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By Email

Division Head
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Dear Sir / Madam

Submission on Stapled Structures Consultation Paper

We thank Treasury for the opportunity to make a submission on the March 2017 Consultation Paper on Stapled Structures (**Consultation Paper**) released on 24 March 2017.

This is a joint submission made on behalf of the following organisations:

- Land Lease Living, Caravan & Camping and Manufactured Housing Industry Association of NSW;
- Aspen Group;
- Gateway Lifestyle Group;
- Hometown America; and
- Ingenia Communities.

Executive Summary

There are approximately 70,000 people living in residential land lease communities (**RLLCs**) in Australia. Approximately 95% of these are low-income retirees on pensions. RLLC operators provide value for money, affordable housing options to Australians, and will continue to grow as an attractive housing alternative for Australia's growing pool of retirees, given the current housing affordability crisis in Australia.

RLLC businesses typically operate by way of a stapled structure. There is however no integrity risk to the revenue as a consequence of the operation of RLLC businesses via stapled structures, as RLLC Operators clearly operate two businesses capable of being operated separately, and the taxation outcomes achieved for both the active and passive businesses are consistent with Australian taxation principles for such businesses.

Any change to the tax policy applying to stapled structures is likely to adversely affect the RLLC industry.

In particular, any change to the flow-through treatment of passive income from RLLC operations will reduce the Australian RLLC sector's international competitiveness, especially when compared with the US, being the world's largest RLLC market. Such change will reduce after tax returns and therefore increase the cost of capital for RLLC operators, and thus reduce the level of investment in the RLLC sector in Australia, and adversely affect the ability of RLLC operators to continue to provide affordable housing to senior Australians.

Overall, what this means is any change to the availability of stapled structures to the RLLC sector will invariably have an adverse impact on some of our most financially vulnerable senior Australians. In this submission we have sought to provide further detail on the RLLC sector, and the potential consequences on not just the RLLC sector but more importantly over 70,000 residents that call an RLLC home.

In summary, we submit the following:

- The RLLC sector should be permitted to continue operating as stapled groups.
- Integrity measures are not required for cross staple dealings of the RLLC sector as they do not result in the conversion of trading income into passive income.
- A specific REIT regime is not required.
- Consultation must not be rushed.

Further details in relation to the above submissions are included in this paper.

1 Who we are

We are industry representatives, and some of the key players in, the RLLC industry in Australia.

RLLCs are communities where residents purchase a dwelling, and lease the land which the dwelling is located on, from a RLLC provider. The land is located in a RLLC, which are often also described as Permanent Parks, Manufactured Home Estates, and Lifestyle Communities.

1.1 Industry statistics

There are over 2,500 RLLCs and caravan parks around Australia, and of those, 1,650 are pure tourist parks, 750 are mixed use parks with tourists and permanent residents, and 170 are dedicated RLLCs for (predominately) senior Australians.

The RLLCs are targeted towards retirees aged over 55, and it is estimated that over 70,000 Australians live in RLLCs and mixed use parks, compared to 190,000 living in retirement villages.

New South Wales and Queensland contain 82% of the RLLCs within the industry.

To use NSW as an example, the NSW Fair Trading Register of land lease communities as at 31 January 2017 shows 495 RLLCs listed on the register (95% of them in rural and regional NSW), with 33,912 residents, and a total of 62,991 sites available. Permanent residents occupied 20,591 sites where the dwelling is owned by the resident, and 3,193 sites where the dwelling is rented from the park owner. An additional 13,414 sites are used by long-term casual occupants. Approximately 34,607 persons permanently live within the RLLCs in NSW alone.

Specifically, the signatories to this submission represent the following organisations:

Land Lease Living, Caravan & Camping and Manufactured Housing Industry Association of NSW

The Land Lease Living, Caravan & Camping and Manufactured Housing Industry Association of NSW represents the interests of owners and operators of caravan and holiday parks, residential land lease communities, and manufacturers of homes and cabins used in land lease communities and holiday parks. It represents over 720 businesses throughout NSW.

Aspen Group

Formed in 2001, Aspen Group is an ASX-listed property group strategically focused on providing “value for money” accommodation. The accommodation sector is considered to have positive long term structural characteristics, with an enduring customer need and effective capital utilisation. Aspen has been a leading owner and manager of holiday and accommodation parks since 2004.

