TECHNICAL SUBMISSION ON CLEAN BUILDING MANAGED INVESTMENT TRUSTS

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1. Executive Summary

The Federal Government has announced the Tax Laws Amendment (Clean Building Management Investment Trust) Bill 2012.

The overall policy intention behind this measure is to provide a clear incentive for Building owners to invest in the construction of new clean green buildings.

This submission:

1) identifies practical issues arising from the Bill; and,

2) provides alternative approaches consistent with the public policy intent of the legislation.

Key technical issues addressed in this submission include:

1. Definition of a clean building managed investment trust

Under the regime "clean building managed investment trusts" cannot earn assessable income from "any other *taxable Australian property".

This will stop eligible projects qualifying for 10% WHT where they earn income on the land from activities like car parks, electricity on-selling etc particularly where those activities are situated on a separate land title.

A clean MIT should be eligible for 10% WHT under the regime where it earns other income that complies with the existing MIT passive income tests.

Tracing

To qualify for 10% WHT, clean buildings must be quarantined in a separate trust and only earn "clean income". These rules:

- disqualify clean buildings that earn incidental income from activities on separate land titles including car parks and electricity on-selling etc;
- disqualify mixed use developments that include clean buildings as a key component of the project;
- disqualify any clean building MITs passing income through MITs that act as head trusts (eg listed and wholesale REITs);
- create a competitive disadvantage for listed and wholesale REITs that bid for new clean projects where they cannot implement "clean" investment structures;
- reduce the risk diversification benefits of pooled assets;
- increase taxes (e.g. stamp duty) and CGT liabilities from restructuring existing holdings; and,
- taint the whole clean building MIT if any one building fails criteria for eligibility.

All of these issues are easily resolved with the use of tracing provisions.

We can see no policy reason why MITs should not trace income from clean office, shopping centre and hotel assets. Any integrity concerns can be readily addressed by restricting the 10% tax rate to clean income derived from clean buildings after 1 July 2012.

2. Meaning of 'Clean Building'

The problems associated with the proposed meaning of a 'clean building' are:

- The test used to determine when construction of a building commences effectively excludes clean buildings constructed on existing foundations or on top of other buildings, and certain staged developments. The more appropriate test for qualification is:
    - Buildings qualify if a certificate of practical completion or certified Green Star or NABERS rating is issued on or after 1 July 2012; or
    - If the commencement of construction test must be used, it should:
        - exclude all preparatory works to the site (including excavation, environmental remediation and site stabilisation) and works below the lowest basement level; and
        - confirm that construction commences on buildings with shared basements or pre-existing foundations once development of the building core starts.
- Owners should also qualify for 10% WHT where they change the construction of their building to a green design once construction is underway.
- The exclusion of substantial renovations encourages demolition of existing buildings and excludes 90% of shopping centre developments. The proposed regime should adopt the GST definition of "new Building" so that embodied carbon in existing structures is not lost.

3. Building use requirements

A clean building MIT can only earn income from "clean" commercial offices, hotels and shopping centres.

A building used for multiple purposes will not qualify where only some of its purposes are eligible.

This means the regime penalises investors providing social amenities or providing mixed use developments, some of which may be mandated by Government planning approvals.

The legislation should allow eligible MIT's to bifurcate or segregate clean income related to clean office buildings, shopping centres and hotels in mixed use developments without the need for costly and inefficient holding structures that quarantine clean buildings.

4. Energy efficiency requirements

The definition of 'clean building' in the legislation requires the building to achieve a 5 Star Green Star rating or a 5.5 star NABERS Energy rating.

Buildings could be excluded based on factors outside the owner's control or on factors that could otherwise be easily rectified.

The program should:

- only require NABERS base building ratings;
- provide a 36 month window for owners to obtain Green Star ratings after building completion;
- provide a make-good period of 180 days where the building falls below a required rating; and
- only apply any reversion to the 15% WHT rate prospectively until the energy rating is regained.

2. Technical Issues

Issue 1. What is a clean building MIT?

