REVIEW OF THE DEBT AND EQUITY TAX RULES –

THE RELATED SCHEME AND EQUITY OVERRIDE INTEGRITY PROVISIONS

A Report to the Government

Board of Taxation

December 2014

© Commonwealth of Australia 2014

ISBN 978-1-925220-28-5

**Ownership of intellectual property rights in this publication**

Unless otherwise noted, copyright (and any other intellectual property rights, if any) in this publication is owned by the Commonwealth of Australia (referred to below as the Commonwealth).

**Creative Commons licence**

Description: CC by_grey

With the exception of the Coat of Arms (see below) and all third party material as attributed in this document, this publication is licensed under a Creative Commons Attribution 3.0 Australia Licence.

Creative Commons Attribution 3.0 Australia Licence is a standard form licence agreement that allows you to copy, distribute, transmit and adapt this publication provided that you attribute the work. A summary of the licence terms is available from http://creativecommons.org/licenses/by/3.0/au/deed.en. The full licence terms are available from http://creativecommons.org/licenses/by/3.0/au/legalcode.

The Commonwealth’s preference is that you attribute this publication (and any material sourced from it) using the following wording:

Source: Board of Taxation, *Review of the Debt and Equity Tax Rules – The Related Scheme and Equity Override Integrity Provisions* (2014).

**Use of the Coat of Arms**

The terms under which the Coat of Arms can be used are set out on the It’s an Honour website (see [www.itsanhonour.gov.au](http://www.itsanhonour.gov.au)).

Contents

Foreword iii

Glossary v

Executive summary vi

Chapter 1: Introduction 1

Background 1

Terms of reference 1

Review processes 2

Chapter 2: Overview and Reflections of the Board 5

Background 5

Operation and purpose of the related scheme provisions 6

Operation and purpose of section 974-80 7

Chapter 3: The Board’s proposal for a new integrated rule 11

Overview of the Board’s proposal 11

The proposed new principles 13

Examples to be included in the Legislative instrument 18

Chapter 4: Alternative solutions not recommended by the Board 41

Introduction 41

Appendix A: List of public submissions 47

# Foreword

The Board of Taxation is pleased to submit this accelerated report to the Acting Assistant Treasurer having completed a component of the review of the debt and equity tax rules.

The Board established a Working Group of its members to oversee the review. The members of the Working Group are Teresa Dyson (Chair of the Working Group) and John Emerson. The Board issued a discussion paper, and held discussions and targeted consultation meetings with a range of stakeholders, both before and after the release of the discussion paper. It received 11 submissions, one of which was confidential. The Board would like to thank all those who so readily contributed information and time to assist with the review.

The Board would also like to express its appreciation for the assistance of Patrick Broughan, John Condon, Larry Magid, Hayden Scott, Jeff Shaw, Steve Ford and Manuel Makas as members of the expert panel; Frank O’Loughlin and John Smith as consultants engaged by the Working Group; and by officials from the Treasury and the Australian Taxation Office.

The ex officio members of the Board – the Acting Secretary to the Treasury, Nigel Ray; the Commissioner of Taxation, Chris Jordan AO; and the First Parliamentary Counsel, Peter Quiggin PSM – have reserved their final views on the observations and recommendations in this report for advice to Government.



Teresa Dyson

Chair, Board of Taxation

# Glossary

|  |  |
| --- | --- |
| ABA | Australian Bankers Association |
| ASX | Australian Securities Exchange |
| ATO | Australian Taxation Office |
| Commissioner | Commissioner of Taxation |
| ENCO | effectively non-contingent obligation |
| Explanatory Memorandum | Explanatory Memorandum to the New Business Tax System (Debt and Equity) Bill 2001 |
| ITAA 1936 | *Income Tax Assessment Act 1936* |
| ITAA 1997 | *Income Tax Assessment Act 1997* |
| NTLG | National Tax Liaison Group |
| Related scheme provisions | section 974-15 and section 974-70 of the *Income Tax Assessment Act 1997* |
| SPV | special purpose vehicle |
| SLA | syndicate loan agreement |

# Executive summary

This report identifies and recommends reforms that would address uncertainty around the operation of the related scheme provisions in sections 974-15 and 974-70 (collectively the related scheme provisions), and the equity override integrity provision in section 974-80 of the *Income Tax Assessment Act 1997* (Cth)(ITAA 1997).

This report was accelerated as a result of stakeholder feedback received on the operation of the related scheme and section 974-80 provisions during a broader post-implementation review of the debt and equity rules. The Board of Taxation (the Board) will deliver its report on other elements of the review of the debt and equity tax rules by 31 March 2015.

The Board recommends that uncertainty around the operation of the related scheme and section 974-80 provisions be addressed by replacing the existing rules with a new provision based on principles the Board has identified. In addition, commercially relevant examples set out in the report should be included in the law to cover the most common types of schemes that give rise to questions about debt and equity characterisation.

Other solutions to resolve the uncertainty around the operation of the related scheme and section 974-80 provisions that have been considered, but not recommended by the Board, are canvassed in Chapter 4 of the report.

This report benefited from formal consultation on the broader post‑implementation review of the debt and equity rules, and from targeted consultation on the proposed principles and commercially relevant examples.

# Chapter 1: Introduction

## Background

* 1. On 14 May 2013, the Board was asked to undertake a review (the review) combining a post-implementation review of the debt and equity rules with a review of whether arrangements within the Australian tax system can be improved to address any inconsistencies between Australia’s and other jurisdictions’ debt and equity rules, that could give rise to tax arbitrage opportunities.

## Terms of reference

* 1. On 4 June 2013, the Board received the following terms of reference:

The Board of Taxation is asked to undertake a post-implementation review of the debt and equity rules in the income tax law (Division 974 of the *Income Tax Assessment Act 1997*).

The debt and equity rules were introduced to classify certain financing arrangements as debt or equity for specified tax purposes (for example, the thin capitalisation rules and the interest and dividend withholding rules) on the basis of the ‘economic substance’ of the arrangement rather than merely on the basis of the legal form. The rules have now been in operation for over a decade.

The standard terms of reference for a post-implementation review requires the Board to consider whether the legislation:

* gives effect to the Government’s policy intent, with compliance and administration costs commensurate with those foreshadowed in the Regulation Impact Statement for the measure;
* is expressed in a clear, simple, comprehensible and workable manner;
* avoids unintended consequences of a substantive nature;
* takes account of actual taxpayer circumstances and commercial practices;
* is consistent with other tax legislation; and
* provides certainty.

In undertaking the post-implementation review, the Board is also asked to:

* examine whether there are unintended misalignments between the debt and equity distinction and related concepts in the income tax law which could potentially result in inconsistent policy outcomes; and
* consider whether there can be improved arrangements within the Australian tax system to address any inconsistencies between Australia’s and other jurisdictions’ debt and equity rules that could give rise to tax arbitrage opportunities.

To the extent that there are unintended misalignments between the debt and equity distinction and related concepts in the income tax law, the Board should also examine the potential for broader application of the current debt and equity rules to ensure consistent policy outcomes.

The Board is asked to report to the Assistant Treasurer by March 2015.

* 1. The Government separately announced in a press release on 14 December 2013 that it intended to proceed with amendments to the integrity rule in section 974-80, however, the design of this measure would be considered as part of the Board’s review of the debt and equity tax rules being conducted.

## Review processes

### Review team

* 1. The Board has appointed a Working Group of its members to oversee the Review. The members of the Working Group are Teresa Dyson (Chair of the Working Group) and John Emerson. In addition, the Board has engaged Frank O’Loughlin  
     (a member of its advisory panel) and John Smith, as consultants to assist with the review.
  2. The Board has also appointed an expert panel from members of its advisory panel, namely - Patrick Broughan, John Condon, Larry Magid, Hayden Scott and Jeff Shaw - to provide further specialist assistance to the Board in understanding the complex operation of the relevant taxation law and its practical application. The Board also received support from Steve Ford and Manuel Makas, who provided specialist advice on the operation of the taxation law for infrastructure and property investment.
  3. The Working Group is being assisted by members of the Board’s Secretariat and by staff members from the Treasury and the Australian Taxation Office (ATO).
  4. The position and affiliations of the Board’s members and advisory panel are listed on the Board’s website.

### Consultation

* 1. The Board’s consultation process has involved:
* preliminary consultations with a range of stakeholders;
* the release of a discussion paper in March 2014 to invite and facilitate submissions;
* targeted consultation meetings with a number of key stakeholders, following the release of the discussion paper.

### Submissions

* 1. The Board received 11 written submissions, including one confidential submission, in response to the discussion paper.

### Board’s accelerated report

* 1. In light of the stakeholder submissions and the uncertainty for both taxpayers and the ATO caused by the current operation of the related scheme and section 974-80 provisions, the Board has accelerated this component of the broader review. The Board will deliver its report on the other elements of the review of the debt and equity tax rules by 31 March 2015.
  2. The Board has considered the issues stakeholders raised in their submissions and at the consultation meetings in relation to the related scheme and section 974-80 provisions, as well as the views of the members of the expert panel, Treasury officials and the ATO. However, the Board’s recommendations and observations in this report reflect its independent judgment.

# Chapter 2: Overview and Reflections of the Board

## Background

1. The comprehensive debt and equity tax rules contained in Division 974 were introduced in July 2001. The rules were designed to provide “greater certainty, coherence and simplicity”.
2. The debt and equity tax rules create a mechanism for determining which financing arrangements are to be characterised as debt interests in an entity and which are to be characterised as equity interests in a company on an economic substance rather than legal form basis. The debt and equity characterisation is used for some but not all purposes of the taxation law.
3. There is a debt bias in the Australian tax system because of tax deductions for debt financing costs, which are not available for finance raised by way of equity investment. This arguably creates an intrinsic tax‑related incentive to choose debt financing which the debt and equity rules, amongst other measures, are designed to address.
4. An important policy concern in designing and operating the debt and equity rules is their impact on foreign investment into Australia. This is a particular concern given that, as a net importer of capital, Australia traditionally relies on foreign investment to boost productivity, increase competitiveness, improve living standards and create employment opportunities.
5. Consistent with the object of the Division rules are required and have been enacted to aggregate two or more arrangements to ensure appropriate characterisation where the economic substance is that of a single arrangement; to disaggregate one arrangement of component parts where the economic substance is that of multiple arrangements; and to look through some sequential financing arrangements.
6. The Board’s review has revealed difficulties and significant practical issues with determining when the current aggregation, disaggregation or sequential rules should be applied.

