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SUBMISSION ON CLEAN BUILDING MANAGED INVESTMENT TRUSTS

The Property Funds Association of Australia Inc. (***PFA***) thanks you for the opportunity to provide our comments on the Federal Government's proposal to provide for a final withholding tax rate of 10 per cent on fund payments from eligible Clean Building Managed Investment Trusts (***Clean MITs***) pursuant to the exposure draft legislation, *Tax Laws Amendment (Clean Building Management Investment Trust) Bill 2012 (**the draft law**).*

The PFA is the peak body representing the Australian unlisted wholesale and retail property funds sector.

Executive summary

The PFA broadly welcomes the policy to reward and encourage foreign investment into Australia through a lower withholding tax rate for MITs that only invest in clean buildings.

However, based on our review of the draft law, the PFA has some practical concerns, namely:

- The proposed NABERS 5.5 star rating is unnecessarily tough and expensive to achieve (for example, we are aware of only two such buildings currently in Australia);
- The relative environmental impact of new builds compared to upgrades has not been considered and the PFA believes extending the law to allow for existing buildings to be eligible is more equitable and still achieves the policy intent of the draft law;
- The draft law does not provide any benefits at the time of build, as it is via tax breaks, not incentives; and
- The proposed 10% rate of withholding is not commercially compelling as foreign investors can substantially achieve the same level of returns through gearing their investments (and the rate is still higher than the previous 7.5% rate).

Comments

Based on our review of the draft law and associated Explanatory Memorandum, we make the following observations and comments:

- It appears that the proposal is trying to create stimulus for new building construction, trying to give an edge for investment in new buildings and whilst doing so ensuring that there is a 'green' angle. The PFA strongly supports initiatives around sustainability and therefore we broadly welcome the policy intention behind the draft legislation;

- In our view, the 5 star green star seems reasonable from a cost and new build perspective. Accordingly, the PFA has no further comment on this test. For completeness we note that we assume that this test requires the pre-requisite green star design and not green star as built;

- Based on our assumption that the NABERS 5.5 star threshold is Base Building Energy, the PFA is concerned that this test is overly onerous and commercially not realistic (due to the significant expense to achieve such a rating). The PFA is only aware of two such buildings in Australia (one currently in Sydney and the other in Canberra). We also assume that the investor will require a commitment agreement as you can't get a NABERS rating until occupied at a reasonable level for a full year;

- Based on our review of the draft law, we believe the relative environmental impact of new builds compared to upgrades has not been considered. New builds are many times as environmentally intensive than upgrades. Based on our internal assessment, from a cost versus environmental impact perspective, spending the same amount on upgrades is by far the better solution (and we believe, achieves the same policy outcome as currently sought to be achieved by the Government);

- The draft law does not provide any benefits at the time of build, as they are via tax breaks, not incentives;

- The definition of MIT is quite narrow and that any tax break available would not apply to many PFA members. From the PFA's perspective, therefore the proposal will not be likely to benefit our members, who are responsible for around $30 billion of property; and

- The 10% rate of withholding is not commercially compelling as foreign investors can substantially achieve the same level of returns through gearing their investments (subject to the thin capitalisation rules). We note that since the passing of *Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012* to increase the MIT withholding tax rate to 15%, the PFA has continued to receive comments from members and foreign investors around the disappointment and potential exit of investments in direct property in Australia, due to not only the increase in the MIT tax rate, but the lack of confidence in the Government's integrity to provide incentives to promote Australia as a financial services hub in Asia.

Recommendations

Having regard to our comments, above, the PFA requests that you consider the following points in developing the draft law:

- The NABERS Energy test should be at an attainable level. Energy management is more complex to deliver in a new building of a higher grade with the additional services required to provide minimum A and Premium grade services. Accordingly, the PFA recommends a 5 star NABERS Energy target for base building services would be world's best practice, is relatively attainable and still meets the policy objective of the draft law;

- To create further stimulus for jobs in the building industry the tax benefit should be extended for investment in existing buildings where the property has a refurbishment project designed to provide the 5 star NABERS Energy rating level. This would create an incentive for investment in the upgrading of existing building stock (held by existing MIT's) and associated retrofit industries, which have huge potential to reach scale and create a large number of new 'green' jobs, and increase green investment;

- A direct incentive program, arguably with some means testing, would be a much better solution. Direct incentives would drive this transformation rather than the tax incentives which as others have noted are not applicable to many of our investment structures;

- If a direct incentive scheme is not considered possible, then the withholding tax rate should be put back to 0%, or possibly 5%; and

- The overall cost of the scheme as drafted is likely to be fairly small, and given the current state of construction and property investment, and the large portion of the productive economy that it represents it warrants a larger and more widely applicable incentive scheme.

Yours sincerely,

ROBERT OLDE
National President
Property Funds Association