Summary

In order to qualify for a 10% WHT rate, the Government proposes assets be quarantined in Clean Building MITs.

The critical stipulations are that a clean building MIT can only:

- comprise assessable rental income and capital gains from eligible office, retail and hotel properties – that is, it cannot mix income from other property types; and
- hold an interest in another clean building MIT.

Problems

This approach creates two sets of problems:

Practical Problems

- A clean MIT may be disqualified if it contains a clean building that generates incidental income from activities undertaken on separate land titles – this could include electricity on-selling, car parking, mobile phone towers etc;
- A clean building MIT will be disqualified if it includes income from mixed use developments, such as the inclusion of housing or student accommodation as part of a retail development – even if this activity is mandated under planning rules such as inclusionary zoning or where the non-qualifying element is critical to the commercial viability of the project;
- A clean building MIT will be disqualified if it contains a mixed use development that includes social amenities that are integral to community development projects.
- MITs are forced to use stapled structures to segregate mixed use projects with non-qualifying buildings. This is not feasible as the non-qualifying buildings may not be able to be transferred to another entity due to legal restrictions in existing contracts and at law;
- REITs need to change their existing structures to quarantine clean buildings and clean income under the regime. This requires board and investor approval and involves significant costs. Competing interests of domestic and global investors may prevent trustees recommending a restructure where it is not in the best interests of all investors;
- Quarantining clean buildings will require interests in land to be restructured into different vehicles after they are acquired, resulting in:
    - both a CGT and a stamp duty cost – even if transitional CGT rollover relief is provided, state governments may not provide stamp duties relief; and
    - a need to refinance and renegotiate debt facilities - Lenders may insist on preserving existing debt covenants. Restructuring asset holdings could downgrade credit ratings and impact the viability of a project;
- If land holdings are restructured to specifically access a 'clean building' concession, it is unclear if the general anti-avoidance provisions in Part IVA will apply. Further, the current

Part IVA review may result in amendments to these provisions which will create increased uncertainty and tax risk for trustee boards and their investors;

- A Clean Building MIT can be disqualified depending on the type of entities and the order in which the clean income passes through those Australian entities – eligibility should not be affected by these technical issues. Refer to Appendix B.

A detailed explanation of the problems with quarantining assets is at Appendix C.

Conceptual Problems

The quarantining of clean buildings in clean MITs:

- reduces the risk diversification benefits of pooled assets;
- increases the cost of running a pooled fund by diminishing economies of operating scale;
- adds direct compliance costs and increases red tape;
- increases taxes, such as stamp duty, and can trigger CGT liabilities;
- creates a competitive disadvantage for existing listed and wholesale REITs bidding for new clean real estate projects if they cannot implement "clean" investment structures;
- forces investors to use complex structures for mixed use developments instead of single investment trusts; and,
- increases industry's reliance on stapled structures and which may not be an appropriate vehicle due to the nature of the titles or manner in which the project is to be developed.

Consequences

An MIT falls out of the clean building MIT regime for perverse reasons.

In addition, the quarantining of 'clean' and 'non-clean' income streams can distort the structuring of investments.

Solutions

A fundamental concept of the proposed regime is the generation of eligible income – that is, income derived by clean buildings.

A clean building MIT should be able to earn incidental income that satisfies the existing MIT passive income tests. Incidental non-rental income earned by a clean building should be allowed.

There is no policy reason to quarantine eligible assets in a special purpose clean MIT vehicles.

The problems created by the need to quarantine assets can be easily resolved by the use of tracing rules.

Australia's tried and tested tracing provisions can be utilised to ensure only eligible assets can access the clean building MIT arrangements.

The rules already recognise tracing in the draft notice provisions but the taxing provisions do not adopt tracing.

The following examples show how Australia's existing conventions will very effectively achieve the tracing of clean income.

Tracing Provisions

Tracing provisions are common in Australia's tax law.

Tracing is business as usual for investors and trusts.

Tracing allows different assets within the one trust to be taxed at different rates.

Tracing provisions:

- link an asset to its correct tax treatment;
- ensure that income and deductions are correctly taxed; and
- minimise additional administrative/compliance costs (because they don't require new structures).

