CONSULTATION – TREASURY LAWS AMENDMENT (STAPLED STRUCTURES AND OTHER MEASURES) BILL 2018

MAY 2018

1. INTRODUCTION

Perpetual Corporate Trust ("PCT") welcomes the opportunity to respond to the proposed integrity measures outlined in the *Treasury Laws Amendment (Stapled Structures and other measures) Bill 2018* ("the Bill").

Our submission represents the views of PCT only and should not be taken to be indicative or representative of the view of the broader Perpetual Group. Our comments are provided from the perspective of PCT's role as Trustee for Managed Investment Trusts ("MITs") that represent some $45 billion in property and infrastructure assets acquired by the Trustee mainly on behalf of some of the largest global institutional investors, including sovereign wealth funds and foreign pension funds. Our submission does not address the specific legislative provisions proposed in the Bill but outlines the key thematic concerns we have identified in relation to the impact of the proposed integrity measures.

At the outset, PCT notes a misalignment in the relation to the scope of the initial consultation paper on Stapled Structures released in March 2017 and the subsequent integrity measures announced in March 2018, to be implemented in part though the Bill. Specifically, the broadening of the scope of these measures to include matters that do not relate to Stapled Structures to address foreign sovereign immunity and foreign pension fund immunity from dividend and interest withholding taxes means that impacted market participants and impacted foreign investors have not been engaged by Treasury at the policy formulation stage. It is therefore not clear as to the extent that the policies have been formulated based on an understanding of the likely outcomes of these measures in relation to the foreign sovereign or foreign pension fund willingness to commit future capital inflows to Australia.

It should also be noted PCT acknowledges the importance of ensuring integrity of Australia's tax base is preserved; however, we believe the Bill adds additional complexity (and associated compliance costs) to an already complicated regulatory framework in relation to foreign investment. We believe the additional complexity is counter to the long-standing policy objective of the Government to remove unnecessary red tape and associated regulatory compliance costs. Most significantly, PCT submits that measures outlined in the Bill will lead to a re-rating of Australian sovereign risk by foreign investors, giving rise to the potential to cause significant long-term detriment in to the Australian economy if foreign investors substitute investment that might otherwise be directed to Australia for capital flows into other jurisdictions.

In providing for the broad suite of integrity measures that go beyond stapled structures but impact on the attractiveness of Australia as a destination for sovereign wealth fund and foreign pension fund investments, PCT is concerned that Treasury has not struck the appropriate balance between ensuring tax base integrity and promoting the broader economic benefits that arise through foreign capital inflow into Australia.

2. SOVEREIGN RISK AND FOREIGN INVESTMENT

PCT submits that effective policy making is evidence based; drawing on a factual and analytical base that sizes the extent of any perceived issues with current policy settings and sets the context for engagement with industry. We note from the 2018-19 Budget Papers that the combined impact of these integrity measures is a gain to consolidated revenue of $30 million in 2018-19 and $400 million over the four-year period ending 2021-22. PCT submits that Treasury has assessed the gains to consolidated revenue in isolation of costs, which will include, but are not limited to initial costs to restructure existing arrangements, ongoing compliance costs recognising the record keeping complexity that is inherent in order for MITs to comply with the revised rules and, most significantly, the opportunity cost to the broader domestic economy if the attractiveness of Australia as a destination for foreign investment is diminished through these measures.

Attached to this submission is a copy of the Infrastructure Partnerships Australia and Perpetual *Australian Infrastructure Investment Report 2017* (The IPA/Perpetual Report), which identifies a few trends that we believe Treasury should be mindful of in considering the broader economic implications of the Bill:

- Political uncertainty poses an increasing challenge to investing in infrastructure in Australia; 62 percent of respondents to the survey conducted in preparing the IPA/Perpetual Report indicate that political type risks are a significant challenge to investing in Australia; 66 percent indicate that they are not optimistic around the Federal Government's approach to infrastructure.
- Tax policy settings was reported as a significant challenge by 35 percent of survey respondents; compared to just five percent in 2016. Perceptions around ease of doing business have also fallen; from 60 percent in 2016 to 27 percent in 2017.
- Australia's attractiveness rating by survey participants in relation to economic stability has fallen from 75 percent in 2016 to 58 percent in 2017.

