KING&WOOD MALLESONS

Level 61
Governor Phillip Tower
1 Farrer Place
Sydney NSW 2000
Australia

T +61 2 9296 2000
F +61 2 9296 3999

www.kwm.com

31 May 2018

To Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600
stapledstructures@treasury.gov.au

Dear Treasury

Comments on Exposure Draft: Treasury Laws Amendment (Stapled Structures and other Measures) Bill 2018

1 Introduction

King & Wood Mallesons welcomes the opportunity to provide our comments on the Exposure Draft *Treasury Laws Amendment (Stapled Structures and other Measures) Bill 2018* (the "**ED**").

King & Wood Mallesons acts for a wide range of participants in the types of arrangements and investments that are the subject of the Paper. While our experiences with these clients have informed our views, the views expressed in this submission are our own and are not provided on behalf of or in support of any particular client or industry groups.

Treasury should be commended on the ED particularly given the timing of the process. Whilst as a general observation, we consider that the ED provides an effective mechanism to give effect to the policy and announcements set out in the Stapled Structures Details of Integrity Package document released on 27 March 2018 ("**Integrity Package**"), there are certain modifications that could be made to clarify the application of the provisions and limit any unintended adverse consequences for taxpayers.

We have outlined below some specific observations and recommendations in relation to the drafting of the ED. We would welcome the opportunity to engage with Treasury to discuss these in more detail, and are happy to assist in preparing drafting to give effect to our recommendations.

References in this submission to the 1936 Act and the 1997 Act are to the *Income Tax Assessment Act 1936* and the *Income Tax Assessment Act 1997* respectively. References to the EM are references to the Explanatory Memorandum to the ED.

2 Executive Summary

2.1 Overview

Although we note that comments have been specifically sought on the technical aspects of the ED we consider that it is important to provide some broader observations from a policy perspective.

2.2 Residual policy concerns

As adviser to foreign investors including sovereign wealth funds and foreign pension plans, as well as Australian domestic investors including superannuation funds, we have had the opportunity to discuss the Integrity Package over recent weeks in person with many representatives of these investors and consider that there are two common themes present in these discussions:

(a) Linking the rate of withholding for *non-concessional MIT income* to the corporate tax rate will place foreign investors at a significant disadvantage as compared to Australian superannuation fund investors. As a consequence of this, foreign investors may not be able to compete in many situations with Australian investors on a pricing basis going forward or may otherwise choose to allocate their investment mandates to countries other than Australia.

Furthermore a number of domestic investors have indicated to us that they also consider that this disadvantage is not appropriate in the circumstances particularly given that there is a view that Australia's need for infrastructure investment in the coming years may not be able to be met solely by Australian investors.

Whilst we understand that the intent is to see the corporate tax rate reduced over coming years, there is considerable political uncertainty that this will occur and foreign investors should not be penalised for Australia's internal political process. As such we consider that a lower rate of withholding for *non-concessional MIT income* would be appropriate;

(b) The effect of the proposals is to retrospectively apply a change in law to the taxation of investments which are intended to be held and operated over significant periods of time. As such the 7 – 15 year transitional periods are not sufficient compensation for such material changes in law. The application of the reforms to existing structures has added to recent concerns as to the uncertainties arising due to changes in administrative approaches as well as material changes to compliance obligations (e.g. FIRB) associated with investing in Australia. This issue could easily be remedied by providing a longer transition period for existing arrangements. In particular, we do not consider it would be inconsistent with the policy which already accepts the need for a transitional period to provide a longer period for *economic infrastructure* in proportion to the term of the relevant underlying arrangement. For example in the context of privatised *economic infrastructure* a transitional period of, say, the greater of 15 years and 40% of the relevant concession or lease term could be provided, particularly where the low risk investment was encouraged by Australian governments for periods up to 99 years.

2.3 Structural and timing recommendations

Given the significance of the reforms it will be important the ED is not finalised until the exposure draft bill containing the remaining elements of the Integrity Package is also released and considered. In particular it will be important that the ED is considered in conjunction with the proposed new integrity provisions that will be required to be adhered to in order to access the transitional rules.

3 Recommended technical clarifications

From a technical perspective our main concerns (and recommendations to address these concerns) are set out below. At a high level our recommendations are designed to achieve greater certainty for regulators and taxpayers alike. They are also intended to be broadly consistent with the policy framework expressed in the Integrity Package.

