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Tax Insights

Taxation of Stapled Structures changes announced

On 27 March 2018 the Government released a detailed paper on the changes it will introduce to tighten the rules around stapled structures.

The key elements of the package are:

Element A: Preventing active business income from accessing the 15 per cent MIT Rate

A new measure will apply a final withholding tax set at the corporate tax rate to distributions derived from certain passive income earned by a Managed Investment Trust (MIT). The paper specifically refers to MIT fund payments derived from cross staple rental payments; cross staple payments made under certain financial arrangements such as total return swaps; or where the MIT receives a distribution from a trading trust.

The paper (together with media release), states that:

- The higher withholding tax will not apply to finance staples or stapled structures in the commercial and retail property sectors to the extent that they generate and pass through rent from third parties
- The higher withholding tax will not apply where only a small proportion of the gross income of the trust relates to cross staple payments
- The government will also introduce a 15-year exemption period concession for certain new, Government-approved, nationally significant, infrastructure assets. The paper indicates that additional conditions may be imposed on entities accessing this concession.

Element B: Preventing double gearing structures through the thin capitalisation rules

The paper highlights a concern with "double gearing" where there is debt issued at both the underlying asset and investor level against the same underlying investment.

The paper outlines a new measure that will lower the thin capitalisation associate entity test (for the purposes of determining associate entity equity and associate entity debt) from 50 per cent or more to 10 per cent or more for interests in flow-through entities.

This measure will also clarify that the thin capitalisation arm's length debt test requires consideration of gearing against the underlying assets for interests in any entity.

Element C: Limiting the foreign pension fund withholding tax exemptions

This measure will limit the withholding tax exemptions for foreign pension funds to interest and dividend income derived from an entity in which the fund has a portfolio-like interest (holds an ownership interest of less than 10 per cent and does not have influence over the entity's key decision making).

Element D: Limiting the sovereign immunity tax exemption

The current ATO administrative practice to grant concessions to foreign government ('sovereign') investors will be replaced with a legislative framework. The sovereign immunity tax exemption will be limited to situations where sovereign investors have an ownership interest of less than 10 per cent and do not have influence over the entity's key decision-making. The paper states that the exemption will not extend to distributions of active business income from trusts, or cross-staple rental income.

Element E: Preventing agricultural MITs

This measure will exclude rent from agricultural land from qualifying as 'eligible investment business income' for a Managed Investment Trust.

Timing and transition

These changes (except the thin capitalisation changes), will take effect from 1 July 2019, other than:

- Arrangements in existence at the date of announcement will have access to a seven-year transition period. For arrangements qualifying for transitional relief, the earliest these tax changes (other than thin capitalisation changes) will apply is 1 July 2026; and
- A 15-year transition period for existing Infrastructure staples will be given in respect to Element A only (withholding tax at company tax rate).

Sovereign investors that have a ruling from the ATO on sovereign immunity for a particular investment extending beyond the seven-year period will be able to access the transition period on that investment until the expiry of the ruling.

Following the implementation of this package, the general anti-avoidance provision within Part IVA of the *Income Tax Assessment Act 1936*, will not apply with respect to the choice of a stapled structure to obtain a deduction in respect of cross stapled rent during the transition period. However consistent with TA2017/1, the Government expects that Part IVA will apply to egregious tax-driven structures such as royalty staples.

The thin capitalisation changes will apply to income years commencing on or after 1 July 2018 (with no transitional period).

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