## Operation and purpose of the related scheme provisions

1. As noted in the discussion paper, in certain circumstances, a number of individual schemes will be ‘related schemes’ and will be effectively aggregated to comprise a notional scheme.[[1]](#footnote-2)
2. The notional scheme is assessed against the debt and equity tax rules. To the extent that schemes are related and the combined effect of those schemes gives rise to a debt interest, the aggregated scheme may be characterised as ‘debt’ under Division 974 where certain conditions are satisfied.[[2]](#footnote-3) Similarly, where the combined effect of related schemes gives rise to an equity interest, the aggregated scheme may be characterised as equity.[[3]](#footnote-4)
3. The characterisation of an interest that arises under the related scheme provisions operates in a three-stage process:

* First, the schemes need to be related to one another under section 974-155. The general rule is that schemes will be related to each other if they are related in any way. This is a very broad threshold test, as many things could be related under this test that are not intended to be treated as such; for example, schemes that are related to each other merely because of their economic effect.
* Secondly, two or more related schemes which together constitute a ‘notional scheme’ must give rise to either a debt or an equity interest. That is, the notional scheme with the combined effect or operation of the constituent schemes must satisfy the debt or equity tests. Further, even if the schemes are related and the notional scheme satisfies either the debt or equity test, it also must be reasonable to conclude that relevant parties ‘intended… the combined economic effects of the constituent schemes to be the same as, or similar to, the economic effects of…’ a debt or equity interest.
* Thirdly, the Commissioner has not made a determination that, in the circumstances, it would be unreasonable to apply the related scheme provisions.

1. If an interest from a notional scheme is characterised as debt or equity, any return paid by the issuing entity is taken to be paid in respect of that debt or equity interest, and not in respect of any component scheme or element.

## Operation and purpose of section 974-80

1. Section 974-80 is an integrity provision intended to ensure that what, in substance, is the provision of equity finance is not classified as debt financing because of structures whereby returns are passed through related entities. Where certain requirements are met, section 974-80 can reclassify an interest that would otherwise (when independently tested) be a debt interest to be an equity interest in the company.
2. As stated in the Explanatory Memorandum,[[4]](#footnote-5) section 974-80 was intended to apply where there is an effective equity interest in a company even though the holder of the interest had no direct interest in the company.[[5]](#footnote-6) It was not intended to apply to situations where the interest held by the ultimate recipient, despite having equity-like features, would be characterised as a debt interest (or formed part of a larger interest that gave rise to a debt interest) under section 974-20.[[6]](#footnote-7)
3. For the provision to apply, a number of key conditions must be met, including:

* the company in question has on issue an interest that is a financing arrangement held by a connected entity that, but for the operation of the provision, would not be an equity interest;
* there is a scheme or series of schemes designed to operate so that the return to the connected entity is used to fund (directly or indirectly) a return to the ultimate recipient; and
* the ultimate recipient’s interest has any of the equity characteristics set out in an equity test (other than the ultimate recipient being a member or stockholder of the company) in respect of the company or a connected entity of the company, provided that the ultimate recipient’s interest does not form part of a larger debt interest.

### History of the application of section 974-80

1. This provision’s operation has been the subject of considerable commentary, debate and consultation. How the provision is applied to stapled security arrangements has been particularly contentious. Over the years, the ATO, Treasury and private sector representatives have been engaged in significant consultations about the operation of the provision.
2. In response to concerns raised by industry and taxpayer groups, the ATO issued a discussion paper to members of the National Tax Liaison Group (NTLG) Finance and Investment Subcommittee in March 2007 regarding the interpretation and policy matters of section 974-80. The discussion paper outlined the ATO’s preliminary and considered views on the provision’s application. The ATO sought comments on the views proposed in the discussion paper.
3. The ATO conducted a further round of consultation with industry and professional bodies following the release of that discussion paper. During this consultation, there was general agreement that section 974-80, as enacted, did not operate as intended despite there being different views about its intention. The industry and professional bodies agreed that they would write to the Government to detail their concerns and request that section 974-80 be amended, and the ATO agreed that it would withdraw the discussion paper, which it did.
4. In the 2011-12 Budget, the then Government announced, with retrospective date of effect to the commencement of Division 974 (generally 1 July 2001), that  
   section 974-80 would be amended to ensure that the provision would apply only to arrangements where both the purpose and effect was that the ultimate investor had, in substance, an equity interest in the issuer company. Additionally, the provision would not apply where the Commissioner considered that it would be unreasonable.[[7]](#footnote-8) After this announcement, the Government received consultation and feedback suggesting that the proposed changes did not provide the necessary certainty.
5. The current Government announced in a press release on 14 December 2013 that it intended to proceed with amendments to the integrity rule in section 974-80, however, the design of this measure would be considered as part of the Board’s post-implementation review of the debt and equity tax rules. The protection provision the Government enacted did not extend to section 974-80.

### The need for a new approach to section 974-80 and the related scheme provisions

1. The taxpaying community, the ATO and Treasury are all aligned in the need to reform section 974-80 without delay to provide greater certainty, coherence and simplicity that the debt and equity tax rules were intended to provide.
2. Following an extensive review and wide consultation with stakeholders (including representatives from Treasury, the ATO and the private sector), the Board concluded that the changes to section 974-80 announced in the 2011-12 Budget would not provide the necessary certainty for the tax community and recommends that they should not proceed as announced.
3. The Board’s work revealed that many of the issues associated with section 974-80 have arisen because the section does not have clearly defined criteria for identifying the arrangements to which it is directed. A particularly problematic feature of the section is that it focuses on whether the return on a debt interest under one scheme is designed to fund the return on an equity interest under another scheme.
4. The Board considers this to be an inadequate test for two reasons. First, the test focuses on a factor present in many arrangements that ought not be aggregated, and therefore produces an excessive number of ruling requests and discussions between the ATO and taxpayers. Secondly, and perhaps more importantly, the test fails to articulate the implied proposition that the schemes effectively should be aggregated only where they give rise to a de facto equity interest in the issuer (or a related entity) of the debt interest. That is, the section should apply where the schemes are designed to do more than merely fund the equity interest: namely, that the schemes are to operate together as a de facto single interest in the nature of equity, and where the separation by interposed schemes is an intentional step directed at obtaining a debt classification (and deduction) for the return on one of them.
5. To address the problems associated with section 974-80, the Board considers it appropriate to correct the main related scheme tests rather than amend or simply repeal section 974‑80. This is because the Board considers that if the main related scheme tests go uncorrected, the issues arising with section 974-80 are likely to arise under those tests, if perhaps in a different form.
6. The Board’s review also revealed problems with the potentially broad application of the existing related scheme provisions, particularly those in section 974‑70. There is a real risk that the provisions could apply in unintended circumstances – for example, some commercial arrangements could be inappropriately aggregated, meaning that taxpayers are forced to rely on the exercise of the Commissioner’s discretion to not aggregate these schemes (which is costly and time consuming for both taxpayers and the tax administrator). This is discussed further in Chapter 4.
7. In light of this, the Board is recommending a new integrated provision (the design of which is discussed in Chapter 3) to address the issues with section 974-80 and the related scheme provisions. The recently introduced taxpayer ‘protection provision’[[8]](#footnote-9) does not apply to taxpayers that have relied on the previously announced amendments to section 974-80.
8. If the Board’s recommendation to not proceed with those amendments is accepted, the Board further recommends that the protection provision be appropriately amended to protect taxpayers that have relied on those announcements. While the Board acknowledges that the date of application of any changes to the law is a matter for Government, the Board also considers that the protection provision should be extended to the date that an amendment to the provision is enacted (assuming that the new provision commences from the date of enactment).

# Chapter 3: The Board’s proposal for a new integrated rule

## Overview of the Board’s proposal

1. As discussed in Chapter 2, the Board’s review revealed significant difficulties with the operation of the existing related scheme provisions, particularly in section 974-70, and the integrity provision in section 974-80 for both taxpayers and the ATO. The wide, non‑targeted application of the rules and the lack of clarity around their operation have contributed to significant practical issues and a likely high incidence of non‑compliance. It was evident that the existing rules require some changes to ensure they better reflect the underlying policy.
2. In an effort to address the problems and to provide both taxpayers and the ATO with greater certainty regarding the law and predictability in its application, the Board has developed a set of principles that seek to deal with constituent and sequential schemes (including stapled structures).
3. The proposed principles are intended to form the basis for a set of rules which, if enacted, would replace the existing related scheme provisions in sections 974-15 and 974-70, and the integrity provisions in section 974-80. That is, to give effect to the Board’s proposal, the existing related scheme provisions in sections 974-70 and 974-80 would need to be repealed and replaced with the new rules.
4. The new rules would operate with a consistent approach, using identifiable and objectively observable touchstones to identify at the outset the most appropriate scheme (whether an aggregated scheme or separate component schemes) that is then characterised as either a debt or equity interest under the existing debt and equity tests. Once characterised, the relevant operative provisions of the taxation law would be applied to the identified scheme’s financial benefits, and if the identified scheme has component schemes that are aggregated to each component scheme’s financial benefit based on the overall debt or equity characterisation.
5. This contrasts with the current rules, which have an inconsistent approach and do not give identifiable and objectively observable touchstones to identify which arrangements need to be aggregated and which do not. In the case of section 974-80, the debt and equity tests are applied to component parts of a scheme at the time the scheme first comes into existence, followed by the potential application of the recharacterisation provisions in section 974-80. In this sense, the new rules would not only address the uncertainties associated with these provisions - they would simplify the operation and structure of debt and equity tax rules generally. The Board is of the view that this approach is a better way of giving effect to the policy intent of Division 974.
6. To provide further certainty and guidance to taxpayers, the Board recommends that the new rules be supported by a number of commercially relevant examples.
7. The Board has developed 8 examples which would demonstrate the application of the proposed new set of rules to common scenarios. It is anticipated that examples could be given the force of law by the Minister making a legislative instrument that sets out the examples.
8. An alternative to making a legislative instrument would be to include the examples in the Explanatory Memorandum. However, the interpretative force of material in the Explanatory Memorandum has significant limitations, particularly when interpretation is challenged in a court, where material outside the legislation is generally disregarded other than in cases of ambiguous language.
9. Consequently, the Board’s preference is for the examples that support the legislative principles to be in the form of a legislative instrument. The Board recognises that this is an unusual approach but considers that it is appropriate in the present circumstances given the need to ascertain the substance, rather than merely the form, of a transaction under the debt and equity tax rules.[[9]](#footnote-10)
10. It is also noted by the Board that the examples would be of particular relevance in determining whether or not a position taken by a taxpayer is a “reasonably arguable” position.
11. The Board acknowledges that it will be difficult to remove all complexity associated with these provisions, and uncertainty and complexity. The Board has sought to develop principles that will allow taxpayers to make a self‑assessment confidently in all but rare cases.
12. The Board envisages that the new rules would align the scope of the relevant provisions with the original policy intent so that fewer arrangements will need to be tested against the related scheme and section 974-80 provisions. For those that do need to be tested, there will be more certainty in the testing process.
13. The Board’s proposed approach establishes principles to address uncertainty regarding the characterisation of schemes. Introducing clearer rules giving effect to the proposed principles would help taxpayers self-assess their situation. These new rules would be complemented by commercially relevant examples, which would be made by legislative instrument and therefore have the force of law. If the principles and examples do not provide clarity, taxpayers would be able to consult ATO guidance. Finally, as a last resort, taxpayers could seek a determination from the Commissioner of Taxation to not aggregate two or more schemes if the rules as applied on a self‑assessment basis inappropriately lead to an aggregation of the schemes.
14. When applying the debt and equity tax rules more broadly, a three-step process would involve:
15. applying the new integrated provision to identify the scheme;
16. applying the debt and equity test to the scheme identified in (i) to determine its character; then
17. using the debt or equity characterisation in (ii), applying the operative provisions in the Act to each instrument, comprising the scheme, to get an outcome for the scheme.
18. The Act’s operative provisions would be expected to apply on a ‘per instrument’ basis. This is because their character is determined either in relation to the independent schemes or the aggregated schemes, by looking at the instrument as a part of an interdependent or interconnected whole.
19. The Board acknowledges that the date of application of any changes to the law is a matter for Government. However, the Board considers that any changes emerging from this report to the related scheme and section 974-80 provisions should apply prospectively. The application of previously announced measures relating only to section 974-80 (and not to the related scheme provisions) will need to be considered separately in the context of the legislative protection measure applicable to other announced but unenacted measures as at 14 December 2013.