Aspen currently owns 5 holiday and accommodation parks across Australia.. Aspen is seeking to expand its portfolio within the "value for money" accommodation sector.

Gateway Lifestyle Group

Gateway Lifestyle Group (**Gateway**) was formed and listed on the ASX on 15 June 2015 as an owner and operator of Manufactured Housing Estates (**MHEs**). Today Gateway owns and operates over 50 MHE parks throughout Australia, and is home to an estimated 9,000 residents.

Gateway believes in affordable and sustainable housing communities for all senior Australians.

Gateway aims to expand its portfolio of affordable housing options by acquiring new MHE parks and developing existing parks and greenfield sites, leveraging their low cost platform across more residents.

With more and more senior Australians requiring an affordable and sustainable living solution, Gateway strongly believes a stable income tax environment is critical to ensure affordability is not compromised, as any adverse impact is likely to be borne by their residents in the short term and beyond that an additional call on the already constrained welfare budget of the Commonwealth.

Hometown America

Hometown Australia Communities is headquartered in Sydney, NSW and is a subsidiary of Hometown America (www.hometownamerica.com), one of the top five owners and operators of RLLCs in the USA. Hometown formally commenced operations in Australia in August 2016, and now has two properties under management, which contain 357 approved sites. The company's goal is to grow, through acquisitions and development, into one of the top owners of residential land-lease communities in Australia.

Founded in 1997, Hometown America is a privately held company that owns and operates residential land-lease communities across the USA. Today, the company owns and operates more than 55 communities in ten states containing over 23,000 homes. Hometown's properties are known for their quality amenities, professional on-site management, and the affordable lifestyle they provide for residents. Hometown's residents enjoy an inspiring lifestyle, a welcoming and friendly environment, and Hometown's dedication to providing a higher standard of living

Ingenia Communities

Ingenia Communities is a leading Australian property group that is listed on the ASX and owns, operates and develops a growing portfolio of lifestyle communities across key urban and coastal markets. With a market capitalisation of over $500 million and supported by over 4,000 investors, Ingenia Communities has a portfolio of 62 communities located in NSW, Queensland, Victoria, Tasmania and WA. Over 4,100 residents reside in over 3,250 homes in these communities.

2 Removal of stapled structure efficiencies will increase the cost of capital, and reduce the level of investment, in the RLLC industry in Australia, impacting the ability to provide affordable housing

Question 13: If tax laws are amended to remove the tax advantages of stapled arrangements, what impact do you consider this would have on the Australian economy, including the cost of capital, level of investment and price of assets? Please include any supporting evidence

It is crucial that the RLLC sector is permitted to continue operating as stapled groups. Stapling allows RLLC operators to be internally managed and run an integrated business platform. Any move away from allowing stapled structures in the RLLC industry without some other change to the law to allow income from site rentals to be treated as passive income will inappropriately increase tax costs in Australia. This will result in an increase in the cost of capital and level of investment in Australia.

Given some RLLC operators fall within the MIT regime, removing the benefits of stapling will have a clear negative impact for the industry to attract offshore investment. Even though there is increasing consumer and market awareness for this sector, the Australian RLLC market is still at an infantile stage and relies heavily on local and overseas investment to fund growth. RLLC operators are also looking to the US to leverage industry know-how as the RLLC market in the US is mature. Any changes with increased tax costs to RLLC operators or less attractive withholding tax arrangements for offshore investors will impact on sector growth.

In the event that cross staple payments and receipts are not deductible or become assessable, operators will either be faced with a larger tax bill or costs of re-organisation/restructure. For instance, debt facilities may need to be re-arranged such that each of the stapled entities is a named borrower to the facility rather than having just the land-owning stapled entity being the named borrower (see section 3 below for details on the typical use of a stapled structure in the RLLC industry). Not only will this involve costs that would otherwise be used to fund operations and development, the cost of funding may increase depending on how banks assess the credit profile of the stapled entities.

Sectoral impacts

Question 15: Are there any specific sectoral impacts that should be considered?

2.1 Affordable housing

Any changes to the treatment of RLLC site rental income will result in the higher tax and investment costs being passed on to aged residents who are typically from a low socio-economic background.

Australia's growing pool of retirees is living longer. For people aged 65-69, some 70% have less than $100k in accumulated superannuation. For many retirees, the sole source of accumulated wealth is ownership of the family home. 50% of Australians have less than approximately $470k in total equity. Typically, those retirees who are looking to downsize and free up equity, will only be able to free up equity of between $60-120k. They typically cannot afford a retirement village villa or unit in their desired location.

