Ashurst

Contact

Steve Whittington
Partner, Tax
+61 2 9258 6547
Steve.whittington@ashurst.com

Vivian Chang
Partner, Tax
+61 2 9258 5732
Vivian.chang@ashurst.com

Sanjay Wavde
Partner, Tax
+61 2 9258 6135
Sanjay.wavde@ashurst.com

Ian Kellock
Partner, Tax
+61 3 9679 3075
Ian.kellock@ashurst.com

Submission on build to rent tax concessions

23 April 2024

Director
Corporate Tax Policy Unit
Corporate and International Tax Division
Treasury
Langton Cres
Parkes ACT 2600

By email only: btr@treasury.gov.au

Dear Corporate and International Tax Division

Introduction

Thank you for the opportunity to provide comments on the exposure draft legislation *Treasury Laws Amendment Bill 2024: Build to rent developments* and *Capital Works (Build to Rent Misuse Tax) Bill 2024* (collectively, the **Exposure Draft**).

Ashurst is a leading global law firm and in Australia (formerly known as Blake Dawson) is one of Australia's largest and most reputable firms. Ashurst's band-1 tax practice is one of the largest tax practices amongst Australian law firms. Ashurst advises clients across all industry sectors, including ASX-listed companies, large multinationals, private companies, funds, financial institutions and governments.

This letter sets out our submissions on the Exposure Draft , and is organised in two sections:

(a) Key policy issues identified in relation to the Exposure Draft; and

(b) Technical drafting issues in the Exposure Draft.

Section references are to the *Income Tax Assessment Act 1936* (Cth) (**ITAA 1936**), *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**), *Taxation Administration Act 1953* (Cth) (**TAA 1953**) and the Exposure Draft.

We would welcome the opportunity to discuss our submission with Treasury further, once you have had the opportunity to review.

* * * * *

Part 1: Key Policy Issues

General comments

We have detailed various submissions in respect of the Exposure Draft below. In general terms, the key points may be summarised as follows:

1. The exclusion of operational assets and assets under construction as at 9 May 2023 will provide no incentive for those assets to include an affordable housing component, create an unlevel playing field between taxpayers, and adversely impact investor sentiment as tax settings are capitalised into the value of exit prices on existing assets;

2. The exclusion of all income other than rental income from the MIT withholding tax concession is not consistent with the Government's announcement in the Budget 2023-24 (which taxpayers have relied on in making investments in the sector), and results in the accelerated depreciation measure and the MIT withholding tax concession counteracting each other – e.g., accelerated depreciation may shelter rental income (effectively at a 15% tax benefit for foreign investors), but will increase capital gains on exit (effectively, a 30% tax cost for foreign investors); and

3. The specific requirements to access the concessions are unduly onerous, and will not act as a sufficient incentive to attract foreign capital into the BTR sector, noting that foreign capital can invest in other jurisdictions and other real estate sectors without the onerous requirements to achieve a 15% MIT withholding tax rate.

In our view, these issues individually, and collectively, demonstrate that the Exposure Draft is not sufficiently concessional to have the desired level of impact on investor incentives.

Background

Following a National Cabinet Statement dated 28 April 2023, the Government announced in Budget 2023-24 (**Budget**) its intention to accelerate the rate at which capital works may be depreciated (from 2.5% to 4%) and reduce the managed investment trust (**MIT**) withholding rate (from 30% to 15%) for eligible new build to rent projects. The Budget outlined the Government's proposed eligibility requirements to access these concessions as follows:

> "*…this measure will apply to build-to-rent projects consisting of 50 or more apartments or dwellings made available for rent to the general public. The dwellings must be retained under single ownership for at least 10 years before being able to be sold and landlords must offer a lease term of at least 3 years for each dwelling.*"

The Explanatory Memorandum specifically notes that the intention of the Exposure Draft is to address Australia's housing supply and affordability crisis. The Explanatory Memorandum notes that more Australians are renting, and renting for longer, and that "*incentivising construction of new BTR developments has the potential to increase housing supply at scale at a time when there is an acute shortage of new rental stock*". It further notes that in comparison to the United States of America or the United Kingdom, the Australian BTR sector is a "*nascent industry… meaning there is significant scope for BTR developments to contribute to increasing housing supply.*"