## The proposed new principles

1. The Board proposes that the existing related scheme and section 974-80 provisions should be repealed and replaced with a new integrated provision that will give effect to the two objects of Division 974 set out in existing subsection 974-10(3).
2. The first object is that the Division should operate on the basis of the economic substance of the rights and obligations arising under two or more schemes, not merely on the basis of the legal form of the schemes. The second object is to prevent the test from being circumvented by entities merely entering into a number of schemes.
3. At the highest level, two broad considerations are involved. The first is that the economic substance of the rights and obligations of the schemes operating together should produce a different result from the actual result of applying the tests to the schemes individually, or to least one of them. In other words, the rights and obligations arising under the schemes as they interact would alter the substance of their economic consequences.
4. The second consideration is that the individual schemes represent in some sense a separation into individual components of a wider arrangement. This implies that the individual schemes are intended to operate together as a whole to produce the altered result. A conclusion about the economic substance of the legal rights and obligations arising under the schemes requires consideration of the economic results obtained from the pricing, terms and conditions of the schemes as they interact with each other, with a focus on the intended ultimate effect of the inter-operation of the schemes.
5. While the detail of the new integrated provision is discussed in greater depth in paragraph 3.22, it is envisaged that the following very high-level principles could apply:

Two or more schemes should be aggregated and taken as one scheme where:

* 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.

1. 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. 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.
2. Notwithstanding the self-assessed operation of the rules giving effect to the above principles, the Board considers that a taxpayer should be able to request in writing that the Commissioner make a determination not to aggregate two or more schemes.
3. As mentioned above, the rationale for the proposed principles is as set out in the existing subsections 974-10(2) and 974-10(3). In some circumstances the existing rule, namely identifying a single scheme, might not operate to reveal the economic substance of the rights and obligations created by interrelated or interdependent financing and ownership arrangements because that rule has been circumvented by disaggregating an arrangement into separate schemes. Aggregation should expose the commercial substance to which the basic test should be applied.
4. To achieve the relevant objectives of Division 974 in relation to aggregating schemes, the Board considers that the effect of one scheme on any other scheme should flow from all of the pricing, terms and conditions (that is, the way in which it expresses the rights and obligations it creates). Furthermore, the schemes should be intended to operate in combination as an aggregate arrangement for the purpose of producing their combined result, rather than merely or incidentally having that effect in combination.

### The pricing, terms and conditions of the schemes

1. The Board proposes that in determining whether to aggregate two or more schemes for the purposes of Division 974, the first element of the enquiry should consider particular aspects of the pricing, terms and conditions of the schemes.
2. Under the Board’s proposal, the initial test to determine whether two or more schemes should be aggregated and taken as one scheme would focus on whether one of the schemes is legally interdependent, or operates in a way that alters or affects the ultimate entitlements or economic consequences to the parties of another one of the schemes. The test is enunciated, in principle, as follows:

Two or more schemes will be aggregated and taken to be one scheme if the pricing, terms and conditions applicable under one scheme:

1. are dependent upon or linked to the pricing, terms and conditions applicable under 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; or
2. operate in a way which would alter 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.
3. This test would require consideration of the constituent documents or understandings in which the pricing, terms and conditions are evident, and the rights and obligations otherwise created. The terms and conditions relating to paying returns and/or consideration under the schemes will be particularly relevant.
4. This test would reflect the approach generally taken in the debt and equity tests insofar as they have regard to the economic substance of rights and obligations. The debt test, in particular, seeks to determine economic substance by explicitly requiring the pricing, terms and conditions of the scheme to be examined.[[10]](#footnote-11)
5. The rights and obligations that go to the nature of returns on or of an interest are fundamental to the classification of interest under the debt and equity tests (unless the interest is a membership or stockholder interest in a company). Accordingly, the test would also rely on the economic effects of rights and obligations created by the schemes, but only rights and obligations which are relevant for the purposes of the debt and equity tests. That is, the rights and obligations that affect the returns on or of the interest, from the perspective of the issuer.
6. One of the purposes of this examination is to ensure that schemes which merely have economic consequences for other schemes are not caught by the rules. This test would focus on the economic effects resulting from the legal arrangements, which affect the returns on, or of, the interest from the issuer’s perspective, and not economic effects more generally.

### Additional tests for the schemes in combination

1. Where the requisite interrelationship of or interdependency between the pricing, terms and conditions of the schemes warrant their aggregation, further tests are considered necessary to identify those schemes that ought to be aggregated (because they are designed to operate in a particular way to secure their combined result) and those that ought not be aggregated.
2. At this level, to identify multiple schemes that are properly considered as a single scheme appropriately, the Board considers that it is necessary to examine the degree of common participation in the schemes and how the schemes are combined. It is intended that these additional tests would be objective tests of purpose.
3. To test whether the issuer and others participate in a way that demonstrates that the schemes are designed to operate together in a particular way to secure their combined result, the Board recommends that consideration be given to the following relevant factors:
4. the nature and extent of the common involvement of the parties to, or arrangers of, any of the schemes in one or more of the other schemes;
5. the manner in which the schemes were entered into or carried out; and
6. the nature and extent of any non-arm’s length relationship or dealing between one or more of the parties to, or arrangers of, any of the schemes in all or part of the schemes.
7. The relevant factors should be tested in relation to the pricing, terms and conditions of the schemes that demonstrate the requisite interdependency or interconnectedness described in paragraph 3.27. The Board considers that these factors would adequately inform any decision to treat two or more schemes as one aggregated scheme, as an interdependent or interconnected whole.
8. Factor (i) would investigate the common involvement of one or more of the parties, including arrangers of the schemes. Common involvement can occur between independent or related parties (for example, where there is collaboration, active involvement in design and decision-making which has been engineered to create an outcome). It requires one or more of the parties to be knowingly involved in the scheme. The extent of involvement would be considered against the pricing, terms and conditions of the schemes that demonstrate the requisite interdependency or interconnectedness described in paragraph 3.27.
9. Factor (ii) would investigate the manner in which the schemes were formulated, entered into or carried out,[[11]](#footnote-12) and whether, having regard to the context surrounding the creation of the schemes, it is evident that the schemes should be regarded as one scheme. It would require consideration of the way in which the effects of the scheme are achieved and of any elements of artificiality or contrivance. Matters beyond the contracts themselves should be considered, extending to circumstances surrounding how the rights and/or obligations came about.
10. Factor (iii) would be relevant in circumstances where one or more of the parties to the schemes do not have an ‘arm’s length relationship or dealing’ with one or more other persons involved in the schemes. For example, this factor would be relevant where there is an ownership connection between the parties. Again, the relationship between the parties would be tested against the features of the pricing, terms and conditions of the schemes that demonstrate the requisite interdependency or interconnectedness described in paragraph 3.27.
11. Considering these factors is intended to ensure that arrangements are not inappropriately aggregated where the requisite contractual or operational link is present but there is no relevant involvement or relationship between the parties. This will be particularly relevant in the case of commercial synthetic or derivative transactions where the issuer of the underlying instrument is not a party to, or involve in, the synthetic arrangement.

### Mere link and commercial understandings

1. As noted above, schemes in which there is a mere consequential or incidental link should not be aggregated. Some schemes will be commercially related through the mechanism of subordination, stapling of either the instruments or the ownership interests, mere funding or taking a security. The Board is of the view that the mere presence of any one or more of these features is not enough to automatically cause two or more schemes to be aggregated and taken as one scheme.
2. Further, normal commercial understandings or dealings in practice regarding the rights and/or obligations of the schemes (including whether they are regarded commercially as separate or as a group or series that forms a whole) should be considered in the process of deciding whether or not to aggregate the schemes.
3. To avoid doubt, the mere fact related parties execute a transaction internally does not mean that it is not commercial. The Board recommends that the new rule ensures that commercial considerations are a touchstone for whether schemes are unnecessarily aggregated under the provisions and should be applied from time‑to‑time in the context of emerging and evolving commercial practices.

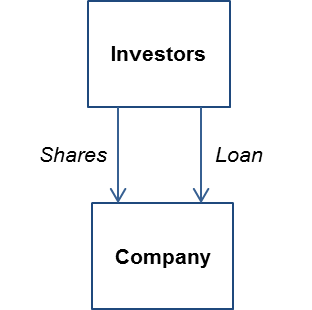
## Examples to be included in the Legislative instrument

1. The Board has developed eight examples which would demonstrate application of the proposed new set of rules to common scenarios. It is anticipated that examples could be given the force of law by the Minister making a legislative instrument that sets out the examples.
2. An alternative to making a legislative instrument would be to include the examples in the Explanatory Memorandum. However, the interpretative force of material in the Explanatory Memorandum has significant limitations, particularly when interpretation is challenged in a court, where material outside the legislation is not universally referred to or relied on, other than in cases of ambiguous language.
3. Consequently, the Board’s preference is for the examples that support the legislative principles to be in the form of a legislative instrument. The Board recognises that this is an unusual approach but considers that it is appropriate in the present circumstances given the need to ascertain the substance, rather than merely the form, of a transaction under the debt and equity tax rules.
4. The Board acknowledges that the proposed approach is not necessarily appropriate for most parts of the Act. However, Division 974 adopts a principles based drafting approach that already contemplates the use of regulations to clarify the operation of the rules to particular investments from time to time. The regulation making power has been used effectively in other cases relating to the application of the debt and equity tax rules. Accordingly, to ensure that the proposed approach is appropriately clarified, the examples should be in a legislative instrument.
5. Finally, current issues associated with the interpretation of the debt and equity tax rules has increased because the examples contained in the Explanatory Memorandum lacked consistency with the words of the legislation. Given this, the Board considers that the proposed approach would overcome existing real interpretation issues and fit in with the structure of Division 974.

