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AUSTRALIA + NEW ZEALAND

28 November 2016

General Manager
Law Design Practice
The Treasury
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Dear Sir,

Improvements to the Debt and Equity Tax Rules

Chartered Accountants Australia and New Zealand (Chartered Accountants ANZ) welcomes the opportunity to make a submission on the exposure draft legislation (ED), exposure draft explanatory memorandum (DEM), and the exposure draft legislative instrument (DLI) released on 10 October 2016 on the changes to the integrity provisions in the debt and equity tax rules in the *Income Tax Assessment Act 1997* (ITAA 1997).

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We have set out detailed comments on the draft materials in the submission attached. A summary of our comments is set out below.

Executive Summary

The key points in this submission are:

- We are supportive of the proposed legislative design and in particular the use of a Legislative Instrument (LI) to provide practical examples.
- Once the aggregation rules do operate it appears to be assumed that the legislative provisions are straight forward and self-executing in respect of the combined scheme. More thought and guidance is needed around this assumption.
- Should the current transitional rule remain unchanged, the final EM needs to give the Australian Taxation Office (ATO) and taxpayers some guidance on how this rule should be applied.
- We make a number of recommendations designed to improve a reader's understanding of the final examples to be included in the final LI.

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Should you have any queries concerning the matters discussed in our submission attached, or wish to discuss them in further detail, please contact me via email at: michael.croker@charteredaccountantsanz.com or telephone (02) 9290 5609.

Yours sincerely

Michael Croker
Tax Australia Leader

Submission on improvements to debt equity integrity rules

The structure of this submission involves commenting on the ED and DEM together, followed by commentary on each example in the DLI.

As a first overarching comment, however, we are supportive of the proposed legislative design outlined in the ED and the DLI. Having principles based integrity rules in the legislation being supplemented by practical examples in a binding legislative instrument is a positive step.

In a number of areas in our tax laws there are provisions that allude to possible regulation making powers, only for the reader of the law to find such powers have never been utilised. It would assist the reader of the debt equity provisions to be made aware that a legislative instrument does in fact exist.

We therefore recommend that the Note accompanying proposed subsection 974-155(3) ITAA 1997 and the legislative declaration power, specifically warn its reader that a legislative instrument does exist.

Our second overarching comment is that there should be more EM guidance and possibly further legislative guidance on what happens once two or more schemes are in fact aggregated. It appears to be assumed that once aggregation occurs the legislative provisions are straight forward and self-executing. However, experience suggests that uncertain and sometimes unintended consequences arise when the interaction issues are then considered.

We therefore recommend that more EM guidance and possibly further legislative guidance is needed on what happens once two or more schemes are in fact aggregated.

We consider that for each DLI example where aggregation occurs, the interaction rules need to be road tested and explained in the EM. Where interaction deficiencies in the legislation are identified the legislation needs to be amended.

1. Exposure draft legislation and exposure draft explanatory memorandum

1.1 Commencement date

The commencement date for the amendments (i.e. the earlier of Proclamation or six months after Royal Assent) is reasonable.

However, we would recommend the ATO clearly advertises to the taxpaying community the final date of commencement, thereby providing a reminder to taxpayers and advisors.

1.2 Application to schemes entered into after commencement

The DEM (paragraph 1.88) does not provide any guidance as to when a transaction is "entered into".

We recommend the final EM provide some additional guidance as to when schemes/transactions are entered into (including the impacts of the material change provisions), possibly leveraging off any pre-existing guidance on this topic – either in old EMs or ATO guidance.

1.3 Protection for reliance on 10 May 2011 announcement on proposed changes

1.3.1 There does not appear to be an actual amendment to the 'protection for discontinued announcements section' (i.e. section 170B of the ITAA 1936), based on the drafting in item 41(1) of the ED. That is:

> "Section 170B of the Income Tax Assessment Act 1936 also **applies as if** the following additional announcement were listed in the table in subsection (8)…."

