

JOINT SUBMISSION BY

The Institute of Chartered Accountants in Australia, the Taxation Institute of Australia, the National Institute of Accountants, CPA Australia and Taxpayers Australia

Draft Taxation Determination TD 2010/D2

Income tax: will the exemption in section 102NA of the Income Tax Assessment Act 1936 continue to apply to a unit trust that has become the interposed trust of a stapled group pursuant to Subdivision 124-Q of the Income Tax Assessment Act 1997 if the trustee of the unit trust later gains control (or the ability to control), either directly or indirectly, [the] operations of an entity that are in respect of a trading business within the meaning of section 102M of the Income Tax Assessment Act 1936

Date due: 17 September 2010

Thank you for the opportunity to comment on Draft Taxation Determination TD 2010/D2 (“the Draft TD”).

The high level ‘Executive Summary’ below is followed by specific comments which expand on these views and raise other technical matters. The Professional Bodies can elaborate on any aspect if required.

All legislative references in this submission are to the *Income Tax Assessment Act 1936* (Cth) and the *Income Tax Assessment Act 1997* (Cth), as applicable.

In this submission, the term “Head Trust” will be used to refer to an Australian unit trust that has been interposed to become the head entity of an Australian stapled group under a restructure to which the CGT roll-over in Subdivision 124-Q applied.

EXECUTIVE SUMMARY

1. The practical effect of the Draft TD’s interpretation of section 102NA is that the Subdivision 124-Q CGT roll-over will become practically redundant. This is clearly not the outcome intended by the relevant provisions and therefore indicates that the Draft TD’s interpretation of section 102NA is incorrect.
2. The Draft TD has incorrectly applied the principles of statutory construction with respect to the interpretation of section 102NA.
3. The Draft TD is inconsistent with the policy objectives behind the relevant provisions.
4. The Draft TD’s interpretation of section 102NA is anomalous having regard to subsection 102N(2) because subsection 102N(2) will permit a foreign entity that is controlled by a Head Trust to directly acquire a trading business after the Subdivision 124-Q restructure without the Head Trust becoming subject to Division 6C.
5. The question posed in the Draft TD is inconsistent with the conclusion.

SPECIFIC COMMENTS

1. The practical effect of the Draft TD's interpretation of section 102NA is that the Subdivision 124-Q CGT roll-over will become redundant

The Draft TD's interpretation of section 102NA means that a Head Trust will not be able to acquire any controlled entities that are carrying on a trading business without becoming subject to Division 6C.

Australian stapled property and infrastructure groups are generally structured so as to permit the group to engage in a range of operations relating to the holding of real property, including both passive investment in land and active activities, such as land development. To facilitate the operational activities of the group, the typical stapled structure involves a flow-through trust, the units in which are stapled to shares in a company or shares in a trust that is taxed as a company. The flow-through trust and its controlled entities will only undertake eligible investment business activities and the corporate side of the staple will undertake any active activities, including the acquisition of land for development purposes and/or the acquisition of new businesses. For legal and commercial reasons, it is common for acquisitions to be undertaken as an entity acquisition (i.e. the relevant asset is located in a special purpose entity which is acquired by the purchaser). The ability to invest in new opportunities and new trading businesses, both on the flow-through and corporate side of the staple, is critical to growth and the maximisation of investor returns.

Based on the Draft TD, a stapled group which undertakes a Subdivision 124-Q restructure will not be able to acquire an entity that is conducting a trading business without triggering the application of Division 6C. For example, assume an existing stapled group carries on a land development business on the corporate side of the staple. If such a group was to undertake a Subdivision 124-Q restructure, then the group would not be able to undertake a simple land development in the future without triggering Division 6C if the land development involved acquiring the entity that held the land (or incorporating new entities the purpose of which is to hold new land developments). As this example illustrates, the Draft TD would effectively constrain the future operations of a stapled group if it chooses to undertake a Subdivision 124-Q restructure. For the reasons discussed in the preceding paragraph, such a constraint is unacceptable from a commercial perspective because the ability to invest in new opportunities is critical to growth and the ability to maximise returns to investors. From a practical perspective, this means that the Draft TD will make Subdivision 124-Q a redundant measure because it will not be commercially feasible for any stapled group to undertake a Subdivision 124-Q restructure given the constraint that would be imposed upon future operations.