The departures in the Exposure Draft from the Government's Budget announcement (discussed in detail below) will harm investor confidence, and this will be amplified as a consequence of the historical uncertainty created by various Governments of the tax treatment of income derived by MITs from build to rent projects. In this regard, we note:

- In 2008, the MIT regime was enacted with the explicit policy objective of attracting foreign capital into various sectors, including the real estate sector.[1] The concessional rate enacted was 7.5%.
- In 2012, the MIT regime was amended to double the withholding tax rate to 15%, with a 10% rate for fund payments made by clean building MITs.[2] Existing structures were not grandfathered.
- Foreign institutional investment in build to rent was abruptly interrupted by Exposure Draft Legislation in 2017,[3] at a time when build to rent was gaining traction as an alternative asset class. This Exposure Draft Legislation sought to facilitate institutional investment in affordable housing via MITs. However, crucially, the Exposure Draft Legislation included amendments which prevented a trust holding residential property other than affordable housing from qualifying as a MIT (i.e., effectively would have prohibited MITs from investing in BTR assets).[4] The notion that these amendments "clarified" that MITs were not intended to invest in residential property was not consistent with previous indications of the policy rationale for the MIT regime. This legislation was not passed, yet generated unnecessary and excessive uncertainty which stalled the growth of a sector that is now touted as critical in addressing the housing supply crisis.
- The Bill that was ultimately introduced into Parliament, being the *Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of*

[1] *Tax Laws Amendment (Election Commitments No. 1) Act 2008* (Cth).

[2] *Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012.*

[3] *Treasury Laws Amendment (Reducing pressure on Housing Affordability No. 2) Bill 2017.*

[4] Ibid, section 275-10(4C)(b).

Tax in Australia and Other Measures) Bill 2018, had the effect of doubling the MIT withholding tax rate on income and capital gains for most forms of housing (to 30%), other than certain preferenced forms of housing (such as affordable housing and specialist disability housing). The Senate Economics Legislation Committee Report in November 2018 included additional comments from Labor Senators who (correctly) regarded the recent legislative developments as a "back flip". Submissions and testimony provided for the purposes of the Report noted that "*the message that went out to the world was that the Australian government doesn't support build to rent housing*". **The Report stated that Labor Senators remained concerned about the impacts of the Government's past decision making and how it has deterred investment and new supply in Australia's housing market, despite the Government's so-called commitment to housing affordability**. In our view, the Exposure Draft's inconsistencies with the Government's Budget announcement risks doing exactly the same.

We submit that in order for the underlying policy objective of increasing the housing supply to be achieved, the measures must be made more concessional, and the eligibility requirements in order to access the concessional measures must be made less restrictive. Without amendments to the proposed measures, foreign institutional capital will continue to preference other asset classes which provide less restrictive and more concessional tax treatment.

Specific Policy Issues

1. Exclusion of operational or mid-construction build to rent developments

As drafted, the Exposure Draft is not intended to apply to operational BTR assets, or BTR projects under construction, as at 9 May 2023.

The exclusion of these BTR assets is unfair and will fail to further the Government's objective of increasing affordable housing, as well as prejudicing existing taxpayers within the BTR sector by granting new entrants a competitive advantage.

While we understand the non-application of the concessions to these assets is to act as an incentive only for new construction and investment, this limitation will have adverse impacts on the BTR sector for a number of reasons:

(a) First, taxpayers holding assets that were operational or under construction as at 9 May 2023 will have no incentive to satisfy the requirements to be classified as a BTR development, as no concessions will be available. Accordingly, for all of those impacted assets, there will be no incentive to meet the affordable housing requirements, or offer tenants more long term secure tenancies. With respect to the quantum of dwellings impacted, a report commissioned by the Property Council of Australia, and prepared by Ernst & Young (**PCA Report**), noted that as at February 2023, 3,909 build to rent apartments were operational, the majority of which were funded by foreign capital, i.e., the type of investor the concessional MIT withholding rate seeks to attract. Further, the PCA Report also noted that 7,431 apartments were under construction, with a further 11,835 apartments in the planning phase. While the PCA Report does not explain the basis of the distinction between 'construction' and 'in planning', it is not uncommon for certain costs that are incurred very early on a project (such as earthworks) to be treated for tax purposes as capital works, such that BTR assets comprising up to nearly 23,000 apartments may be impacted. Further, it is probable that further build to rent projects were in planning or had entered construction from the date of the PCA Report to the Budget time. The Exposure Draft misses the opportunity to increase *affordable* housing supply by approximately 2,300 dwellings, and to ensure that tenants have the opportunity to obtain the security of a long term tenancy in approximately 23,000 dwellings.

In our view, the Exposure Draft should be amended to permit pre-existing BTR assets and those under development as at 9 May 2023 to qualify for the relevant concessions, provided that they meet the requirements in section 43-152(3). If there is reticence to provide accelerated depreciation on these assets, the two measures could be de-linked so that the MIT withholding tax concessions would apply to all assets (but the accelerated depreciation would only apply to capital works incurred after 9 May 2023).

(b) Second, adopting materially different tax treatment for some BTR assets creates an unlevel playing field with respect to the competitive environment in the BTR sector. In short, some taxpayers will be forced to compete against other taxpayers who receive preferential tax treatment, which (in turn) impacts the decisions they make regarding (for example) rent to charge, services to provide, among other similar commercial factors. We note that this has been a material concern of Treasury when laws are changed in an adverse manner for taxpayers – to take an example, Treasury was reluctant to provide grandfathering or transitional arrangements as part of the thin capitalisation measures, on the basis that it could skew the competitive environment in favour of incumbents who had pre-existing financial arrangements on issue. We submit that the same logic, and the same approach, should be adopted for these concessional tax measures.

(c) Third, we are informed by our clients that one of the key issues with sourcing capital to invest in BTR assets is to establish that the assets will be comparably priced to other real estate assets at the time of exit. That is, although MITs invest in real estate primarily for the purpose of rent, an important component of investors' overall returns may be forecast capital gains on exit. Because there are limited assets in the BTR asset class in Australia, there have also been limited sales (and so limited pricing information). If the first traded assets are those assets that are treated adversely from a tax perspective, it is expected that that will lower their market prices. This, in turn, will impact investor sentiment on new BTR assets, as the pricing information available will suggest limited capital growth opportunities.

(d) Fourth, it is unfair on taxpayers who were early movers in the BTR space, and will discourage taxpayers more generally from being early movers when they are expecting tax changes. Many taxpayers made investments in the BTR sector on the basis of reasonably anticipated tax changes. To take an example of why this was reasonable, Chris Bowen, then Shadow Treasurer (and now the Minister for Climate Change and Energy) announced on 29 March 2019 in an address to the Financial Services Council:

> *"We think there's more to be done here, and is why today I can announce that an incoming Labor Government will reform the tax treatment for Build to Rent to ensure it's a viable part of the housing market in Australia, just as it is in several comparable countries.*
>
> ***We will do this by ensuring Build to Rent housing can be included within a Managed Investment Trust when they meet requirements that are currently in place for commercial property assets, basically where they are a passive investment held primarily for the purpose of deriving rent.***
>
> ***This means that eligible Build to Rent investments will pay a 15% tax rate, not the 30% rate proposed by Scott Morrison, which would be double the rate for investments in shopping centres and office buildings.***
>
> *It will make build to rent viable in Australia and provide a tax rate in keeping with the treatment in other countries.*
>
> [Emphasis added]

In an investment environment, taxpayers often act upon the opposition's policy agenda to anticipate tax changes on the reasonable assumption that there will be a change in Government. Yet, the Exposure Draft fails to account for taxpayers who paved the way for BTR to gain traction within

Australia, by explicitly denying them the concessions that were advocated for when the Government was in opposition.