### Example 1: Shareholder loan – no aggregation

#### Background facts

* Four investors each subscribe for 25 per cent of the ordinary shares in a company and make a loan to the company in equal proportions. For example, investors might lend $75 for each $25 of share capital provided.
* Assume that there is no relationship between the pricing, terms and conditions of loan and the pricing, terms and conditions of the shares in the company.



#### Applying the proposed new principles

##### Shares in the company and shareholder loans

1. The pricing, terms and conditions of the shares in the company are not dependent on or linked to the pricing, terms and conditions of the shareholder loans in a manner that would affect the application of the debt or equity tests. The company is obliged to perform its obligations under the shareholder loan, regardless of the terms attached to the shares.
2. The pricing, terms and conditions of the shares in the company do not operate in a way which would alter the economic consequences of the pricing, terms and conditions of the company loans (or vice versa).

### The schemes in combination

1. As there is no relevant dependency, link or economic effect between the pricing, terms and conditions of the shares and the pricing, terms and conditions of the loans, it is not necessary to consider the schemes in combination against the relevant factors.

### Mere links and commercial understandings

1. As there is no relevant dependency, link or economic effect between the pricing, terms and conditions of the shares in the company and the loans, it is not necessary to consider any mere links and what would be the commercial understanding of whether the interests would be regarded as one or two interests.

|  |
| --- |
| ***Factors not critical to this analysis and that should not change the application of the test:***   * the number of investors and proportion of ownership; and * the comparative amount of debt and equity.   ***Changes to this scheme that would not result in aggregation***   * If, instead of a loan, the shareholders subscribed for mandatorily redeemable preference shares that were debt interests, the analysis would be the same as for the loan example. * Mere stapling of the shares and the loan (or mandatorily redeemable preference shares) would not result in the aggregation of the schemes.   ***Changes to this scheme that would result in aggregation***   * If the terms of the loan prohibited the paying the loan principal unless there is proportionate repayment of share capital, the pricing, terms and conditions of the loan would be dependent or linked to those of the shares.   + When the schemes are considered in combination, the fact that the investors and lenders are the same entities would support the conclusion that the schemes are dependent or linked.   + This would not be a scheme where normal commercial understandings or dealings in practice would result in the schemes being treated as separate things. |

### Example 2: Finance trust and company staple – aggregation

1. This example considers a stapled finance trust and company arrangement.

#### Background facts

* The company is formed to acquire and hold for the long term certain substantial physical assets intended to be financed to the greatest possible extent with external debt on arm’s length terms.
* External financiers indicate preparedness to provide finance provided the investors in the company commit an amount of permanent capital as a buffer for losses. Shareholder loans will not be acceptable, even if subordinated to external loans, if the shareholders are free to insist on repayment of those loans. Further external borrowing would also not be permitted.

The following arrangement is carried out to serve these ends.

* A Division 6 tax transparent non-trading unit trust is established to act solely as a provider of finance for the company. The unit trust will have one asset, a loan to the company.
* The shares in the company and units in the unit trust are stapled pursuant to a security holder agreement (stapling agreement).
* Trustee Co (not shown for simplicity), the trustee of the unit trust, is wholly owned by a professional trustee company and has nominal capital. The company has a right to nominate two of the three directors of Trustee Co. If the professional trustee company no longer wants to wholly own Trustee Co, it must give the company the option of acquiring the shares.

*The unit trust deed and the stapling agreement*

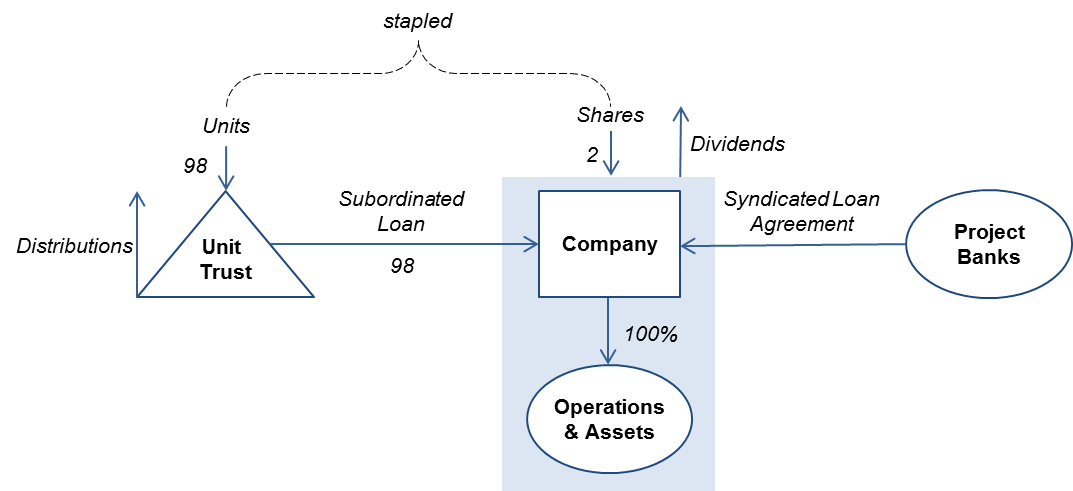
* Under the unit trust deed:
  + the unit holders have no right to insist on a distribution or return of capital or the redemption of their units in any circumstances;
  + subject to the terms of the stapling agreement, the trustee may, in its absolute discretion, distribute capital or redeem some or all of the units held by a unit holder or held by all members but is not obliged to do so;
  + whether, and of so to what extent, income distributions are made is at Trustee Co’s discretion;
  + a reorganisation of capital is prevented unless a corresponding reorganisation occurs for shares and a fixed ratio of units to shares is maintained;[[12]](#footnote-13)
* The stapling agreement:
  + takes precedence over the unit trust deed and the company’s constitution;
  + does not permit the unit trust to consolidate, sub-divide, cancel, buy back or redeem the units (or vice versa) unless there is a corresponding transaction with the shares (or vice versa);
  + despite any rule of equity or law or provision of the unit trust deed, requires the trustee not to exercise its powers or discretions only in the interest of the unit holders in the trust independently of, or without regard to, the position of the shareholders in the company. The effect of this clause is that trustee Co’s powers need to consider the circumstances of the company such that the trustee may not call up and distribute capital (the loan principal) if to do so would be injurious to the interests of the investors in their capacity as the shareholders, by reason of its effect on the company, even in circumstances where that is otherwise permitted. This rule overrides the normal fiduciary duty of the trustee to act only in the interests of the beneficiaries.

*The Loan*

* The funds contributed to the unit trust by the stapled securities investors are used to fund the loan. Assume a nine year loan term at an arm’s length interest rate. Unpaid interest capitalises into the loan but is fully repayable at year nine with the loan principal.
* There is no expectation that upon repayment of the loan the unit trust will be wound up and the trust capital distributed.

*The syndicated loan agreement (SLA)*

* The company is also funded by money borrowed from the external financiers under a SLA. The debt has tranches repayable at maturity dates of five years and seven years. As intended, the SLA indicates the maximum amount that can be borrowed externally.
* The security trustee for the external financiers holds the following security in support of the SLA to company:
  + share mortgage over the shares in company; and
  + a fixed and floating charge over all of the assets of company.
* The trustee of the unit trust enters into a subordination deed with the company and the security trustee under the SLA which provides that the trustee of the unit trust, without consent from the project banks, agrees to defer (until a sunset date) making any claim against the company with respect to the repayment of the loan if any debt was outstanding under the SLA.
* The company uses the SLA and loan funds to acquire the intended assets. It derives third party revenues from the operations it conducts in respect of the assets and interest upon the loan, if paid, is paid from this revenue. The loan would continue to accrue interest.
* The loan is assumed to be a Division 974 debt interest when tested as a single scheme.
* The combined effect of these arrangements is that the unit holders are unable to require the trustee to enforce its rights against the company and are unable to insist on the distribution of the loan principal and the company is able to control it, and if so, when and to what extent that happens. This is accepted by the external financiers and ratings agencies as meeting their requirements.



#### Applying the proposed new principles

##### Pricing, terms and conditions of the schemes and their operative effect

1. There is no direct link between the loan or its terms and the shares or the terms on which they were issued which would require analysis under the first principle set out in 3.27(i) above.  The loan is affected by the trust and the company contracts with the trustee in the knowledge of that trust. The trust is formally linked by the stapling agreement to the shares. Thus there is at least some indirect link and the first principle is potentially relevant. In this case, however, the second principle set out in 3.27(ii) renders it unnecessary to analyse that interdependency in terms of the first principle.
2. This is not a matter that is mere subordination of one liability to another, mere stapling (of either, or both, debt instruments or ownership interests in entities), or the mere the provision of funding, or the mere existence of a security interest contemplated by 3.40 above.
3. The terms and conditions of the arrangements are such that there is no effective obligation of the company to repay the loan absent a parallel return of capital on its issued shares, which is a discretionary matter, and the company is in a position to determine if, and if so when and to what extent, that happens and cannot be challenged. Where any obligation to return capital or loan funds is for all practical purposes at the discretion of the borrower, that does not constitute an effectively  
   non-contingent obligation (ENCO) and as such the arrangements that produce this result operate in a way that ‘affect the application of the debt test or the equity test to one or more of those schemes’,under principle (ii) set out in 3.27 above, in this case the loan scheme. The features of the arrangement that secure that two or more schemes have this operation are:

* the terms of the trust deed that exclude any rights of unit holders to insist on a distribution or return of capital or the redemption of their units, prevent a reorganisation of capital unless a corresponding reorganisation occurs for shares and a fixed ratio of units to shares is maintained;
* the terms of the stapling deed that do not permit the unit trust to deal with its capital unless there is a corresponding transaction with the shares (and vice versa) and which ensure that the unit trust is administered in the interests of unit holders having regard to, the position of the shareholders in the company;
* the company’s control over management and ownership of the trustee of the unit trust; and
* the loan is the entire asset base of the unit trust and the only source from which any distribution of capital to unit holders could be made

1. In these circumstances the primary principle (ii) in 3.27 above is satisfied.

### The schemes in combination

1. Given primary principle (ii) is satisfied, it is necessary to consider the nature and extent of common involvement of the parties, the manner in which the scheme is entered into and carried out, and the nature and extent of any non-arm’s length dealing.
2. All elements of the schemes in aggregate are orchestrated and directed in a holistic way and each element is an integral part of a unified whole. It is appropriate to aggregate all of its constituent elements. In the case of the company it is party to the shares and the loan and from its perspective it is appropriate to aggregate the loan and the shares and test them against the debt and equity tests.
3. It follows that by aggregating the schemes in this Example, the principles operate to ensure that the company cannot achieve indirectly what it could not achieve directly, that is classify an instrument that is in substance equity as debt.

