THE TAX INSTITUTE

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Mr Robert Raether
Division Head
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: stapledstructures@treasury.gov.au

Dear Mr Raether,

Stapled Structures

The Tax Institute welcomes the review of stapled structures and the opportunity to make a submission to the Treasury in relation to the *Stapled Structures Consultation Paper* (**Consultation Paper**). The Tax Institute is supportive of Treasury undertaking this review. We hope that the review achieves the outcome of providing certainty for the tax treatment of stapled structures which are critical to attracting investment, in particular foreign investment, into vital infrastructure.

Summary

The Tax Institute regards the review of stapled structures as a priority activity given the uncertain circumstances that currently surround the tax treatment of stapled structures. The Australian Taxation Office has formed the view that there may be a growing incidence of arrangements that endeavour to re-characterise trading income as passive income in order to attract concessional tax treatment thereby raising questions about the tax treatment of stapled structures. However, the intended policy setting in relation to the taxation of passive income derived in conjunction with trading income is as yet unclear and should be clearly articulated before changes are made to the applicable tax rules.

Appropriate incentives need to be in place in the Australian tax system to ensure Australia can attract sufficient capital investment for vital infrastructure. Given the size of infrastructure projects and that the Australian Government has only committed $50 billion over the 2013-14 to 2019-20 period towards current and future investment in

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public infrastructure[1], foreign investment is needed. Consequently, should the Government determine that the tax treatment of stapled structures should change, it is our view that it is critical that the current concessional rules are grandfathered for existing stapled structures.

Discussion

1. **Treasury review of stapled structures**

It is important that Treasury's review of stapled structures occurs in a timely manner. The tax treatment of stapled structures is currently in a state of flux given the Australian Taxation Office (**ATO**) recently issued *Taxpayer Alert TA 2017/1 Re-characterisation of income from trading businesses* (**TA 2017/1**) and the *Privatisation and Infrastructure – Australian Federal Tax Framework* draft document (**Draft Framework**) at the same time that Treasury is undertaking this review. The numerous reviews concurrently surrounding the tax treatment of stapled structures creates difficult circumstances for investors considering investing in these types of structures, as the potential tax outcomes have become uncertain.

The risk of a reduction in public confidence in the operation and administration of the tax system is also increased with these types of investments, given the underlying assets were often previously publicly owned, the tax rules that apply to them once privately owned are complex (and evidently uncertain) and many tax arrangements and outcomes are subject to negotiations with the ATO before they can be implemented. These factors heighten the need for a clearly articulated policy setting and legislative response in relation to these investments.

The four-week time frame to consider such a complex matter is arguably far too short and therefore prevents thorough consultation from occurring. In our view there are a number of aspects in this review that will benefit from further and more thorough consultation.

We appreciate that a balance needs to be achieved between giving enough time to consultation on this important and complex area and resolving the current state of flux. Accordingly, we recommend that this review be treated as a priority.

2. **Background**

Stapled structures are structures which have been in use in Australia for the last thirty years or so[2]. It is widely acknowledged that they are structures which offer certain tax advantages to certain investors when compared with the use of a company structure for the same type of investment. Aside from this, there are also commercial reasons

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[1] Refer to p1 of Austrade's *Investment opportunities in Australian Infrastructure* document (Dec 2016) (https://www.austrade.gov.au/International/Invest/Opportunities/Major-infrastructure)
[2] Refer to the 'History of Stapled Securities' in the Consultation Paper at p4

why these structures are adopted[3]. We understand, for example, that these structures allow lenders to provide finance against pre-tax cash flows which may not be available when a corporate structure is used.

Over the time that stapled structures have been in use in Australia, certain amendments to the tax law have been made to support these structures. Examples include the introduction of a 15% withholding rate in the Managed Investment Trust (**MIT**) regime and Division 6C of Part III of the *Income Tax Assessment Act 1936* (Cth) (**1936 Act**) being revised with the inclusion of section 102MB in 2008. As a result of these amendments, stapled structures have become a common feature of the tax and investment landscape in Australia.

