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Review of the Debt and Equity Tax Rules
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Review of the Debt and Equity Tax Rules - EY Submission

EY is pleased to respond to the Board of Taxation's (the Board) discussion paper 'Review of the debt and equity tax rules', released on 25 March 2014 (the paper).

Division 974 of the Income Tax Assessment Act 1997 (ITAA97) is a significant area of tax law which may apply in respect of all categories of taxpayers for a broad number of income tax purposes and we support the role of the Board's post-implementation review.

We have been involved in contributing to other submissions and we therefore limit ourselves to only a few strategic issues in this EY submission.

We do not favour large scale revision of Div. 974

In our experience, Division 974 has generally worked as intended to characterise arrangements as debt or equity for tax purposes in accordance with the economic substance of the arrangements.

However, as noted in the paper, in some circumstances neither Division 974 debt or equity treatment may apply or Division 974 debt or equity classification may not apply to an area of law and therefore arrangements will be treated in accordance with general principles. We believe this is appropriate.

Arrangements may be entered into with a vast variety of different terms and conditions. It is difficult for the rules to address all the possible different circumstances or potential complex outcomes that may arise, other than by adopting an in-substance law approach, designed around a primary organising principle with a series of broad tests.

Clarity is needed in known uncertain areas, largely identified in the Board paper and the priority should be to provide that clarity

Clarity for the operation of the law is needed in certain priority areas, in order to be consistent with the policy of the Division. This includes areas where ATO interpretation does not align to the policy intent of the law.

Our input is to focus the immediate actions to rectify particular areas of the law, through appropriate targeted amendments developed through a process of consultation with industry and other stakeholders, rather than to start again and reinvent the regime.

We set out in the appendix our submission for a number of key Division 974 issues which should be addressed or refined in the law, concerning the:

- Section 974-80 integrity rule – the unacceptably broad potential application of this rule must be restricted to apply only in the narrow circumstances it was included to address. This requires significant revision of s.974-80. We submit that the Board should consider, in fact, the repeal of s.974-80 because it adds little to the policy outcomes in combination with s.974-70, Part IVA and the thin capitalisation rules

- Related scheme rules – should apply in more limited circumstances

We recommend against wide-ranging policy initiatives in respect of hybrid securities pending OECD actions under way

The issue of hybrid securities and cross border hybrid tax treatment mismatches between Australia and other tax jurisdiction's debt and equity rules should be left to OECD and G20 Base Erosion and Profit Shifting (BEPS) process.

In our view the reference to the Board of Taxation in the May 2013 Budget to review the treatment of hybrid securities may have had significant relevance then, but has been overtaken by the OECD and G20 global project for the BEPS process, which commenced in earnest with the July 2013 OECD work plan. Australia, as an OECD participant and G20 leader this year, and Australian businesses, are involved in these processes in depth.

Cross border tax treatment mismatches will always arise as a natural result of each jurisdiction enacting their own tax laws. Such differences may result in legitimate arbitrage opportunities in line with decisions taken by a jurisdiction to support or promote business in their country including to help local businesses compete internationally. As well as double non-taxation scenarios it is possible that double taxation may arise, for example outside of the tax treaty network.

The Board will be aware that the changes proposed to be introduced to replace section 23AJ of the ITAA1936 by the proposed new section 768-5 of ITAA1997 "Foreign equity distributions on participation interests", currently the subject of an exposure draft, adds a new form of hybrid to the Australian and international tax equation.

While the paper proposes a tax policy exploration of hybrids in a process parallel to that of the OECD BEPS review process, the possibility of Australian action in respect of cross border hybrids' taxation issues in isolation to the wider international approach is dangerous for Australia as a capital importing country.

Further, we suggest that Australian policy adventurism, outside the G20 initiatives, is premature and counter to the Australian G20 leadership initiatives to see G20 countries working together on a united approach to the BEPS actions.

