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## Stapled Structures – Consultation Paper

The Corporate Tax Association (CTA), the key representative body for major companies in Australia on corporate tax issues, welcomes the opportunity to provide comments on the Treasury Consultation Paper ‘Stapled Structures’ (CP). We also note our meeting with the Treasury and the Australian Taxation Office (ATO) on Monday 10 April during which a number of the issues canvassed in the CP were discussed.

In providing feedback on the issues raised in the CP it is worth reiterating the scope of the paper and its objectives. These can be gleaned from the following statements in the CP:

*“The CP seeks stakeholder views on the potential policy options in relation to stapled structures, the taxation of real property investments and the characterisation of trading income.”*

*“The CP is not limited to specific integrity or compliance issues highlighted by the ATO (Taxpayer Alert TA 2017/1). Rather the Government seeks to undertake a holistic examination of the taxation of investment income derived using these structures, including the dichotomy between trading income and passive income.”*

*“The consultation will be carried out with a view to examining policy options to modernise Australia’s taxation regime so as to remove the tax distortions that may be identified from the use of stapled structures.”*

There are also a number of ‘external’ factors which are relevant in determining the scope of objectives of the CP:

- The recent release of Taxpayer Alert TA 2017/1
- The recent release of the ATO’s draft infrastructure framework
- The timeframe for submissions on the CP (four weeks) and the potential for an announcement on the outcome of consultation in the 2017-18 Federal Budget (9 May)

Although each of the issues canvassed in the CP and the stated objectives of the CP are all worthy subjects of consultation and potential refinement, binding them together in the context of the ATO's recent activity in related areas in a pre-Budget environment does not bode well for a sensible and appropriately considered outcome.

The use of stapled structures, as recognised in the CP, has grown exponentially over the past 15 or so years. Although this in itself is arguably cause for concern from a policy perspective, it also means that any proposed changes to the use of those structures must be carefully considered prior to announcement and certainly prior to implementation. The use of stapled structures in the property and infrastructure sectors, both of which are heavily reliant on foreign investment, also demands that genuine caution be exercised in the context of policy refinements or change.

In making these observations, we recognise that the current environment (the increasing use of stapled structures outside property and infrastructure and ATO concerns around re-characterisation of trading income) is giving rise to uncertainty both domestically and from the perspective of foreign investors looking to invest in stapled structures. From this perspective, we acknowledge the difficulty the Government faces in balancing the need for certainty with the need to preserve the positive features of stapled structures for those taxpayers that use them appropriately. It is in this context that we make the following comments:

#### **Re-characterisation of income**

Concerns around the re-characterisation of income must be considered as a stand-alone issue in terms of appropriate action, whether that be through the application of existing law (such as Part IVA) or specific changes to existing law or new law. As noted on page 7 of the CP, the fragmentation of an integrated business in order to inappropriately separate trading income and passive income has been identified as a growing trend not only for stapled securities, but also other structures (such as vertical structures or entities under common ownership). As such, determining the best course of action to address this concern should be a separate and distinct process from that aimed at the use of stapled structures.

Although we (and the ATO) consider that cases such as those outlined in TA 2017/1 might attract the operation of Part IVA, we understand there is a concern that the outcome under such a 'blunt' provision may unduly impact transactions that are outside the scope of the nefarious activities of the types identified in TA 2017/1, thereby potentially encroaching on legitimate activities and structures.

Further and thorough consideration needs to be given to this point – that is, whether concerns around re-characterisation of income can be addressed through the operation of Part IVA or whether specific changes to existing law or the introduction of new law is required.

Proper consideration of the most effective path to address the specific issue of re-characterisation of income would require a commitment to targeted consultation with appropriate timeframes.

## **Taxation of real property investments**

As noted at page 7 of the CP, there is a wide spectrum of structures which separate trading and passive income flows, ranging from structures that fall “well within the policy intention of Division 6C and the MIT withholding rules, such as A-REIT staples that derive largely all their income as rental from third party tenants, to highly structured fragmenting of trading businesses, which arguably go well beyond the original policy intention.”

We would venture a little further than this statement and suggest that highly structured fragmenting of trading businesses undoubtedly go well beyond the original policy intention of Division 6C and the MIT withholding rules. As such, concerns around the operation and/or proliferation of such businesses should not muddy the waters for those that are operating well within the confines of Division 6C and the MIT withholding rules.

If there are concerns around the current taxation of real property investments, these should be considered in isolation to concerns around re-characterisation of trading income. One is a policy decision on concessional treatment of certain types of passive income to investors and the other an integrity issue for those that play at the fringes.

In relation to the A-REIT regime, it is worth noting the following:

- Australia has a mature property investment market operating within a well-established A-REIT regime. Although comparing our regime with other regimes can provide a helpful point of reference, any overlaying of international REIT regimes without due consideration of the characteristics of our regime and its level of maturity would likely result in unwarranted restructuring and refinancing obligations.
- The revamped MIT regime, including the new integrity rule aimed at cross staple arrangements, has only been in place since 1 July 2016. Sufficient time should be allowed to evaluate the effectiveness of the new regime and its specific arm’s length integrity rule .

## **The use of stapled structures**

Treasury makes some interesting observations around the increased use of stapled structures in the CP, the most telling being Australia’s very low percentage of income that can be derived from non-rental activities without tripping over Division 6C.

Given the concerns with the re-characterisation of income do not lie with the use of stapled structures per se, the answer appears to lie in enhancing the operation of Division 6C. Although we understand that a review of Division 6 C is a significant undertaking (and therefore one not to be taken lightly), the provision is well known for its cumbersome and restrictive operation. A holistic and considered review of its application would deliver significant benefits, not only in terms of reducing the need for stapled structures, but also in the context of providing greater certainty for

taxpayers across the board. Such a review would also meet the stated objective of the CP:

*"..to examine policy options to modernise Australia's taxation regime so as to remove the tax distortions that may be identified from the use of stapled structures."*<sup>1</sup>

### **Limiting the use of stapled structures**

The CTA recognises the issues canvassed in the CP are complex and as such require careful analysis before any policy changes are made (if at all).

We also however recognise that integrity concerns exist, and that these concerns if left unchecked have the potential to grow. If these integrity concerns are seen as pressing, a remedy may be to retain the existing rules for stapled structures for A-REITs and specified infrastructure projects and introduce specific anti avoidance rules with a lower "principal purpose" test to manage integrity concerns. This approach, like the others canvassed above, would also require careful consideration and an appropriate period of consultation.

Should you have any questions in relation to the above, please do not hesitate to contact me or Paul Suppree.

Yours sincerely



Michelle de Niese  
Executive Director

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<sup>1</sup> Page 1 CP