PCT submits the trends outlined above paint a worrying picture as to the impact of sovereign and regulatory risk impacts on investor appetite for future infrastructure investments in Australia.

Given the significant infrastructure pipeline and the known infrastructure deficit in Australia, PCT believes that any measures that diminish the attractiveness of Australia as a destination for investment inflows into infrastructure are short sighted. In this context, PCT maintains it is not correct to assume that domestic investors will step in to fill any shortfall in capital should foreign investors retreat from Australia. Based on our research, there is no objective evidence that foreign investors are 'crowding out' local investors in relation to infrastructure investments. Australia competes with other markets for capital inflows; large institutional investors (be they on-shore or offshore) will deploy capital consistent with their investment objectives and strategies, which are likely to include parameters that constrain the extent to which investments can be concentrated in any specific asset class or geographic location.

As Treasury would be aware, consortia established to acquire Australian infrastructure assets have typically involved a mix of local and foreign institutional investors, driven mainly by the size of capital commitment required and the lengthy holding period for infrastructure assets that is typically contemplated by institutional investors. Even though the bidding process for Australian infrastructure assets has typically involved numerous consortia each composed of a mix of local and foreign investors, Treasury should not assume that foreign investors can be readily substituted for domestic investors in the competing consortia.

PCT questions the validity of the benchmarking outlined in the explanatory materials in relation to the 'unintended emergence of a dual corporate tax system', between land rich foreign institutional investors and domestic corporations. If tax revenues benchmarking is to be undertaken between integrated corporate structures and stapled structures, the net effective tax rate should be relied upon, recognising that there are very few large domestic corporations that in fact pay the headline corporate tax rate. In any event, PCT believes the relevant point for comparison here should be the tax outcomes achieved by domestic institutional investors (like APRA regulated superannuation funds or the Future Fund) and the equivalent foreign investor types.

Moreover, taking infrastructure privatisation as an example, the former owner, typically being a State Government entity or instrumentality would be generally subject to no income tax in relation to either the land rich or operating components of the infrastructure asset. Any income tax revenue received by Treasury arising out of the privatisation of that asset is hence incremental to the budget compared to the nil income tax that would in all likelihood have been received had the infrastructure asset remained in public ownership.

PCT submits that the proposed changes are leading to an unfavourable revision in Australia's sovereign risk rating by foreign investors and cautions of the unintended economy wide consequences if foreign capital eschews Australia in favour of other jurisdictions.

3. COMPLEXITY AND RED TAPE

PCT is concerned that the Bill injects an additional layer of complexity into an already complicated set of regulatory arrangements governing foreign investment and withholding tax concessions offered to certain foreign investors. For example, introduction of terminology such as 'non-concessional MIT income' and provision of a definition that runs to circa 633 words, seems out of alignment with good drafting practices and creates scope for additional confusion, uncertainty and cost. PCT submits a principles based rather than prescriptive approach may be more appropriate in this instance, particularly given that the ATO already has broad anti-avoidance powers under Australian income tax law. Alternatively, PCT proposes that the definitions provided be substantially streamlined (possibly by clearly defining what is concessional MIT income and what will be considered non-concessional MIT income). Alternatively, another 'payment type' be introduced into the withholding tax rules, to clearly distinguish 'concessional Fund Payments' from 'non-concessional Fund Payments'.

PCT is also concerned regarding proposals that require the Treasurer to 'approve' infrastructure before it is able to access 15 years' of withholding tax concessions in relation to rental income flowing between the operating entity and the asset trust, recognising foreign investors are already subject to the Foreign Investment Review Board approvals process before assets can be acquired.

We also believe that there are challenges for a domestic MIT Trustee engaged only to operate the asset trust in ensuring that withholding tax obligations are managed in accordance with the Bill, given the greater degree of upstream and downstream look through that will be required in relation to the complete set of arrangements (passive investment and operations).