Releasing equity while retaining pension and rental assistance from government is increasingly attractive and for some, the only viable option. RLLCs are becoming increasing popular as an affordable housing option as they allow retirees the conversion of home equity into a comfortable retirement in a community setting.

Currently, site lease payments average circa $140-$180 per week. After rental assistance, the rent works out at less than 20% of the pension. The rental covers the cost of management and maintenance of the community.

2.2 Sectoral impacts which should be considered

Whilst it is difficult to quantify any negative impact from any proposed changes as a result of the government's review of stapled structures, the RLLC industry is wary that the tax costs of operations will increase whether as an intended or unintended consequence of any changes arising from this review; and the industry's ability to attract investment either onshore or offshore will be affected.

To the extent changes are made without a complete review of the meaning of passive income for the purposes of Division 6C, there is a real risk that MHE operators with a stapled structure will have to pay more tax, for example, as a result of cross staple lease payments being made non-deductible. Increased tax costs will be, at least partly, passed on to residents.

As noted above, site lease payments currently average $140-$180 per week. If the tax cost of any amendments to the tax concessions available to RLLC providers were to be passed on in full, it represents an increase of up to $54 per week in site lease, which some retirees will need to fund out of their pension payment. This represents approximately 14% of the maximum basic rate of pension for singles, or 9% of the

maximum pension payable to a couple. This is a significant portion of the aged pension and could render RLLC living unaffordable for some pensioners.

3 Use of Stapled Structures in the RLLC Industry

3.1 Income generating activities of RLLCs

RLLC providers provide budget accommodation in residential parks to low income retirees in the over 50's demographic in Australia, effectively by separating land ownership from house ownership. RLLCs are targeted at the over 50s age group.

Permanent residents of RLLCs purchase and own a manufactured home, and enter into a Residential Site Agreement (**RSA**) with the RLLC operator to lease the dwelling site upon which the home is located. The fee payable under the RSA for site rental covers the costs associated with the day to day operation and management of the RLLC, and the use of the community facilities.

A manufactured home is a self-contained dwelling that is either built or packaged off-site and then transported to the estate for installation. This includes any associated structures that form part of the dwelling. It is a chattel, not a fixture, although it is usually not a moveable dwelling.

The land and community facilities continue to be owned by the land owner, who operates the residential park or leases it to a manager.

RLLCs are regulated by state legislation, and generally provide retirees with a long-term affordable housing option.

3.2 "Active" and "passive" businesses of RLLC Sector

Similar to real estate investment trusts (**REITs**), the RLLC sector operates two businesses which are combined, but are capable of being operated entirely independently. The two businesses consist of an "active" business and a "passive" business:

- the "active" business consists of
  - deriving income from building and selling manufactured homes; and
  - deriving service income from residents for operating the RLLCs; and
- the "passive" business consists of deriving rental income from the leasing of land on which dwellings are located to residents.

The use of stapled structures within the RLLC sector, to separate the active business and the passive business, does not result in a conversion of trading income into passive income, and is not the subject of the integrity risks which are identified in the Consultation Paper, for reasons explained below.

3.3 Income tax treatment of RLLC Sector income

Stapled structures are used within the RLLC sector as a result of consultation with the Australian Taxation Office (**ATO**). The ATO has previously expressed the view that it does not accept that a payment received under an RSA would be accepted as "rent" income, on the basis that the fees received under the RSAs are not purely related to site rental.

As a result, if a landowning trust enters into RSAs directly with residents, it would be treated as a trading trust for the purposes of Division 6C of the *Income Tax Assessment Act 1936*. The income earned by the trust, which includes passive rental income from residents, would be deemed to be active income assessable at the corporate tax rate in the event that the trust is a public trust.

It is clear that the income streams earned under an RSA can be distinguished, such that it would be possible for residential parks to have two separate businesses operated by two third parties, that is:

- a landowner deriving passive rental income; and

- an RLLC operator earning active income from operating the residential park.

During the Private Binding Ruling request process, the ATO stated that it would only consider Division 6C not to be breached where:

- a trust and its sub-trusts own land only;
- a trust and its sub-trusts lease the land to an operator company and/or its wholly owned subsidiaries under a normal lease agreement; and
- the operator company and/or its wholly owned subsidiaries enter into the RSAs with residents, and operate the residential parks.

