CONSULTATION – TREASURY LAWS AMENDMENT (MAKING SURE FOREIGN INVESTORS PAY THEIR FAIR SHARE OF TAX AND OTHER MEASURES) BILL 2018

1. INTRODUCTION

Perpetual Corporate Trust ("PCT") thanks Treasury for the opportunity to respond to the proposals outlined in the *Treasury Laws Amendment (Making sure foreign investors pay their fair share of tax and other measures) Bill 2018* ("the Bill").

Our submission represents the views of PCT only and should not be taken to be indicative or representative of the view of the broader Perpetual Group. Our comments are provided from the perspective of PCT's role as Trustee for a portfolio of Attribution Managed Investment Trusts and Managed Investment Trusts ("MITs") that represent some $55 billion in property and infrastructure assets acquired by the Trustee, on behalf of some of the largest global institutional investors, including sovereign wealth funds and foreign pension funds.

PCT welcomes the clarification that residential housing investment and agricultural land investments can continue to be held in MIT structures, however we question whether the package of measures proposed in relation to affordable housing is sufficient in relation to facilitating the provision of long term housing security for affordable housing residents. PCT also welcomes Treasury's acknowledgement that the approved economic infrastructure exemption should be applied to a 'facility' rather than 'asset' but questions the apparent removal of the discretion to approve other than transport, energy, communications and water infrastructure as approved economic infrastructure facilities.

PCT acknowledges the importance of ensuring integrity of Australia's tax base is preserved. However, we remain concerned with the tone and substance of key provisions in the Bill, which we believe can be construed as being anti-foreign investment into certain Australian assets. In increasingly global capital markets, foreign investors will find alternative jurisdictions for their investments if Australia is perceived as being less open to foreign investment. For a nation that has historically been a net importer of capital, creating a perception that Australia is seeking to reduce foreign investment will in the long term be counterproductive for Australia's economic growth.

In this context, PCT do not endorse measures that are designed to achieve short term revenue maximisation objectives at the expense of promoting longer term economic growth prospects for Australia. We are also not in favour of measures that apply retrospectively to pre-existing arrangements, particularly where investors have committed capital that remains undeployed in existing structures prior to the publication of the initial integrity measures March 2018[1].

PCT does not support measures that introduce additional (and in some cases, complicated) administrative processes that contribute to creating a less favourable environment for foreign investment flows into Australia. In this context, having completed implementation of systems changes to accommodate for the introduction of AMITs, the changes foreshadowed in the Bill will require further systems developments to be undertaken, or cumbersome and error prone manual processes to be adopted to enable the correct tax characterisation of "fund payments".

Moreover, as outlined in our submission to Treasury's May 2018 consultation on this package of integrity measures, PCT believes that the use of emotive language that purports the "emergence

[1] In some cases that PCT has direct knowledge of, capital has been raised prior to the publication of the initial Taxpayer Alert published in January 2017

of a dual corporate tax system that taxes foreign institutional investors in land-rich industries at rates anywhere between zero and fifteen percent", whilst "other large businesses remain subject to the current top corporate tax rate", without any substantive factual evidence to support these claims is counterproductive. In PCT's view, generalisations that are not supported by an objective evidence base do not facilitate an informed and impartial policy debate, particularly as it is ***effective tax rates*** that drive investment decisions. In relation to Australian Superannuation Funds, the Association of Superannuation Funds of Australia (ASFA) has noted:

> *Superannuation funds pay 15 per cent tax on earnings for assets held in accumulation products and 0 per cent for investment earnings supporting pensions and income streams. As the Australian corporate tax rate is higher than these rates, franking credits often exceed the tax liability of superannuation funds on dividend income. As franking credits are refundable, excess credits can be used to offset tax liabilities relating to income on other assets, or be added to returns as cash*[2].

PCT suggests caution is warranted as it cannot be assumed that domestic institutional investors will step in to compensate for reduced foreign capital inflows into Australia.

