

# TAX BRIEF

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30 July 2018

## Stapled Structure Integrity Measures – Revised Exposure Draft

On 26 July 2018, the Government released revised draft legislation (**ED**) to give effect to various announced integrity measures aimed primarily at stapled groups. The measures have been discussed in prior publications from a real estate perspective (on [28 March 2018](#) and [21 May 2018](#)) and from an infrastructure perspective (on [27 March 2018](#) and [18 May 2018](#)). This Tax Brief focusses mainly on the changes from the original ED which will primarily impact real estate groups.

### Summary of proposals

The following proposals from the original ED are also in the revised ED although the details surrounding some of these proposals have changed:

- Imposition of 30% managed investment trust (**MIT**) withholding tax (**WHT**) rate to distributions of certain income from cross staple arrangements;
- Imposition of 30% MIT WHT rate to distributions attributable to trading income;
- Requiring thin capitalisation to be calculated on a look through basis for interests of 10% or more in trusts and partnerships (rather than 50% or more); and
- Restricting the sovereign immunity and foreign superannuation fund WHT exemptions to payments by entities in which the non-resident has a less than 10% interest.

The following proposals have been added to the revised ED:

- Limiting tax concessions available to MITs holding agricultural land;
- Limiting tax concessions available to MITs holding residential premises.

Each proposal has been considered below.

### Cross Staple Arrangements

As noted in our publications dated [21 May 2018](#) (real estate) and [18 May 2018](#) (infrastructure), net income derived by MITs from operating entities within a stapled group will generally be subject to 30% WHT when distributed to non-residents. This will exclude:

- Amounts subject to other types of WHT (e.g. interest);

- Amounts not subject to MIT WHT (e.g. foreign source income);
- Cross staple rental payments funded by rent from third parties; and
- De minimis cross staple dealings (broadly, where cross staple dealings make up less than 5% of the gross assessable income of the relevant trust in the stapled group).

For this purpose, the definition of a stapled group and the exemption for cross staple rental payments funded by rent from third parties remain broadly unchanged from the original ED.

The main changes to the rules dealing with cross staple arrangements are:

- The exclusion for de minimis cross staple dealings has been amended as follows:
  - The test will continue to be calculated by reference to the prior year's income except where the trust was not a MIT or did not exist in the prior year. In this case, the test is calculated by reference to a reasonable estimate of the relevant amounts based on the current year.
  - The numerator in the calculation (i.e. income from cross staple arrangements of the relevant trust) now excludes interest and Australian real property capital gains.
- Capital gains made by a MIT from sales of Australian real property assets to a stapled operating entity will not be considered cross staple arrangements and therefore will continue to be eligible for the concessional 15% MIT WHT rate.

The current ED clarifies that the cross staple arrangement rules will apply to fund payments made on or after 1 July 2019 in respect of the 2020 income year. Transitional rules will be available for 7 years (a longer 15 year transition applies for some infrastructure assets). Details regarding the transitional rules are included in our publications dated [21 May 2018](#) (real estate) and [18 May 2018](#) (infrastructure). Note that clarification has however been provided in the revised explanatory memorandum that the renewal of a cross stapled lease arrangement should be covered by the transitional rules.

## Income from Trading Entities

As with the original ED, the revised ED proposes that a 30% WHT rate applies to income derived through all non-controlling interests in trading trusts or trading partnerships (even where less than 10%). Where however the amount derived is not subject to MIT WHT (e.g. interest and foreign source income), the 30% WHT rate will not apply.

The MIT trading entity rule will apply from 1 July 2019. Transitional protection will be available for 7 years provided that the MIT held the relevant interest before 27 March 2018.

## Income from Agricultural Land

The revised ED proposes that a 30% WHT rate apply to income of a MIT that is attributable to certain agricultural land (whether or not held by the MIT). For this purpose, agricultural land is Australian real property that:

- Is used, or could reasonably be used, for carrying on a primary production business; and
- Is held primarily for the purpose of driving rent.

The 30% WHT rate for income from agricultural land will also apply to capital gains attributable to the sale of an entity where agricultural land makes up more than 50% of the assets of that entity. This applies even where the interest held in the entity is less than 10%.