In addition, there appears to be no proposed 'warning note' to be included in section 170B alerting the reader to this additional transitional provision. We are concerned that in the future this transitional protection extension may be overlooked.

We recommend the final legislation be modified so that going forward any reader of section 170B is alerted to this transitional provision.

1.3.2 Pursuant to the current drafting of this transitional rule, there is the obvious difficulty in working out how a taxpayer or the Commissioner can conclude there is retrospective protection because "the Commissioner [should have] considered it would be unreasonable for the provision to apply".

We recommend that if the current transitional rule remains unchanged, the final EM needs to give the ATO and taxpayers some guidance on how this rule should be applied.

1.4 Examples may extend or narrow operation

The wording of proposed subsection 974-155(3) of the ITAA 1997 is not entirely consistent with the comments in section 15AD of the *Acts Interpretation Act 1901* because the latter does not contain a reference to "narrowing" the operation of proposed section 974-155.

Nevertheless, we acknowledge the insertion of the additional “narrowing” criteria appears appropriate given we are dealing with an integrity provision.

Even so, the proposed subsection 974-155(3) provides that by legislative instrument the Minister may “declare examples to illustrate” the operation of subsection (1), which is all of the gateway tests, as well as examples covering paragraph (2)(a), which is the specific carve outs from the interdependence tests. The sub-section then goes on to say such examples may extend or narrow the operation of that subsection, with a note saying the examples are not exhaustive.

In our view, examples that are intended to “illustrate the operation” of a law have different ramifications to any examples that “extend or narrow the operation”.

The DEM at paragraphs 1.15 and 1.78 suggests that the current examples in the DLI will give guidance as to how the new scheme aggregation rule will apply. We infer from this that the current examples appear to be more consistent with the “illustrate the operation” concept.

We recommend that the final EM provides some commentary on whether the final examples have been drafted on the basis they are just illustrating how the provisions are to be applied, or, is there some deliberate attempt to expand or narrow the scope of the legislative wording in any of the examples.

1.5 Amendments to section 974-105

We acknowledge the changes proposed in section 974-105 of the ITAA 1997 are needed given the focus on stapled structures and the need to also deal with returns paid by entities other than just companies. We also acknowledge that the proposed section 974-105 changes are not meant to go as far as resulting in all family trust arrangements with debt interests now potentially having to consider the operation of this provision.

Nevertheless, it does mean private groups with trust and companies in their structure need to be cognisant of this change. For example, if there are debt interests into a family discretionary trust and this trust is somehow funding a related private company, interest paid on the debt interest can be denied as a deduction to the trust if it is concluded the totality of the scheme is really an equity injection into the private company.

We recommend that the final EM might need an example to highlight its possible impact (or non-impact) on this segment of the taxpaying community.

1.6 Subsection 974-155(4) – avoiding circularity

According to the DEM (paragraph 1.21), proposed subsection 974-155(4) and the note at the end of the definition of ‘scheme’ in subsection 995-1 of the ITAA 1997 has been inserted to avoid circularity. That is, the new scheme aggregation rule does not apply to schemes that have

already been aggregated under the rule. This intent is not apparent from reading subsection 974-155(4).

We recommended that subsection 974-155(4) includes a note consistent with the intent expressed in the DEM.

1.7 Subdivision 215-B

Having decided the current related scheme rules need to be removed from the debt equity provisions and replaced by these new rules, it is somewhat curious from a tax policy viewpoint to decide that the related scheme rule should be retained in Subdivision 215-B of the ITAA 1997 (non-share dividends that are unfrankable when paid by certain ADIs).

We recommend that input from the banking industry be sought on the suitability of the retention of the related scheme rules in Subdivision 215-B.

2. Exposure Draft Legislative Instrument

2.1 Part 2 example: shareholder loan

We would recommend that the wording in item 7(2) is aligned to the wording in item 7(5) so the direct linkages between the investor and the company are clear.

In the Explanation of facts at item 7(4) in the DLI it is stated: “The amount of the loan principal is proportionate to the subscription value of the ordinary shares”. It is not clear what this statement is intended to convey (albeit we acknowledge the original Board of Taxation example had similar wording).