PCT also does not favour the implementation of broad sweeping measures that prejudice the interests of investors due to circumstances that they may not necessarily influence or control; or deem all income to be of particular character based on an arbitrarily determined thresholds. For example, to deem all income of a head trust as 'agricultural MIT income' where it holds investments in other vehicles that hold non-agricultural land lacks appropriate foundations in fairness and equity. As an aside, PCT also notes that it is relatively straightforward to structure around these requirements through setting up discrete MITs to separate the holdings of these interests, so we question the effectiveness and policy intent of these measures.

PCT remains concerned that Treasury has not struck the appropriate tone nor balance between ensuring tax base integrity and promoting the broader economic benefits that arise through foreign capital inflow into Australia.

2. RESIDENTIAL AND AFFORDABLE HOUSING

PCT welcomes the clarification that residential housing investments can continue to be held in MITs and the prospect that MIT residential housing income received that is referable to affordable housing can be eligible for the concessional 15 percent withholding tax rate.

Whilst we appreciate that matters of broad housing policy are likely to be outside of Treasury's remit in relation to the current consultation, we believe it is a material limitation that "rent to buy" affordable housing schemes have not been considered in scope for these proposed changes. The concessions that are articulated encourage the use of residential housing stock held in MITs for affordable housing for a period of 10 years, at which time these interests can be disposed of and concessional rates of capital gains tax payable. This will not necessarily result in improved long-term housing security nor a path to home ownership for affordable housing residents.

Recognising that a single MIT can hold a diversified portfolio of interests, PCT questions the rationale for characterising the entirety of a capital gain on sale of indirect interests in a diverse portfolio of underlying assets as residential housing income of the MIT if residential premises investment accounts for more than 50 percent of the underlying exposures. PCT also requests that Treasury clarify the tax treatment for an AMIT that has been structured to offer different

[2] The Association of Superannuation Funds of Australia (ASFA) *Dividend imputation – its rationale and its impact on superannuation outcomes*, August 2015, p8

classes of membership interests, with each discrete class of interest referable to a different pool of assets, where the largest class of member interests relates to residential housing assets.

PCT welcomes the affordable housing measures included in the Bill, but believes that, to encourage long term housing security, these measures could be further extended to encourage the establishment of innovative rent to buy schemes

3. AGRICULTURAL LAND

PCT welcomes the clarification by Treasury that agricultural land can continue to be held within a MIT structure and any capital gain realised on the sale of agricultural land for rent from an asset trust to an operating entity will not be considered “non-concessional MIT income.

However, as noted in relation to indirect interests held in residential housing assets, PCT questions the rationale for deeming the entirety of a capital gain on sale of indirect interests in a diverse portfolio of underlying assets MIT agricultural income of the MIT if agricultural land held for rent represents more than 50 percent of the underlying exposures. PCT believes it is more appropriate for the character of the underlying exposures to be retained, and any capital gain realised should be able to be pro-rated across fund payment types of different character.

In addition, as noted in relation to an MIT’s ability to be eligible for the concessional withholding rate during the transitional period only where the MIT receives income or gains attributable to agriculture land held by another MIT that is 100 per cent held, PCT questions the rationale for deeming an MIT ineligible for the concessional withholding rates during the transitional period where the MIT has invested into a joint venture. PCT believes it is more appropriate for all income or gains attributed to agriculture land to be eligible for the concessional withholding rate during the transition period regardless of the percentage held by a MIT as in our experience the reason for a less than 100 percent ownership of another MIT is due to capital and or debt limitations.

4. ‘APPROVED’ ECONOMIC INFRASTRUCTURE

PCT also welcomes Treasury’s acknowledgement that the approved economic infrastructure exemption is proposed to be applied to a ‘facility’ rather than ‘asset’. However, we remain concerned in relation to:

- the apparent removal of the discretion to approve other than transport, energy, communications and water infrastructure as approved economic infrastructure facilities. PCT believes that it may be prudent to maintain the discretion to deem other facilities as ‘approved economic infrastructure’, on a case by case basis and as new national imperatives arise. For example, carbon sequestration facilities designed to combat climate change could in due course be deemed economically significant infrastructure but may not be able to be approved as such under the proposed definition.
- The Treasurer reserving the ultimate discretion to determine an ‘approved economic infrastructure facility’ recognising that the States assume significant fiscal responsibility for provision of economic infrastructure in Australia and recognising historical tensions in Federal/State relationships and the often-competing priorities between Federal and State governments in terms of promotion of economic development and achievement of State policy objectives. State Governments should reserve the right to approve infrastructure facilities as economically significant. Alternatively, the right to deem infrastructure as economically significant should be reserved to Infrastructure Australia.

