Corporate tax update

1 May 2015

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Board of Taxation Report on debt and equity rules

On 2 April 2015, the Commonwealth Government released the Board of Taxation’s (BoT) accelerated report into one component of the debt and equity tax rules. In the Report, the BoT recommends reforms to the related schemes provisions (section 974-15 and section 974-70) and the equity over-ride rule (section 974-80) in the debt and equity provisions of the Income Tax Assessment Act 1997. The BoT’s recommendation is in line with the announcement by the former Government in 2011 that the rules be amended because of their uncertainty which has created significant practical difficulties.

In summary, the BoT has made a recommendation to repeal the related schemes and equity over-ride provisions and replace them with a new integrated provision that looks to the connectedness and economic consequences of various schemes. The BoT states that, in determining whether two or more schemes should be aggregated and taken as one scheme, the following very high-level principles could apply:

- There is a dependency or interconnectedness between two or more schemes such that the pricing, terms and conditions of one or more schemes operate in a way which would alter or affect the economic consequences of the pricing, terms and conditions of one or more other schemes in a manner which would affect the application of the debt test or the equity test to one or more of those schemes; and
- The issuer and others participate in a way that demonstrates that the schemes are designed to operate in this way in combination to secure their combined result (see paragraph 3.21 of the BoT’s Report).

Two or more schemes should not be aggregated and taken to be one scheme merely because of the existence of an arrangement that involves the subordination of a liability, stapling (of either, or both, debt instruments or ownership interests in entities), the provision of funding, or the existence of a security interest (paragraph 3.22 of the Report). Additionally, if, having regard to normal commercial understandings or dealings in practice, the schemes would commercially be recognised as separate schemes, they should not be aggregated and taken to be one scheme under the debt and equity tax rules (paragraph 3.22 of the Report).

The BoT’s Report suggests that the new provisions should contain a set of commercially relevant examples which will be made by legislative instrument (and will have the force of law). The arrangements (and whether the BoT proposes that they should be aggregated under the new provisions) are as follows:

- Example 1. Shareholder loan – no aggregation
- Example 2. Finance trust and company staple – aggregation
- Example 3. Debt raised by a property trust – no aggregation
- Example 4. Trust and company staple – no aggregation
- Example 5. Hybrid Tier 1 structure – aggregation
- Example 6. Chain of debt and equity – no aggregation
- Example 7. 99/1 structure – no aggregation
- Example 8. Contra-put scheme – aggregation

In his media statement regarding the Report, the
Assistant Treasurer confirmed that the Government will consult on exposure draft legislation to implement the BoT’s recommended approach in the coming months.

For further information contact Luke Bugden on (02) 8266 4797.

**Taxation Determination on the equity over-ride rule**

On 22 April 2015 the Commissioner of Taxation released its final Taxation Determination TD 2015/10 which sets out the Commissioner’s view that paragraph (d) of subsection 974-80(1) of the ITAA 1997 will not be satisfied merely because a company has issued a debt interest issued to a listed property trust within the same stapled property group.

This Determination was previously issued in draft as TD 2014/D20 and is substantially the same as the draft.

In relation to ‘stapled trust and company structures’ where the ‘stapled trust’ provides loan funds to the ‘stapled company’, TD 2015/10 states that the fact that the company has issued a debt interest to the trust will *not on its own* (emphasis added) be sufficient to conclude that the scheme or series of schemes is designed to operate so that the interest on the loan is used to fund (directly or indirectly) a return to the stapled security holders. As a result, section 974-80 would not in these circumstances be satisfied so as to classify the loan as equity. The Commissioner’s view in TD 2015/10 is that to satisfy paragraph (d) of subsection 974-80(1), “a stronger connection between the interest on the loan and the trust distributions must be evident from the structure of the scheme or series of schemes, such that it is reasonable to conclude that the [property trust’s] distributions to the stapled security holders are indirectly a return from [the company]”.

The Commissioner goes on to state that “relevant connections could include that [the company] was almost exclusively funded by the loan from [the property trust] and/or the return on the loan was designed to pass the vast majority of [the company’s] profits to the [property trust]”.

Since TD 2015/10 leaves it open as to the circumstances in which, in the Commissioner’s view, paragraph (d) of subsection 974-80(1) will be satisfied, it is questionable whether taxpayers can place reliance on the Determination (as a Public Ruling) to self-assess whether paragraph (d) of subsection 974-80(1) is satisfied based on the taxpayer’s specific facts.

For further information contact Peter Collins on (03) 8603 6247.

**High Court to hear appeal on question of whether a liquidator is required to retain money from proceeds of asset sale to pay a future tax liability**

The High Court has granted the Commissioner leave to appeal against the Full Federal Court decision in Commissioner of Taxation v Australian Building Systems Pty Ltd (in liq) [2014] FCAFC 133. In that case, the Full Federal Court held that a company liquidator, appointed under the Corporations Act 2001, was not required under section 254 of the Income Tax Assessment Act 1936 (ITAA 1936) to retain an amount from the proceeds of sale of an asset to pay income tax that may be payable under any future assessment issued to the company. For further information see *PwC’s TaxTalk Monthly – November*.

For further information contact Ronen Vexler on (02) 8266 0320.
Let’s talk

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

Tom Seymour, Managing Partner  
+61 (7) 3257 8623  
tom.seymour@au.pwc.com

Scott Bryant, Adelaide  
+61 (8) 8228 7450  
scott.a.bryant@au.pwc.com

Adam Davis, Melbourne  
+61 (3) 8603 3022  
adam.davis@au.pwc.com

Warren Dick, Sydney  
+61 (2) 8266 2935  
warren.dick@au.pwc.com

Murray Evans, Newcastle  
+ 61 (2) 4925 1139  
murray.evans@au.pwc.com

David Ireland, Sydney  
+61 (2) 8266 2883  
david.ireland@au.pwc.com

Anthony Klein, Melbourne  
+61 (3) 8603 6829  
anthony.klein@au.pwc.com

David Lewis, Perth  
+61 (8) 9238 3336  
david.r.lewis@au.pwc.com

Julian Myers, Brisbane  
+61 (7) 3257 8722  
julian.myers@au.pwc.com

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