If the facts are implying that the final quantum of the monies lent would be some mutually agreed ratio to the price of the shares, then we note the following:

i) In practice it would seem unusual for the loan agreement not to refer to this ratio which is contrary to the further facts at item 7(4).

ii) Nevertheless, assuming the loan agreement is silent, then as noted in the DEM, pursuant to the definitions of what constitutes a ‘scheme’ and an ‘arrangement’ it may well be irrelevant that the loan/share ratio is not expressly mentioned in the documented loan agreement. That is, if the general understanding of the parties was the final loan principal would be an agreed ratio to the value of the shares subscribed, then this is likely to form part of the scheme.

iii) Accordingly, the statement at item 7(4) which notes: "However, the loan agreement does not expressly refer to the ordinary shares or to their value" might be an incomplete analysis of the facts because it does not also consider an undocumented understanding that is likely to exist in practice.

iv) Ultimately, however, it becomes apparent after reading later guidance in the example (see item 12(1)(b)) that "changes to the comparative amounts of equity and debt under the 2 schemes", are unlikely to result in the aggregation rule applying. This implies that by itself, the loan/share ratio is unlikely to be a relevant fact.

Accordingly, we would recommend that the wording in the facts at item 7(4) either be deleted or modified.

We also consider that in practice, in a shareholder loan scenario, it is much more likely documentation will exist (or a mutual understanding will exist) where it is acknowledged the company is seeking to issue both debt and equity capital and the investor is seeking to provide debt and equity capital. Thus there are some linkages (albeit casual) in their conditions.

We therefore recommend that a variation of the facts be discussed in Division 2 items 12 and 13.

In this regard:

i) We presume, given the commentary in DEM paragraph 1.28, the mere fact the loan documentation, or company minutes, etc. refer to the share subscription or vice versa, this would not result in the interdependence test being satisfied. Thus, the final LI could usefully confirm the EM comments.

ii) We also consider that in practice it is much more likely there will be conditions inserted in the loan agreement such that any drawdown of monies lent is 'dependent on or linked to' the subscription of the shares. That is, the investor will naturally not want to be committed to providing shareholder lending to a company without also gaining an equity interest in the company. Indeed, even if the investor was still willing to lend money to the company without having an equity interest, we consider it is likely to be on very different terms if the investor has no equity control over the company.

iii) In this case, where any drawdowns are linked to the subscription of shares, whilst items 12 and 13 (in particular item 12(1)(c)) do not immediately suggest there might be an aggregation concern, nevertheless, it is our opinion the requirements in proposed paragraph 974-155(1)(a) may well be satisfied and, assuming paragraph (1)(b) is satisfied, the interdependence test is therefore satisfied.

iv) Moreover, there does not appear to be anything in proposed subsection 974-155(2) that would provide a carve-out in the revised fact pattern where the loan drawdown and

share subscription are linked. Whilst it might be argued all that is occurring is the debt and equity are now ‘effectively stapled’, the existing stapled security carve out does not address this fact pattern.

v) Accordingly, the final LI could then usefully comment on the design test.

vi) In our view, the factors outlined in proposed subparagraphs 974-155(1)(c)(i) and (iv) might raise adverse inferences, other paragraphs may be neutral, whilst subparagraph (1)(c)(v) would strongly point to the conclusion that the interdependency of the debt and equity funding is not designed to operate together to produce a combined economic effect.

vii) We believe the final LI could therefore conclude that the design test is unlikely to be satisfied and therefore the revised fact pattern would not cause the aggregation rules to apply.

viii) Furthermore, we also observe that not only might the drawdown of loan monies be dependent on acquiring an equity interest, but the investor may naturally wish for the loan to be repaid in the event he/she is no longer a shareholder (or at the very least have some rights to renegotiate the terms of the loan).