KING&WOOD MALLESONS

3.1 Non-concessional MIT Income

	Technical concern	Recommendation
(a)	**Switch off of Part IVA** The Integrity Package stated that the general anti-avoidance rule in Part IVA would not apply "*with respect to the choice of a stapled structure to obtain a deduction in respect of cross staple rent during the transition period*". It appears that new section 12-453 has been drafted to achieve this outcome by providing an express choice to taxpayers, allowing them to fall within the exceptions to tax benefits provided in section 177C(2). However, this drafting may not be sufficient to achieve the objective of "switching off" the application of Part IVA in respect to the choice of a stapled structure. There is significant uncertainty relating to the existing operation of section 177C(2) - in particular the two conditions that must be satisfied to access this exception. The second of these conditions is that the scheme was not entered into for the purposes of creating the necessary state of affairs to allow access to the particular choice, election etc. There are a series of cases which highlight this being a key issue of debate and contention including *Walters v Commissioner of Taxation* (2007) 162 FCR 421, *Noza Holdings v Commissioner of Taxation* [2011] FCA 46 and *Commissioner of Taxation v Macquarie Bank Limited* (2013) 210 FCR 164 and which raise considerable doubt as to whether the particular drafting approach will achieve the necessary certainty. It is extremely important that the reforms provide clear drafting to give effect to the intention to exclude the adoption of a stapled structure from being susceptible to challenge under Part IVA where a choice for the purposes of section 12-453 has been made. This is particularly so given the ATO's public views on the application of Part IVA to stapled structures (see for example Taxpayer Alert 2017/1). The provisions also do not provide any comfort in relation to any pre or post transition period or to stapled structures outside of the transitional regime. The protection should be extended to such structures on the basis that the new regime set out in the ED comprehensively deals with the integrity concerns raised in connection with stapled structures.	Part IVA should be specifically amended to provide that the establishment and use of an Asset Entity and Operating Entity in a cross-staple arrangement the subject of the relevant election, insofar as it relates to cross-staple payments, cannot be subject to a Part IVA determination by the Commissioner. The amendment should apply to arrangements both within and outside the transitional provisions.

KING&WOOD MALLESONS

	Technical concern	Recommendation
(b)	**Treatment of capital gains on sale of properties as *non-concessional MIT income***	
	From a policy perspective capital gains made on a disposal of an asset by an *asset entity* to an *operating entity* should not be captured by the provisions given the passive nature of the holding of such assets by an *asset entity*. Furthermore such transactions are already subject to the non-arm's length income rules in Subdivision 275-L of the 1997 Act.	Section 12-440 should make it clear that capital gains made by an *asset entity* on a sale to a *non-asset entity* are not to be treated as non-concessional MIT income
(c)	**Clarification of assets included as *economic infrastructure assets***	
	Economic infrastructure assets are defined as transport, energy, communications and water infrastructure. From the ED and EM it is not clear whether *energy infrastructure* would include, for example, assets such as gas storage and processing facilities. Furthermore, in relation to the requirement that the use be for *public purposes* although the EM helpfully refers to ports that are used by the public or cargo for use or sale by the public it is not clear whether some privately owned assets including ports (e.g. where a port is owned by private sector entities for purposes of loading own product or private infrastructure is used to transport goods to that port) would fall within this. Similarly, in relation to other infrastructure assets which provide their output to, say, a single entity (e.g. government authority), which then has the responsibility of providing it to the public, it would seem the intent is to include such assets however there are no specific examples of this in the EM. There should also be the ability for the Treasurer to add items to the definition to ensure the definition is able to be more readily modified to deal with future changes	The EM should be amended to provide specific reference to *energy infrastructure* including assets such as gas storage and processing facilities. Further examples of other categories would also be helpful. A new definition of *public purposes* should be included. The definition should specifically provide that *public purposes* include dealings in, transmission of, generation or provision of services or other output directly or indirectly to persons other than parties to a *cross-staple arrangement*. The EM should also be amended to make it clear the provision of services or output to one participant is eligible where those services, output or benefit thereof is provided more broadly to the public.