We highlight that the OECD thinking in relation to hybrid securities, the most recent public papers being "Public Discussion Draft BEPS Action 2: Neutralise The Effects Of Hybrid Mismatch Arrangements (Recommendations for Domestic Laws) 19 March 2014 – 2 May 2014" and "BEPS Action 2: Neutralise the effects of hybrid mismatch arrangements (Treaty Issues) 19 March 2014 – 2 May 2014" raise for discussion the potential to limit the focus on hybrids so as not to attack:

- Widely held securities or
- Securities issued to unrelated investors.

Those limitations are being discussed as we write as potential recommendations which the OECD CFA will develop for OECD and G20 members.

In our view it would be quite inappropriate for Australia to entertain analyses which might be inconsistent with international tax policy thinking.

As well, for Australia to be inconsistent could be counter to our national interest, if it meant denial of interest deductions in bona fide transactions by public and other widely held entities that have tax exempt foreign investors. The interaction with other areas of the Australian tax law must also be carefully considered.

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Should you have any questions concerning this submission, please do not hesitate to contact in the first instance either Simon Jenner on (02) 8295 6367 or Tony Stolarek on (03) 8650 7654.

Yours sincerely

Ernst & Young

Appendix

Section 974-80 integrity rule (question 5.1)

The wide-ranging concern about Div. 974 has arisen in large part, in our view, from the ATO conflation of issues relating to the integrity rule in s.974-80 and the related schemes rules in section 974-70. This approach, which arose from 2005 or thereabouts and was manifested most clearly in the ATO section 974-80 discussion paper of 2007 and a (withdrawn) draft ruling TR2012/D5 in 2012, has made the legislation unmanageable.

We therefore recommend, as set out below:

- Section 974-80 be constrained legislatively not to apply its recharacterisation to investors which hold equity in a company
- Section 974-80 be constrained so as not to apply where the related interest rules of section 974-70 apply
- Section 974-8- to be constrained not to apply to stapled securities which, as the Division 974 EM stated, were to be dealt with under the related interest rules
- Consideration be given to the repeal of section 974-80, on the basis that it is redundant in the light of the combined operation of the related scheme rules in section 974-70, Part IVA and the thin capitalisation rules.

The potential application of the section 974-80 integrity rule must be constrained so that it would apply only in the narrow circumstances that it was included in the law, to address particular circumstances where an instrument that satisfies the debt test is used to fund an effective equity interest held by an ultimate investor.

The objective of section 974-80 is clear from the Explanatory Memoranda accompanying its introduction – refer Appendix 2 and Appendix 3 which we attach to underscore that these issues were raised and a policy intent was identified at inception of the law, which has been missed in the later administration of the law. The policy intent of s974-80 was to overcome the use of tiered debt and equity structures designed to use debt in lieu of equity to provide equity returns to investors.

Paragraphs 2.41 to 2.45 of the explanatory memorandum (EM) to the New Business Tax System (Debt and Equity) Bill 2001 set out the policy intention of the rule. For example paragraph 2.41 states:

> Sometimes it is possible for an effective equity interest in a company to arise even though the holder of the interest has no direct interest in the company. Instead there may be a series of related arrangements entered into by the company and connected entities culminating in the payment of a return to an investor in respect of an interest which provides the investor with an effective interest in the company.

Section 974-80 is intended to apply to back-to-back arrangements and other schemes that are "deliberately designed so that the return to the connected entity is in turn used to fund either directly or indirectly a return to the ultimate recipient" (paragraph 1.28, supplementary explanatory memorandum to the Bill).

The examples in the EM demonstrate that the section is intended to deal with a sequence of instruments issued through a chain of wholly owned entities. It was not intended to apply to re-characterise all related-party debt funding arrangements as equity.

We emphasise that this was the generally agreed approach to the interpretation of section 974-80 until the ATO commenced in 2006 or thereabouts to adopt a much wider interpretive view as to the scope of the provision.