ix) In a fact pattern where now both the drawdown and repayment of the loan are linked to the shareholding, it is apparent from the wording in item 12(1)(c) that the DLI is not prepared to automatically conclude the aggregation rule would not apply. Given the actual wording of item 12(1)(c) we do not think this is an unreasonable starting position. We also note that based on the wording of item 13(1) it might be inferred, by analogy, that an adverse aggregation conclusion may arise.

x) However, there are important distinctions in a fact pattern where the company can repay the investor loan in accordance with any principal and interest schedule in the loan agreement, albeit subject to full repayment or re-pricing if the investor is no longer a shareholder, as compared with the specific concerns listed in item 13(1).

xi) Therefore, additional guidance could be provided in item 13 of an example of where the interdependence test may again be satisfied but the design test is not.

In summary, we recommend that additional guidance on the shareholder loan example be inserted in the final LI in Division 2 items 12 and 13.

The additional guidance would cover a variation(s) to the existing shareholder loan example likely to be encountered in practice, namely, the existence of linkages between the shareholder loan drawdown and repayment profile and the duration of the equity investment.

We also note that in the shareholder loan example the investor owns 100% of the company and thus in reality it can control the actions of the company in respect of the loan. The issue of whether this fact is, or is not, relevant is discussed below in the Part 6 example.

2.2 Part 3 example: chain of debt and equity

We observe that in the Part 2 example discussed above, the DLI includes the main example in Division 1 and then usefully includes a Division 2 section that discusses some changes to the facts in the main example. This structure is also used to some extent in the examples in Part 7 and 9, but not in the other Parts.

We recommend that each Part of the final LI should be drafted using the structure in Part 2 of the DLI.

That is, additional guidance is provided to the reader based on some changes to the facts in the main example in each Part. The guidance could cover additional facts which would not change the conclusion in the main example as well as facts that may well change the conclusion. Both the ATO and tax professionals could assist Treasury in developing further 'what if' scenarios. In this regard, our submission includes some 'what if' scenarios.

In the Part 3 example, some additional 'what if' scenarios that come to mind are as follows:

i) The Part 3 example is similar to the fact pattern in Tax Determination TD 2015/2[1] which discusses the operation of section 974-80. It is apparent from this Tax Determination that the fact the UK Holding Co has a pool of other profits out of which to pay dividends was a relevant factor in section 970-80 not applying. It is also apparent in the Compendium of comments in TD 2015/2 EC that the ATO was reluctant to express a view as to whether section 974-80 could be invoked lower down the chain at the Dutch Co level, notwithstanding it might not apply higher up the chain at the UK Holding Co level.

We therefore recommend that the final LI should comment on these matters so the reader can compare and contrast outcomes under the new regime compared with the old.

This would include the following:

- If the facts were changed and the UK Holding Co's profits were limited solely to dividends received from Dutch Co, would the new aggregation rules still not apply?
- If the facts were changed such that the UK Holding Co's share subscription into Dutch Co was funded by way of debt and it was clear that the UK Holding Co had its own sources of cash flow to repay the principal and interest, but, it is also clear that not paying dividends on the Dutch Co shares has consequences on the loan to Aus Co, what now is the outcome? In essence this variation of the facts is seeking to

[1] TD 2015/2: Income tax: will paragraph 974-80(1)(d) of the Income Tax Assessment Act 1997 be satisfied merely because a non-resident entity has chosen to invest indirectly in a debt interest issued by an Australian resident company and there is one or more equity interests interposed between the non-resident entity and the entity holding the debt interest?

highlight whether the aggregation rules must be considered at each level of the funding structure. Neither the ED nor the DLI are clear on this point. That is, is the aggregation rule applied at the Aus Co level to treat the debt as equity even though it is clear that the ultimate source of the funding is debt and it is clear that the ultimate debt can be repaid without reliance on any cash flow from Aus Co?

ii) The final LI could discuss the implications of Board papers, company minutes, tax advice, internal correspondence, funding requests etc all recognising that the share issue by Dutch Co is funding the loan to Aus Co and in reality any dividends payable by Dutch Co can only come from interest on the loan whilst ever the Dutch Co remains a special purpose company.