The Trustee will be ultimately liable for determining whether to withhold 15% or the maximum corporate tax rate in relation to any fund payment that involves an operating entity flowing through rental payments to the asset trust, yet may not have the visibility as to the underlying arrangements to appropriately assess the applicable rate to apply, particularly where there is a master lease to a single operating entity in place, which then may or may not sub lease to

unrelated third parties. PCT submits that in these circumstances, the Trustee should be held harmless if it has made all required inquiries and relies in good faith on information that has been supplied by third parties.

4. ‘APPROVED’ INFRASTRUCTURE ASSETS

PCT submits that there should be an objective framework that pre-qualifies certain infrastructure assets as ‘approved infrastructure assets’ – effectively, the Bill has already identified transport infrastructure, energy infrastructure, communications infrastructure and water infrastructure used for public purposes as the nature of assets that can be approved infrastructure assets. We believe the availability of a pre-approved list of asset types will provide market participants with greater transparency and greater certainty, as well as not adding to the already significant costs that are incurred when investors bid for infrastructure assets.

PCT notes foreign investment in the asset types proposed for ‘approved infrastructure assets’ would already be subject to Treasurer approval through the Foreign Investment Review Board and that the Treasurer has the existing right to decline to approve foreign investment if not deemed to be in the national interest.

PCT believes an objective list of asset types that are ‘approved infrastructure assets’ should be published and maintained by Treasury.

In PCT’s view, by focusing on discrete assets, the Bill also artificially segments ‘public use’ versus ‘private use’ infrastructure; only the former can be considered significant economic infrastructure. Arguably, a service road on a toll road may or may not satisfy the ‘public use’ requirements as these have been specified, even though it is integral for ‘public use’; a private freight line used to transport coal to a power station similarly may or may not satisfy the public use test. It is imperative that the framework outlined for approved infrastructure does not artificially fragment integrated assets into ‘private use’ and ‘public use’ components where both components are required to efficiently and effectively provide services to the public.

PCT submits that the public use test should clarify that integrated assets used collectively to provide goods and services to the public can be approved economic infrastructure.

PCT does however see merit in reserving the discretion for approval of other infrastructure assets outside of the types already listed if deemed in the national interest, or if deemed by a State Government as being of significant State interest; recognising that the States assume significant fiscal responsibility for provision of economic infrastructure in Australia. Given historical tensions in State/Federal relationships, PCT believes it is imperative that an apolitical framework is implemented in relation to approval of other infrastructure types as ‘economically significant’ and it is from this perspective that we do not believe it appropriate that the Federal Treasurer has the last say as to whether infrastructure is of economic significance.

PCT believes that discretion should be retained by the Treasurer to deem infrastructure that is captured in the pre-approved list of economically significant infrastructure as an ‘approved infrastructure asset’ where it is in the national interest to do so, but that States also be able to nominate specific infrastructure that is not captured in the pre-approved list as an ‘approved infrastructure asset’ where it is in the State’s interest to do so.

5 CONCLUSION

PCT is concerned as to the unintended consequences arising from the Bill. On a tactical level, we foresee a substantial increase in cost to comply will be incurred if the Bill is legislated in its current form, particularly given the complex drafting and the new administration arrangements that will be required to ensure compliance with these measures. For MIT Trustees engaged to hold assets on behalf of offshore investors, it will be particularly challenging to navigate through these changes, requiring an increase in reliance on external expert advice and hence ongoing additional administrative costs. We do not believe the operational implications here have been appropriately considered by Treasury in formulating the proposals outlined in the Bill.

More fundamentally however, PCT is concerned that these changes do not appropriately consider the strategic imperative to continue to encourage the growth of the Australian economy, which is in part achieved through enabling foreign capital flows into productive investments. The revenue inflows that Treasury has estimated to arise from these measures may indeed provide short term incremental benefits by way of additional tax revenue. However, the longer-term implications arising from this broad suite of integrity measures may in fact undermine Australia's longer term economic prosperity if offshore investors elect to prefer jurisdictions other than Australia as the destination for their capital. We urge Treasury not to dismiss this risk lightly, recognising the increasingly global nature of capital markets and global orientation to investment opportunities adopted by large institutional investors.