The income from the asset can then be tagged for the applicable WHT rate when it is pooled in the head trust for distribution.

Here are just a few examples of items that are currently tagged:

- interest income;
- foreign income;
- domestic income;
- capital gains;
- dividend income; and,
- losses.

Tracing will allow MIT managers to optimise their fund structures and composition based on market drivers rather than tax compliance obligations, while meeting the public policy objectives of the clean building regime in a manner that conforms to Tax Office integrity requirements.

In addition, the provisions also need to be amended to stop eligibility being impacted by the type of Australian entities and order in which the income flows through those entities. Technical tables that highlight the inappropriate outcomes are attached in Section 3.

This is easily rectified with changes to 12-385 and 12-390 (refer to Appendix A).

Issue 2. Meaning of clean building

Summary

The legislation defines a building as 'clean' if, inter alia, "construction of its foundations began on or after 1 July 2012".

Construction of foundations is deemed to have occurred when the ground has been broken.

Problems

The proposed rules will exclude buildings constructed on existing foundations, staged developments or where owners upgrade their construction design to a green building in response to the regime.

The proposed definition for "commenced construction" undermines the policy intention to incentivise green construction.

Practical Problems

- The proposed definition of 'construction commencement' is more stringent than current tax law precedents – 'breaking ground' can occur during site preparations works, which are not generally considered to constitute the commencement of construction.
- The proposed definition will disqualify buildings constructed in multiple stages from inclusion as a clean building where:
    - development stages straddle the 1 July 2012 date; and,
    - there are common footings.
- The proposed definition will exclude eligible new buildings that are constructed on top of existing structures even where such structure is a clean building – as no new foundations are constructed.
- The proposed definition discriminates against investors who respond to the policy incentive – that is, a decision is made to significantly improve the environmental performance of a building that is already under construction as at 1 July 2012.

Conceptual Problems

- The concept of 'construction commencement' relates to building procurement expenditure. However, a WHT regime relates to the production and distribution of income – in this case, clean income.
- Eligibility for access to the 'clean building' rate of 10% should be triggered by a tax event relevant to the policy goals of the legislation.
- The definition of 'new' excludes major retrofits. Whereas GST law treats existing buildings as new where they are substantially renovated.
- Excluding buildings retrofitted to a high clean building standard provides a tax incentive to demolish assets. This will result in a negative environmental outcome as the benefits of the energy embodied in existing structures will be foregone.

Consequences

The current approach incentivises perverse environmental externalities.

Solutions

It is recommended that a more appropriate test for qualification of a building is as follows:

- Eligibility should apply to assets with a certificate of practical completion or certified Green Star or NABERS rating on or after 1 July 2012; or
- If construction commencement must be used, then the following tests should be included:
    - "construction of the foundations" should be defined to exclude any preparatory works to the site (including excavation, environmental remediation and site stabilisation) and all works below the lowest basement level;
    - an eligibility rule should be included to allow buildings with shared basement facilities or pre-existing foundations to qualify for the 10% WHT once development of the building cores starts (ie: substantive above ground work); and,
    - an eligibility rule should be included to allow owners to qualify for 10% WHT where they change the construction of their building to a green design once construction is underway.

The legislation should adopt the GST definition of `new building' to ensure that substantial renovation which creates an 'as new' building can access the clean building MIT regime.

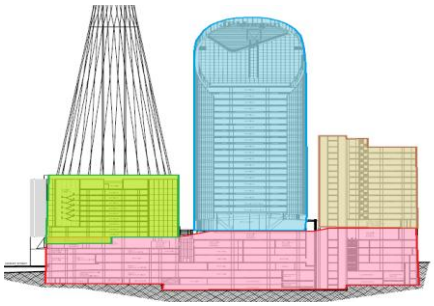
Examples of types of building developments that would be jeopardised by a "commencement of construction" definition.