On 6 November 2014, the Commissioner of Taxation issued Private Binding Ruling 1012722925808 (the **PBR**) consistent with this view.

Due to this view, stapled structures have become more prevalent in the RLLC industry. However, unlike other industries referred to in the Consultation Paper, the use of stapled structures in the RLLC industry is designed to retain the “passive” status of income from providing land to residents/ occupiers, as well as to “aggregate” the active businesses of developing and selling homes and providing services with that passive business.

4 International competitiveness

Question 5: How important is tax in determining the international competitiveness of Australia as a foreign investment location for assets and activities typically placed in stapled structures?

4.1 Comparison to taxation of RLLC Operators in the US

The US MHE market is the largest, and longest-standing, in the world, and for those reasons provides the best comparison.

(a) US RLLC operators qualify as US REITs

There are a number of US RLLC operators which are structured as US real estate investment trusts (**REITs**). The largest listed RLLC REITs in the US include:

- Sun Communities Inc, which owns over 250 communities with approximately 93,000 sites; and
- Equity Lifestyle Properties Inc, which owns over 380 communities with approximately 143,000 sites; and
- UMH Properties Inc.

Broadly, the US REIT regime allows shareholders of qualifying REITs to access concessional tax treatment. In order for an entity to qualify as a REIT, it is important that the entity predominantly invests in assets which fall within the definition of “real property”. For the purposes of the REIT rules, the definition of “real property” and “real estate assets” includes mobile home units installed in a planned community.

Accordingly, RLLC operators are able to access the tax concessions available under the US REIT regime.

(b) Comparative tax treatment of US RLLC operators and Australian RLLC operators

We note that the current taxation treatment of RLLC operators in Australia under the Stapled Group structure, is in substance the same as the taxation treatment of US RLLC operators that elect into the REIT regime.

The below table provides a high level summary of the taxation treatment of different streams of income from a RLLC operator in the hands of each relevant stakeholder, under both systems.

Stakeholder	Rental/ passive income	Active income	Retained income
RLLC operator	Tax exempt/ flow-through status	Corporate tax	Corporate tax
Domestic investors (individuals)	Individual tax rate	Individual tax rate	N/A
Foreign investors (individuals)	Withholding tax (generally, 30%, or 15% for distributions to investor in country with a valid tax treaty)	Australia: No withholding tax unless unfranked (generally, 30%, or 15% for distributions to investor in country with a valid tax treaty) US: Withholding tax (generally, 30%, or 15% for distributions to investor in country with a valid tax treaty)	N/A

The substantive impact the taxation treatment under both the US and Australian regimes is that:

- Income from the "active" business, as described above, is subject to the corporate tax rate;
- Income from the "passive" business, as described above, is subject to flow through taxation treatment, and non-resident investors are able to access the concessional withholding tax rate of 15%.

If stapled structures are removed in Australia, without being replaced by a regime allowing equivalent concessional taxation treatment of passive income derived by RLLC operators, Australia's RLLC sector would become uncompetitive with the US.

We submit however that Government should resist replacing the current taxation regime for AMITs with a new REIT type regime in Australia. The AMIT rules are already a world class tax regime for collective investment vehicles and the rules have only just been implemented after many years of consultation between industry, Treasury and the ATO. Adopting a REIT regime will likely add complexity and trigger considerable restructuring and financing obligations with no additional tax integrity benefits.

4.2 Importance of tax in choosing to invest in Australia

Tax plays an important role in attracting investment capital in order to fund the acquisition and development of RLLCs. In the case of the RLLC operators listed on the ASX, the ability to provide flow-through tax treatment and access to the MIT regime is key in attracting overseas equity capital.

For foreign groups looking to establish a business of developing, owning and operating RLLC, unless Australia is competitive with other jurisdictions in respect of the way it taxes returns from RLLCs, those groups will establish RLLC businesses elsewhere.

Without overseas equity capital, the growth of the RLLC sector would be greatly hindered, thus impacting the ability to provide affordable housing to senior Australians.

We understand the policy concerns raised in the Consultation Paper and support a targeted solution. This cannot be rushed however and Treasury needs to work with industry and the ATO to address the integrity concerns in the Consultation Paper while preserving the longstanding tax arrangements that currently apply to the RLLC sector that have been widely adopted and relied upon by sponsors and the broad investor community.

Yours sincerely

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