

20 April 2017

Division Head
Corporate and International Tax Division
The Treasury
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PARKES ACT 2600

Email: stapledstructures@treasury.gov.au

Dear Sir

Consultation Paper – Stapled structures

Chartered Accountants Australia and New Zealand (Chartered Accountants ANZ) is pleased to provide the following comments in response to the Consultation Paper on Stapled structures issued by Treasury on 24 March 2017.

Who we are

Chartered Accountants ANZ is made up of over 100,000 diverse, talented and financially astute professionals who utilise their skills every day to make a difference for businesses the world over. Our members are known for professional integrity, principled judgment and financial discipline, and a forward-looking approach to business. We focus on the education and lifelong learning of members, and engage in advocacy and thought leadership in areas that impact the economy and domestic and international capital markets.

We are represented on the Board of the International Federation of Accountants, and are connected globally through the 800,000-strong Global Accounting Alliance, and Chartered Accountants Worldwide, which brings together leading Institutes in Australia, England and Wales, Ireland, New Zealand, Scotland and South Africa to support and promote over 320,000 Chartered Accountants in more than 180 countries.

Background to the consultation

The release of the Consultation Paper follows closely on the heels of the ATO's Taxpayer Alert TA 2017/1 *Re-characterisation of income from trading businesses* and the draft *Privatisation and Infrastructure – Australian Federal Tax Framework* and the uncertainty created for stapled structures, including in relation to real estate and infrastructure, which are heavy users of such structures. Submissions on those documents conclude on 28 April 2017.

The Consultation Paper raises tax and other policy issues arising from those ATO documents. The tenor of the Consultation Paper is that the ability to use stapled structures poses a systemic risk to the tax system, i.e. risks which cannot be adequately dealt with by the ATO. However, it suggests that certain real estate investment trusts should continue to benefit from look through treatment in some form if stapled structures are no longer viable. Treasury is also interested in policy options for the development of 'critical' infrastructure.

We understand that the short consultation period is to allow the Government to consider the issues and respond appropriately in the forthcoming Budget on the way forward.

However, the short time frame also means that it is not possible for us to comment on the specific questions posed in the Consultation Paper, many of which raise complex policy issues. Instead, we set out below some relevant policy background and suggestions on the process to progress the consultation.

In summary, given the significance and complexity of the issues involved we urge the Government not to make any hasty decisions regarding the tax treatment of stapled structures in the Budget. Rather, we recommend that the Government use the Budget to provide as much certainty as possible on arrangements which are acceptable and a roadmap for the consultation process to address the issues posed in the Consultation Paper, potentially led by the Board of Taxation.

Relevant policy background

There is a degree of interaction between the issues in relation to stapled structures and the rules for managed investment funds.

There have been a number of reviews and changes to the tax arrangements for managed funds over the years¹. Those reviews have generally been conducted against established policy settings including that:

- The tax treatment for trust beneficiaries who derive income from a trust should largely replicate the tax treatment for taxpayers as if they had derived the income directly.
- In recognition of the tax advantages available to trusts that are not available to companies deriving business income, flow through taxation of income from widely held trusts, such as managed investment trusts, should be limited to trusts undertaking activity that is primarily passive investment to maintain competitive neutrality.

In today's environment those tax advantages, which are not available to shareholders in a company, are primarily the ability to distribute tax deferred income and, for resident individuals and superannuation funds, access to the CGT discount. For foreign investors, treatment of managed funds as trusts encourages investment in Australia and in Australia's fund management industry, particularly by foreign pension funds and sovereign wealth funds. In particular, as noted in the Consultation Paper, foreign investors can access concessional withholding tax rates on distributions under Australia's managed investment trust and royalty or interest withholding tax rules.

Implicit in these policy underpinnings is that allowing widely held, listed or publicly offered companies to be taxed like trusts would be detrimental to the corporate tax base.

¹ For a history of the changes and the reasons for those changes from the perspective of the author see Cooper, Graeme S., *Reforming the Taxation of Trusts – Piecing Together the Mosaic* (April 21, 2013). Sydney Law Review, Vol. 35, No. 1, pp. 187-235, 2013; Sydney Law School Research Paper No. 13/33.