iii) If the shares issued by Dutch Co were cumulative redeemable preference shares with their dividend rate matching the interest on the underlying loan, would this result in the funding carve out in proposed subsection 974-155(2) no longer being available?

iv) Additional facts similar to iii) above would then allow for practical comments to be included on the application of:

- Proposed subsection 974-155(1)(b). That is, does the single aggregate scheme remain a debt interest and if so how?
- Proposed section 974-155(1)(c). That is, is the design test satisfied notwithstanding the combined economic effect of the two schemes might in fact still result in a debt interest?

2.3 Part 4 example: offshore capital raising

We refer to our earlier recommendation, namely, that the guidance in each Part could also cover additional facts which would not change the conclusion in the main example as well as facts that may well change the conclusion.

In the Part 4 example, some additional 'what if' scenarios that come to mind are as follows:

i) What happens if the facts in item 21(6) are changed such that the terms and conditions for the issue of the preference shares are in fact silent on any entitlement to dividends being subject to US Co receiving a corresponding amount of interest from Head Co on the debentures? Instead, any entitlement to dividends is left to the operation of an assumed general corporations law rule that US Co cannot pay a dividend to US investors if US Co (whose only income source is interest from Head Co) has no profits.

The intention would be to compare and contrast the outcome here with the statement on dividend payments made earlier in Part 3 item 17(2)(b). The intention is also to highlight if the convertibility of US Co's preference shares into Head Co's shares (at Head Co's discretion) together with the fact that US Co is a special purpose vehicle, is sufficient to cause aggregation.

ii) What happens if the facts in item 21(4) are changed and the option to convert into Head Co's shares is not at Head Co's discretion, but rather, at the discretion of the US

Investors when US Co does not pay a dividend?

The DLI example is based on a Board of Taxation example which indicated the preference shares are convertible into Head Co's preference shares. However, the Board of Taxation example did not say if the conversion right was held by Head Co, US Investors or both. We note in the Board of Taxation example, it was concluded that aggregation was appropriate because of the contingent nature of the dividend but the Board made no adverse inferences about convertibility.

Hence, it is considered appropriate to provide additional guidance on convertibility (particularly as conversion rights are again viewed as problematic in the next example).

Consistent with one of our overarching recommendations earlier, we recommend that for the Part 4 example, and later examples where the conclusion is reached that there should be aggregation, guidance is needed on exactly how the legislative provisions would then operate on the aggregated schemes.

We acknowledge that including this additional guidance in the final LI may be problematic having regard to the limited purpose of the instrument. However, this should not stop additional commentary being added to the final EM or possibly an accompanying ATO Law Companion Guide

2.4 Part 5 example: contra-put scheme

The impression left after reading the Part 4 and Part 5 examples plus the legislative example embedded in proposed section 974-105, is that where a head entity has the discretion to issue shares rather than having a subsidiary repay a loan, aggregation is a highly likely outcome.

We recommend that other 'what if' scenarios are needed to highlight when this may not always be problematic.

In this regard the equivalent Board of Taxation example seeks to dismiss concerns where synthetic instruments are sold by unrelated parties and comments could easily be added in the final LI to cover off this point. Consideration could also be given to an example where the head entity does have the requisite discretion to issue shares but it is far from certain this discretion would be exercised - either because the conversion rights are operative only where solvency problems emerge, or, because of the conversion pricing at commencement of the arrangement.

2.5 Part 6 example: 99/1 staple structure

In the Part 6 example, the facts at item 33(6), namely the borrowing company does not control the trustee of the trust lending the money raises the following issues:-

i) We understand it is not uncommon in a stapled structure for the stapled company to control or own the company that is the responsible entity of the stapled trust – meaning that this example would not be applicable for many stapled property groups.

ii) The equivalent Board of Taxation example did not include in its facts the requirement that the company does not control the trust.