Many taxpayers relied on announcements of this nature as part of making a decision to invest in BTR assets. These taxpayers are delivering increases in the housing supply more quickly, which is what the Government is hoping to achieve, and so it seems perverse to penalise them. In addition, many of the early investors are foreign investors, given their understanding of the asset class in foreign jurisdictions. If the concessions are now limited to exclude these taxpayers, the message being sent to investors is very clear: do not invest early, do not anticipate tax changes; rather, wait until the Budget announcement is made. Such an approach, if it had been adopted, would only have worsened Australia's housing affordability issues.

(e) Fifth, and finally, this approach to tax policy making more generally will adversely impact investment. If integrity-related measures are not grandfathered and not subject to transition, but concessional measures only apply to investments made after the date of Government announcement, the implication for investment decisions is: the tax treatment of your existing assets can only be adverse – you will be subjected to integrity measures, but you will never receive a concession. This is not a favourable environment for foreign institutional capital to continue to invest in Australia.

2. 15-year limitation

The introduction of a build to rent compliance period of 15 years, during which the MIT withholding tax concession applies, is not consistent with the Government's Budget announcement, which many taxpayers relied on in making decisions to invest in BTR assets. For those taxpayers that relied on the Government's announcement, they will now find that their modelling supporting the investment is incorrect, and that projects may now not be economically feasible.

The 15 year limitation for the MIT withholding tax concession will mean that there is little additional incentive to invest in BTR assets in Australia. For many BTR projects, it is not uncommon to take 8-10 years in order to generate net (or taxable) income. This position is likely to be pushed out further as a consequence of the capital works concession. Accordingly, the MIT withholding tax concession is likely to have application only for a very limited timeframe – potentially, approximately 5 years. In addition, and because the concession only applies for that 15 year period, any capital growth will take into account the subsequent loss of the concession, again impacting project economics.

We would strongly recommend that Treasury consider some financial models of BTR projects, in order to understand the extremely limited nature of the concessions being proposed. In short, based on our understanding of those financial models, most foreign institutional investors would see little additional incentive to invest in BTR assets (and, in fact, they may be worse off as a consequence of the affordability requirements).

More generally, we note that foreign institutional investors have options as to where they invest their funds, including in respect of other Australian asset classes (such as commercial office, retail, etc.). There is no time limit for withholding tax concessions in respect of these other asset classes. Given these tax settings, we understand many foreign institutional investors would have little incentive to re-allocate their targets in the Australian market.

3. **Reduced MIT withholding rate only applies to eligible fund payments consisting of rental income**

The Exposure Draft excludes any other form of taxable income from being eligible for the MIT withholding tax concession, other than rental income. For example, any forecast capital gain arising from the disposal of a BTR asset will not be eligible for the MIT withholding tax concession. This position is not consistent with the Government's Budget announcement (again, which many taxpayers relied on in making investments), but it will more generally nullify the incentive to invest in BTR assets.

With respect to the Budget announcement, this simply stated that there would be a *"[reduction of] the final withholding tax rate on eligible fund payments from managed investment trust (MIT) investments from 30 percent to 15 percent"*. There is no general feature in the MIT regime where capital gains are treated in a different manner to rental income (other than capital gains in respect of non-land assets). Accordingly, taxpayers relied on the Budget announcement in making investment decisions, justifiably considering that capital gains on their BTR investments would be eligible for a 15% withholding tax rate.

More generally, one consequence of prohibiting capital gains from being eligible for the MIT withholding tax concession is that the two concessions – the MIT withholding tax concession and the capital works concession – actually work against each other. To take an example, the capital works concession in the form of accelerated depreciation will decrease taxable income during the holding period, being taxable income in the form of rental income. In other words, the capital works concession will have a tax effect of 15% of the accelerated amount. However, capital works deductions also have the effect of reducing the cost base for capital gains tax purposes, such that the capital works concession will ultimately increase the capital gains in respect of the BTR asset – capital gains that will be subject to tax at 30%. Accordingly, what the measures give with one hand, they take away with another. This combined impact will severely limit the overall impact of the concession on investors' willingness to invest in BTR assets. We have attached a modelled scenario of this impact in the Appendix.