PCT believes that State Governments should also be able to deem infrastructure facilities in their jurisdictions as economically significant, or that Infrastructure Australia be charged with the responsibility of assessing and approving significant economic infrastructure facilities.

PCT also believes that where a request for approval of significant economic infrastructure facility is not granted, the grounds for non-approval should be a mandatory requirement for inclusion in the notice in writing to the applicant.

5. FOREIGN SOVERIGN AND FOREIGN PENSION FUND INVESTORS

PCT notes and appreciates that Treasury had introduced the concept of a "sovereign entity group" for the purposes of establishing whether participation interests exceed the 10% threshold.

In relation to the "influence" test proposed for foreign sovereign and foreign pension fund investors, PCT requests that Treasury provide additional guidance as to the fact patterns that will constitute "influence" in this context. PCT also submits that the relevant holding and influence tests should be applied at the level of each underlying investment.

Moreover, PCT believes that the "influence test" should be modified to accommodate situations where the right to appoint a participant to an advisory board or other decision-making body is exercised through appointment of an Australian Investment Manager or specialist consultant, engaged by the Foreign Sovereign or Foreign Pension Fund to oversee their interests in Australian Investments. We believe that this approach is consistent with the policy objectives underlying the "substantial investment management in Australia" eligibility requirement for a withholding MIT.

6. TRANSITIONAL ARRANGEMENTS

PCT submits that the grandfathering period for existing arrangements be extended to include arrangements where capital has already been committed by investors prior to 28 March 2018, but has yet to be deployed, recognising that the commitment may have been based on information disclosures that were accurate at the time these were made, but are now rendered inaccurate because of the proposed changes outlined in the Bill.

Where a MIT is part way through deploying committed capital, PCT sees the scope for considerable administrative issues if there is a mix of grandfathered and non-grandfathered assets held within a single MIT and associated operational costs.

7. CONCLUSION

PCT welcomes some of the measures that are outlined in the Bill, particularly in relation to the affordable housing measures and acknowledgement that the approved economic infrastructure exemption should be applied to a 'facility' rather than 'asset'.

PCT however remains highly concerned in relation to the substantial complexity that is being injected into an already complicated set of arrangements in relation to withholding tax and the substantial cost that will be incurred by market participants to effectively operationalise these changes, particularly as fund administrators may be required to extend existing systems functionality to cater for these changes. We do not believe these operational implications have been appropriately considered by Treasury in formulating the proposals outlined in the Bill. For MIT Trustees engaged to hold assets on behalf of offshore investors, it will be particularly challenging to navigate through these changes, requiring an increase in reliance on external

expert advice and hence ongoing additional administrative costs, and risks of non-compliance given the extent of look through that will now be required in relation to underlying arrangements. From this perspective, we believe that Treasury should consider pushing back the implementation date for these measures by twelve months or adopt a facilitative compliance approach during the first year of implementation.

PCT appreciates that Treasury is mandated to ensure that all taxpayers pay their fair share of tax; but is concerned that the tone adopted in releasing these measures can be seen as anti-foreign investment. We believe that this is problematic for a net capital importing jurisdiction like Australia. The tone related signalling impacts may undermine the strategic imperative to continue to encourage foreign capital flows into productive investments to support the growth of the Australian economy. In this context, we urge Treasury to recognise the increasingly global nature of capital markets and global orientation to investment opportunities adopted by large institutional investors, as it cannot be assured that Australian institutional investors will substitute for capital flows from foreign institutional investors if the latter believe that that their capital is no longer welcome in Australia.