It is true that in an earlier Board of Taxation stapled security example (the finance trust and company staple example which has now become example 9 in the DLI) it was concluded aggregation did occur and one of the negative features listed by the Board of Taxation was the fact the company could effectively control the trustee. However, it does not appear to have been a significant negative factor given it did not rate a mention when the Board of Taxation went on to discuss changes in the example to avoid aggregation.

We therefore query whether much weight should be attached to the 'control' exercisable over the lender.

iii) The 'no control' fact in this example then just raises much broader issues. For example, in every case where a subsidiary is lending money to its parent company it will clearly be the case that the borrower is controlling the lender. Whilst we recognise this fact is not totally irrelevant given the design test has, as a factor, the relationship between the parties, its mere existence should be of little concern. The other consequence of inserting the 'no control' fact in this example is that it begs the question of whether ownership and management control issues in earlier examples 1-5 (particularly example 1) are, or are not, relevant.

We recommend that the final LI needs to exclude the 'no control' fact from this particular example because we doubt it is critical to the final the conclusions.

Nevertheless, the implications of control need to be better explored in the final LI having regard to the broader issues noted above.

We also observe the Explanation of facts at item 33 seems somewhat unusual (albeit we acknowledge they are consistent with the Board of Taxation's example).

We would have thought that in most cases the stapled group, covering N Co and M Trust, will have little idea on how the investors have funded themselves. How are the legislative provisions applied in this 'what if' fact pattern? Is the inference gleaned from earlier examples that the stapled group can safely ignore any consideration of the ultimate finding source (e.g. in example 1 of the DLI it is silent on the ultimate funding source, even though in practice it is much more likely that the company in that example will know where the investor is getting his funding because it is 100% owned)?

Moreover, if for some reason the stapled group is aware of the ultimate funding, it would seem unusual in practice for the all investors to be so heavily geared at a 99:1 ratio. Indeed, under the previous section 974-80 regime, the potentially more worrying 'what if' scenario is where the ultimate external funding by investors is coming from predominantly equity not debt (or it is unknown) but the stapled group wants to allocate almost no equity to the stapled company and

most of the equity to the stapled trust having regard to the different tax profiles of company vs trust plus investor preferences for a pre-tax returns.

Later in the Part 7 example, there is also the fact at item 43(3) that the allocation of equity funding between the stapled trust and equity has been determined by reference to their respective values. However, in this Part 6 example involving the 99:1 split it is unlikely to have been determined on this basis and yet it appears to be either an irrelevant or neutral fact in the Part 6 example?

For consistency we recommend that some comment is needed in the Part 6 example.

2.6 Part 7 example: debt raised by a property trust

In the Part 7 example, the facts at item 41(4) include the assumption that Y Co has no control over the trustee of X trust.

Our earlier comments on the ‘no control’ facts in the Part 6 example are equally relevant here and we recommend the matter is addressed in the final LI.

We also observe that the example note at the end of item 49 seeks to highlight that the stapled trust has many assets so returns on the trust’s capital reflect its entire net asset position, not just the internal loan. These comments are appropriate in this example but they do raise possible implications for the earlier examples in Part 3 and 4 where the structures include single purpose entities within the group structure. This is particularly so given the adverse inference in the later Part 9 example (see Note 2 at item 68) where the entity in that example only has a single asset.

We recommend the final LI needs to consider more holistically the impacts of single purpose entities in the different examples.

2.7 Part 8 example: trust and company staple

In the Part 8 example, the facts at item 54(3) include the assumption that Q Co has no control over the trustee of P trust.

Our earlier comments on the ‘no control’ facts in the Part 6 example are equally relevant here and we recommend the matter is addressed in the final LI.

We note that in the equivalent Board of Tax example there were brief comments on the impacts of the dividend stopper condition (the DLI facts at 56(c) discuss this condition) but it is now unclear whether the DLI's conclusions on this matter are different to the Board's observations, and if so, does it ultimately make any difference.