### Mere link and commercial understandings

1. When regard is had to normal commercial understandings, it will also be concluded that the shares, the units and the loan should be aggregated. Together they form an integrated package for the provision of the company’s capital and would appropriately be seen as integrated single capital investments. There does not appear to be any basis for contending that investment markets would see separate instruments. Further, from the perspective of external lenders, the loan and units will be seen as de facto equity or share capital.

### Loan, subordination deed and the SLA – not aggregated

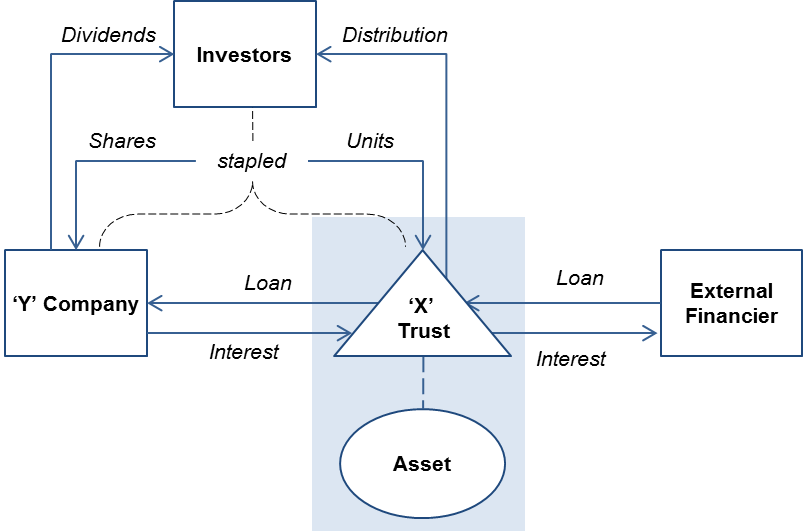
1. Under the terms of the subordination deed, the pricing, terms and conditions of the loan are linked to the pricing, terms and conditions of the SLA. However, they are not linked in a manner which would affect the application of the debt or equity tests to either of the schemes.
2. The subordination deed only has the effect of placing the SLA at the head of the queue should there be a shortfall of assets to meet the obligations of the company and trustee, but does not go to the character of the relevant obligations. The loan and the SLA will not be aggregated under the proposed principles. For completeness, this outcome is consistent with normal commercial understandings.

|  |
| --- |
| ***Change to this scheme that would avoid aggregation***   * The outcome would change if other circumstances existed resulting in an expectation - and structural scope - for the loan to be repaid, otherwise than at the discretion of the company, and where the funds are available to be returned to unit holders either as a return of capital or as a winding up. For example:   + If the beneficiaries have the right to require the units to be redeemed, their interest will be debt-like, and will be commercially distinct from irredeemable shares.   + If the trust was to operate only during the term of the loan (that is, when the loan was repaid at the end of the nine year term the repaid moneys are distributed), the discretionary powers of the trustee and the inability of the unit holders to require earlier redemption would not alter the economic effects of the loan. Terms creating interdependency with the shares would be temporary and not alter the effectively non-contingent character of the loan. As the trust is temporary, the units would not necessarily be seen as one security with the shares. * A guarantee by the company that unit holders would be repaid unit capital would prevent equity characterisation (perhaps through an application of aggregation that produced a debt interest rather than an equity interest). This could be true even if the trustee held shares in the company rather than the loan. * Example 3 illustrates a case in which the trust would not be aggregated. This is because the trust has functions and other assets apart from the loan. |

### Example 3: debt raised by a property trust – no aggregation

#### Background facts

* X Trust is a listed property trust. It holds Australian commercial properties with a total market value of $500 million. It derives rental income from leasing these properties to third parties.
* X Trust is not taxed under Division 6C.
* Y Company is an associated company responsible for managing the properties held by X Trust. It also acts as a responsible entity for X Trust and undertakes property development. X Trust pays service fee to Y Company at market rate for managing properties.
* The shares in Y Company are stapled to the units in X Trust pursuant to the stapling deed. The stapled securities are listed on the Australian Securities Exchange (ASX).
* The stapling deed:
  + stipulates that is takes precedence over the unit trust deed and the company’s constitution;
  + does not permit the unit trust to consolidate, sub-divide, buy-back, cancel or otherwise reorganise any units unless there is a corresponding transaction with the shares (or vice versa).
* Under the X Trust deed, the trustee may, in its absolute discretion distribute income or capital on some or all of the units held by a unit holder.
* The stapling deed and the X Trust deed are subject to the ASX listing rules.
* The stapled securities are offered to investors by way of a prospectus. A total of $50 million is raised on the issue of stapled securities. Funds raised are allocated to Y Company and X Trust having regard to the new asset value of the two entities - $30 million is contributed to X Trust and $20 million to Y Company.
* X Trust borrows an additional $50 million (external loan) from an independent third party lender (external financier). The external loan has a term of nine years, and is interest bearing. Unpaid interest accrues and is payable together with any principal at the end of the loan term.
* X Trust on-lends $80 million ($30 million raised by way of prospectus and $50 million external loan) to Y Company, at a mark up on the interest rate on the loan from the external financier. The loan has a term of nine years. Unpaid interest accrues and is payable together with any principal at the end of the loan term.



### Applying the proposed new principles

#### The loan, units in X Trust and shares in Y Company – not aggregated

1. It is necessary to consider the entire financing arrangement for Y Company to determine whether the loan should be aggregated with the shares and the units, or alternatively, with only the shares or only the units.

##### Pricing, terms and conditions of the schemes

1. Under the stapling deed, there is interdependency between the pricing, terms and conditions of the shares in the Y Company and the pricing, terms and conditions of the units in the X Trust. As with Example 2, the terms of the stapling deed requiring the units and the shares to be disposed of or otherwise dealt with together are not enough to aggregate the scheme giving rise to the units and the shares, or any of the schemes giving rise to the units or the shares with the scheme giving rise to the loan.
2. Unlike Example 2, the pricing, terms and conditions of the shares in Y Company or of the units in X Trust are not linked to, and do not affect, the pricing, terms and conditions of the loan by reason of the provisions in the stapling agreement. In this case, the interest of the unit holders in X Trust cannot be seen as an interest in the loan and neither the stapling agreement nor the unit trust deed constrains or affects the obligation of the trustee to repay the external financier who has supplied the funds on lent as the loan. The power to return capital is exercisable in respect of the funds of X Trust remaining after making provision for repayment of X Trust’s liabilities, including the external loan.
3. Moreover, unlike Example 2, the trustee of X Trust can return invested capital to the unit holders independently of any actions of Y Company. It is not reasonable to conclude that the pricing, terms and conditions of the shares, the pricing, terms and conditions of the units, or the pricing, terms and conditions of the shares and the units, operate in a way which would alter the economic consequences of the pricing, terms and conditions of the loan.

### The schemes in combination

1. Even if the share, the unit and the loan schemes were combined, the manner in which the schemes were entered would not support their aggregation. The stapling arrangement was in existence and X Trust had its established activities and assets before the funds were on lent to Y Company.

### Mere link and commercial understandings

1. Under normal commercial understandings, the loan, the units and the shares in this Example would be regarded as separate interests, particularly since the loan is only one asset of the trust and redemption of a unit or a return of capital would reflect the net asset position of the trust as an entirety.

#### The external loan, the loan, units in X Trust and shares in Y Company – not aggregated

##### The pricing, terms and conditions

1. The pricing, terms and conditions of the external loan are not dependent on or linked to the pricing, terms and conditions of the loan, of the shares in the Y Company or of the units in the X Trust.
2. The pricing, terms and conditions of the loan, or of shares in Y Company, or of the units in the X Trust do not operate in a way which would alter the economic consequences of the external loan in a manner which would affect the application of the debt or equity tests to one or more schemes.

##### The schemes in combination

1. Even if the schemes were combined, the lack of common involvement between the external lender and the Y Company and the X Trust, the arm’s length dealing between them and the commercial manner in which the schemes were entered would not support their aggregation.

##### Mere link and commercial understandings

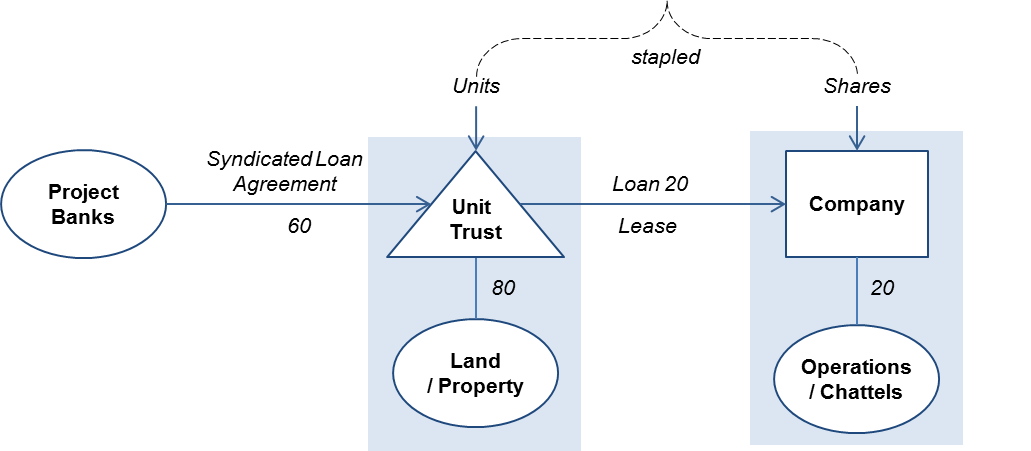
1. Under normal commercial understandings, external loan, the loan, the units and the shares in this Example would be regarded as separate interests.

|  |
| --- |
| ***Change to this scheme that would not result in aggregation***   * If the capital funding is instead by way of a re-allocation from the Y Company to X Trust (by way of capital distribution on Y Company’s shares that is compulsorily applied as an additional capital contribution to the X Trust units held by shareholders of those shares, and subject to approval by the shareholder), the unit, the shares and the loan schemes will not be aggregated. This is in accordance with normal commercial understandings and because:   + The pricing, terms and conditions of the loan will not be dependent on or linked to the pricing, terms and conditions of the shares and of the units.   + The pricing, terms and conditions of the shares and of the units do not operate in a way which would alter the economic consequences of the pricing, terms and conditions of the loan.   ***Change to this scheme that would result in aggregation***   * If under the constituent documents, the return payable to the X Trust unit holders was determined by reference to, and was contingent on, the return paid by Y Company on the loan from X Trust, the schemes would be aggregated. This would be because:   + The pricing, terms and conditions of the loan would be linked to or dependent on the pricing, terms and conditions of the stapled securities as the returns on the stapled securities are contingent on returns on the loan.   + The fact that investors are common to both Y Company and X Trust and they have knowingly and willingly participated in the scheme supports the conclusion that there is a link or dependency between the schemes.   + This arrangement is not one where normal commercial understandings or dealings in practice would result in the schemes being treated as separate things. |

