



Mr Wayne Poels
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Dear Mr Poels

REGULATION IMPACT STATEMENT – FINAL ASSESSMENT SECOND PASS

I am writing in relation to the attached Regulation Impact Statement (RIS) prepared for the proposed changes to the tax treatment of stapled structures.

I believe the RIS meets best practice requirements and is consistent with the ten principles for Australian Government policy makers.

In particular, the RIS addresses the seven RIS questions:

- *What is the problem?* – Over recent years, a growing number of taxpayers have sought to re-characterise trading income into more favourably taxed passive income. Additionally, in certain circumstances, foreign investors can access lower tax rates on returns from investments in agricultural or residential land held through a Managed Investment Trust (MIT). When combined with existing concessions used by foreign pension funds and sovereign wealth funds, some foreign investors can pay tax rates of 15 per cent or less (in some cases, almost tax-free), rather than 30 per cent on Australian business income. These tax benefits are not available to domestic investors, and are only available for investments in land rich businesses. As such, they may distort investment decisions and encourage higher foreign ownership of land rich investments relative to Australian investors who do not receive these concessions.
- *Why is government action needed?* – The use of staples and similar structures has grown significantly in recent years and expanded into new sectors, beyond their traditional use in commercial and retail property. Hundreds of millions of dollars in revenue is potentially being forgone because of staples and broader tax concessions. Left as is this could grow to be in the order of billions of dollars.
- *What policy options are you considering and what is the likely net benefit of each option?* – Treasury considered six policy options to address the conversion of trading income in stapled structures:

1. Status quo – no law changes would be made to address stapled structures and other related concessions.

The ATO continues administering the existing law with the view that the general anti-avoidance provisions might apply, as outlined in the Taxpayer Alert 2017/1 issued by the Commissioner in January 2017.

The ATO has yet to test in court whether the general anti-avoidance provisions apply to a stapled structure and the uncertainty of its application gives rise to compliance costs as investors work closely with the ATO to confirm details of their structuring. This option may have significant implications for Australia's tax revenue base.

2. Prevent trading income from accessing the 15 per cent MIT withholding tax rate.

This option applies a 30 per cent final MIT withholding tax rate on 'fund payment' distributions from a MIT to a foreign investor when the income is sourced from a cross staple payment that is not derived from third party rent.

There may be an initial effect on the price of assets held in a staple as well as increased ongoing compliance costs for a staple involved with cross staple payments. However, this option provides significant revenue protection with foreign investors prevented from accessing the concessional tax rates for passive income on what is actually trading income and therefore paying appropriate tax on land rich investments. It will not affect domestic investors who will continue paying tax at their marginal rates.

3. Close the double gearing loopholes in the thin capitalisation rules to prevent foreign investors from converting trading income into more favourably taxed interest income.

This option closes a clear loophole in the tax law and affords significant revenue protection.

4. Legislate and tighten the sovereign immunity tax exemption to prevent sovereign investors accessing a zero per cent tax rate on trading income.

This option would provide significant revenue protection. The higher levels of tax for some sovereign investors may reduce the price they are willing to pay for Australian assets. However, the transitional arrangements available, including a seven-year transition period, for investments made before the announcement should mitigate any impact.

5. Limit the withholding tax exemption for foreign pension funds to interest and dividend income derived from portfolio investments.

Under this option, foreign pension funds with significant ownership interests in Australian businesses will have to pay interest and dividend withholding tax. This helps ensure Australia collects a fair share of tax on economic activity that occurs in Australia. To mitigate any potential effects on asset prices in markets where foreign pension funds are significant investors, a seven-year transition period is included for existing investments.

6. Prevent income from agricultural land from accessing 15 per cent MIT rate.

Under this option, income from agricultural land would be subject to a MIT withholding tax rate at a rate equal to the top corporate tax rate. This option prevents foreign investors from accessing preferential tax outcomes that are not available to Australian investors, while continuing to allow investors to utilise MITs.

7. Prevent income from residential housing accessing 15 per cent MIT rate.

Under this option, distributions derived from investments in residential housing that are not used to provide affordable housing would be subject to a MIT withholding tax rate at a rate equal to the top corporate tax rate. This option prevents foreign investors from accessing preferential tax outcomes that are not available to Australian investors, while continuing to allow investors to utilise MITs.

8. Package options 2, 3, 4, 5, 6 and 7 together.

This option has the advantage of targeting both the use of stapled structures as well as broader incentives for converting trading income into passive income and emerging structures, thereby providing significant revenue protection benefits.

- *Who will you consult and how will you consult them?* – Treasury released a public consultation paper on 24 March 2017 examining trading income through stapled structures with final submissions due on 20 April 2017. Submissions were received by over 50 stakeholders and the Treasurer issued a media release on 2 May 2017 extending the timeline for the review to allow more time for consultation and policy development. Treasury completed a second round of consultation, in a targeted format, in July 2017. Public consultation was also undertaken on exposure draft legislation in relation to residential housing MITs from 14 September 2017 to 28 September 2017. Following announcement of the measures on 27 March 2018, Treasury has continued to engage with a broad range of stakeholders (which included industry groups, stapled entities, investor groups and their advisers) on implementation of the package. The rounds of consultation included:
 - the first tranche of exposure draft legislation released for public comment from 17 May 2018 to 31 May 2018;
 - a revised second tranche of exposure draft legislation (including the agricultural and residential MIT changes) released for public comment from 26 July 2018 to 10 August 2018; and
 - the release of a consultation paper on the conditions stapled entities must comply with to access the infrastructure exception and the transitional arrangements for public consultation from 28 June 2018 to 12 July 2018, followed by the release of exposure draft legislation to give effect to these conditions from 7 August 2018 to 14 August 2018.
- *What is the best option from those you have considered?* – The RIS conclusion is that the Government should adopt Option 8, that is, package Options 2, 3, 4, 5, 6 and 7 together, as it addresses the identified problems comprehensively. This targets both the conversion of trading income into concessionally taxed passive income as well as other tax concessions that investors use in conjunction with stapled structures and MITs generally to lower effective tax rates. If some of the options are implemented without others, the reforms will only be partially effective in protecting the corporate tax base.
- *How will you implement and evaluate your chosen option?* – Legislation is required to implement the preferred option, which the Government intends to introduce in Parliament as soon as possible. Options 2, 4, 5, 6 and 7 will take effect from 1 July 2019 with Option 3 taking effect from income years commencing on or after 1 July 2018. The ATO is well placed to monitor the effectiveness of the measures. Mechanisms, such as election into the transitional arrangements and the 15 year exception for new, Government approved nationally significant infrastructure, will provide a method of evaluation.

I am satisfied that the RIS addresses the concerns raised in your letter of 29 May 2018. Specifically, the RIS:

- includes further quantification of impacts where possible to demonstrate their significance, in particular, for the revenue impacts;
- includes further analysis of the nature and significance of the investment impacts;
- provides further detail on the consultation process undertaken and a summary of the consultation feedback; and
- includes amendments to improve the accessibility of the RIS.

The Office of Best Practice Regulation has agreed that the package will increase compliance costs by an average of \$4.76 million per year, on an annualised basis. A regulatory offset has not been identified. However, Treasury is seeking to pursue net reductions in compliance costs and will work with affected stakeholders and across Government to identify regulatory burden reductions where appropriate.

Accordingly, I am satisfied that the RIS now meets best practice consistent with the Australian Government Guide to Regulation.

I submit the RIS to the Office of Best Practice Regulation for formal assessment.

Yours sincerely



Maryanne Mrakovic
Deputy Secretary
Revenue Group