The scope of activities which a managed fund may engage in and still be regarded as deriving primarily passive income has changed over the years mainly to remove uncertainties and ambiguities in the law and to keep pace with changes in commercial practice, particularly in respect of public unit trusts which invest in real estate. Arguably there remains room for improvement.

More recently, non-arm's length income rules were introduced to address integrity concerns associated with beneficiaries of a managed fund which is a managed investment trust or 'MIT' accessing the benefit of the trading/operational activities of a stapled entity in a tax advantaged way compared to investors in a company.

There have also been a number of changes designed to make the Australian funds management industry more attractive to foreign investors. These include changes to the rate and method of taxing foreign investors in managed funds which qualify as MITs² and relaxing the circumstances in which a trust would satisfy the MIT definition to benefit from the reduced withholding tax and the ability to elect for CGT treatment.

It is against this backdrop that the ATO has issued Taxpayer Alert 2017/1 and the draft *Privatisation and Infrastructure – Australian Federal Tax Framework*. The Taxpayer Alert is primarily concerned with arrangements which seek to fragment an integrated trading business in order to re-characterise trading income into more favourably taxed passive income. The issue is how to differentiate between acceptable and non-acceptable stapled arrangements.

The Consultation Paper is not seeking to address the specific issues raised in TA 2017/1. Instead it seeks to examine whether, despite the various reviews and changes which have already occurred, Australia has the right policy settings and, if not, what those policy settings should be.

Our submission

We appreciate the concerns expressed by Treasury in the Consultation Paper. We would therefore support a holistic examination of the taxation of investment income derived by stapled structures, including the dichotomy between trading and passive income. The increased use of stapled structures in the context of infrastructure privatisations and in industries which are not traditional users of such structures justifies a review, particularly when coupled with the MIT withholding tax rules.

In the event that stapled structures in their current form are found to pose a systemic risk to the tax system we would also welcome consideration being given to policy options for specific sectors identified by the Government. The Consultation Paper flags certain real estate investment trusts and investment in 'critical' infrastructure. In this regard we agree that we should draw on overseas experience where relevant to inform the policy debate.

We accept that the Government should be able to reassess and change policy settings where it is appropriate to do so. However, where this affects existing structures and impacts on the returns to their investors, particularly in long term projects, it will be a factor to be taken into account by potential investors in relation to future projects. Therefore any decision to transition, rather than grandfather, existing arrangements should not be taken lightly. This is particularly the case for stapled REITs which are not of concern but may incur substantial costs in transitioning to another structure.

² This culminated in a final flat rate of 15% withholding tax on MIT distributions (30% otherwise).

Where taxpayers which have operated within existing parameters (i.e. arm's length transactions and in line with industry practice) are required to transition, any transitional arrangements should also include protection from the ATO applying Part IVA of the *Income Tax Assessment Act 1936*.

In our view:

- Given the complexity of the issues involved and their long term significance, particularly in relation to infrastructure, the Government should be dissuaded from announcing any specific law changes prior to undertaking a thorough consultation process.
- To address the level of uncertainty which now exists the Government should use the forthcoming Budget to:
 - Refine its messaging to the extent possible on the sort of arrangements which are, and are not, of concern as a result of the limited consultation conducted by Treasury; and
 - Announce a consultation strategy which outlines the likely steps and indicative timeframes involved in developing an appropriate framework and its conversion into legislation. That timeframe should be realistic.
- The Government should consider tasking the Board of Taxation to lead this project. Not only did the Board conduct a *Review of the tax arrangements applying to managed investment trusts* which considered a number of issues raised in the Consultation Paper but it has also reported to the Government on the *Taxation Treatment of Collective Investment Vehicles*.
- The ATO should continue to target arrangements involving the aggressive use of stapled structures which undermine the corporate tax base. While TA 2017/1 purports to identify the arrangements of concern, our feedback is that it is ambiguous and would benefit from being rewritten and/or amended to more clearly identify the issues of concern.

If you have any questions please contact me on 02 9290 5609 or by email at michael.croker@charteredaccountantsanz.com or Susan Cantamessa on 02 9290 5625 or by email at susan.cantamessa@charteredaccountantsanz.com.

Yours sincerely



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