Significant uncertainty remains with how section 974-80 may be applied by the ATO to taxpayers funding infrastructure investments and to property related investment businesses using stapled structures not of the abovementioned type which was intended to be covered by section 974-80. This includes uncertainty following the ATO's (subsequently withdrawn) draft tax ruling TR 2012/D5 issued in relation to stapled company and debt structures and when the interest deductions incurred on debt of a company, stapled to an affiliated public trust, could potentially be disallowed under the debt equity rules. That draft ruling sought to retrospectively adopt an unacceptably broad interpretation of the existing provision.

The impact of the ATO's views may change the tax treatment of both Australian and non-resident investors into these assets where interests and therefore returns on those interests are re-characterised from debt to equity.

The rule should not apply to stapled groups. Ordinary commercial arrangements such as those between a financier and a borrower should not support a conclusion of sufficient influence such that entities are connected and potentially subject to the rule.

The rule could be redesigned to apply only where there is a sole or dominant purpose of entering into an arrangement to convert an otherwise equity interest return into a debt interest return in the circumstances intended to be covered by the rule.

For example, all of the matters identified in paragraph 26 of the withdrawn TR 2012/D5 would be commonly found in the senior debt covenants imposed on special purpose stapled structures established to build and maintain an infrastructure project. Many of those requirements would also be common to banking covenants imposed on corporate borrowers by arm's length financiers. It is submitted that such requirements would not give rise to the suggestion that the arm's length financier sufficiently influences the borrower or vice versa.

There are other rules to address the apparent mischief which the ATO is concerned about in stapled structures. Most relevantly, para 2.53 of the EM suggests that the related scheme rules were intended to be the mechanism to deal with stapled securities, not section 974-80, and we suggest that this should be a prime focus for the Board. The retargeting of section 974-70 to deal with stapled securities should enable clarification of section 974-80 and clarification of its intent to apply, as we have noted above, only to tiered debt structures, and not to structures where investors already have equity in a company.

We note for completeness that structures involving excessive and inappropriate debt interests are also dealt with potentially under the Part IVA general anti-avoidance rules and, in some cases, by the thin capitalisation rules.

Associate test too broadly drawn

We agree with the Board raising at para 5.52 the issue that:

> 5.52 In the above diagram, an ordinary legal form debt interest issued by a company is held by the stapled trust. If the ownership, governance arrangements or the stapling of the trust and the company result in them being 'connected entities', section 974 80 becomes relevant. An issue that has been identified in this respect is that the phrase 'connected entity' in the context of stapled structure arrangements, which refers to the definition of 'associate' in section 318, is too broad to apply in practice given that it is largely based on the definition of 'sufficient influence'.

In our view the definition is too broad, and the concept of sufficient influence is unworkable in the context of two independent parties – namely the relevant company and the relevant trust - which may well act in contemplation of the position of the other party but are not controlled by the other party. It is inevitable that stapled entities have common interests and are conscious of these. But this commonality does not and should not make one sufficiently influencing the other.

This is a long-standing problem with the reference to the section 318 concept of associate, not only in the context of section 974-80 but in the context of other provisions in the tax law.

The reference would benefit from adjustment.

Related scheme rules (question 4.5)

The related scheme rules add complexity and uncertainty to the determination of the classification of instruments as debt or equity.

We agree that the broad drafting of the rules gives rise to tensions in practice between whether there is a single scheme or a number of related schemes that must be tested. This means that a subjective decision must be made whether schemes are connected or not, if the potential connectivity of the schemes is correctly identified in the first place.

The discretion of the Commissioner to determine that related schemes do not give rise to a debt or equity interest respectively “if the Commissioner determines that it would be unreasonable to apply that subsection to those schemes” is a useful potential aid to flexible administration (there is no such discretion in relation to section 974-80), but the discretion creates further uncertainty.