### Example 4: Trust and company staple – no aggregation

#### Background facts

* The company and unit trust are stapled (as is a trustee company, not shown for simplicity) under the terms of a security holder agreement. The unit trust is a Division 6 tax-transparent non-trading trust.
* The unit trust has two investments:
  + a cross staple loan to the company (the company loan); and
  + real property and affixed improvements that are leased to the company.
* The unit trust is funded by way of units subscribed for by security holders, and by money borrowed from project banks under an arm’s length loan facility (SLA).
* The unit trust would lease the property to the company under a lease agreement for an arm’s length rental amount. The unit trust would advance loan funds to the company under a cross-staple loan agreement. The loan would be for a nine year term, and at an interest rate of eight per cent.
* The security trustee for the project banks would hold the following security under the SLA to support the unit trust:
  + unit and share mortgages over the units in the unit trust/shares in the company; and
  + a fixed and floating charge over all the assets of the unit trust and the company.
* The company would be the obligor or guarantor under the SLA, and a party to the SLA. The company would guarantee the performance of the unit trust to the project banks under the SLA. The company would also agree not to pay dividends (would impose a dividend stopper) unless permitted under the SLA (that is, out of available post-debt service cash flows).
* The company would provide the security and guarantees required pursuant to the SLA to support its obligations to the unit trust under the lease and cross-staple loan.
* The company would derive third-party revenue from the operations it conducts.
* This example is based on project financed single-project economic infrastructure ownership models that can apply to assets such as toll roads, ports, airports, electricity generation assets and so on.



### Applying the proposed new principles

#### Company shares and the company loan – not aggregated

##### Pricing, terms and conditions of the schemes

1. The pricing, terms and conditions of shares in the company are not linked or dependent on the company loan’s pricing, terms and conditions in a manner that would affect the application of the debt or equity test. The company must fulfil its obligations under the company loan, regardless of the terms attached to its shares.
2. The pricing, terms and conditions of the shares in the Company do not operate in a way that would alter the economic consequences of the pricing, terms or conditions of the company loan (or vice versa).[[13]](#footnote-14)

### The schemes in combination

1. As there is no relevant dependency, link or economic effect between the pricing, terms and conditions of the shares in the company and the pricing, terms and conditions of the company loan, it is not necessary to consider the schemes in combination against the relevant factors.

### Mere linkages and commercial understandings

1. As there is no dependency, link or economic effect between the pricing, terms and conditions of the shares in the company and of the company loan, it is not necessary to consider any mere links and whether there would be one or two interests. To avoid any doubt, mere stapling would not create the requisite dependency or link.

### Units in unit trust and company loan – not aggregated

#### Pricing, terms and conditions of the schemes

1. The pricing, terms and conditions of units in the unit trust are not dependent on or linked to the pricing, terms and conditions applicable to the company loan in a manner that would affect the application of the debt or equity tests. The company must fulfil its obligations under the company loan, regardless of the terms attached to the units in the unit trust.
2. The pricing, terms and conditions of the units in the unit trust do not operate in a way that would alter the economic consequences of the pricing, terms and conditions of the company loan in a manner that would affect the application of the debt or equity tests (or vice versa).

### The schemes in combination

1. As there is no relevant dependency, link or economic effect between the pricing, terms and conditions of the units in the unit trust and the pricing, terms and conditions of the company loan, it is not necessary to consider the schemes in combination against the relevant factors.

### Mere links and commercial understandings

1. As there is no dependency, link or economic effect between the pricing, terms and conditions of units in the unit trust and the company loan, it is not necessary to consider mere links and what would be the commercial understanding of whether the interests would be regarded as one or two interests.
2. Assuming that a dependency, link or economic effect were found, the new rules would ensure that mere funding of the unit trust by the company loan and unit holders subscribing for units does not create a dependency or link.

#### SLA and company loans – not aggregated

##### Pricing, terms and conditions of the schemes

1. The SLA’S pricing, terms and conditions are linked to or dependent on the pricing, terms or conditions of the company loans. Commitments given to a lender under the SLA are a necessary pre-requisite to the ability of the unit trust to source funds to on-lend to the company under the company loan.

### The schemes in combination

1. Considering how the schemes are combined, referring to the factors suggested above, leads to a conclusion that the schemes are interdependent. Most notably, there is common involvement among the parties to the schemes and a close relationship between the unit trust and the company.

### Mere links and commercial understandings

1. This principle does not break the aggregation of the scheme as obligations under the SLA extend beyond the mere taking of security.
2. However, having regard to normal commercial understandings or dealings in practice, the SLA and the company loans would be commercially recognised as separate schemes and therefore would not be aggregated.

### The company loan and real property lease – not aggregated

#### Pricing, terms and conditions of the schemes

1. The pricing, terms and conditions of the company loan are not dependent on or linked to the pricing, terms and conditions of the real property lease. The company loan and the real property lease do not operate in a way such that the pricing, terms and conditions of one alter the economic consequences of the pricing, terms and conditions of the other scheme.

### The schemes in combination

1. As there is no dependency or link between the company loan and the real property lease, it is not necessary to consider the schemes in combination.

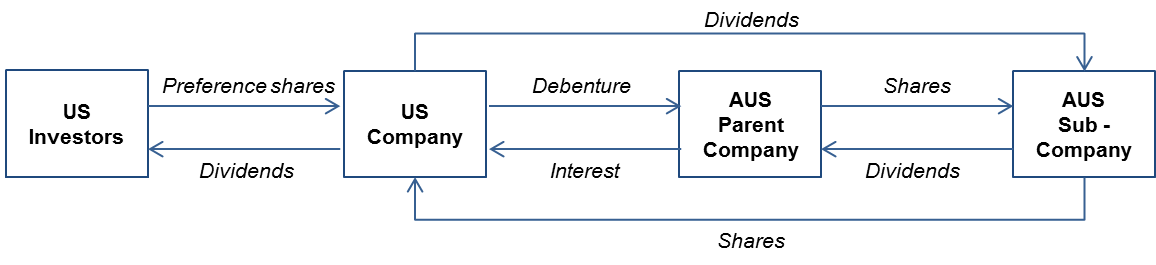
### Mere links and commercial understandings

1. As there is no dependency or link between the pricing, terms and conditions of the company loan and the real property lease, it is not necessary to consider the mere links and commercial understanding. Furthermore, mere stapling would not create a dependency or link.

### Example 5: Hybrid Tier 1 structure - aggregation

#### Background facts

* Head Co initiates a single plan to raise finance from US investors.
* US Company is incorporated in Delaware by Head Co to facilitate the arrangement. US Company is a wholly owned subsidiary of another subsidiary of Head Co.
* US Company issues US$ 350 million of preference stock in the US market. US Company uses the funds raised from issuing of preference shares to acquire a debenture from Head Co.
* Under the terms of the preference shares, the US investors are entitled to 6 monthly non-cumulative dividends, provided that US Company receives a corresponding amount of interest from Head Co in respect of the debenture. Interest payable to US Company is cumulative.
* The preference shares are convertible into preference shares in Head Co.



### Applying the proposed new principles

#### Pricing, terms and conditions of the schemes

1. The pricing, terms and conditions of the preference shares are linked to or dependent on the pricing, terms and conditions of the debentures. The terms of the preference shares includes a specific condition that the US investors will only be entitled to six monthly non-cumulative dividends to the extent that the US Company receives a corresponding amount of interest from Head Co on the debentures. That is, the return to the US investors is legally contingent on receiving interest on debentures from Head Co.

### The schemes in combination

1. The fact that Head Co and US Company have knowingly and willingly entered into the preference share and the debentures scheme to raise finance for the Head Co, and that US Company is indirectly wholly owned by Head Co supports aggregation of the preference shares and debentures.

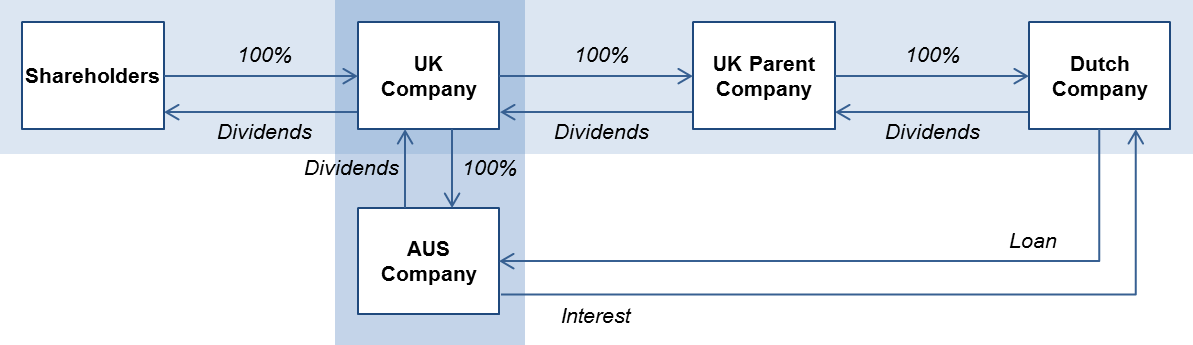
### Mere linkage and commercial understandings

1. This arrangement is not one where normal commercial understandings or dealings in practice would result in the schemes being treated separately.

### Example 6: Chain of debt and equity – no aggregation[[14]](#footnote-15)

#### Background facts

* UK Co, a widely held UK resident company, wholly owns another UK company, UK Parent Co.
* UK Parent Co incorporates a special purpose company in the Netherlands, Dutch Co, in order to acquire a debt interest in an existing Australian resident subsidiary of UK Co, AUS Co.
* UK Parent Co contributes $100 to acquire all the issued shares in Dutch Co.
* Dutch Co uses the funds contributed by UK Parent Co to acquire the debt interest in AUS Co. AUS Co pays interest to Dutch Co pursuant to the loan agreement.
* Dutch Co pays dividends to UK Parent Co based on Dutch Co’s available profits.
* UK Parent Co pays dividends to UK Co out of a pool of dividends received from subsidiaries, including Dutch Co. UK Co pays dividends to its shareholders.



