for comments closes on 9 August 2019. However, on taxpayer specific issues such as the nature of a facility and concessional cross staple rent cap where the ATO appears reluctant to provide further public guidance, it may be more useful to engage in discussion with the ATO and/or seek a private binding ruling directly from the ATO.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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