Law Council OF AUSTRALIA

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The Treasury
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20 April 2017

Dear Robert

Stapled Structures – Consultation Paper

The Business Law Section of the Law Council of Australia welcomes the opportunity to provide its submission on the Consultation Paper on Stapled Structures. (the **Consultation Paper**). The submission below represents the views of the Taxation Committee, the Corporations Committee and the Foreign Investment Review Committee of the Business Law Section (the **Committees**).

The Committees acknowledge that submissions will be made available on the Australian Treasury website and does not seek to keep this submission confidential.

The Consultation Paper is premised on there having been a growth in arrangements that re-characterise trading income into more favourably taxed passive income, expanding into new sectors beyond infrastructure and property.

The Committees note the history to staples as summarised in the Consultation Paper. These structures have, as noted, been around since the 1980s. Not noted in the Consultation Paper is that over the many years, the Australian Taxation Office has considered, reviewed and ruled on many of these structures. It is only now, near 30 years after the first stapled security was issued in Australia, that the ATO has publicly raised concerns with the use of the structure and Treasury considered that the underlying policy basis and settings need revisiting.

These structures were well understood when Subdivision 124-Q was introduced, when the Board of Tax considered reform of section 974-80[1] and when significant concessions were made to Division 6C in 2008 with the passing of Tax Laws Amendment (Election Commitments No 1) Act 2008 (which introduced, among other things, the 25% and 2%

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[1] Refer Discussion Paper issued by the Board of Tax in March 2014 titled 'Review of the Debt and Equity Tax Rules', in particular paragraph 5.46 of the where the Board notes as follows:

> *"The Board understands that stapled structures are a commercial reality and are a significant subset of the investment population."*

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safe harbours and expanded the range of financial instruments in which investment could be made).

In August 2015 the Senate Economics Reference Committee issued a report as part of its review into corporate tax avoidance and minimisation in which it recognised the existence of staples and the split of passive and active income as follows:

> ***2.10 Property trusts, such as Real Estate Investment Trusts (REITs), do not pay corporate income tax on passive rental income but distribute this to investors who pay***
> ***tax at their own individual tax rate.4 In Australia, stapled securities are used to split***
> ***the passive and active income earning activities of property investments. Active income from trading activities, such as funds management and property development,***
> ***are subject to corporate income tax.***

The Committees acknowledge the suggestion that there may be structures that "artificially re-characterise active trading income as a passive income flow to reduce their overall tax liability", structures that "take advantage" of concessional tax treatment offered by the MIT regime and also structures which may have achieving a tax benefit as the "predominant driver of the fragmentation". However, these structures, particularly with the form of language used in the Consultation Paper to describe them, should be addressed through existing tax laws and not form the basis for broader policy and legislative reforms. The Committees suggest that these issues are able to be, and would be best, dealt with through compliance activities and applying existing laws, including section 102R, sections 275-605, 275-610 and 275-615 and Part IVA[2].

The Committees submit that if, contrary to the view above, there is a need for the law to be amended to address a policy shift, it should be either that there is a review and reform of certain aspects of Division 6C (being the activities which constitute eligible investment business and the safe harbours) or a tailored avoidance or similar provision addressing only those specific structures that involve highly structured fragmenting of trading businesses, which "go well beyond the original policy intention".

In the words of the Board of Taxation when considering the application of section 974-80 to stapled structures: "if there are any specific integrity concerns, any response should be proportionate and carefully targeted at genuine cases of mischief".[3]

The Consultation Paper notes that the Government is committed to ensuring that Australia is an internationally competitive location for foreign investment. The Committees support this proposition and consider that any decision for reform be taken with full regard for this objective.

The Consultation Paper poses a series of specific queries, on which we provide specific comments below.

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[2] Also having regard to published views on these rules by the Commissioner of Taxation, for example LCG 2015/15, TD 2015/2, TD 2015/3 and now TA 2017/1.
[3] Refer Discussion Paper issued by the Board of Tax in March 2014 titled 'Review of the Debt and Equity Tax Rules', paragraph 5.46.