### Applying the proposed new principles

#### Pricing, terms and conditions of the schemes

1. The pricing, terms and conditions of the loan (from Dutch Co to AUS Co) are not dependent on or linked to the pricing, terms and conditions of the ordinary shares in Dutch Co that would affect the application of the debt or equity tests. That is, the company must fulfil its obligations under the loan agreement without referring to the terms attached to the shares.
2. The pricing, terms and conditions of the loan do not operate in a way that would alter the economic consequences of the ordinary shares in Dutch Co in a manner in which would affect the application of the debt or equity tests to one or more of the schemes (or vice versa). The return on the loan is merely a source of funds used to pay dividends to the UK shareholders.

#### The schemes in combination

1. As there is no dependency or link between the loan and the ordinary shares in Dutch Co, it is not necessary to consider the schemes in combination.

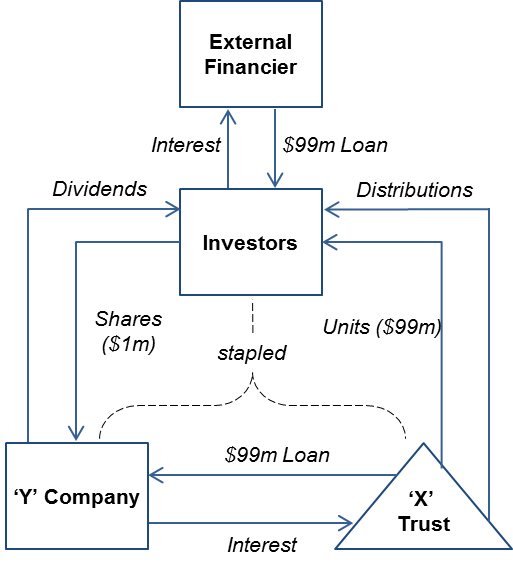
#### Mere linkages and commercial understandings

1. As there is no dependency or link between the pricing, terms and conditions of the loan and of the ordinary shares in Dutch Co, it is not necessary to consider mere links and commercial understandings or dealings in practice. To avoid any doubt, mere funding is not sufficient to create the requisite dependency or link.

### Example 7: 99/1 structure – no aggregation

#### Background facts

* The investors borrow $99 million from an external financier (external loan). The investors use the funds to acquire units in X Trust and contribute $1 million of their own money to subscribe for shares in Y Company.
* The units and shares are stapled to one another and can only be disposed of together.
* X Trust lends at interest the $99 million received form the investors in Y Company (loan).
* The investors’ entitlement to demand the return of invested trust capital or the distribution of trust income is unfettered by limitations in the trust instrument or by collateral agreements, and is not contingent upon the company’s ability to return share capital or distribute profits to its shareholders.



### Applying the proposed new principles

#### Loan and shares in Y Company – not aggregated

##### Pricing, terms and conditions of the schemes

1. The pricing, terms and conditions of the shares in Y Company are not linked to or dependent on the pricing, terms and conditions of the loan as the repayment of the loan is not legally contingent on a distribution being made on Y Company shares (or vice versa).
2. The pricing, terms and conditions of the shares in Y Company do not operate in a way that would alter the economic consequences of the pricing terms of the loan in a manner which would affect the application of the debt or equity tests to one or more of the schemes (or vice versa).

### The schemes in combination

1. As there is no dependency or link between the loan and Y Company shares, it is not necessary to consider the schemes in combination.

#### Mere linkage and commercial understandings

1. As there is no dependency or link between the pricing, terms and conditions of the loan and Y Company shares, it is not necessary to consider mere linkages and commercial understandings. Furthermore, mere stapling would not create a dependency or link.

#### Loan and units in X trust – not aggregated

##### Pricing, terms and conditions of the schemes

1. The pricing, terms and conditions of the units in X trust are not linked to or dependent on the pricing, terms and conditions of the loan as distributions from X Trust are not legally contingent on a return being made on the X Trust loan (or vice versa).
2. The pricing, terms and conditions of the units in X Trust do not operate in a way that would alter the economic consequences of the pricing, terms of the loan in a manner which would affect the application of the debt or equity test to one or more of the schemes (or vice versa).

##### The schemes in combination

1. As there is no dependency or link between the loan and units in X Trust, it is not necessary to consider the schemes in combination.

##### Mere link and commercial understandings

1. As there is no dependency or link between the pricing, terms and conditions of the loan and of the units in X Trust, it is not necessary to consider mere link and commercial understandings. To avoid any doubt, mere stapling would not create a dependency or link.

##### External loan, shares in Y Company and units in X Trust – not aggregated

* 1. The pricing, terms and conditions of the external loan are not linked to or dependent on the pricing, terms and conditions of the shares in Y Company and units in X Trust (stapled or not).
  2. The pricing, terms and conditions of the shares in Y Company and units in X Trust (stapled or not) do not operate in a way that would alter the economic consequences of the pricing terms of the loan in a manner which would affect the application of the debt or equity tests to one or more schemes (or vice versa). The return on the shares and/or units is a mere source of funds which could potentially be used to pay returns on the external loan.

The schemes in combination

* 1. Even if the schemes were combined, the arm’s length dealing between the external lender and other parties to the schemes and the commercial manner in which the schemes were entered would not support their aggregation.

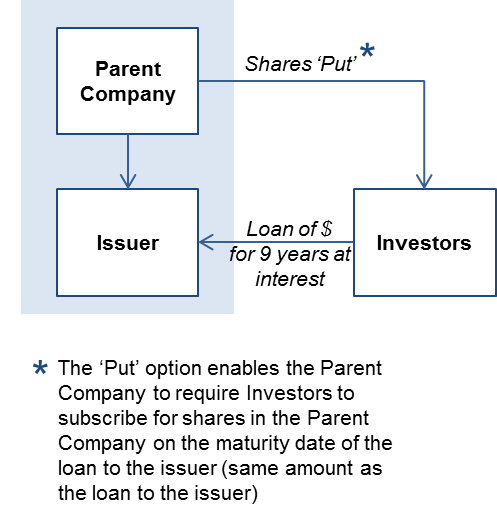
Mere link and commercial understandings

* 1. Under normal commercial understandings, the external loan and the shares and/or units in this Example would be regarded as separate interests.

### Example 8: Contra-put scheme – aggregation

#### Background Facts

1. A fully-owned subsidiary of Parent Company borrows $10 million from an investor at nine per cent interest for nine years.
2. The investor provides Parent Company with a put option over Parent Company shares giving Parent Company the right, but not an obligation, to sell  
   one million shares at $10 each to the investor. The put option can only be exercised at the maturity of the loan.



### Applying the proposed new principles

#### Loan and put option – aggregated

##### Pricing, terms and conditions of the schemes

1. The pricing, terms and conditions of the put option are not linked to or dependent on the pricing, terms and conditions of the loan in a manner that would affect the application of the debt or equity tests, as the rights and obligations under the put option are not related to fulfilling obligations under the loan (or vice versa).
2. The pricing, terms and conditions of the put option operate in a way that alters the economic consequences of the pricing, terms and conditions of the loan in a manner that would affect the application of the debt or equity tests. The investor cannot retain the repayment of the loan principal and may instead receive shares in an entity connected with the borrower, which would affect the application of the debt test (shares in a connected entity are not a financial benefit under subsection 974‑30(1)).

### The schemes in combination

1. The strong degree of issuer participation in the schemes indicates that they are dependent or linked because the investor is a participant in both schemes, and Parent Company’s ownership of the investors’ sub-company suggests that the schemes were designed to have an economic effect different from its legal form as a loan.

### Mere link and commercial understandings

1. It is arguable, but unlikely to be accepted, that the two schemes would be recognised as separate under normal commercial understandings. As noted above, the put option is linked to or dependent on repaying, or failing to repay the loan. However, the put option provides Parent Company with the ability to convert the loan into an equity injection at the loan’s maturity. Given the common ownership of the sub-company and Parent Company, it would be difficult to succeed in arguing that the schemes are separate.

### Variation to this example

1. Contrary to this example, synthetic instruments that are linked to the dividend yield or price of a share created and sold by financial intermediaries without any involvement of the applicable company, are not intended to be aggregated. While there is a clear linkage between the two schemes by reference to the express terms, there is no common involvement between the promoters of the instrument and the company in relation to the synthetic instrument. Accordingly, it is not appropriate to aggregate the synthetic instrument with the shares.

### Operation of the machinery provisions

1. As stated in paragraph 3.10, a three-step process will apply: applying the new integrated provision to identify the scheme; applying the debt and equity tests to the scheme identified under the integrated provisions to determine its character; and applying the operative provisions in the Acts to each instrument so characterised to get an outcome for the scheme.
2. The Board notes that, as part of the implementation of the proposed new rule, careful consideration will be required as to how the rules interact with the operative provisions (for example, the deductibility and franking provisions) in the Acts.

# Chapter 4: Alternative solutions not recommended by the Board

## Introduction

1. The Board considered a number of alternative solutions as part of the review but does not recommend them for reasons set out in this chapter.