The definition of 'related schemes' is very broad (refer para 4.79), notwithstanding the existence of a Commissioner’s discretion not to deem schemes to be related. These include the initial funding of an entity by a mixture of debt and equity (with potential impact of sections 974-15 or 974-70), where the use of shareholder and other agreements between the parties, often required for credit purposes, adds to the risk of related scheme characterisation.

In our view an Australian company is permitted to borrow funds for commercial purposes, subject to the thin capitalisation rules where relevant and where the debt is not subject to Part IVA. An Australian company is permitted to borrow funds from its shareholders. And in the same way as it could borrow from its shareholders directly, an Australian company should be permitted to borrow from a trust in circumstances where the company is managed and operates distinctly from the trust.

We further submit that section 974-70 was not intended to overturn the capacity of an Australian company to so organise its affairs, but the words of section 974-70 can be interpreted broadly in that way.

The rules should either be narrowed to apply in more limited circumstances or should be adjusted to apply in a more direct manner to common arrangements to achieve the expected debt or equity outcomes.

We support the insertion of clarifying legislation, complete with notes and examples in the legislation, to cover in particular exclusion in relation to the initial establishment of a structure.

As noted above in respect of section 974-80, it appears clear from the EM that section 974-80 was identified as having application to only certain tiered stapled securities such as those designed to provide bank capital but structured as debt securities. Further the efforts by the ATO to interpret section 974-80 to deal with the broader range of stapled securities result in a distortion of that provision.

We recommend therefore that a formal review be undertaken of section 974-70 to clarify its application and non-application to various forms of stapled securities to develop clearer policy and legislative language, and that this initiative should then allow section 974-80 not to be applicable to the characterisation of stapled securities.

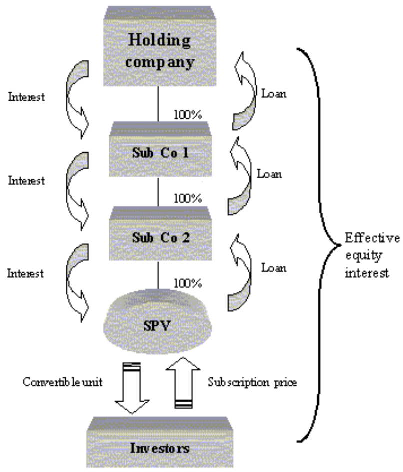
Appendix 2. Extracts from the Explanatory Memorandum for New Business Tax System (Debt and Equity) Act 2001

"Interests that fund returns on equity interests

2.41 Sometimes it is possible for an effective equity interest in a company to arise even though the holder of the interest has no direct interest in the company. Instead there may be a series of related arrangements entered into by the company and connected entities culminating in the payment of a return to an investor in respect of an interest which provides the investor with an effective interest in the company.

2.42 A common scenario where this can arise is the issue of an equity interest through a SPV controlled by a holding company. Diagram 2.1 illustrates an example of this structure.

Diagram 2.1



2.43 In Diagram 2.1 there is a series of related arrangements under which the ultimate investors have obtained an effective, but not an actual, equity interest in the holding company. The investors hold units in a the SPV which provide returns contingent on the profits of the holding company and which may convert into ordinary shares of that company. The subscription price has been on-lent, at interest, by the SPV to the holding company through its subsidiaries. The holding company has funded the contingent returns paid by the SPV by way of the payment of interest through its subsidiaries. Assuming the SPV is a trust, the investors do not have a direct equity interest in any company. The structure relies not only on the interest on loans made by the subsidiaries being deductible, but also the returns paid by the SPV being deductible, perhaps under the terms of a foreign tax law, notwithstanding that the latter are profit-contingent. This is designed to ensure that the holding company's corporate group has received a net tax deduction for the funding of effective dividends to effective shareholders in the holding company.