The second consequence is simply that foreign capital will be able to invest in other assets that are not subject to such materially different treatment – for example, a foreign investor investing in commercial office buildings, logistics assets, student accommodation assets, retail assets – may be able to achieve a 15% withholding tax on both rental income and capital gains. Accordingly, the proposed exclusion of capital gains will materially reduce their incentive to shift target allocations into the BTR sector.

We submit the MIT withholding tax concession should apply to all income and capital gains derived from eligible BTR assets.

4. **Affordability requirements and lack of trading trust safe harbour**

We understand paragraphs 43-152(3)(d) and (e) are intended to ensure that at least 10% of dwellings within a build to rent development are affordable dwellings throughout the build to rent compliance period and that at least one apartment of each type, e.g., different combinations of floor size, bedrooms and bathrooms, must be an 'affordable dwelling'.

In order to meet the general MIT requirements, it is necessary (in this circumstance) that the trust invests in land for the purpose, or primarily for the purpose, of deriving rent. That is, a trust that is a "trading trust" is not eligible to be a MIT. One impact of the affordable housing requirements is that the trust will derive less rent than it would be able to if it charged market rents. Accordingly, the affordable housing requirements may have the effect that many trusts will in fact not meet the MIT requirements, which in turn will mean they are ineligible for the MIT withholding tax concession.

In our view, there are various solutions that could be adopted that would not jeopardise the affordability requirements as follows:

1. First, a safe harbour could be introduced exempting trusts that invest in build to rent development from needing to satisfy the trading trust requirement for MIT status. Given the requirements for the asset to be held under single ownership for a period of 15 years, this should ensure that the asset remains used as a BTR asset throughout this period (i.e., the asset could not be sold as units).
2. Second (and alternatively), the Exposure Draft could provide that in ascertaining whether the trust is a trading trust, the rental income from the affordable housing component is to be determined by reference to market rent.

On the affordability requirements more generally, we note a number of issues:

- The requirement that each dwelling type has a dwelling that is affordable is unduly onerous. To take an example, it is not uncommon for penthouse apartments and sub-penthouse apartments to be designed as premium dwellings with different amenity value (e.g., floor space, bedrooms, etc.). If a building has (for example) two penthouse apartments and four sub-penthouse apartments, half of the penthouse apartments and a quarter of the sub-penthouse apartments will be required to meet the affordability requirements. We do not see the rationale for requiring this: the policy surely is not to make premium products (such as a penthouse apartment) affordable (which may require a discount in excess of 25.1%, in which case the there will be a de facto lottery to secure these apartments, wasting tenants' time with applications to affordably priced luxury apartments); it is to ensure that all BTR assets have a component where Australians are able to live affordably.

- Affordable dwellings must be tenanted by eligible tenants, and the Policy Fact Sheet notes that in applying the income thresholds, an owner of a build to rent development will be required to assess the initial and ongoing tenant eligibility. Although it is not entirely clear, it is implied that if a tenant is subsequently identified as ineligible, the conditions in section 43-152(3)(d)(ii) would not be satisfied. To take an example, if a tenant received a pay increase, or became a spouse, or provided an income tax return as evidence of gross earnings, and subsequently amended that return to disclose increased earnings, the relevant thresholds may be exceeded. It would likely be illegal to remove that tenant from the building on the basis that their income had increased (or their marital status had changed). Accordingly, if these rules are to apply on an ongoing basis, BTR assets will need to have a much higher proportion of affordable tenancies (in the above example, both of the luxury penthouse apartments would need to be affordable, to operate as a buffer if one of the tenant's income increased). This is simply not a workable solution (and it will be sufficiently adverse to returns to counteract the concessions). Accordingly, we recommend that income levels should only be tested on a historical basis at the date of signing the lease.

- The Exposure Draft should provide rules as to what constitutes 'amenities', as there is considerable uncertainty as to types of dwellings that need to have at least one equivalent affordable dwelling. For example, for design / planning reasons, it is plausible that all three bedroom, two bathroom apartments within a building have slightly different dimensions, floor plans, etc. such that they are each unique. Similarly, it is not clear if amenity would include (for example) views, and other similar factors. Given these uncertainties, we recommend that the legislation provide that apartments are considered the same where they have the same number of bedrooms and bathrooms, and any smaller apartment is within 80% of the floor area of the larger apartment. This will ensure that taxpayers can appropriately identify the relevant groups of apartments (if this requirement is to remain).