KING&WOOD MALLESONS

	Technical concern	Recommendation
(d)	**Clarify concept of "asset"** The provisions apply in respect of an "asset". However, many projects or concessions will naturally expand over time with such expansion contemplated at the time such concessions or projects were established. There are also contractual requirements imposed on certain projects or concessions to continue to develop and exploit those rights or concessions under the terms of the agreements with the relevant States or other government authority. For example, in the case of some privatised infrastructure, there is a requirement that further assets relating to the project (e.g. a part) are required to be sold to the State and leased to the relevant asset trust. In some cases it may not be clear that these are composites as they are legally a new asset but required as part of the overall concession. These assets should be included within the transitional provisions. Whilst the EM contemplates a distinction between "enhancements" and "new assets" such distinction is not made clear through the drafting contained in the ED. It is therefore important to provide the necessary certainty to participants with projects that will naturally expand over time that those expansions are clearly caught within the transitional or ongoing concessional provisions. The reliance on the term "asset" for the purposes of the operative provisions itself provides some uncertainty. In particular, many arrangements are made up by a combination of assets which will naturally be added to over time. We also note that the difficulties in relying on a single concept of asset are evident in draft taxation ruling TR 2017/D1 which considered issues such as whether composite assets were single or separate assets and the effect of modifications. The draft ruling refers to comments that in many cases it will simply be left to a taxpayer to make judgement calls.	We recommend that: ▪ A concept of asset enhancement/alteration be introduced into the legislation to clarify that such enhancements and alterations are subject to the relevant concessions and do not result in any current concessions being lost; ▪ A concept of asset scope increasing being specifically included where contiguous assets or assets proximate in location are acquired by the asset trust and operated as a cohesive business; and ▪ The term asset should be defined to contemplate groups of assets that operate in an integrated manner rather than requiring a separate examination and identification of specific assets.

	Technical concern	Recommendation
(e)	**Clarify concept of *rent***	
	Going forward there will need to be greater certainty as to whether an amount paid by a non-stapled entity to a stapled entity is rent. The borderline between what is and is not rent for the purposes of the existing Division 6C of the 1936 Act is often a matter of administration by the Commissioner of Taxation. Consideration should be given to updating and clarifying what activities are eligible, to eliminate some of the uncertainty that currently exists in relation to how the provisions apply to particular investments and asset classes, including renewables, student accommodation and other land based activities. Furthermore, many major infrastructure projects contemplate that the private sector is only given licence rights to occupy the relevant premises and the narrow concept of rent could exclude some of these projects. Often licence fees are derived as part of payment streams from Government entities (such as availability and outsourcing) with these receipts being paid across staples.	Rent should be defined for the purposes of providing clarity as to whether payments from a non-stapled entity are eligible to be treated as *non non-concessional MIT payments*. For example, rent could be defined as including all income from Australian real property, even where: ▪ the relevant tangible asset may not at law constitute a fixture; or ▪ the relevant interest granted in order to generate income may not strictly constitute a lease and simply be a contractual licence. Income from these types of assets and activities is still passive investment income, even though it may not neatly fall within the relevant legal category of "rent".

3.2 Application and Transitional Provisions

	Technical concern	Recommendation
(a)	**Clarifying assets eligible for transitional relief** As referred to at 3.1(e) above, it is important that the term *asset* is clearly defined in the legislation so as to ensure that enhancements to existing assets as well as acquisition of new complementary assets are covered by the transitional provisions. Reliance on statements in the EM will not provide the necessary level of certainty for participants.	Refer recommendation 3.1(d) above.

KING&WOOD MALLESONS

	Technical concern	Recommendation
(b)	**Reference to committed v contracted** Para 9 of the Transitional Rules provides that the transitional rules may apply in two circumstances: ▪ Where there is an announcement by an Australian government agency in respect of the acquisition or creation of an asset before 27 March 2018 (and certain other conditions are satisfied); or ▪ An entity has entered into a contract before 27 March 2018 in relation to the acquisition or creation of an asset (and certain other conditions are satisfied). The Integrity Package referred to the transitional provisions applying to assets that were "made or committed" to at the time of the announcement. We consider that there may be circumstances in which entities are committed to a particular project or asset but may not have entered into a formal contract for acquisition of a particular asset. E.g. there may be binding agreements between consortium parties in relation to particular project or asset but formal contracts in relation to acquisition of an asset themselves may not be in place pending certain approvals (e.g. FIRB).	Para 9 item (2)(a) should be clarified to refer to contracts or arrangements having being entered into by one or more entities which otherwise contemplate the acquisition of or creation of one or more assets.
(c)	**Requirement to have established stapled entities as at 27 March 2018** The transitional provisions in Para 9 require that it is reasonable to conclude that all the entities that will be *stapled entities* already existed as at 27 March. We consider this is too narrow as there may be circumstances in which there are formal contracts re a particular project or asset in place or substantially negotiated positions in respect of such projects or assets with the formal creation of one or more of the stapled entities still to be effected. In practice the establishment of the legal entities is, as a matter of commercial practice, often left to the end of the process. Furthermore it would seem not to be necessary given the other conditions of Para are such that the key gating issue for the provisions is, in the case of item (1) a public decision with significant preparatory steps by an Australian government agency and in the case of (2) some form of commitment or contract in relation to the relevant asset or arrangement.	Items (1)(c) and (2)(c) at Para 9 should be amended to require that it is reasonable to conclude that as at 27 March 2018 two or more of the entities that are to be established to acquire or create the relevant assets were intended to be a stapled entity.