<table>
<tr><th colspan="2">MIT Project – Barangaroo South, Sydney</th></tr>
<tr><td>  </td><td>Value: $6 billion

Jobs: 27,000 (including 500 indigenous workers)

Green: 6 star Green Star, 5 star NABERS Energy and Water, blackwater treatment, Tri-generation</td></tr>
<tr><td colspan="2">Issues impacting eligibility for 10% green WHT.
• Multiple stages for development.
• Staggered build over 15 years.
• Site preparation works for a shared basement, which will include site wide shared utilities, had commenced but construction of the buildings that will sit above the shared basement had not commenced as at 1 July 2012.</td></tr>
</table>

MIT Project – Westfield, Sydney



Value: $2.7 billion

Jobs: 5,500 commercial jobs

Green: 85 Castlereagh street - 6 star Green Star v2 design

100 market Street - 6 star Green Star v2 design

77 Castlereagh Street – 4.5 star NABERS (refurb from 1.5 star)

Retail – 5 star green star design

Energy and Water, water harvesting and recycling, 90kl diesel tanks

Issues impacting eligibility for 10% green WHT:

- Multiple stages of development. Development Consent has been granted for the sub-division of the Precinct into four lots, comprising the three office buildings and the retail stratum.
- Not all stages meet green rating eligibility criteria of 5 star green star or 5.5 star NABERS.
- Decision to build 85 Castlereagh Street office building, a green design building was made after the foundations were excavated down 14 meters below Castlereagh Street level and the foundations were laid.
- The Office Components of the Precinct receive income from the car park, which is located in the proposed Retail Stratum.

MIT Project – Ocean Keys Shopping Centre

Value: $113 million

Jobs: 150 construction jobs + 300 retail jobs

Green: NABERS 3-4 star

Issues impacting eligibility for 10% green WHT:

- An extension to the existing complex
- Development approval for the retail centre is conditional upon constructing residential housing.

MIT Project – Wollongong West Keira Retail Centre (under construction)	
	**Value:** $224 million **Jobs:** 470 **Green:** 5 star Green Star (with Tri-Generation) 4 star NABERS Energy Rating **Energy and Water**, tri-generation, carbon systems

Issues impacting eligibility for 10% green WHT:

- An extension to the existing complex
- Development approval for the retail centre is conditional upon constructing student housing.

Issue 3. Building use requirements

Summary

Clean building MITs can only comprise income from 'clean' offices, hotels and shopping centres.

A building used for multiple purposes is only eligible to be classified as 'clean' where those uses are offices, hotels and shopping centres.

Problems

Several examples noted above demonstrate that buildings generate incidental income. This income can taint the 'clean' MIT.

The Building Use Requirements section of the legislation gives rise to further externalities, as follows:

- Houses – including affordable houses partially funded under the National Rental Affordability Scheme (NRAS) - can often be attached to retail sites.
- Projects often involve construction of parkland facilities, car parking, cultural facilities, sporting facilities, education centres and other community facilities – either voluntarily or because they are mandated by government through the planning approval process.
- Housing and student accommodation is often included as a component of retail or other mixed use developments – this is often mandated by government through the planning approval process.
- Certain urban greenfield developments and urban renewal projects combine residential, retail and office buildings within a single MIT holding structure to ensure that appropriate community facilities exist (e.g. parks, shopping centres, schools etc).

Consequences

Investors can be penalised where they provide social amenities voluntarily or where they meet the requirements of government planning rules.

Solutions

The legislation should be aligned to policy purpose – the generation of clean income after 1 July 2012.

Buildings should remain eligible even where they are attached to or co-located with building uses not covered by the clean MIT regime.

The legislation should acknowledge these arrangements and allow eligible MIT's to bifurcate income related to clean office buildings, shopping centres and hotels without the need for costly and inefficient holding structures to segregate clean income from clean buildings.

Example: Urban renewal projects are jeopardised by unnecessary restrictions on mixed developments.