### Repealing section 974-80 and relying on Part IVA and the existing related scheme provisions in section 974-70

1. The Board received a number of submissions that proposed repealing section 974-80 and relying on the existing section 974-70 and the general anti-avoidance provision in Part IVA. The Board considered the proposal at length. It concluded that this approach was not an appropriate solution for the following reasons.
2. Section 974-80 and Part IVA serve different purposes. Part IVA is not a self-executing provision but rather requires the Commissioner to make a determination to apply the provision and strike down an Australian income tax benefit where certain conditions are satisfied. The determination requires an objective conclusion, after having regard to eight specific factors, that the scheme was carried out for the sole or dominant purpose of obtaining a tax benefit. It is a last resort not a front-line integrity measure, and its broad terms are designed to capture undesirable arrangements that are not negated by other specific provisions in the Acts.
3. By comparison, section 974-80 is intended to ensure that one or more instruments in a series of related arrangements are not classified as debt interests where those classifications would be inconsistent with the economic substance of the entire series of arrangements. That is, section 974-80 is a specific integrity provision that reclassifies what would otherwise not be equity interests (upon which distributions would probably be deductible) as equity where the overall arrangements exhibit sufficiently prescribed equity features. Section 974-80 is first and foremost a provision to protect the integrity of the debt and equity rules by ensuring instruments in the series are appropriately classified as equity.
4. The Board considered that the uncertainty and complexity associated with the existing section 974-80 would likely be replaced with another type of complexity and uncertainty if section 974-80 was repealed and Part IVA was required to do the heavy lifting. The analysis required to determine whether any series of financing arrangements attracted the operation of Part IVA was thought to be complex and uncertain, and necessarily very specific to particular facts. Accordingly, it would be especially difficult to provide useful general indicators or guidance on the possible application of Part IVA to individual debt and equity classification scenarios. Further, Part IVA (because of the tax benefit and dominant purpose elements) might not adequately address the arrangements that section 974-80 was intended to address.
5. Importantly, even if Part IVA can deny deductions for returns on relevant arrangements, it cannot go the extra step of ensuring that those arrangements are characterised as equity interests. On the other hand, in these cases section 974-80 is designed to ensure equity interests are properly classified.
6. As a consequence, while returns on the individual arrangements in the series are not deductible, they can be franked (subject to the availability of franking credits). Section 974-80 seeks to ensure the integrity of the debt and equity rules by appropriately classifying the interests issued under a series of arrangements at the outset. To create the appropriate reconstructive treatment as equity of what would otherwise be classified debt (or vice versa) would require yet further amendment to Part IVA.
7. The Board also noted that parties would be exposed to severe penalties and interest if Part IVA were to be applied to deny ‘tax benefit’ deductions from the arrangements.
8. If section 974-80 were to be repealed, the series of arrangements that it was intended to deal with could still be considered under the ‘related schemes’ provisions of section 974-70. In that event, the individual schemes in the series could be treated by section 974-70 as part of one single larger scheme under which only an equity interest was issued, so that the debt deductions would still be denied. Any application of section 974-70 would need to be considered before applying Part IVA.
9. While repealing section 974-80 would clearly remove some uncertainty about whether section 974-80 or section 974-70 applies more appropriately to a particular case, some of the uncertainty surrounding the present application of section 974-80 would still arise in considering the application of section 974-70.
10. In the course of consultation, it appeared that the tax community is not fully aware of the potential application of section 974-70 to a series of schemes that are presently being considered under section 974-80. The focus has been on applying section 974-80 to these arrangements.
11. The ATO has expressed a view, based on a real arrangement, that  
    section 974-70(2) could apply to treat what would otherwise be a debt interest issued by a company to a trust as part of a larger equity interest where the units in the trust and the shares in the company are stapled to each other and the funds used to acquire the debt interest are raised from issuing the stapled securities to the stapled security investor (cross-staple funding arrangements).
12. The ATO has also stated that, in its view, where subsection 974-70(2) applies in respect of a cross staple funding arrangement such that it gives rise to a single equity interest, section 974-80 cannot be applied. In such circumstances, the ATO consider that the relevant interest for the purposes of section 974-80 is the single equity interest arising from the application of subsection 974-70(2) and that the requirement in paragraph 974-80(1)(c) will not be satisfied.
13. The Board recognises that the existing related schemes provisions in  
    section 974-70 also present some challenges. In particular, the provisions do not operate precisely to identify schemes that affect each other in such a way that they should be aggregated. Some commercial arrangements could be inappropriately aggregated in the first instance: affected taxpayers ultimately rely on the Commissioner exercising discretion to not aggregate these schemes.
14. Arguably, some of the matters that the Commissioner is obliged to consider in this last resort (such as the ‘purpose’ and ‘effect’ of the schemes) - to decide whether or not to aggregate what would otherwise be considered related schemes - should be considered earlier. The matters might be better considered as threshold elements in the exercise of ‘relating’ so that taxpayers could be more certain of outcomes without having to resort to seeking the Commissioner’s discretion.
15. Under the existing provisions, the general rule is that schemes will be linked to each other if they are related in any way. This is a very broad test as many features will appear to be relevantly related under the test. For example, schemes will be considered related where the schemes are based on stapled instruments or where one scheme compliments or supplements the other. Although the legislation acknowledges that schemes are not related merely because one refers to the other or they have a common party, since the related scheme provisions are applied broadly, there is a risk that they could apply in unintended circumstances.
16. For instance, in a project financing circumstance where an entity is being financed for the first time, it would be usual to expect a combination of debt and equity funding (the debt funding consisting of both subordinated and senior debt). Initial funding arrangements may give rise to a related scheme under the existing provisions which can result in all the interests on issue initially being characterised as either wholly equity or wholly debt (usually the former). This outcome is not commercially sensible.
17. Where both debt and equity interests have been issued at the same time to fulfil a funding requirement, the interests may be considered ‘related’ because one of the schemes would, from a commercial point of view, be unlikely to be entered into unless the other scheme was entered into. They may also be considered related because one scheme complements or supplements the other. While it may be clear that the parties never intended the combined economic effects of the schemes to be the same, the broad operation of the related scheme rules signifies that the position is not clear given that the funding may be regarded as ‘complementary’ in the context of initial funding issues. Even where the equity contribution precedes the debt funding (which is normally the case), the schemes could be regarded as a single arrangement due to the broad definition of a ‘scheme’.
18. Given the uncertainty and potential overreach of the related scheme provisions (discussed in Chapter 2), the Board understands that taxpayers are often left with no other option but to request that the Commissioner exercise their discretion to make a determination to not apply the related scheme provisions. In consultation, affected stakeholders have indicated that this exercise can be time-consuming, costly and can hold up commercial transactions.
19. Some stakeholders warranted the repeal of section 974-80 given the existence of section 25-85. One submission noted that section 25-85 explicitly accepts that debt interests featuring certain equity-like returns (irrespective of whether or not those debt interests are held by related or unrelated parties) should not be precluded from deductibility, and argued that only the amount of the debt deduction that exceeds the benchmark rate of return plus 150 basis points should be regarded as a non-deductible return of an equity nature.
20. As a solution, it was suggested that all transactions involving returns that do not exceed the benchmark plus 150 basis points should be excluded from the rules, with the possible exception of Tier 1 capital schemes.
21. Furthermore, it was submitted that, to achieve greater certainty and policy consistency, the Board could repeal section 974-80, leaving section 25-85 as the relevant integrity provision to restrict excessive debt deductions for payments that effectively represent the holder’s equity participation in the underlying company. The other option was amending section 974-80 to prevent the provision from applying where the return on the relevant debt interest issued by the underlying company does not exceed the benchmark rate of return for the relevant debt interest plus 150 basis points.
22. The Board considered that this proposal would too easily, and inappropriately, result in behavioural changes that would enable debt interests to replace equity interests in many cases.

### Retain section 974-80 with some amendments

1. As discussed in Chapter 2, the then Government announced in the 2011-12 Budget, with retrospective date of effect to the commencement of Division 974, that section 974-80 would be amended to ensure that the provision would apply only to arrangements where both the purpose and effect was that the ultimate investor had, in substance, an equity interest in the issuer company. The then Government also announced that the provision would not apply where the Commissioner considered that it would be unreasonable.
2. The current Government announced that it intended to proceed with the amendments to section 974-80. The design of the measure would be considered as part of the Board’s post-implementation review of the debt and equity tax rules. The Board’s review of section 974-80 was not restricted to any proposals previously announced.
3. The Board considered this option, but again thought that this approach was sub-optimal. As noted in the Board’s discussion paper, the consultation and feedback the Government received after this announcement suggested that the proposed changes did not provide the necessary certainty. The Board considered other options to amend the existing section 974-80, which included inserting something other than the designed to operate test and the possibility of legislating both an ordering rule (for example, stating that the related schemes rule would apply in the first instance) and an apportionment rule.
4. While the Board acknowledges that it would be easier to prioritise the provisions and ensure that section 974-80 works properly, greater pressure would still be placed on the related scheme provisions in section 974-70. Without appropriate amendments to fix the existing difficulties with the operation of section 974-70 noted in Chapter 2, the points of uncertainty or disagreement would simply be shifted to another provision.
5. This outcome is less than optimal. It is for this reason that the Board considers its approach of solving the problems inherent in the law, as outlined in this paper, as the preferred option.
6. Finally, the Board received a suggestion during consultation that a *de minimis* threshold should be legislated to carve out certain smaller entities from having to apply the related scheme and equity override provisions where the transaction is not above a certain threshold. Again, it was suggested that this *de minimis* threshold could be similar to the *de minimis* threshold in the thin capitalisation provisions in Division 820.
7. However, the Board again considered that this proposal would too easily, and inappropriately, result in behavioural changes that would in many cases enable equity interests to be replaced by debt interests.

Appendix A: List of public submissions

Infrastructure Partnerships Australia

Deloitte

Australian Private Equity and Venture Capital Association Limited

Ernst & Young

PwC Australia

Law Council of Australia, Business Law Section

Australian Bankers Association

The Tax Institute

Property Council of Australia

Customer Owned Banking Association

1. Subsections 974-15(2) and 974-70(2) of the ITAA 1997. [↑](#footnote-ref-2)
2. Subsection 974-15(2) of the ITAA 1997. [↑](#footnote-ref-3)
3. Subsection 974-70(2) of the ITAA 1997 [↑](#footnote-ref-4)
4. Explanatory Memorandum to New Business Tax System (Debt and Equity) Bill 2001, paragraph 2.41. [↑](#footnote-ref-5)
5. As noted in the discussion paper, the policy intention of section 974-80 as expressed in the Explanatory Memorandum was directed towards, but not limited to, preventing the deductibility of equity-like regulatory capital (that is, instruments marketed as deductible Tier 1 capital issued by some Banks). Diagram 2.1 in the Explanatory Memorandum, and depicted in the Board’s discussion paper, provides an illustrative example of the type of scenario that section 974-80 was intended to apply to. [↑](#footnote-ref-6)
6. Explanatory Memorandum to New Business Tax System (Debt and Equity) Bill 2001, paragraph 2.49. [↑](#footnote-ref-7)
7. Federal Government, ‘Debt/Equity tax rules – clarification of the scope of an integrity provision’, Budget Paper No 2 – Part 1: Revenue Measures, Budget 2011-12. [↑](#footnote-ref-8)
8. Section 170B of the Income Tax Assessment Act 1936 (Cth) (ITAA 1936). [↑](#footnote-ref-9)
9. The term ‘reasonably arguable’ has the meaning given by section 284-15 of Schedule 1 to the Tax Administration Act (TAA). The test is whether, having regard to the “relevant authorities”, and on an objective analysis of the law and application of the law to the relevant facts, it would be concluded that what is argued for is about as likely as not correct or is more likely than not correct. [↑](#footnote-ref-10)
10. As in the case of the debt test, the pricing, terms and conditions must be considered in their entirety. Although it is acknowledged that in a particular case, not all of the pricing, terms and conditions will be relevant, and of those that are relevant, some may be neutral.  [↑](#footnote-ref-11)
11. This includes considering the method or procedure by which the particular scheme in question was established – *FC of T v Spotless Services Limited 96* ATC at pages 5201 and 5209. [↑](#footnote-ref-12)
12. Corresponding provisions occur in the stapling agreement and company constitution. [↑](#footnote-ref-13)
13. The dividend stopper is not a part of the company loan scheme, nor does it alter the economic consequences of the company loan. In any event, the dividend stopper alters the economic consequences of the shares but does not affect the equity scheme’s application to the shares. [↑](#footnote-ref-14)
14. This example is based on Tax Determination (TD) 2014/D18. [↑](#footnote-ref-15)