KING&WOOD MALLESONS

3.3 Superannuation Funds for Foreign residents

	Technical concern	Recommendation
(a)	**Participation interest should be tested at level of originator of dividend or interest payments** New section 128B(3CA) requires that the participation interest of the superannuation fund is tested in the entity from which the relevant fund *derived* the relevant income. From a policy perspective it would seem that this interest should be tested at the level of the entity that originated the payment of the interest or dividend and not at the level of the first entry point into Australia. This is because it could lead to anomalous outcomes in certain circumstances, particularly in a fund context. For example, in situations where a foreign fund might have directly made a loan to an Australian entity and have no participation interest in that entity (and absent any of the rights set out in section 128B(3CB)(b)) it would be expected that interest paid under such arrangement would be eligible for the exemption. However if the foreign fund instead invested in an Australian debt fund that made loans to Australian entities (in circumstances where the Australian debt fund did not have a participation interest in those entities), and the foreign fund held a 10% or greater interest in that Australian debt fund, then such payments would not be exempt. Similar issues arise where an Australian feeder fund is established for foreign investors into an Australian fund. Adopting such an approach will therefore create a significant disincentive for foreign pension funds to use Australian asset managers or invest into Australian assets via Australian funds.	The *participation interest* for the purpose of section 128B(3CA) should be tested at the level of the originator of the interest or dividend payment.
(b)	**Clarify that standard investor protections should not result in deemed 10% interest – debt interests** There are a number of concerns with the breadth of proposed section 128B(3CB)(b) which operates to deem a foreign superannuation fund to have a 10% interest in particular circumstances in the context of "debt interests". Firstly, the section refers to conferral of a right. This should be clarified to confirm that the section requires	Section 128B(3CC) should be modified to make clear that rights conferred that are consistent with arm's length financings are to be disregarded.

	Technical concern	Recommendation
	consideration of existing rights and not contingent or conditional rights. Secondly, we consider that the section will likely capture market standard lender protections therefore excluding foreign superannuation funds from the benefit of the exemption in circumstances that are consistent with arm's length lending arrangements. In this respect we note that in the 2011 Proposals Paper for "*Options to codify the tax treatment of sovereign investments*" ("**Sovereign Paper**") it was specifically stated that the intention of the reforms was not to capture standard "investor protections". Whilst section (3CC) provides that rights arising on the breach of a debt interest are to be ignored, there are other investor protections which are common and which may or may not relate to debt interests. For example, debt documents will often require a borrower or borrower group to obtain certain approvals from financiers for changes to certain functions or activities or in respect to disposal of material assets of the group. Debt documents will also often be modified and restrictions imposed or relaxed as part of standard commercial refinancings. These are rights or arrangements that don't necessarily follow a default or arise under the debt interest. Furthermore it should be made clear that the obtaining of protections re the operations of an entity at the outset of an investment or financing should not fall foul of section 128B(3CB).	Whilst this does not provide absolute certainty it does allow for benchmark loan transactions to be identified and used as a basis for supporting a particular financing.
(c)	**Clarify that standard investor protections should not result in deemed 10% interest – equity investments** The deeming rules as set out in the Sovereign Paper on which section 128B(3CB) is based were not intended to apply in respect of equity investments. Instead the 10% limit itself was considered to be an appropriate indicator of a passive vs non passive investment and "eliminates the need for any facts-and-circumstances considerations". The application of section 128B(3CB) (in particular subsection (b)(ii)) adds the uncertainty of the facts-and – circumstances investigation that will be required for what we consider is little benefit.	Section 128B(3CB)(b)(ii) should be removed.

	Technical concern	Recommendation
	There seems to us to be no policy reason for these provisions to be applied where a party has an economic or voting interest of less than 10 per cent. From a commercial perspective it is difficult to see what form of influence such investment could provide the foreign superannuation fund in practice where their voting and economic rights are restricted at that level. Even if the superannuation fund is allowed input in particular matters it is difficult to see why the nature of such limited input should preclude the availability of the exemption. Furthermore, in the context of many Australian funds there are standard investor protections including rights to sit on investor committees or vote on certain material matters. The fact that a minority investor who has a less than 10% interest in a fund should have those protections or rights should not automatically mean that they should be deemed to have a non-portfolio interest in the relevant fund. This is further accentuated by the issue raised at 3.3(a) where the testing is required to be undertaken at the fund level where it pays no regard to the nature of any underlying interests that the fund may have in the underlying entity that makes the payment of the relevant interest or dividends.	

