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Committee Secretariat
Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Committee Secretariat

Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015 and related bills

Thank you for the opportunity to provide a submission to the Senate Economics Legislation Committee's inquiry into the *Tax Laws Amendment (New Tax System for Managed Investment Trusts) Bill 2015* and related bills (**the MIT bills**).

The Property Council is the peak body representing the interests of owners and investors in Australia's $670 billion property investment industry. The Property Council represents members across all four quadrants of property investment, debt, equity, public and private.

The property industry is critical to underpinning the retirement savings and economic prosperity of Australians. The industry represents 11.5% of Australia's GDP and employs 1.1 million Australians, more than mining and manufacturing combined.

Industry strongly supports the introduction of a new tax regime for Managed Investment Trusts (**MITs**), and urges Parliament to pass the MIT bills as currently drafted.

The MIT reforms are critical to ensuring Australia has a robust and globally competitive tax regime for property trusts.

Property MITs are collective investment vehicles which provide investors the opportunity to:

- invest in large scale real estate assets they could not own directly;
- diversity their investment portfolio to reduce the risk from market down turns; and
- benefit from the market experience and insights of professional fund managers.

The introduction of a MIT regime presents an opportunity to cement Australia as a top tier destination for global real estate investment capital.

The industry currently operates under rules that were designed long before MITs ever existed and they create an unreasonable level of complexity and uncertainty for a key industry that drives the Australian economy.

The reforms will provide certainty to industry and help attract patient long term capital that Australia needs to build prosperity.

During the second reading debate on the MIT bills, the Hon. Dr. Andrew Leigh MP mentioned two potential technical issues that he wanted to explore relating to the multi-class and attribution/withholding tax rules.

Industry draws considerable comfort from the fact that the operation of both the multi-class and attribution/withholding tax rules were extensively discussed with Government, Treasury, ATO, industry and stakeholders during the development of the MIT bills.

On the specific issues raised by Dr Leigh, Treasury and Government designed the provisions, in consultation with the ATO and industry, to ensure the rules operate appropriately.

Industry is confident to endorse the rules as introduced into Parliament without further changes.

Specifically, the discussions on the operation of the multi-class rules determined that there is no material risk of misapplication of the rules because the ATO will apply the general anti-avoidance rules where there is no legitimate non-tax reason for setting up a multi-class MIT. This is backed by the proposed ATO ongoing monitoring of the rules and an extensive new framework of FIRB rules that will flag any anti-avoidance.

In relation to the operation of attribution and withholding tax rules, Treasury and Government, in consultation with the ATO and industry, concluded that the withholding tax mechanism in the MIT bills is the most appropriate way to ensure the right tax is paid by the right investors without unnecessarily penalising the attribution MIT (**AMIT**) or other investors because:

- attribution of the AMIT's taxable income to investors ensures the investors are responsible for paying tax on their share of the AMIT's income;
- in all but exceptional circumstances, the investor will have sufficient cash distributions to pay the tax; and
- in the unlikely scenario where the cash distribution is less than the tax payable, the investor will pay the difference. Custodians are also statutorily indemnified under the bill from any cash shortfall by international investors (and will likely also have a contractual indemnity from the relevant investor).

We have provided further background on both these issues in the Appendix.

We recommend that all sides of politics maintain support for the MIT reforms as currently introduced into Parliament.

In the circumstances and given the tight timetable, we recommend the MIT bills proceed as is, and we revisit whether any concerns arise in the years following the rules taking effect.

We strongly support Treasury's proposal to monitor the MIT reforms post-implementation, and will work with Treasury to resolve any unforeseen circumstances. We envisage that the ATO will play an important role in monitoring the situation post-implementation.

As always, industry is keen to work with all sides of politics to ensure concerns are allayed and the rules are implemented on the current MIT timetable.

We are available to discuss our submission and any feedback at your earliest convenience.

Please contact Belinda Ngo (02 9033 1929) or myself (02 9033 1944).

Yours sincerely

Andrew Mihno
Executive Director, International and Capital Markets

APPENDIX

1. Multi-class provisions

The need for the MIT regime to deal with multi-class MITs was raised in the Board of Taxation Report of August 2009 (*Review of the Taxation Arrangements Applying to Managed Investment Trusts)*.

In that report it was noted that:

> "*Feedback from stakeholders and written submissions have confirmed to the Board that requiring a single class of units would ignore* ***the commercial reality for many MITs where multiple classes are seen as necessary to attract investment in units****.*
>
> *The Board recognises that substantial compliance costs and other taxation consequences would be faced by many existing MITs if they were required to restructure to a single class of units in order to benefit from the new regime. At the same time, the Board recognises that maintaining a structure with multiple classes of unit holders does, and will continue to, impose compliance costs on MITs when making distributions. However, this reflects a decision by the MIT made against the background of the commercial operation of the industry.*
>
> ***The Board considers that the MIT regime should not hinder genuine commercial decisions by MITs to issue different classes of units.****"* *(emphasis added)*

The recognition of multi-class MITs was implicit in the Government's acceptance of the Board of Tax's Recommendation 4 in the then Assistant Treasurer's Press Release of 7 May 2010 and is noted by Treasury in the October 2010 Discussion Paper (*Implementation of a new tax system for managed investment trusts)*.

