13 August 2018

Brendan McKenna
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Brendan

**Exposure draft legislation on stapled structures – managed investment in housing & agricultural land**

The Financial Services Council (FSC) welcomes the opportunity to make submissions on the second stage legislation relating to stapled structures contained in the exposure draft *Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax and Other Measures) Bill 2018* and related explanatory materials. The FSC's submission specifically relates to managed investment in residential housing and agricultural land.

The FSC has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than $3 trillion on behalf of 14.8 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world.

**Managed investment in residential housing**

The FSC welcomes the policy in the draft bill stating that managed investment trusts (MITs) can invest in residential housing, specifically Build-to-Rent housing. As the FSC indicated in our submission to the Government of 5 October 2017,[1] there are substantial benefits to permitting this type of investment, in particular Build-to-Rent is likely to be an important solution to Australia's housing affordability and supply problems.

Permitting Build-to-Rent also means MITs can invest in 'mixed use' developments that involve some element of residential investment. There are many investments by Australian funds, offshore and locally, that are mixed use property developments. This may for example include apartments above a shopping centre, which can sometimes be a requirement of a local council. In some cases the residential investment may be a small part of the total investment.

Nevertheless, the FSC has concerns about the proposal contained in the draft bill to impose a higher withholding tax rate on Build-to-Rent. In the FSC's view this is unnecessary and inappropriate, for the following reasons:

- Build-to-Rent properties are likely to reduce rent pressures, making renters better off.

[1] See: https://fsc.org.au/resources/resource-detail/?documentid=871c03b3-93f6-e711-812b-480fcff12ac1

- This measure is not protecting revenue. The Government would currently be receiving almost no revenue from Build-to-Rent as the asset class is nearly non-existent in Australia.
- If Build-to-Rent expands, then any revenue impact of a lower withholding tax rate would be offset by factors including:
  - The costs to governments from rent assistance and social housing is likely to decline (as noted earlier, Build-to-Rent is likely to reduce rent pressures).
  - If prospective home owners instead choose to rent long-term in a Build-to-Rent property, then the impact on government budgets is likely to be positive as home ownership is significantly tax preferred over rental properties.
  - If prospective housing investors instead choose to invest in a Build-to-Rent property, then tax revenue of governments could increase as state land tax treats individual investors more favourably, and the extent of negative gearing could decline.
- There is no clear policy rationale to have a higher withholding tax rate on managed investment in housing compared to commercial property such as office and retail — particularly commercial accommodation such as hotels.
- This tax differential is likely to show up, in part, as higher rents for tenants in these properties. Similarly, there is no clear rationale why a resident in a Build-to-Rent property should pay higher rent than a tenant in commercial property including an office block or shopping centre. A tax penalty causing higher housing rents is, on the face of it, inequitable.
- The Build-to-Rent sector is well developed in some other countries, such as in the USA, and Australia needs to support, not penalise, the participation of foreign managers and investors with substantial expertise in this sector.
- If Build-to-Rent expands in Australia, this will mean the one missing domestic managed investment asset class (residential property) will at last be available in volume to local and foreign investors. This will aid diversification and allow investors to gain exposure to residential property without having to buy a property directly.

**Managed investment in agricultural land**

The FSC also does not support the proposals contained in the draft Bill to impose a higher withholding tax rate on MIT investment in agricultural land. Some of the FSC's concerns are similar to the concerns with Build-to-Rent, while some are specific to agricultural land. These concerns are outlined below.

*Policy*

- The proposal will disadvantage Real Estate Investment Trusts (REITs) holding agricultural land compared to all other REITs. There is no clear policy rationale to have a higher withholding tax rate on managed investment in agriculture compared to commercial property such as office and retail.
  - This tax differential is likely to show up, in part, as higher rents for these properties. There is no clear rationale why rents for agricultural properties should be higher than for other commercial property. For example, it is unclear why supermarket chains will potentially have lower rents than their fresh produce suppliers.
- The Government has indicated it is interested in promoting managed investment into agriculture through superannuation funds, including by instituting a Parliamentary Inquiry into this issue – the Standing Committee on Agriculture and Water resources inquiry into barriers to superannuation fund investment in Australian agriculture, announced 24 May 2018. In this context, it is inconsistent to *encourage* managed investment into agriculture *inside* super on the

one hand, to provide much needed capital for the industry, while *discouraging* managed investments *outside* of superannuation on the other.
    - The proposed higher withholding tax rate on MIT investment in agriculture is likely to indirectly constrain superannuation investment in agriculture, as super funds can make substantial investments through MITs, and the higher withholding tax rate on MITs will discourage MITs from holding agricultural land.
- If the government is concerned about foreign ownership of agricultural land, then the issue is better dealt with through foreign investment rules. In addition, the issues often raised with foreign ownership of farms usually relate to land that is wholly owned by a particular foreign investor, or a particular related group of foreign investors; these concerns do not apply across the board to widely held MITs.
- The policy rationale for this measure has not been made sufficiently clear in the legislation, accompanying material or Government announcements.

The FSC is also concerned about some details of this proposal relating to agricultural land.

We are concerned with the proposal in the draft legislation that a higher tax rate would apply to land that could 'reasonably be used' for carrying on a primary production business (see EM at paragraph 1.103). This would mean land actually being used for a different, non-farming, purpose could have the higher tax rate imposed just because the land could alternatively be used for farming. This could catch any MIT owning urban fringe or regional property applied to a different use, only because the land could have been used for primary production.

- Any capital gain on vacant rural land would also likely have the higher tax rate apply, even if both the seller and buyer are not using the land for farming. Vacant rural land could be captured by this proposal even if it is being held pending commercial (non-farming) development.

In addition, as the transitional provision (item 12) is currently drafted, it appears that a MIT holding an interest in agricultural land through another entity would only be entitled to transitional relief from the higher MIT rate if it held 100% of the other entity at all times from 26 March 2018. As a result a MIT with a substantial existing or even controlling interest in a joint venture or other form of shared ownership investment in agricultural land will be ineligible for transitional relief, and will instead have a 30 per cent withholding from 1 July 2019 onwards. This is an inequitable and inappropriate result.

**Recommendation**
The FSC recommends a higher proposed MIT rate should not apply to MITs investing in agricultural land or residential housing.

Please contact me with any questions in relation to this submission on [redacted].

Yours sincerely,

[redacted]

Michael Potter
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