In this regard, the DLI at 61(2) says the conditions of the external loan are linked to the internal loan because of the commitments given by Q Co. The DLI infers that without the dividend stopper condition given by Q Co, the P Trust could not have borrowed monies. Consequently, it is suggested that P Trust could not have on lent monies. Therefore, the conclusion appears to be that in substance the internal and external loans are linked because of the Q Co commitment (albeit the additional requirement of proposed sec 974-155(1)(b) that the debt becomes equity if aggregated, is ultimately not satisfied).

The Board's observations appear to assess the dividend stopper condition from a different, possibly narrower viewpoint (see footnote 13 page 33 of the Board's report). The Board appears to suggest that the external loan is not linked to any loan scheme but rather is linked to Q Co's shares because the external loan condition directly alters the economic consequences of the shares.

Whilst we acknowledge the Board's analysis is very brief and it's possible the conclusions above are not mutually exclusive, it is nevertheless confusing.

We make three recommendations in connection with this matter, namely:

- The DLI should look to resolve the confusion around the apparent 'narrower and most direct linkage' approach in the Board of Taxation report vs the apparent 'in substance and indirect linkage' approach in assessing the interdependence test.
- If the latter approach is in fact the intended tax policy objective (albeit with other tests potentially limiting its broad scope) the DLI needs to better illustrate this in other examples. For example, in the existing examples which involve single purpose entities or raise issues of one party controlling another, just how far should you take this 'in-substance' approach without resulting in the actual legal obligations between the parties becoming almost a secondary consideration?
- Include an alternate 'what if' scenario in this example so as to change the terms and conditions of the internal loan alluded to in the Note at item 59(3). That is, include the dividend stopper condition as part of the part of the internal loan conditions and discuss the ramifications. We surmise this change of facts may not alter the final conclusion but it would be useful to confirm this in the final LI.

2.8 Part 9 example: finance trust and company staple

In the Part 9 example, the facts at item 66(3) discuss S Co's influence over the Trustee Co (indeed these facts are similar to the equivalent example in the Board of Taxation report) and the inference is that S Co controls Trustee Co.

Our earlier comments on the 'no control' facts in the Part 6 example are equally relevant here and we recommend the matter is addressed in the final LI.

Nevertheless, given the facts in this DLI example are broadly consistent with the facts in the equivalent Board of Taxation example, and the Board of Taxation reached a similar conclusion that aggregation should occur, some earlier observations are worth restating and other observations on this example are warranted.

Firstly, in the Part 9 example we acknowledge S Co's ability to control the Trustee Co may well be a relevant factor. Nevertheless, for reasons noted earlier it would be concerning if much weight was ultimately placed on this fact given that control of the trustee is not an uncommon arrangement in stapled arrangements.

We also acknowledge that the facts in 66(4)(c) namely, the Trustee must have regard to the interests of S Co's shareholders and not just the interests of the Trust's unit holders, is again a relevant factor. Once again, however, we understand that this requirement would commonly occur in a stapled security structure. Indeed, the very nature of a stapled structure suggests it would be strange if the Trustee did not consider the interests of S Co's shareholders and vice versa, given the units and shares are stapled and are owned by the same persons.
The stapling agreement provisions in the Part 9 example that do appear unusual are 66(4)(d) and (e). These provisions indicate neither the unit holders nor the shareholders have any rights in any circumstances to insist on a distribution, return of capital or capital redemption. We understand that this would not be usual practice in a stapled structure. However, it is debatable whether these facts alone are sufficient to reach an aggregation conclusion in this example.

The other adverse inferences we can glean from the facts are:

- The R Trust holds only one asset being the internal loan;
- The existence of the agreement under which R Trust's rights to demand a repayment of the internal loan cannot occur without the consent of the external financiers; and possibly
- At the end of nine years (when in theory the internal loan should be repaid and the external financiers have already been repaid), the Trustee may still be precluded from demanding repayment (albeit this point is not clear).

Notwithstanding the Part 9 example is consistent with the equivalent Board of Taxation example, we recommend that this example may need some of the facts to be altered and its analysis expanded becomes it is incorporated into the final LI.