Section 102NA is a provision that was introduced as a part of the measures relating to the Subdivision 124-Q CGT roll-over. The intention behind these measures is discussed in further detail below. However, regardless of these intentions, it would clearly be an inappropriate outcome if section 102NA effectively precludes stapled groups from being able to restructure in the manner specifically contemplated by Subdivision 124-Q. This suggests that the Draft TD's interpretation of section 102NA should be rejected if the provision can be interpreted in a manner that would preserve the ability of stapled groups to be able to undertake the kind of restructure that is contemplated by Subdivision 124-Q.

2. The Draft TD has incorrectly applied the principles of statutory construction with respect to the interpretation of section 102NA

In testing whether a Head Trust is carrying on a trading business for the purposes of Division 6C, subsection 102NA(2)(b) disregards a trading business that is carried on by:

(i) a company that was, **before the scheme was completed**, one of the stapled entities referred to in Subdivision 124-Q of the Income Tax Assessment Act 1997; or

(ii) a subsidiary of one of those stapled entities that is a company, or an entity that is

controlled or able to be controlled, directly or indirectly, by that company; or

*(iii) a trust whose trustee was, **before the scheme was completed**, assessed and liable to pay tax under Division 6B or this Division, and that was, before the scheme was completed, one of those stapled entities; or*

(iv) an entity that is controlled or able to be controlled, directly or indirectly, by the trust referred to in subparagraph (iii). (emphasis added)

Paragraphs (i) or (iii) of this provision incorporate a temporal requirement in that they refer specifically to a time “before the scheme was completed”. In comparison, paragraphs (ii) and (iv) do not contain the words “before the scheme was completed”. Given the absence of these words in paragraph (ii) and (iv) it is reasonable to assume that Parliament did not intend to limit their application to controlled entities of a Head Trust that carry on a trading business and which were in existence at the time of the Subdivision 124-Q restructure. That is, if Parliament had intended for paragraphs (ii) and (iv) to be so limited then it is reasonable to conclude that a temporal requirement would have been adopted in the drafting. For this reason, it is submitted that a literal interpretation of section 102NA supports the conclusion that the application of paragraphs (ii) and (iv) was not intended to be limited to controlled entities of a Head Trust that were in existence at the time of the Subdivision 124-Q restructure.

Further, if the Draft TD’s interpretation of section 102NA is correct, then a controlled entity of the stapled group that was carrying on a trading business before the Subdivision 124-Q restructure could directly acquire a trading business (i.e. as an asset acquisition) after the Subdivision 124-Q restructure without Division 6C commencing to apply. However, if the relevant trading business was acquired by way of an entity acquisition, then Division 6C would commence to apply (i.e. because the trading business would be carried on in an entity that was not a member of the former stapled group). This is clearly an anomalous outcome and therefore suggests that the Draft TD’s interpretation of section 102NA is incorrect. It is noted that paragraph 22 of the Draft TD appears to suggest that this would not be the case. Specifically, what paragraph 22 appears to suggest is that section 102NA applies so that there is no circumstance in which a stapled group that undertakes a Subdivision 124-Q restructure could directly or indirectly acquire a trading business subsequent to the Subdivision 124-Q restructure without triggering the application of Division 6C to the Head Trust. It is submitted that the words in section 102NA cannot be interpreted to support this conclusion.

The Explanatory Memorandum to the *Tax Laws Amendment (2007 Measure No.5) Bill* (“the EM”) states at paragraphs 8.58 and 8.60, in relation to section 102NA:

“Without these amendments to Division 6C of the ITAA 1936, an interposed head trust that is a public unit trust would be a public trading trust, because it would be controlling an active trading business through the ownership of the subordinate company which was formerly a part of the stapled group...

*Essentially, under these amendments a previously stapled company, owned or controlled by the interposed trust, **will be able to continue to operate as it had before the restructure**, without the interposed trust being taxed as a company. The interposed trust will be able to own, or control, **any previously stapled public unit trusts on the basis that they are not carrying on a trading business.**” (emphasis added)*

The discussion in paragraphs 15 to 19 of the Draft TD appear to suggest that the ATO consider that paragraph 8.60 of the EM supports the view that section 102NA was only intended to apply to trading businesses that were carried on at the time of the Subdivision 124-Q restructure. It is submitted that this is not what paragraph 8.60 is intending to convey. Rather, when paragraph 8.60 is read in its context, arguably its purpose is merely to explain how section 102NA(2) would operate, using the structure of the stapled group as it existed at the time of the Subdivision 124-Q restructure as an example.