2.44 The appropriate tax outcome for situations like this one where related arrangements comprise an effective equity interest is to treat the related arrangements which effectively fund the payment of the returns on the effective equity interest (i.e. the returns to the investors in the SPV in Diagram 2.1) as equity interests. Thus the loans by the subsidiary companies in Diagram 2.1 would be equity interests rather than debt interests because they are interests issued by related companies which are used to fund the payment on the deemed equity interest. ***[Schedule 1, item 34, section 974-80]***

2.45 The starting point in determining whether an equity interest arises in cases like these is to look at the holder(s) of all the related arrangements. The combined effect of related arrangements will result in the holder of an interest (in any entity) having an equity interest in a company if:

- the interest (even though it is issued by another entity) will or may convert into an equity interest in the company, or provides returns which are either contingent on the economic performance of the company or a connected entity, or at their discretion; or
- returns on the interest are effectively from the company because, although there is no direct payment to the holder by the company, the company provides a return to another entity which effectively on-pays that amount (directly, or through interposed related companies) to the entity that provides the return to the holder.

2.46 The consequence of this type of arrangement is that all the interests through which the ultimate returns are funded are taken to be equity interests (in the entity in which the interest is directly held). In these cases it does not matter that the payment(s) that fund the ultimate return to the holder of the interest that represents an effective equity interest in a company may not themselves be contingent on the economic performance of the paying company or be at its discretion. Thus, in Diagram 2.1, the on-payments actually constitute interest on a loan between the connected entities and are not contingent on economic performance at all. However, when combined with the interest held by the investors in the SPV, they ensure that the return to the investors are effectively from the holding company (on whose economic performance the returns are based), albeit indirectly through a number of entities and by way of interest payments on loans.

2.47 It is important to note that, in these cases, the only entity taken to have an equity interest in the company is the entity which holds a direct interest in the company and which funds the payment to the investor whose return represents an effective equity interest in the company. That investor, and any interposed entities, is not taken to be an equity holder in the company itself - just an equity holder in the entity in which the investor has a direct interest. If the interest is held in a connected entity that is not itself a company (e.g. a trust) then it will not be an equity interest (because only companies, or entities taxed as companies, can issue equity interests). However, because the payments to fund the ultimate return must (by definition) flow through that non-corporate entity, the entity itself will have an equity interest in the company or a related company.

2.48 Section 974-80 applies to treat an interest in a company as an equity interest only if that interest is not already an equity interest. Therefore if in Diagram 2.1 the loans between the connected entities were back-to-back equity interests mirroring the interest issued by the SPV, section 974-80 would have no effect. ***[Schedule 1, item 34, paragraph 974-80(1)(c)]***

2.49 As a result, the debt test (see paragraphs 2.124 to 2.209).) does not apply individually to each of the interests identified in section **974-80** which fund the return to the ultimate recipient. Instead, the test applies in relation to the interest held by the ultimate recipient - if that satisfies the debt test then the funding interests will not be equity interests. For example, if the interest in the SPV in Diagram 2.1 constituted a debt interest in the SPV because the SPV or a connected entity guaranteed repayment of the subscription price within 10 years, none of the loans between the connected entities would be an equity interest. ***[Schedule 1, item 34, subsection 974-80(2)]***

Example 2.9: Application of section 974-80 to a stapled security

An Australian resident bank issues a fully-paid preference share to a trust that is controlled by its subsidiary. The subsidiary issues to the trust a deeply-subordinated perpetual note that pays a non-cumulative coupon whose payment is contingent on distributable profits of the bank. The trust then issues to investors a stapled security for $100 comprising a beneficial interest in the note and the preference share.

The holders of the security receive a non-cumulative coupon whose payment is contingent on distributable profits of the bank. While the note pays the coupon, the preference share pays no dividends.

The funds raised by the issue of the stapled securities are lent by the trust to the subsidiary and then on-lent by the subsidiary to the bank at a fixed market rate of interest under a term security.