We note that the questions asked and issues that require consideration warrant a consultation period greater than four weeks. The Committees do not consider that clear well considered policy would be able to be developed if there was an attempt to work toward an announcement of changes in the 2017-18 Federal Budget.

1. How important are the non-tax reasons for using stapled structures? Please explain your view.

There are a variety of non tax reasons for adopting a stapled and/or fragmented structure. The importance of which will vary with every particular arrangement.

The fragmentation of asset ownership can be relevant for financiers, who may prefer to lend to the entity with ownership of assets which are not directly affected by operational liability. The structure allows for clear ring-fencing for groups of financiers.

The separation can be important for flexibility in future separation of the assets from the operation. Even where initially stapled, the interests are easily unstapled and operations can be sold by a clear entity sale without assignment or novation of contracts and moving significant amounts of assets (with attendant registration and other administrative complexities).

A common key factor, as noted in the Consultation Paper, is the ability for investors to obtain cash returns in early years which would otherwise be restricted without accounting profit. This is often important for investors to show steady returns over the lifecycle of the project, consistent with industry expectations of “bond-like” returns from infrastructure. If cash is trapped within the project, it will adversely impact the return on the investment.

It is important to note that tax related reasons for using stapled structures do not necessarily depend upon any reduction in the total income tax payable in respect of the relevant activities. In particular, stapled structures can ensure that a significant proportion of the tax liability for a project is incurred at the investor level, rather than at the project vehicle level, which can considerably facilitate the financial viability of borrowings by the project entity. Even though financiers will generally have security, so that their lending will thus rank ahead of unsecured liabilities for income tax, financiers wish to be confident that the project cash flows can fund project liabilities so that events of default or project insolvency are unlikely and therefore prefer that cash flows are determined to the maximum extent possible on a pre-tax basis. The financial modelling for projects generally assumes that the trust side of a stapled structure will not incur income tax liability (thus ensuring that cash flows are available to meet debt service commitments), and the legal input into such a project invariably includes the requirement for an opinion that the trust side of the stapled structure is capable of qualifying for tax flow-through treatment. This does not depend, in any way, on achieving a reduction in the overall tax liability – as long as the liability is borne by the investors rather than the project vehicles, the financiers will largely be indifferent to the total income tax liabilities generated by the project.

Stapled structures are also particularly important for tax exempt investors including State and Local governments and their various bodies (including superannuation and investment bodies). The use of the structure can often mean the difference between these bodies investing and not investing in a project. There are a number of reasons for this, including that given their nature, a 20% or greater investment by a tax exempt body into certain trusts can change the character of that trust for other investors from a flow-through to a taxable entity.

2. What impact would the loss of an ability to make cash distributions at the early stages of a project have on the attractiveness of long-term infrastructure investment for investors? Are there alternative ways to address this problem, such as used in other countries?

As noted in the Consultation Paper, fragmented structures can result in distributions to investors in periods where accounting profits have not accrued. This is often relevant in long term projects with early stage loss periods. As noted, this can be attractive to pension funds in meeting their cash flow needs, however it is broadly relevant to all sophisticated investors with investment parameters requiring consistent returns.

The inability to make such distributions would, as Treasury obviously acknowledges, have an impact on the investor, and consequently funding of the investment (where investors that require such returns divert their capital elsewhere).

One area of reform that may go part way to addressing this issue is in the ability of a company to pay dividends where it does not have profits. While the amendments made to the Corporations Act in 2010 to remove the profits test were thought to be amendments which went to achieving this outcome, it is generally considered that they did not.

Prior to the amendments to section 254T in 2010, a company was specifically restricted in that section to only paying dividends out of company profits. Accounting profits are often neutralised by non-cash expenses, even though companies otherwise have sufficient cash resources to pay a dividend.