We also strongly recommend that safe harbours be included so that if the affordability requirements are failed in minor ways, or for insignificant periods, that the misuse tax does not apply (i.e., where the failure is subsequently remedied). The prospect of a punitive rate of tax applying, even where the relevant taxpayer has tax losses (discussed below), will discourage most taxpayers from seeking to qualify.

Finally, we strongly recommend that Treasury consider some financial models for potential BTR projects, and consider the impact of the affordability requirements. Our understanding is that the affordability requirements substantially erode, if not entirely erode, the concessions being provided (from an internal rate of return perspective), such that the concessions are highly unlikely to result in a step change of investment in the sector. Treasury should consider providing further concessions, such as to treat net rental income (if any) from the affordable component as not subject to MIT withholding tax at all (or treat the proportion of the dwellings that are affordable (i.e., at least 10%) of the fund payment as subject to tax at a lower rate, such as 5% or 10%).

*   *   *   *

Part 2: Technical Issues

1. **Application of amendments**

The amendments made by the Exposure Draft apply to capital works that commenced after 7:30 PM on 9 May 2023. As currently drafted, it is not clear how this is intended to apply with respect to the MIT withholding tax concession. In particular, MIT withholding tax applies to fund payments, and it is not clear if the rules require (for example) pre- and post-9 May capital works to be separately recorded, and income be allocated (on some basis) between those capital works to determine which part of a fund payment is eligible for the concessional withholding tax rate.

As noted above, we recommend this be removed, so it also applies to capital works begun prior to that time. However, if that is not the case, the section needs to be updated to make it clear how it applies in the context of the MIT withholding tax concession.

2. **Misuse tax**

The current formulation of the build to rent misuse may result in a tax being payable notwithstanding a taxpayer is in an overall tax loss position. Presently, the build to rent misuse tax is 1.5% of the build to rent misuse amount. The build to rent misuse amount is the sum of the amount of the build to rent capital works deduction amounts and ten times the build to rent withholding amounts.

Where accelerated depreciation has been claimed and there is a subsequent failure of the relevant requirements, the misuse tax will apply and be payable, even if the taxpayer would be in a tax loss position in the absence of the overclaimed depreciation deductions. Accordingly, tax may be payable (at a rate that includes an interest component), notwithstanding there would have been no tax payable if capital works deductions were claimed at a 2.5% rate. In addition, and as noted above, the misuse tax could apply through no fault of the trustee. This makes little sense. We would recommend that the accelerated depreciation deductions should be reversed by including an amount in assessable income equal to that amount.

If the misuse tax is retained (as opposed to including the amount in assessable income), the tax will be a significant disincentive to investors, as they will ultimately end up in a worse position than if they had simply not sought to qualify for the concessions. This is especially the case given the prospect of failing to meet the requirements through circumstances beyond the control of the trustee.

3. **Period of tenancy**

The eligibility requirement imposed by section 43-152(3)(a) requires that each dwelling is available to the public to be tenanted by way of lease for a period of 3 years or more or is currently tenanted by way of a lease that was offered for a period of 3 years or more. However, the Note states that for the purposes of this requirement, a lease is still offered to the public for a period of 3 years or more even if a prospective tenant subsequently requests and the lessor accepts a shorter lease. The note should be updated to clarify that provided the tenancy is offered for a period of three years, that this is sufficient. To elaborate, it is common in the BTR sector for apartments to be offered on terms of one year, two years, or three years at the election of the tenant. The note currently suggests that a one year tenancy would be acceptable, but only if the tenant suggests it. If this is the intended impact, logistical issues may arise in that tenants may be unaware of their right to request a shorter lease term.