Further, paragraph 16 of the Draft TD refers to the relevant provisions as being given full effect where previously stapled entities “continue their existing operations after the reorganisation”. The typical structure of an Australian stapled property group is for the trust and its subsidiaries to carry on the eligible investment business activities and the corporate trust/company side of the staple to undertake any trading activities, including the acquisition of new trading businesses or entities that carry on trading businesses. Therefore, the Draft TD will not permit a previously stapled group to continue to be able to carry on its “existing operations” because there is no entity within the Head Trust group that will be able to acquire an entity that will be conducting a trading business (e.g. a simple land development) without triggering the application of Division 6C.

As discussed in section 1, the practical effect of the Draft TD is that the Subdivision 124-Q CGT roll-over will become redundant. As recognised in paragraph 14 of the Draft TD, statutory interpretation requires that legislation is considered in its context. Further, where there is conflict between different provisions in a statute, the provisions are to be interpreted on the basis that they are intended to achieve “harmonious goals”. As stated at paragraph 14 of the Draft TD:

“Statutory interpretation requires that legislation be considered in its context. As Brennan CJ, Dawson, Toohey and Gummow JJ noted in CIC Insurance v. Bankstown Football Club Ltd [1997] HCA 2; (1997) 187 CLR 384 at CLR page 408 (footnotes omitted):

*[T]he modern approach to statutory interpretation (a) insists that the context be considered in the first instance, not merely at some later stage when ambiguity might be thought to arise, and (b) uses ‘context’ in its widest sense to include such things as the existing state of the law and the mischief which, by legitimate means such as those just mentioned, one may discern the statute was intended to remedy. Instances of general words in a statute being so constrained by their context are numerous. In particular, as McHugh JA pointed out in Isherwood v. Butler Pollnow Pty Ltd, if the apparently plain words of a provision are read in the light of the mischief which the statute was designed to overcome and of the objects of the legislation, they may wear a very different appearance. **Further, inconvenience or improbability of result may assist the court in preferring to the literal meaning an alternative construction which, by the steps identified above, is reasonably open and more closely conforms to the legislative intent.***

As McHugh, Gummow, Kirby and Hayne JJ noted in Project Blue Sky Inc v. Australian Broadcasting Authority [1998] HCA 28; (1998) 194 CLR 355 at paragraphs 69 to 71 (footnotes omitted):

The primary object of statutory construction is to construe the relevant provision so that it is consistent with the language and purpose of all the provisions of the statute. The meaning of the provision must be determined ‘by reference to the language of the instrument viewed as a whole’. In Commissioner for Railways (NSW) v. Agalinos, Dixon CJ pointed out that ‘the context, the general purpose and policy of a provision and its consistency and fairness are surer guides to its meaning than the logic with which it is constructed’. Thus, the process of construction must always begin by examining the context of the provision that is being construed.

A legislative instrument must be construed on the prima facie basis that its provisions are intended to give effect to harmonious goals. *Where conflict appears to arise from the language of particular provisions, the conflict must be alleviated, so far as possible, by adjusting the meaning of the competing provisions to achieve that result which will best give effect to the purpose and language of those provisions while maintaining the unity of all the statutory provisions. Reconciling conflicting provisions will often require the court ‘to determine which is the leading provision and which the subordinate provision, and which must give way to the other’. **Only by determining the hierarchy of the provisions will it be possible in many cases to give each provision the meaning which best gives effect to its purpose and language while maintaining the unity of the statutory scheme.***

Furthermore, a court construing a statutory provision must strive to give meaning to every word of the provision. In The Commonwealth v. Baume Griffith CJ cited R v. Berchet to support the proposition that it was 'a known rule in the interpretation of Statutes that such a sense is to be made upon the whole as that no clause, sentence, or word shall prove superfluous, void, or insignificant, if by any other construction they may all be made useful and pertinent.' (emphasis added)

Having regard to these accepted principles of statutory construction, an interpretation of section 102NA that has the effect of making Subdivision 124-Q a redundant measure is clearly not to be the preferred interpretation if there is another interpretation that does not result in this outcome.

3. The Draft TD is inconsistent with the policy objectives behind the relevant provisions

The Draft TD asserts that the policy objectives relating to the Subdivision 124-Q CGT roll-over and the consequential amendments to Division 6C were limited to facilitating the restructure of Australian listed stapled groups by interposing a Head Trust so that the Head Trust can acquire a foreign real estate vehicle by issuing equity in a single entity (i.e. the new Head Trust, as opposed to issuing stapled interests).