MIT Project – Newcastle CBD urban renewal	
	**Owner:** 33% by Hunter Trust and 66.67% by Landcom Newcastle CBD to be transformed into a combination of residential, commercial and retail space. Newcastle CBD land is spread over 19 separate addresses and 31 individual land titles. Expected development value: $600m

Issues impacting eligibility for 10% green WHT:

- This is a mixed use residential, commercial and retail development.
- It will only qualify if ineligible assets are segregated and transferred to a different entity.
- Existing joint venture arrangements between a government entity and the MIT may not allow the segregation of the assets.
- This is difficult as it comprises of 19 addresses and 31 separate titles.

Issue 4. Energy efficiency requirement

Summary

Owners must obtain either:

- 5 star Green Star Design and As-Built rating within 24 months of completion; or,
- A NABERS Commitment Agreement that certifies performance at 5.5 star level that is maintained at all times during the income year.

These must be obtained prior to and at the time the building starts producing assessable income.

Problems

The criteria are ambitious and owners can easily be excluded based on criteria that the owner cannot control or that could otherwise be easily rectified.

- NABERS ratings should relate to the portion of the building over which an owner has control – that is, a NABERS Base Building certification.
- Even where a Base Building rating is employed, tenants activities can severely downgrade a building's performance. The 5.5 Star NABERS rating is a tough new standard that is less than 12 months old. Some leeway or a make good period would provide fair treatment for building owners. We suggest a 180 day make good period. Such an approach was developed for the Gillard Government's proposed green tax breaks program.
- The NABERS retail and hotel tools currently cannot be relied on as a standard for energy efficiency. The NABERS hotel rating is new and untested. The NABERS energy retail tool is being revised but the amendments will not deal with all outstanding issues.
- Currently there is no NABERS Commitment Agreement rating for retail or hotels. Retail and hotel developments are forced into Green Star.
- The proposed legislation appears to require a Clean Building to obtain and maintain an NABERS energy rating for all parts of a development that are rateable. This would oblige developments to obtain and maintain any and all ratings that are developed in the future. The requirement should only be to maintain ratings that have been obtained.

Consequences

Clean buildings will be unfairly excluded from the regime due to ambitious performance criteria that:

- the owner cannot control; or
- could be rectified if given a reasonable period of time.

Solutions

The following should be adopted to address the issues identified above:

- The NABERS rating scheme should apply to the base building component of an eligible clean building (as defined by NABERS).
- Owners should be able to obtain a 5 star Green Star Design and As-Built rating within 36 months of completion.

- If the performance of a Clean Building falls below the 5.5 star NABERS rating, the owner should have a make good period of 180 days before the 10% WHT rate is removed.
- Clarify that the 10% WHT rate applies at the time the Clean Building obtains either a Green Star Design certification or NABERS Commitment rating.
- Clarify that if a Clean Building does not obtain or maintain its final Green Star As Built or NABERS efficiency rating for whatever reason, the WHT rate reverts to 15% prospectively.

Given that a typical new Clean Building will take a number of years to return a profit in order to use the 10% withholding tax regime, these proposed changes will have a negligible impact on Government revenues.

Appendix A – Recommended Amendments to the Bill and EM

Recommendations

Legislative Amendments

Amend 12-385 and 12-390 to:

1) insert the words ("other than parts of the payments which are reasonably attributable to fund payments from a clean building managed investment trust)" after the words "fund payments" wherever occurring
2) insert after 12-385 (3)(a) and 12-390(3)(a):
"(aa) if the address or place for payment of the recipient is in an information exchange country and a part of the fund payment is reasonably attributable to a fund payment from a clean building managed investment trust – 10%: or"
3) insert after 12-390(6):
"(aa) if the recipient is a resident of an information exchange country and the covered part is attributable to a fund payment from a clean building managed investment trust – 10%; or"

Amend 12-425 to delete sub paras (b) and (c). Insert after (a) the words:

"(b) it traces an amount of assessable income from clean buildings held by the trust; or

(c) it holds a direct or indirect interest in another trust ("the other trust") derives an amount of assessable income from *clean buildings; and

(d) some or all of the assessable income of the MIT includes a distribution that is referrable to the assessable income from *clean building held by the other trust."