The Tax Institute acknowledges that the use of stapled structures in recent years has led to a response from the ATO to increase compliance work in relation to these structures, evidenced by the recent issue of TA 2017/1. In particular, we understand the ATO has formed a view that there is a growing incidence of endeavours to re-characterise trading income to passive income in order to attract concessional tax treatment.

Australia has recently gone through an extensive review of the taxation of MITs. This began in 2006 when reduced withholding rates were introduced for distributions from MITs, primarily to attract foreign investment into Australia, and has culminated in the recent introduction of the attribution rules for MITs. We are unclear what has subsequently occurred to prompt the Government to now want to curtail these concessions by addressing the taxation of stapled structures, other than perhaps the emergence of the ATO's concern there may be a growing incidence of arrangements that re-characterise trading income as passive income.

Potential changes to the taxation of stapled structures (for example removing the availability of tax concessions) may well undo some of the changes that have been made to the MIT regime, which, we note, took a significant amount of effort to achieve. For example, the introduction of the arm's length rule into the MIT regime should go some way to address the ATO's concerns around the re-characterisation of trading income as passive income.

Stapled structures are used in a variety of industries and for a variety of purposes. They are also a useful tool to attract foreign investment into Australia. Should the Government decide to remove the tax concessions for stapled structures, it risks deterring foreign investors from investing in Australia due to the exposure to the high Australian corporate tax rate.

Given that Australia is a 'capital importer', it is important that these types of tools are available to ensure capital continues to be attracted to Australia. If they are not made available, then other incentives will be required to ensure that Australia remains

[3] Refer to page 6 of the Consultation Paper

internationally competitive (for example having a corporate tax rate that is comparable to international competitors).

If it is considered that existing provisions are incapable of addressing recent concerns, then the introduction of specific anti-avoidance rules may be appropriate. In our view, any further changes that the Government determines should be made to the tax-related legislative framework for stapled structures should be very carefully considered and subject to further consultation.

3. Policy Setting

The Tax Institute is unclear what the policy setting is that Treasury is trying to achieve. For example, it is unclear in the Consultation Paper whether the policy intention is to remove all tax advantages of stapled arrangements or only targeted ones. Once the policy setting is established, this should be applied consistently across all circumstances involving stapled structures. Subsequently, a number of the issues raised by Treasury in the Consultation Paper will then be able to be addressed more completely.

As a starting point, it would be helpful to clearly articulate the intended policy setting in relation to passive income derived from land assets, for example whether taxation on a flow-through basis is or is not acceptable. Assuming that it is, a clear articulation of what is and is not acceptable in relation to activities / arrangements involving both passive and active income should also be provided. By way of example, the Consultation Paper's focus on arrangements that separate passive assets from an active business would seem to imply that the organic aggregation of businesses deriving active income with businesses deriving passive income is acceptable, although this is not clear.

4. Specific questions in the Consultation Paper

Below we provide our views in relation to specific issues raised in the Consultation Paper.

a) Importance of tax concessions (refer to Questions 5, 13, 14, 15)

The tax attributes of stapled structures are a relevant consideration when choosing this kind of structure. Removing the concessional tax treatment from these kinds of structures will result in ordinary tax rates applying, namely Australia's 30% corporate tax rate[4]. Given this rate is above the rate of most OECD members (which averages to just under 25%[5]), this would leave Australia in an uncompetitive position and less able to attract capital investment.

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[4] Most stapled structures are sufficiently large that the lower corporate tax rates contained in the *Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016* are unlikely to be available.
[5] http://stats.oecd.org//Index.aspx?QueryId=58204

In addition, we note that stapled structures are not commonly used in other jurisdictions. While we cannot be certain of the reasons for this, we suggest that it might be associated with the fact that other jurisdictions have a lower corporate tax rate than Australia and therefore there may be less impetus to rely on tax-preferred structures such as trusts. Given the high corporate rate in Australia, there is more inclination for investors to utilise tax-advantaged structures.