The bank has issued an interest (the term security) to its subsidiary (a connected entity) which carries a right to a fixed return. The interest would not (but for section 974-80) be an equity interest in the bank. However, there is a scheme under which the return to the connected entity is to fund (indirectly through the trust) a return to the ultimate recipient of the return, who is the holder of the stapled security. The amount of the return to the holder of the stapled security is effectively contingent on the economic performance of the bank since it is a return on the beneficial interest in the note, whose returns are contingent on the economic performance of the bank.

Under subsection 974-80(2) the term security (representing the loan to the bank of the funds raised on the issue of the stapled security) constitutes an equity interest in the bank. As an equity interest, the bank is liable to frank the term security coupons.

The subsidiary company has also issued an equity interest (the perpetual note) which is an equity interest under item 2 in the table in subsection 974-75(1).

Example 2.10: Application of section 974-80 to offshore trust units exchangeable into preference shares

An Australian resident bank issues *trust preferred securities* through a trust in Foreign Country 1 to investors in that Foreign Country. The securities are perpetual and exchangeable into the banks preference shares. They provide non-cumulative returns contingent on profits of the bank .

The proceeds of the Foreign Country 1 issue are used by the trust to purchase redeemable debt securities issued by a special purpose subsidiary of the bank that is resident in Foreign Country 2. These securities pay an arm’s length, fixed rate of interest to the Foreign Country 1 trust, which is used to fund the returns to the investors in the trust. The proceeds from the Foreign Country 2 issue are on-lent to the bank by the subsidiary in Foreign Country 2 on terms similar to the redeemable debt securities. Should a contingency occur such that the trust is not required to pay a return to its investors, the funds are made available to the bank.

Section 974-80 applies to this trust preferred issuance as follows. The Foreign Country 2 subsidiary has an interest in the bank (a connected entity) that carries a right to a fixed return from the bank. That interest would not otherwise be an equity interest in the bank (because it would otherwise be a debt interest). However, there is a scheme or a series of schemes under which the return to the Foreign Country 2 subsidiary funds the return to the Foreign Country 1 investors, albeit indirectly through the trust.

Thus, the return to the Foreign Country 1 investors, which is ultimately funded by the interest payments by the bank to the Foreign Country 2 subsidiary, is effectively contingent upon the economic performance of the bank, in addition to them being convertible into equity interests of the bank (the preference shares). Therefore the interest held by the Foreign Country 2 subsidiary in the bank is an equity interest in the bank, returns on which are not deductible but may be frankable and, if not franked, subject to dividend withholding tax.

Integration of related schemes

2.50 Some interests in a company are made up of 2 or more related instruments. To provide a correct reflex of the economic substance of related instruments of this kind it is necessary to integrate them and treat them as a single interest for the purposes of the equity interest definition (and, in turn, for determining whether the terms of the interest satisfy the debt test).

2.51 Therefore, an integration test is required for determining whether an interest is an equity interest in a company. The test adopted by this bill draws on subsection 82L(2) of the ITAA 1936 (applicable to convertible notes). Under this test, 2 or more related schemes (whether or not they come into existence at the same time) to which a company is a party give rise to an equity interest in the company if they would have done so had they constituted a single scheme. ***[Schedule 1, item 34, subsection 974-70(2)]***

2.52 This integration test applies where 2 or more schemes which, by reason of the relationship that they bear to each other or the connection that they have to one another, can be said to be related and operate together to have the effect or operation of an equity interest in a company. For the schemes to be integrated, the company must be a party to them, in the sense that it must enter into, cause another entity to enter into, participate in, or cause another entity to participate in, the schemes. This ensures that a company will not be taken to have issued an equity interest if it has not been involved in some way in its creation. Also, the combined effect of the schemes to produce an equity interest must be intended by the company rather than being produced by mere chance. ***[Schedule 1, item 34, subsection 974-70(2)]***

2.53 Interests that are referred to as being stapled together (in the sense that they are not detachable from each other) would constitute related schemes for these purposes. In this context stapled instruments has its ordinary commercial meaning. ***[Schedule 1, item 34, paragraph 974-155(2)(a)]***

2.54 In addition, the following examples of interests would be related even if they are detachable:

- interests that are commercially connected in the sense that it is unlikely that one would be entered into without the other;
- interests that are dependent for their effect or operation on the effect or operation of another interest; and
- interests that complement or supplement the effect or operation of each other.