Delete 12-430 and replace it with:

"(1) A building is a ***clean building*** if:

(a) part or all of the building achieves practical completion that is certified on or after 1 July 2012; or

(b) part or all of the building satisfies the requirements in subsections (2) and (3).

(2) A building satisfies the requirements in this subsection if:

(a) the building is a commercial building; and

(b) part or all of the building is used to produce assessable income; or

(c) the building satisfies the requirements prescribed by the regulations for the purposes of this paragraph.

(3) A building satisfies the requirements in this subsection if:

(a) the building has achieved at least a 5 star Green Star rating for part or all of the base building as certified by the Green Building Council of Australia; or

(b) the owner of the building has applied to obtain accreditation from the Green Building Council of Australia for part or all of the base building and expects the building to achieve a 5 star Green Star rating for each part of the building that will be rated within 18 months of practical completion; or

(c) the building has achieved at least a 5.5 star energy rating for each part of the building that will rated National Australian Built Environment Rating System (***NABERS***) for part or all of the base building; or

(d) the owner of the building has applied to obtain accreditation from the National Australian Built Environment Rating System (***NABERS***) for part or all of the base building and expects the building to achieve at least a 5.5 star energy rating for each part of the building that will rated within 36 months of practical completion; or

(e) the building satisfies the requirements prescribed by the regulations for the purposes of this paragraph."

Explanatory Memorandum Amendments

Amend the EM (EM 1.7, 1.15, 1.16) to confirm:

- Clean MITs can receive ineligible income (taxed at the appropriate WHT rate);
- Clean MITs can hold ineligible buildings (taxed at the appropriate WHT rate).
- Delete the word "rental" from EM 1.15.

Amend the EM to make it clear that a new clean building includes non-structural substantial renovations (e.g. extensions, retrofit and change of use) that meet the energy hurdles.

Amend the EM (EM 1.21 and 1.23) to confirm that:

- Eligible sections of a mixed use development should receive the 10% WHT rate.
- All clean buildings can receive the 10% WHT irrespective of any associated facilities – the associated facilities should be listed completely or left out.

Amend the EM *(EM 1.26, 1.28,1.29, 1.32)* to confirm clean buildings must attain only one of:

- 5 Star Green Star (Design) rating; or,
- 5.5 Star NABERS Energy Commitment Agreement for the base building

Amend the EM to confirm that:

- 10% WHT rate applies at the time the Clean Building obtains either a Green Star Design certification or NABERS Commitment rating;
- if a Clean Building does not obtain or maintain its final As Built or NABERS efficiency rating for whatever reason, the WHT rate reverts to 15% prospectively.

Appendix B - Supplementary Material - Notice and Withholding Provisions

The Notice and Withholding Provisions

In our view, the proposed 10% WHT provisions are not properly aligned and, create inappropriate outcomes.

Currently, eligibility for the 10% WHT depends on the type of Australian entities and the order in which the income passes through those Australian entities.

Eligibility should not be affected by the type of entities or the order in which income passes through those entities;

The provisions need minor changes to properly align the outcomes and ensure eligibility is independent of the ordering of the chain of Australian entities.

While the Notice Provisions at 12-395 are appropriately drafted, the Tax Provisions at 12-385, will not allow Clean Building MIT income pass through a non-Clean Building MIT depending on which entities the income flows through.

The Notice Provisions

The notice provisions at 12-395 seem to be appropriately drafted and to properly provide for the tracing of CB MIT income through a chain of Australian entities:

Entity	Section	Provision	Comments
MIT and Custodian	12-395(3)(aa)	The notice….must specify the part (if any) of the payment which is reasonably attributable to a fund payment from a clean building managed investment trust	This seems to be the correct approach as it effectively traces the portion of the distribution of the CB MIT
Other Entities	12-395(6)(aa)	The notice….must specify the part (if any) of the payment which is reasonably attributable to a fund payment from a clean building managed investment trust	As above.