3.4 Sovereign wealth funds

	Technical concern	Recommendation
(a)	**Participation interest should be tested at level of originator of dividend or interest payments** Section 880-105(1)(d) is on similar terms to section 128B(3CA). For the same reasons enunciated at 3.3(a) we recommend that participation interest be tested at the originator level.	The *participation interest* for the purpose of section 880-105(1)(d) should be tested at the level of the originator of the interest or dividend payment.
(b)	**Clarify that standard lender protections should not result in deemed 10% interest** Section 880-105(2) is on similar terms to section 128B(3CA). Again, for the same reasons enunciated at 3.3(b), we recommend that participation interest be tested at the originator level.	Section 880-105(2) should make clear that rights conferred that are consistent with arm's length financings are to be disregarded.

KING&WOOD MALLESONS

	Technical concern	Recommendation
(c)	**Clarify that standard investor protections should not result in deemed 10% interest – equity investments** Section 880-105(2) is on similar terms to section 128B(3CA). Again, for the same reasons enunciated at 3.3(c), we recommend that *participation interest* be tested at the originator level.	Section 880-105(2)(b)(ii) should be removed.
(d)	**Sovereigns from the same country should not be combined in determining level of participation interest** The combination should be limited to circumstances in which the sovereign agencies are acting in concert in relation to an investment or for a common purpose. There are a number of examples where sovereign investors from the same country may independently make a decision to invest in a certain asset or fund and the returns are used for distinct purposes of the particular sovereign country.	Section 880-1-5(d) should be amended to provide that the interests of sovereign entities are only combined where they are acting in concert.
(e)	**Clarify definition of sovereign entity** The current definition in section 880-55(2) sets out the circumstances in which an entity would satisfy the requirements to be a *sovereign entity*. However, we are concerned that this definition differs from the approach that has been adopted historically by the ATO. We are also concerned with how narrow the definition of *sovereign entity* is. In particular, we are aware of certain governmental agencies or bodies that have been established by foreign governments that may be required to manage monies for governmental purposes on a sovereign basis as well as for other purposes including for the purposes of providing pensions. In such cases, there may be some notional or other pooling of funds by the relevant governmental agency or body. While there are ordinarily overriding administrative or other fiduciary obligations imposed to ensure that the monies managed on behalf of the foreign government and for pension purposes remain clearly identified, the narrow drafting in section 880-55(2), particularly in relation to the exclusion of superannuation funds for foreign residents, may result in such arrangements previously accepted by the ATO no longer being eligible.	We recommend that consideration be given to the definition of *sovereign entity*, in particular to align more closely with how the provisions have historically been applied.

KING&WOOD MALLESONS

	Technical concern	Recommendation
(f)	**Transitional relief should not be limited to those sovereigns with private rulings** The Exposure Draft provides that the transitional provisions for sovereign entities only applies to those entities that had acquired an asset and received a private ruling on or before 27 March 2018. This can be problematic given that to date the sovereign immunity tax exemption has been reliant on ATO practice and, as a general matter, it has become more difficult to obtain a ruling from the ATO on the exemption more recently (including in circumstances where the ATO had ruled previously i.e. when applying for "refresh rulings".) Limiting the relevant assets for which a sovereign entity has a private ruling could unfairly place certain sovereigns at a disadvantage, particularly where: ▪ The ATO refused to provide a ruling pending the release of the policy announcement / draft legislation or changed its view from an earlier ruling; ▪ the ATO had communicated through other means that the sovereign immunity tax exemption would apply (e.g. provided a letter of comfort); ▪ a separate ruling was not applied for as the investment asset was similar to another investment asset which the sovereign entity have obtained a ruling for; and ▪ reallocation between funds / entities owned and controlled by the same sovereign.	The transitional provisions should apply to arrangements or assets in existence at the date of the announcement that either: ▪ had previously been subject to an ATO ruling which had lapsed; or ▪ had some other form of written comfort from the ATO; or ▪ only change in identity of legal owner of asset / investment and not beneficial ownership.
(g)	**Requirement to be a MIT** It is unclear why a sovereign should be required to invest or derive its income in Australia through a trust that is a MIT. In particular there can be significant additional costs of establishing and maintaining MITs which are not applicable to non-MITs.	Remove the requirement in section 880-105(1)(b) that where the paying entity is a trust that it be a MIT.

KING&WOOD MALLESONS

Concluding comments

We would welcome the opportunity to discuss these matter and our recommendations with Treasury and, in particular, to assist with any drafting to give effect to recommendations.

In the first instance, please contact Scott Heezen on [redacted]

Yours faithfully