While the profits test was removed from the specific words of section 254T and replaced with a solvency-based test, which allows a company to pay a dividend where:

(a) the company's assets exceed its liabilities immediately before the dividend is declared and the excess is sufficient to meet the payment of the dividend;
(b) the payment of the dividend is fair and reasonable to the company's shareholders as a whole; and
(c) the payment of the dividend does not 'materially prejudice' the company's ability to pay its creditors,

it did not remove the profits test from company law. The text of the new section 254T states when a company may not pay a dividend. It does not say when a company may pay a dividend. While the intention of the changes in 2010 seems clear, the words of the new section 254T can only be taken so far. This has been acknowledged by the ATO in TR 2012/5 (refer in particular, paragraph 34).

Given this, regard could be had to amending section 254T of the Corporations Act to specifically state that profits are not needed in order for a dividend to be paid, together with attendant amendments to the Income Tax Assessment Acts (in particular, section 44). However, even if this issue is addressed, it will not necessary provide the same level of flexibility as stapled arrangements in all circumstances and, more importantly, the other commercial issues identified above are still extremely relevant.

3. Are there other countries where the use of stapled structures is common? If so, please provide details, including an outline of the tax rules applicable to stapled structures.

The Committees submit that simply focusing on stapled structures alone without a broader consideration of features of each tax regime, such as corporate tax rates, withholding taxes, the existence of other concessionary regimes or tax flow through vehicles, is flawed.

As the Discussion Paper notes, both the US and Canada have implemented laws which impact on the use of stapled structures in those jurisdictions, but both have concessional REIT regimes.

The REIT regimes of Germany, Singapore, Hong Kong, Japan have also all been given significant consideration by Government, with the Board of Tax analysing each in 2008 as part of its review of Managed Investment Trusts.

The Board of Taxation has also noted the considerable use of Common Contractual Funds in Ireland and SICAVs in Luxembourg and the extent of capital invested in those funds from Asia, a key jurisdiction in which Australia competes for inbound capital.[4]

In short, the context in Australia is different.

The government has clearly recognised that Australia's corporate tax rate is very high by international standards. It has also been recognised that 'at the international level, Australia's tax system stands out for its heavy reliance on company income tax'[5]. It should not be assumed that, just because (if this is the case) relevant sectors of other countries' economies can work adequately without stapled structures, that that would necessarily be true in Australia.

It is not possible in the short timeframe of four weeks to prepare and present a detailed comparative analysis which allows for a holistic comparison of the tax treatment of infrastructure and property vehicles in relevant competing jurisdictions. However, we agree that this analysis is useful and necessary before reaching any conclusions on the future treatment of stapled vehicles in Australia.

4. Are there other countries which provide specific tax concessions or a separate regime for infrastructure investments? If so, please provide details of the concessions or regimes.

We refer our comments above.

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[4] Refer the Board of Tax's report to the Assistant Treasurer on the Review of Tax Arrangements Applying to Collective Investment Vehicles dated December 2011.
[5] Australia's Future Tax System, www.taxreview.treasury.gov.au.

5. How important is tax in determining the international competitiveness of Australia as a foreign investment location for assets and activities typically placed in stapled structures?

While much can be written on this, the Committees submit that this work has been done.[6] As an example, the Committees refer to the extensive analysis undertaken by the review panel, chaired by Ken Henry, on Australia's Future Tax System, which reported to the Treasurer in 2010.

The broader analysis on the taxation of investments (generally) is applicable to any of the assets and activities typically placed in stapled structures.

Noted by the review panel, taxes on investments can affect many of the drivers of economic growth, affecting investment in fixed (including intangible) capital, innovation, allocative efficiency, entrepreneurship and exposure to foreign direct investment.

Taxing the returns on investment can reduce the willingness of domestic and international investors to invest in Australia.

With globalisation, the diversity of income tax laws across jurisdictions has become ever more important.

With respect to assets typically placed in stapled structures, it is common that these provide a stable passive income flow, and with these types of assets and income flows there is sensitivity to changes (including tax). For certain investors that can be more relevant, for example an investor not otherwise subject to tax on their income (e.g. a foreign sovereign wealth fund), an investor resident in a jurisdiction which does not provide a credit for foreign taxes, or an investor that simply cannot fully utilise franking credits.