The following should be noted regarding the limitation on income from agricultural land:

- The definition of a primary production business is very broad.
- Contrary to the initial announcement by the Government, holding agricultural land will not make the MIT a trading trust. The consequence is a higher WHT rate on the income from the agricultural land. This is a positive change.
- The 30% WHT rate can apply to income in years when the land is not actually being used for a primary production business (the test is whether the land could reasonably be used for this purpose rather than how it is actually used).

The MIT agricultural land rule will apply from 1 July 2019. Transitional protection will be available for 7 years provided that the MIT held the relevant interest before 27 March 2018.

## Income from Residential Premises

The revised ED proposes that a 30% WHT rate apply to income of a MIT that is attributable to Australian residential assets. The following are excluded:

- Commercial residential premises (e.g. hotels and certain student accommodation); and
- Premises that are used to provide affordable housing.

The 30% WHT rate for income from Australian residential premises will also apply to capital gains attributable to the sale of an entity where Australian residential premises make up more than 50% of the assets of that entity. This applies even where the interest held in the entity is less than 10%.

The following should be noted regarding the limitation on income from Australian residential premises:

- Contrary to the initial Government announcement, the holding of residential premises will not result in a trust failing to qualify as a MIT. The consequence is a higher WHT rate on the income from the residential premises. This is a positive change.
- Contrary to the initial Government announcement, the holding of foreign residential premises will not be impacted by these measures.

The MIT residential premises rule will apply from 1 July 2019. Transitional protection will be available for 10 years provided that the MIT held the relevant interest before 14 September 2017 and the amount received in relation to the residential premises is received by the MIT before 1 October 2027.

## Foreign Superannuation Fund and Sovereign Immunity Measures

The foreign superannuation fund measures remain broadly the same as in the original ED (refer to our publications dated [21 May 2018](#) (real estate) and [18 May 2018](#) (infrastructure)). The main changes are as follows:

- In working out whether the superannuation fund has an interest of less than 10% in the entity, only equity interests are taken into account (including non-share equity interests). The original exposure draft also included certain debt interests.
- The revised ED now provides guidance as to what type of influence is relevant for the purpose of the test.

The superannuation fund measures apply from 1 July 2019 with a 7 year transitional period for interests held before 27 March 2018 (refer our earlier publications for further details).

The sovereign immunity measures remain broadly the same as the original ED (refer our publications dated [21 May 2018](#) (real estate) and [18 May 2018](#) (infrastructure)). The main changes are as follows:

- The definition of what entities are eligible for sovereign immunity has been clarified. Note that the rules are applied to sovereign entities on a group basis by reference to the (federal or state, where relevant) government owner of the sovereign entity (not individual entity basis).
- The test for determining whether the sovereign entity has an interest of less than 10% in the relevant entity is broadly the same as that used for superannuation funds.
- The test for determining whether the sovereign entity has “influence” over the relevant entity is broadly the same as that used for superannuation funds.
- It is now clear that the exemption will not apply to non-concessional MIT income.
- The requirement that the investment must not be held in the course of carrying on a trading business has been removed.

The sovereign immunity measures apply from the 2020 income year. There is a 7 year transitional period for sovereign entities that applied for a private ruling in respect of the investment before 27 March 2018 provided the ruling is granted and applies at any time between 27 March 2018 and 1 July 2026. This is a positive change from the prior draft which required a ruling to have been granted prior to 27 March 2018.

The market value rules in the current ED differ to the original ED in that the cost base of the asset at the relevant time set out in the transitional rules will be the higher of the original cost and market value at the relevant time.

## Thin Capitalisation

The thin capitalisation measures remain broadly the same as the original ED (refer our publications dated [21 May 2018](#) (real estate) and [18 May 2018](#) (infrastructure)). The main change is that an integrity measure has been introduced for the purposes of determining whether an investing entity has an interest of less than 10% in another entity where the investing entity holds that investment via one or more interposed entities.

The changes to the thin capitalisation rules apply from 1 July 2018 with no transitional protection.

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