4. **74.9% rent threshold**

Subparagraph 43-152(3)(d)(i) outlines one of the key affordability requirements associated with the underlying policy objective of increasing the affordable housing stock. The section presently refers to "rent payable under any lease offered to the public for the dwelling is 74.9% or less of the market rent". In competitive environments, in order to secure a lease, it is not uncommon for individuals to offer above the asking price for rent in order to secure suitable accommodation. The Explanatory Material should be updated to confirm whether this is acceptable – i.e., whether, in this circumstance, the relevant requirements are met as the rent is payable under a lease which was "offered to the public" at 74.9% or less of the market rent.

More generally, we note that taxpayers may offer tenants a number of services or potential add-ons – such as furnishings, dog walking, dry cleaning, etc.. It would be useful for the Explanatory Material to expressly state that payments for these items are not included in the rent, even where they are bundled in one lump sum payment. Other potential tenant amenities of this nature include access to a swimming pool, gym, rooftop terrace, or co-working spaces,

5. **Market rate of rent**

The use of the undefined term 'market rate' gives rise to ambiguity. It is not clear, for example, whether "market rate" refers to the rent payable for equivalent units in the same building, or average rent in the suburb, or city, etc.. To assist taxpayers in meeting the requirements, we recommend that the concept of the market rate of rent be clarified to confirm that it is a reference to rent for the equivalent units in the same building. In addition, it should be clarified (in the Explanatory Material) that taxpayers may determine this on different reasonable bases – e.g., they could use the average rent of those comparable units (excluding affordable houses), or they could use an average weighted to more recent leases (given the length of tenor of some of the leases). This is material because failure to properly ascertain what constitutes market rent will distort the discount provided for affordable dwellings, and risk taxpayers failing to meet the requirements.

Consistent with the comments above, the concept of a market rate of rent should also be clarified that it does not capture fees for services or furnishings, or other similar items.

6. Stapled structures

Build to rent developments, as with other asset classes such as student accommodation, are commonly held within stapled structures. This is often done for legal reasons (i.e., to protect assets from potential liabilities) and to simplify arrangements with tenants who want services to be provided to them (e.g., dog walking, dry cleaning). One common structure is for the asset-holding trust to lease the building to the operating entity, and the operating entity to enter into subleases with tenants (so that the tenant is subleasing and being provided services by the same legal entity).

Based on our reading of the legislation, this kind of arrangement should not prevent the relevant concessions from applying. However, it should be clarified that it does not matter if the units are offered to the public by an entity that is not the freehold owner of the property.

7. Failure for reasons outside the control of the trustee

As presently drafted, once there is a failure of the relevant conditions, the asset ceases to qualify for the concessions. However, it is possible that failures may arise temporarily, or for reasons outside the control of the trustee. To take an example, if a person misrepresents their income, it is possible that this could result in a failure of the affordable housing requirements.

We strongly recommend that a safe harbour be included so that where the conditions are not satisfied on a temporary basis, or for reasons outside the control of the trustee, that the relevant requirements are considered to be satisfied. In addition, we recommend that the Commissioner should have a discretion to treat the requirements as being satisfied where he considers it fair and reasonable to do so.

8. Reporting requirements

The imposition of reporting requirement is unduly onerous. We note, in this regard, that there are no equivalent reporting requirements of this nature for MITs generally, including for MITs that are concessionally taxed (e.g., clean building MITs). The reporting requirements will act as a further deterrent for investment, particularly in the absence of the measures being as or more concessional than the tax treatment of other asset classes.

Appendix

Please refer to excel spreadsheet.

Depreciation @ 4% p.a. (different tax rates)

		0	1	2	3	4	5	6	7	8
Cost base		100.0	96.0	92.0	88.0	84.0	80.0	76.0	72.0	68.0
Depreciation	4%		4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Tax saving from depreciation	15%		0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6
Additional tax on capital gains due to depreciation	30%									
Total tax benefit/(cost)			0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6

9	10	11	12	13	14	15	Total
64.0	60.0	56.0	52.0	48.0	44.0	40.0	
4.0	4.0	4.0	4.0	4.0	4.0	4.0	
0.6	0.6	0.6	0.6	0.6	0.6	0.6	9.0
						- 18.0	- 18.0
0.6	0.6	0.6	0.6	0.6	0.6	- 17.4	- 9.0