[Schedule 1, item 34, subsection 974-155(2)]

2.55 Schemes can be integrated for these purposes even if one or more of them constitutes an equity interest in its own right (e.g. a stapled security comprising an interest-bearing note and a preference share). In this regard the decision of *Network Finance Pty Ltd v FCT* (1976) 6 ATR 589 is overcome. (In the *Network Finance* case it was held that if an interest in itself is a convertible note, it cannot also be related to another interest to cause it and that other interest to be treated as a convertible note). ***[Schedule 1, item 34, subsection 974-70(2)]***

2.56 However, if *all* the related schemes are equity interests themselves, they will not be integrated to form a separate, combined equity interest. ***[Schedule 1, item 34, subsection 974-70(3)]***

2.57 If related schemes are combined to form a single integrated equity interest, returns in respect of the individual schemes are taken to be returns in respect of the integrated equity interest and not in relation to any other interest. For example, a stapled interest-bearing note and preference share that do not satisfy the debt test would be taken to be a single equity interest, and both the interest payments on the note and dividends on the share would be taken to be payments in respect of that interest and not payments in respect of the note or the share as separate instruments. ***[Schedule 1, item 34, section 974-105]***

2.58 In addition, the debt test applies to the single interest arising from the integrated schemes rather than each component part. Therefore it is possible to have an interest arising from integrated schemes that include interests listed in the table in subsection 974-75(1) being treated as a debt interest. An example of such an interest is a preference share stapled to a note which constitute separate schemes and together satisfy the debt test. ***[Schedule 1, item 34, subsections 974-70(1) and (2)]***

Commissioners discretion not to integrate

2.59 To ensure the proposed debt/equity rules are not undermined by the issue of discrete instruments with a combined effect equivalent to an equity (or debt interest), it is necessary to have a broad integration rule of the kind explained in paragraphs 2.50 to 2.58.

2.60 However, it is possible that such a broad rule could operate inappropriately, having regard to the objects of the debt/equity test in general and the integration rule in particular. For example, schemes that are related schemes within the definition of that term which could technically be combined to produce a particular effect may, in economic substance, have a different effect. In these cases the Commissioner may determine that it would be inappropriate to integrate certain schemes. In this regard the Commissioner will be guided by the purpose of the scheme, as well as their effect. **[Schedule 1, item 34, subsection 974-70(4)] "**

Appendix 3 Extracts from Supplementary Explanatory Memorandum and Correction to the Explanatory Memorandum

1.27 The inclusion of paragraph 974-80(1)(ca) will ensure that there is a threshold requirement that the scheme be a financing arrangement in order to be classified as an equity interest. The provision in which this amendment appears deals with an equity interest arising from arrangements funding returns through connected entities. If the interest is not a financing arrangement it cannot be an equity interest.

1.28 The amendment of paragraph 974-80(1)(d) is a technical amendment that will ensure that the provision applies as intended, which is only in those cases where the scheme or schemes are deliberately designed so that the return to the connected entity is in turn used to fund either directly or indirectly a return to the ultimate recipient.

1.29 This means, generally speaking, that section 974-80 would not apply unless there is a plan constituted by documented rights and obligations that provide for the direct or indirect funding of a return to the ultimate recipient. A lack of documentation would not preclude the application of the provision if the design was clear from the surrounding facts and circumstances. However, mere association between the parties would not be a sufficient indicator of the relevant design."