The Taxing Provisions

Under the Tax Provisions at 12-385, eligibility for the 10% WHT is dependent on which entities the income passes through:

Entity	Section	Provision	Comments
MIT	12-385(1) and 3(aa)	A trustee of a trust that is a *managed investment trust in relation to an income year that makes a *fund payment in relation to that income year to an entity covered by section 12 410 must withhold an amount from the payment if the address or place for payment of the recipient is in an information exchange country and the fund payment is a payment from a clean building managed investment trust – 10%;	A MIT which is not a CB MIT can only access the 10% rate if the fund payment is a payment from a CB MIT. A payment which is "reasonably attributable" to a CB MIT will not satisfy this requirement. As such CB MIT income cannot pass through a non-CB MIT
Custodian	12-390(1) and 3(aa)	A *custodian must withhold an amount from a payment (the later payment) it makes if: (a) all or some of the later payment (the covered part) is reasonably attributable to the part of an earlier payment received by the custodian that was covered by a notice or information under section 12 395; and (b) the later payment is made to an entity covered by section 12 410. if the address or place for payment of the recipient is in an information exchange country and the fund payment is a payment from a clean building managed investment trust – 10%;	CB MIT Income should pass through a Custodian at 10% provided that it is the only income covered by the relevant fund payment. The introductory words of the Custodian rules refers the reasonably attributable test in the notice provisions but the actual withholding rules is limited to fund payments from CB MIT's

Entity	Section	Provision	Comments
Other Entities	12-395(4) and (6)(aa)	An entity that is not a *managed investment trust or a *custodian must withhold an amount from a payment it receives if: (a) the payment or part of it (the covered part) was covered by a notice or information under section 12 395; and (b) a foreign resident (the recipient) is or becomes entitled: (i) to receive from the entity; or (ii) to have the entity credit to the recipient, or otherwise deal with on the recipient's behalf or as the recipient directs; an amount (the attributable amount) reasonably attributable to the covered part. if the recipient is a resident of an information exchange country and the covered part is attributable to a fund payment from a clean building managed investment trust – 10%;	These provision appear to be properly aligned with the notice provisions

Examples

The examples below highlight the random and perverse outcomes. Eligibility for 10% WHT is dependent on the order in which the income flows through the entities.

For instance, the clean building income can pass through a custodian (or another entity), to a foreign investor but not through another MIT and then a custodian to the foreign investor:

Chain of Entities	Notice Requirements	Withholding	Comment
CB MIT to Foreign Investors	No notices required	10% under 12-385(3)(aa)	Appropriate notice requirement
CB MIT to Other Entity to Foreign Investors	Notice from CB MIT to the Other Entity must specify the part (if any) of the payment which is reasonably attributable to a fund payment from a clean building managed investment trust.	10% under 12-390(6)(aa)	Appropriate notice requirement
CB MIT to Custodian to Foreign Investors	Notice from CB MIT to the Custodian must specify the part (if any) of the payment which is reasonably attributable to a fund payment from a clean building managed investment trust.	10% under 12-390(3)(aa)	Appropriate notice requirement
CB MIT to MIT to Foreign Investors	Notice from CB MIT to the MIT must specify the part (if any) of the payment which is reasonably attributable to a fund payment from a clean building managed investment trust.	15% because 12-385(3)(aa) does not contain a "reasonably attributable" test	This is a perverse notice requirement - it means CB MIT income is traced through all entities other than a MIT. If this is correct, it means that the very people most likely to build Green Buildings are incapable of accessing the 10% rate. It is also inconsistent with having a reasonably attributable test in the notice rules.

Chain of Entities	Notice Requirements	Withholding	Comment
CB MIT to MIT to Custodian to Foreign Investors	Notice from CB MIT to the MIT must specify the part (if any) of the payment which is reasonably attributable to a fund payment from a clean building managed investment trust. Notice from MIT to Custodian must specify the part (if any) of the payment which is reasonably attributable to a fund payment from a clean building managed investment trust.	15% because 12-390(3)(aa) does not contain a "reasonably attributable" test.	This is a perverse outcome notice requirement - it inappropriately denies the Foreign Investors access to the 10% rate.