The multi-class MIT rules are designed to assist the funds management sector establish investment platforms that allow investors to have a number of different asset portfolios within the one overall MIT structure.

It is expected that MITs and their institutional investors will be adopting tax positions that are consistent with the framework and policy intent of the law. For example, a MIT with office and industrial property assets could offer Class A investors an interest in the office property assets and Class B investors an interest in the industrial property assets. This just makes MITs more nimble in responding to investor needs.

The ability for a multi-class MIT to have a class with just one member was recognised both in the Explanatory Memorandum accompanying the Bills, and in the ATO's Draft Law Companion Guideline LCG 2015/D5.

During the extensive discussion on the MIT bills, Government and Treasury, in consultation with the ATO and industry, concluded that aggressive structures where there is no legitimate non-tax reason for setting up a multi-class MIT would attract application of Australia's very robust general anti-avoidance rules.

In addition, industry notes that Government has recently announced new requirements on foreign investment applications to ensure multinational companies investing in Australia meet their tax obligations. These requirements include advising the ATO if any transactions with non-residents could potentially be subject to the anti-avoidance measures in Australia's tax laws. A breach of the rules could result in prosecution, fines and potentially divestment of the asset.

As such, industry does not see the need to make any further changes to the legislation for this issue.

2. Attribution and withholding tax

A fundamental feature of the new MIT regime is the ability to separate attribution of tax liability from the cash distribution made by AMITs. This ensures that investors pay the appropriate tax on their share of the AMIT's income.

The withholding tax rules have been drafted to recognise this separation and ensure the right tax is collected from the right entities. The rules calculate withholding tax liability based on the amount of income attributed to investors. They impose the withholding tax liability on the AMIT (where non-resident investors hold their interest in the AMIT directly), or the custodian (where non-resident investors hold their interest in the AMIT via a custodian).

Typically, as in the past, the AMITs will make cash distributions and these distributions will cover any withholding tax obligations of the custodians.

The MIT bills provide clarity on who is responsible for payment of withholding tax where an AMIT's cash distributions for a year are less than the withholding tax liability in respect of that year. We expect that this technical issue would only arise in exceptional circumstances, but it is necessary for the law to cover the technical issue in order to ensure the MIT regime is robust and the revenue is appropriately protected.

Overall the MIT withholding tax regime seeks to achieve the following outcomes:

- Provide certainty to non-resident investors that Australia has a final withholding tax system, and it is only in exceptional circumstances, that non-resident investor will be required to pay top up tax / seek a refund of tax paid.

- Ensure that Australian tax is paid on behalf of non-resident investors in respect of their share of the Australian source income (largely rental, unfranked dividends, interest and capital gains on Australian property) of the AMIT at the time the income is derived (within 3 months of year-end).

- Ensure that the rules can operate where a non-resident investor holds their interest indirectly through custodians or other interposed entities and where AMITs hold interests in other AMITs.

- Provide clarity in the legislation as to who has the tax liability, which covers all circumstances – thus a trustee will know the consequences of the way it exercises its discretions.

We understand concerns have been raised by the custodians as to how the regime will operate where an AMIT's cash distribution is less than the withholding tax liability.

Listed property trusts generally have a stated distribution policy (for example, a percentage of Funds from Operation, or a similar metric). In all but exceptional circumstances, listed property trusts distribute more than 30% of the taxable amounts subject to withholding tax (thus the cash distributions are sufficient to cover the withholding tax obligations).

There could be rare situations where cash distributions are less than the withholding tax liability, for example, a financial crisis across the market, or the sale of a significant asset where the capital gain is reinvested in the fund (and this decision is determined by the fund to be in the best interest of investors). However, the trustee typically ensures cash distributions cover the tax payable.

Where, for instance, funds sell an asset, it may be in the investors' best interest to reinvest those funds and maintain capital for the long term benefit of all investors. In most situations, such a fund will have sufficient free cash to distribute at least the withholding tax liability amount, and still satisfy its fiduciary obligation to invest appropriately for the fund.

In rare circumstances, the capital gains tax can be so high that no distribution of available cash will cover the withholding tax liability. This could happen where the asset has been held for a considerable period of time, the fund has claimed building allowance depreciation to reduce the tax cost base, and capital values have appreciated significantly. An example of this could be a premium office building in Sydney CBD held for an extremely long period of time.

In any event, a decision to distribute less than withholding tax liability is not taken lightly and involves significant board and investor communications. It is a significantly adverse message to investors if distributions were to fall below the tax payable and this would generally not be a preferred option for trustees – they must act in the best interest of all the investors, so it would only happen where this is in their best interests.

MITs are subject to disclosure requirements, and therefore any fundamental change in distribution policy or forecasts would need to be notified to investors.

Under the proposed rules, in these rare circumstances, the custodians would have the withholding tax liability, however, the rules also provide the custodians with a right of indemnity against the non-resident investor on whose behalf they hold the interest in the AMIT to recover any amounts paid.

As such, industry does not see the need to make any further changes to the legislation for this issue.