In the event the Government removes the tax concessions for stapled structures and introduces alternative measures, for example adjusting the safe harbours available in sections 102MB and 102MC of Division 6C of the 1936 Act and allowing for a higher percentage of trading business to be carried out by trusts subject to flow through taxation under Division 6 of Part III of the 1936 Act, we query whether this will simply result in the same concern arising for the ATO. If adjusting the safe harbour percentages is just to mitigate the removal of the tax concessions, this may likely result in the same apparent problem of re-characterisation of income continuing.

b) Appropriate mechanism to remove the tax advantages of stapled structures (refer to Question 6)

We refer to the three options set out in the Consultation Paper under the heading *Dealings between Stapled Entities* on p14 to remove the tax advantages.

Given there is insufficient time to thoroughly consider each option noted in the Consultation Paper to unravel the tax concessions provided for stapled structures in the tax system, we suggest that Treasury separately consult on this matter thoroughly, when time permits.

It would be useful to know from Treasury the desired policy setting and which tax advantages are under consideration to be removed or whether all tax advantages are under consideration. There are also a number of other issues to consider before being able to determine what might be the appropriate mechanism to remove the tax advantages. For example, the effectiveness of the arm's length rule in the MIT regime and the definition of 'land' (for example, should 'fixtures' be excluded?) for the purpose of Division 6C.

This all depends on what the intended policy setting is for the tax treatment of stapled securities. Accordingly, until this is known, it is difficult to provide further information at this stage.

c) Potential exclusions and concessions (refer to Questions 8, 11 and 12)

It is critical that the tax concession treatment provided for stapled structures be preserved for certain structures, including structures involving critical infrastructure assets that are vital to the community.

Treasury should also consider other concessions to incentivise investment into key infrastructure in Australia.

d) Implementation of a specific REIT regime? (refer to Questions 9 and 10)

Australia already has in place a policy setting for the taxation of real estate investment trusts (**REIT**) that provides clearer rules on what constitutes a transparent structure for investing in real property for taxation purposes. Whether any changes are required to the current REIT regime depends on the intended policy setting for the tax treatment of stapled securities and passive activities with a relationship to trading businesses.

Should the Government determine that the rules for transparent structures should be reviewed, Treasury could consider implementing a REIT regime similar to those of other countries.

e) Implementation and transitional issues (refer to Questions 18, 19 and 20)

Grandfathering

The Tax Institute strongly supports grandfathering of the existing rules pertaining to the tax treatment of stapled structures.

If the existing rules are grandfathered, the grandfathered rules should not apply to newly acquired assets by existing structures. This would ensure there is no retrospective impact on existing structures from any new law that is implemented and there is a level playing field going forward for all new acquisitions made through stapled structures.

Alternative - Transitional arrangements

If transitional arrangements are chosen rather than grandfathering, then a suitable transitional period should be permitted for as long as possible. For example, Treasury should consider allowing at 10-year transitional period given that investments through stapled structures typically run for lengthy periods. An alternative may be to align the transitional period to the remaining effective life of the assets in the stapled structure.

Various concessions should be made available to affected taxpayers who want to change their existing structures to comply with the new law rather than remain in an unfavourable tax position. For example, a CGT rollover for any CGT disposals occurring as a result of restructuring to comply with the new rules. Duty concessions (or an exemption) should also be made available for existing structures that choose to transfer assets to meet the new income tax rules.

In addition, there will be implications for State government entities that were planning to privatise certain assets. Under the current rules, the State government entities that have already privatised assets will be significantly advantaged compared to State government entities that privatise assets following the removal of the benefits of stapled structures (if this occurs).

Further, the implications for certain structures where private rulings have been sought from the ATO to confirm the tax treatment may need to be reviewed.

If you would like to discuss any of the above, please contact either myself or Tax Counsel, Stephanie Caredes, on 02 8223 0059.

Yours sincerely

Matthew Pawson
President