Appendix C – 10 key problems solved by tracing

1. **The overall design of the draft legislation forces the use of stapled structures** (from a policy perspective) as this allows for the segregation of projects with a mixture of both qualifying and non-qualifying elements.

2. **The nature of some projects means that it is simply not feasible to separate the different elements of the projects into the different stapled vehicles**, meaning these otherwise eligible projects are unable to qualify.

3. **The draft legislation prejudices existing listed and unlisted REITs that are widely held by institutional investors**. The ability of these MITs to take advantage of this measure is severely limited, as it would require a change to their existing structures. Such changes require investor approval, result in significant costs and would only benefit non-Australian investors in the REITs. This could put existing Australian REITs at a disadvantage when bidding for projects in a competitive situation.

4. **These measures will require existing interests in land to be restructured into different vehicles**, to allow new 'clean building' projects after 1 July 2012 on the land to qualify for these measures. Any restructuring may give rise to both a CGT event arising on restructuring and a stamp duty cost. These costs will act as a disincentive to land owners taking action to so as to allow otherwise eligible projects to qualify for the 'clean building' initiative. Transitional CGT rollover relief will be required to enable restructuring of asset holdings to access the clean MIT regime. It is unclear whether the state governments will review and amend the stamp duties legislation to avoid imposition of stamp duty that may arise from restructuring.

5. When restructuring land holdings so as to take advantage of this 'clean building' concession**, the potential application of the general anti-avoidance provisions in Part IVA must be considered**. There is uncertainty as to how the courts would apply the Part IVA in relation to a scheme to entered into by a MIT for the sole or dominant purpose of accessing a lower tax withholding rate for its investors. Further, it is unclear how the general anti-avoidance provisions may apply following the changes arising from the current Part IVA review.

6. **A Clean Building MIT can be disqualified depending on the type of entities and order in which the clean income passes through those Australian entities** – for instance, the clean building income can pass through a custodian (or another entity), to a foreign investor but not through another MIT and then a custodian to the foreign investor. – eligibility should not be affected by these technical issues. Refer to Appendix C.

7. **A clean MIT will be disqualified where it passes income to a head trust** – that is, in line with intended MIT design.

8. **Current funding arrangements will need to be restructured**:

    a. Debt covenants will need to be reviewed and renegotiated as assets will be moved out of the current MIT group into the CB MIT.

    b. Prima facie, moving assets into CB MIT may result in breach of debt covenants unless they are renegotiated which may also result in funding risk to the current MIT group as renegotiated loan terms may not be as favourable as current loan terms.

    c. The CB MIT may be required to obtain separate debt funding for its clean building assets which will result in additional funding costs.

9. **Establishment of new CB MIT to hold the clean buildings will result in/require**:

    a. **Board approval** and/or securityholder approval to staple the new CB MIT to the current MIT.

b. **Additional regulatory and compliance fees** such as legal fees, registry fees, investor relations cots, etc to establish the new CB MIT, obtain relevant approvals, notify Securityholders and ASX, prepare necessary legal documentation to give effect to the new staple structure.

c. **Additional compliance costs** for new CB MIT – distribution calculations, income tax returns, GST returns, external tax compliance fees, financial reporting costs.

10. **Significantly limits development of clean buildings which are part of a mixed development**:

a. Mixed use developments will be ineligible for the 10% WHT tax rate unless the residential, commercial and retail developments can be segregated and transferred to different entities so that only the eligible clean buildings are held by the CB MIT. The Newcastle CBD urban renewal project is comprised of residential, retail and commercial developments across 19 addresses and 31 separate titles.

b. Restructuring the ownership of the mixed developments is not commercially efficient or viable as a general solution for obtaining foreign investment funding for clean building developments. As outlined above, the restructure will trigger CGT and stamp duty costs and require complex segregated funding arrangements for what is essentially a single development. It is not possible for the CB MIT to avoid these costs by only acquiring land relating to eligible clean building at the outset of the development project. This is because the land usage cannot be determined until the masterplan and development design for the entire urban renewal is finalised which results in higher CGT and stamp duty costs as the transferred land will have a higher value once development plans are approved.

Contacts

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