It is submitted that this is an incorrect understanding of the policy objectives. It is acknowledged that one of the motivations behind the relevant measures was to permit an Australian listed property group to interpose a Head Trust and to acquire a US Real Estate Investment Trust by offering equity in the new Head Trust (for example, refer paragraph 8.5 of the EM). However, it is clear that the measures were regarded as giving effect to a broader policy objective, being to improve the international competitiveness of Australian listed property groups.

For example, the introduction of the relevant measures was announced in the Minister for Revenue and Assistant Treasurer's Press Release No. 031 of 4 April 2007 (the "Press Release"), which stated.

"The Minister for Revenue and Assistant Treasurer, Peter Dutton, announced details of changes to the tax law to enhance international competitiveness of Australian property trusts.

"Stapled groups, such as Australian listed property trusts are becoming increasingly dependent on the acquisition of overseas assets in a bid to increase their competitive position"...

"To facilitate this, the Government will be amending the taxation laws to allow these stapled entities to restructure with an interposed head trust without taxation sequences"...

"These proposals seek to improve the international competitiveness of stapled entities, such as Australian property trusts, and to facilitate their expansion into offshore markets". (emphasis added)

The Press Release clearly states the objective of the relevant measures as being to improve international competitiveness of stapled groups "and" to facilitate foreign investment. Therefore, the Draft TD's assertion that the policy objective is limited to the foreign expansion point is clearly incorrect. Further, if section 102NA is applied as contemplated in the Draft TD, then the Subdivision 124-Q restructure will effectively become redundant. In other words, if the ATO apply the position in the Draft TD then Subdivision 124-Q will do nothing to assist international competitiveness or foreign expansion because stapled groups will not, from a practical perspective, be able to undertake such a restructure. Accordingly, it can be seen that the Draft TD's interpretation of section 102NA has the effect of defeating Parliament's intentions on this matter and is therefore clearly contrary to the policy objectives.

Further, it is submitted that another general purpose of the Subdivision 124-Q restructure was to permit Australian stapled groups to adopt a more streamlined structure given the range of complexities that are involved in operating a stapled group (e.g. regulatory, accounting). The Draft TD is contrary to this purpose given it will effectively preclude stapled groups from being able to undertake a Subdivision 124-Q restructure from a practical perspective.

4. The Draft TD's interpretation of section 102NA is anomalous having regard to subsection 102N(2)

Where an Australian unit trust acquires a foreign entity, subsection 102N(2) tests whether the foreign entity is carrying on a trading business by collectively looking at the activities of the foreign entity and its controlled entities. In this regard, the foreign entity will not be treated as carrying on a trading business provided the activities of the foreign group as a whole consist of investing in land primarily, or primarily for the purpose of deriving rent.

It is acknowledged that the specific purpose of subsection 102N(2) is to accommodate the fact that foreign jurisdictions have different rules with respect to landholding regimes (e.g. the US Real Estate Investment Trust regime). However, based on the Draft TD, an Australian unit trust that is the head trust of a formerly stapled group will be able to acquire further offshore trading businesses provided the activities of the foreign group still carry the required purpose of deriving rent. In contrast, the Australian unit trust will not be able to acquire any Australian entities that carry on trading businesses (irrespective of their size) without triggering the application of Division 6C. This appears to be an anomalous outcome given the comparative advantage that it confers upon offshore as opposed to domestic investment.

5. The question posed in the Draft TD is inconsistent with the conclusion

The question posed by the Draft TD is:

*“will the exemption in section 102NA of the Income Tax Assessment Act 1936 continue to apply to a unit trust that has become the interposed trust of a stapled group pursuant to Subdivision 124-Q of the Income Tax Assessment Act 1997 if the trustee of the unit trust later gains control (or the ability to control), **either directly or indirectly**, of operations of an entity that are in respect of a trading business within the meaning of section 102M of the Income Tax Assessment Act 1936”.* (emphasis added).

The conclusion reached in the Draft TD relates specifically to the ATO's interpretation of subsections 102NA(2)(b)(ii) and (iv). Neither of these provisions are concerned with the direct acquisition of a trading business by the Head Trust given that they relate to the status of entities that are controlled by the Head Trust. In other words, the Draft TD does not concern “direct” acquisitions by the Head Trust.