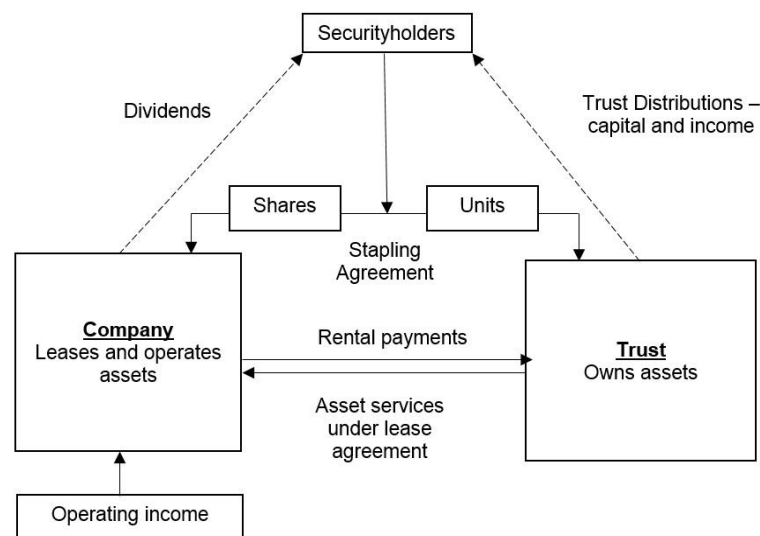


## Why Stapled Securities

Stapled Securities involve the stapling together of separate securities such as a share in a company and a unit in a trust which cannot be traded separately. This type of structure, of which there are many variants, has been used quite intensively in Australia by A-REITS (real estate investment trusts) and infrastructure funds. The major banks have also previously utilised stapling in the construction of non-innovative tier one (NIT-1) capital instruments, such as StEPS (issued by ANZ), PEARLS (CBA), SPS (Westpac) and NIS (NAB).

Stapling of securities requires some form of contractual relationship between the entities whose securities are being stapled. At the simplest level, the securities could be issued by the one entities, such as the debt security (loan note) and equity structure used in the spin-off. Another possibility is for one security, such as a preference share, to be issued by a parent company and the other, such as a loan note by a subsidiary. A third approach is for contractual operating agreements between a company and a “related” trust (or several trusts) to underpin the stapling of the securities. In that latter form, the trust might own physical assets and lease them to the company for use in generating income. As illustrated below:

**Stapled Securities: Company & Trust**



The most obvious rationale for stapling is tax arbitrage. If stapling reduced the total tax bill paid on income generated by a particular business activity, stakeholders (other than government) benefit. The above figure provides a simple illustration of how this can work. Because the trust is a “pass-through” entity for tax purposes, income it receives is not subject to company tax as long as paid out to unit holders. Consequently, lease payments by the company by the company reduce its taxable income and company tax paid, and increase the income of the trust on which company tax is not paid.<sup>1</sup>

In the case of the Australian banks, the structures were designed to reduce company tax paid to foreign governments, via tax deductibility of interest payments issued by the subsidiary. While consequently higher company tax was paid in Australia, this also generated offsetting franking (tax) credits for investors.

Other potential sources of value creation result from possible market imperfections or investor behavioural biases. Constraints on companies paying dividends when unprofitable may mean that trusts are better able to distribute available cash flow to investors. Attaching franking credits to stapled securities which are more “debt-like” may appeal to low tax rate investors who do not want increased equity exposure. Higher leverage might be possible through the use of “internal” debt provided via stapled securities without creating owner-creditor agency problems, and high pay-out ratios may reduce owner-manager agency problems by preventing managers squandering free cash flow.

<sup>1</sup> Similar effects could be achieved by the trust making a loan to the company, which buys the assets, with interest payments from the company to the trust reducing company tax paid. There are a number of complicating factors in design of such arrangements including efficient use of depreciation tax shelters. The imputation tax system used in Australia also complicates the analysis.

*Extracted from Australian Centre for Financial Studies – Why Stapled Securities June 2012*

**Disclaimer**

Past performance is not a reliable indicator of future performance. The information and any advice in this publication does not take into account your personal objectives, financial situation or needs and so you should consider its appropriateness having regard to these factors before acting on it. This article may contain material provided directly by third parties and is given in good faith and has been derived from sources believed to be reliable but has not been independently verified. It is important that your personal circumstances are taken into account before making any financial decision and we recommend you seek detailed and specific advice from a suitably qualified adviser before acting on any information or advice in this publication. Any taxation position described in this publication is general and should only be used as a guide. It does not constitute tax advice and is based on current laws and our interpretation. You should consult a registered tax agent for specific tax advice on your circumstances.