Stuck together on tax

By Barbara Drury
June 27, 2007

Got stapled securities? Then you had better get an accountant.

The taxation of capital gains and income from stapled securities is so complex it is guaranteed many investors filing their annual income tax return will get it wrong.

That is the view of Mark Rogerson, of capital gains tax software specialist, AIMS-STM, who says people may end up paying too much or too little tax. It is almost guaranteed that the amount owed will not match the amount paid.

Stapled securities involve two or more securities "stapled" together and traded as one entity. Westfield Group is the best known listed stapled security but other high profile examples include GPT, Deutsche's DB RREEF Trust, Macquarie Goodman Group, Transurban Group and Babcock & Brown Infrastructure.

A study by AIMS found investors who owned shares or units that later become part of a stapled security could end up paying significantly more capital gains tax if they sold within 12 months of stapling than they would have paid if they sold out before stapling.

A large part of the increase in capital gains tax is due to the loss of the 50 per cent discount on shares held for more than 12 months. The exact tax outcome will depend on the dates you bought and sold, and the stapling formula used by the company issuing the securities.

If you had bought your original holding before September 1985 when capital gains tax was introduced and sold before stapling, all of your capital gain would have been exempt.

The popularity of stapled securities, particularly in the listed property and infrastructure sectors, has resulted in exponential growth in recent years. There are 64 stapled securities listed on the Australian Stock Exchange, 18 of them in the top 100 companies. Tax headaches can arise because although the stapled security must be bought and sold as one unit, each underlying company or trust is treated

separately for tax purposes.

Listed property trusts must distribute 90 per cent of the income they collect from rent which is taxed in investors' hands at their marginal rate and company profits are taxed at 30 per cent before being paid out as dividends with franking credits.

This means investors receive separate payments for dividends and distributions paid on the companies and unit trusts underlying the stapled securities and these must be recorded and reported separately for tax purposes.

Rogerson says company dividends are assessed at pay date and trust distributions are assessed on the ex dividend date, that is, the first day of trade after the distribution is paid. Where this gets tricky is that most, although not all, stapled securities go ex dividend on June 26.

"Quite often a stapled security's distribution at the end of a tax year has an underlying trust distribution in one tax year and the underlying company dividend in the next year," he says.

The upshot is investors need to account for the distribution over two tax years.

Rogerson says trust distributions may include capital gains that need to be included in your tax return. This can be difficult to work out when distributions are made quarterly or half yearly and the components are not broken down. "There may also be a deferred tax component in distributions you have to take off the cost base," he says.

Tax on capital gains or losses is also treated separately for each of the underlying securities. So even though you buy and sell Westfield as a single entity, you must calculate capital gains tax by apportioning purchase costs and sale proceeds and doing the calculations on the underlying holdings of Westfield Holdings, Westfield Trust and Westfield America.

Stapled securities are bundled together according to a ratio set by the issuer. For example, a listed property group may decide to staple together one of its companies with one of its trusts in a ratio of 60:40. That is, for every $1 purchase investors receive 60 cents worth of one security and 40 cents worth of the other. By the time you decide to sell your units the apportionment ratio may be 70:30.

Some stapled securities have up to five underlying holdings, increasing the complexity. These ratios are generally published on the company's website and can vary over time, in some cases monthly.

If you have bought your units in several parcels, or received units through a dividend reinvestment plan along the way, you need to take several ratios into consideration.

And if you decide to sell only part of your holding you need to decide which parcel of units to match it with for capital gains tax purposes.

Rogerson says some groups don't give out apportionment ratios, leaving investors to work out an estimate.

Even with those who do publish ratios, it can be difficult getting them going back in time. He suggests investors talk to their accountant to ensure they have all the ratios and underlying distributions and dividends correct.

DON'T DO DOUBLE DUTY

A study by AIMS-STM has found that investors could end up paying double the amount of capital gains tax if they delay selling shares or units that later become part of a stapled security.

Say, for example, you invested $10,000 in June 2000 in each of the three Westfield securities at the time - Westfield Holdings, Westfield Trust and Westfield America Trust. In July 2004 the three were stapled together and began trading as Westfield Group.

If you sold all three on June 30, 2004, immediately before stapling you would have received a total market price of $41,956 and ended up with an assessable capital gain of $7563. However, if you had waited and sold 10 days later for the same amount, your assessable capital gain would have doubled to $15,206.

The main reason for this is that special distributions were made on the original securities to buy parcels of the other securities being stapled together at very low cost.

For example, if you held 1000 Westfied Trust units prior to stapling you would have received 280 of the new Westfield Group shares.

In addition, a special distribution of $1.01 was made on each of your Westfield Trust units to buy 280 Westfield Holdings shares and 280 Westfield America units. This is to ensure you end up with 280 stapled securities comprising equal numbers of each of the three underlying securities.

But here's the rub. Because the acquisition date of these new securities is the date of stapling, you lose the 50 per cent CGT discount for shares held longer than 12 months. So even if you bought your original Westfield units years before, a large proportion of your holding is now deemed to have been bought on the date of stapling.

This situation is not peculiar to Westfield. A similar result was found for the three Deutsche trusts stapled in October 2004, although the difference was marginal for the General Property stapling the same year.

The news is even worse for very long-term investors. If you had bought your original stake in Westfield before the introduction of CGT you would be even worse off.

Say you had purchased 1000 shares in Westfield Holdings the day before CGT was introduced on September 20, 1985. Capital reconstructions and bonus issues would have boosted your holding to 20,000 shares by June 2004. If you sold your shares on June 30, 2004 they would have been worth a massive $380,000 and tax free. But if you sold in July you would have shown an assessable capital gain of $280,000.