
The use of stapled structures of concern ... again

1 February 2017

In brief

On 31 January 2017, the Commissioner of Taxation issued Taxpayer Alert TA 2017/1 (the **Alert**) expressing his concern over contrived arrangements that fragment integrated trading businesses in order to re-characterise trading income into passive income which may be taxed more favourably.

The Commissioner states that certain stapled structures that split land (and assets attached to land) and the trading business are being used in these arrangements.

In detail

A Taxpayer Alert is a warning about an activity that is causing the Australian Taxation Office (ATO) concern. Taxpayer Alerts are principally designed to target significant and emerging aggressive tax planning arrangements that the ATO has under risk assessment.

In TA 2017/1, the Commissioner acknowledges that stapled structures have been used for many years including in the infrastructure and the commercial property investment sectors. In this regard, the Commissioner states in the Alert that the ATO is generally not concerned with what are described as “traditional stapled structures” (property staples) where cross-staple dealings tend to be immaterial compared to the core business operations of each entity, and the Asset Trust receives all or most of its income such as rent from unrelated third party tenants in respect of its discrete passive investments.

The structures raising the most concern are those where trading income is re-characterised as passive income and diverted to a flow-through trust with the result that:

- the Asset Trust is a flow-through entity for tax purposes where the investors are ultimately subject to tax on the net income of the trust;
- distributions from the Asset Trust may be subject to tax at rates between 0% to 30% in the hands of investors; and
- the Operating Entity is unlikely to have significant taxable income, largely because of deductions in respect of payments to the Asset Trust.

The Alert states that the ATO is reviewing the effectiveness of these arrangements under the substantive provisions of the tax law. However, even if the structures comply with those provisions, it is concerned

that these arrangements are being entered into or carried out for the dominant purpose of obtaining a tax benefit which may attract the operation of the general anti-avoidance provisions in Part IVA of *the Income Tax Assessment Act 1936 (Cth)*.

The Alert identifies the following four particular arrangements that are of concern:

- 1) Finance staple
- 2) Synthetic equity staple
- 3) Royalty staple
- 4) Rental staple

Taxpayers and advisors who implement these types of arrangements will be subject to increased ATO scrutiny.

The Commissioner confirms that the Alert does not extend to Australian real estate investment trusts (A-REITs) which derive all or most of their rental income from unrelated third party tenants and have not entered into arrangements set out above. It also does not apply to the privatisation of businesses which are effectively land (and land improvements) based or heavily reliant on particular land holdings and related improvements.

PwC View

The issues covered in the Alert concerning staples are not new and have been discussed with the ATO in extensive consultations over a number of years. In fact, the concessional tax rates introduced in the managed investment trust (MIT) rules were introduced at a time of record numbers of listed stapled entities. Stapled acquisition vehicles have heavily featured in over \$50 billion of recent infrastructure privatisations subjected to intense ATO scrutiny, including electricity transmission, electricity distribution and ports. It is unclear how the issues in the Alert relevant to other stapled asset classes like renewable energy generation, telecommunications infrastructure and other infrastructure related assets are different.

The release of the Alert was not expected and raises more questions than answers, potentially creating a more uncertain environment for stapled structures. In particular:

- Stapled structures have been used for over 20 years in the Australian infrastructure and real estate market so it is not clear why a general alert (and not a more targeted alert) has been issued.
- The Alert does not identify the relevant industries to which the Alert could apply and it does not specify the type of assets that would be acceptable to be held in stapled structures (for example, toll roads, airports, windfarms, solar assets, agriculture, utilities, ports, telecommunications etc). As a result, it is difficult to understand how many stapled structures are impacted.
- There is no detail as to whether the Alert applies to existing stapled structures or whether it will apply prospectively to new structures established. In addition the Alert does not distinguish between restructuring an existing business without an ownership change to other circumstances such as establishing a new business.
- There appears to be no distinction between greenfield and brownfield assets (as new businesses are also targeted as rental staples) and whether this distinction would have any impact on whether stapled structures would be acceptable to use.
- Privatisations are specifically carved out from the Alert without any detailed reasoning. A question arises as to how or why assets leased in privatisations are different to other greenfield and brownfield asset classes. The ATO acknowledges in the Draft ATO Privatisation and

Infrastructure – Australian Federal Tax Framework that privatised assets constitute a single unified business.

- As tax outcomes and tax conditions have become far more relevant in the Foreign Investment Review Board (FIRB) process, where FIRB approval is required, the release of the Alert may make the approval process more complex for investors.
- Affected taxpayers will need to consider the impact of the Alert on project financed structures / debt covenants. This may provide additional complexity for investors in projects such as renewable energy projects.

Takeaway

In light of the Alert, it will be important to engage with the ATO in relation to any stapled structure to understand the ATO's position as to whether any particular stapled structure would be acceptable in the relevant circumstances.

It will be interesting to see the additional guidance the Commissioner will provide in relation to stapled structure asset classes and the additional details as to what is viewed as acceptable.

Let's talk

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

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