As an example, an investor who may otherwise be able to access the 15% MIT withholding rate that is forced to invest into a corporate structure would face a doubling of their effective tax rate (as compared with the 15% rate for Australian super funds whether they invest in trusts or in a corporate). Such costs are carefully factored into the pricing of assets and changes will affect returns and may restrict the ability of some to invest.

While it goes without saying, the point should be made that tax is only one factor impacting on investment. Treasury has over many years of receiving submissions considered this and noted that '...most people who attempt to quantify tax burdens on cross-border investment or income pick a set of assumptions when picking their case...[and] international comparisons of tax burdens usually ignore important non-tax factors...'[7]. The level and composition of cross-border investments can depend on factors such as investors' desire for liquidity and risk diversification, as well as the institutional frameworks of the country in which the investment is made.

[6] For example, work such as that undertaken by the Australia's Future Tax System review in 2010, discussions such as those in the Tax Forum in October 2011, and examples of reports commissioned and prepared by organisations such as Deloitte Touche Tomatsu, Taxation impediments, November 1995.

[7] Treasury, Transcript 18 September 1995, pg 892.

It is important to appreciate that Australia does not operate on a level-playing field when competing with major countries in North America, Europe and parts of Asia. Australia has a relatively small market (and is therefore capable of generating relatively smaller absolute returns) and in addition it is geographically distant from major sources of capital. When looked at from that perspective, one can appreciate that having access to tax-effective structures which might not exist elsewhere in the world is a necessary comparative advantage rather than one to be undone on the simple basis that they don't exist elsewhere.

6. What would be an appropriate mechanism to remove the tax advantages of stapled arrangements?

We do not comment on whether removal of so-called 'advantages' of stapled arrangements is 'appropriate' at all. That is a policy question. If it is decided that such removal is appropriate to any extent, then our comments are as follows.

We refer comments above in relation to the potential for amendments to section 254T of the Corporations Act and attendant taxation provisions.

We also note the examples provided in the Consultation Paper of changes implemented in the United States and Canada and the options noted on page 14.

As outlined at the outset of this submissions, the Committees submit that if Treasury considers that there is a need for the law to be amended to address a policy shift, it should be a tailored avoidance or similar provision addressing only those specific structures that involve highly structured fragmenting of trading businesses, which "go well beyond the original policy intention".

A threshold issue is what structures are intended to be covered. In particular, would the proposed 'removal' apply only where there was 100% common ownership of ordinary securities in the stapled entities, and if not, how would the distinction be drawn? We consider that such a distinction would be extremely problematic. One difficulty of the proposal is that it appears likely to create 'all or nothing' differences which may end up depending on minute differences in levels of commonality of ownership. The proposal would also be likely to create highly artificial distinctions between various forms of financings. For example, unrelated party debt financing would, presumably, not preclude characterisation of a structure as 'stapled', but would the same be true of hybrid unit issues with preferred rights?

The question of what level of commonality of ownership is considered problematic raises the question of whether the whole premise of the paper is mistaken. That is:

(a) the existing laws contain certain policy settings as to when tax flow-through treatment should be available for particular activities in particular circumstances (e.g. Division 6C, and the general rules applicable to trusts or partnerships);

(b) the Consultation Paper appears to proceed on the assumption that separation of such activities needs to be justified in some way;

(c) the converse starting point would seem equally valid – a presumption that separation of such activities is perfectly normal (e.g. any normal business leasing its premises from a landlord), in which case it should be articulated why, in principle, commonality of ownership of various assets and activities is problematic.

The Committees support review of the definition of eligible investment business in the context of a broader review of Division 6C, including to ensure that any proposed amendments do not have any unintended and inappropriate consequences. The Committees' submission on this issue is set out in further detail below at Question 14.

7. Are there any international models for removing such advantages that could work in the Australian context?

Given the timeframe provided for response, we have not sought to fully consider and detail all international approaches. Again we note that given the importance of this issue and the importance of adopting a consistent approach for any agreed policy, further detailed consideration of the issues raised in the Consultation Paper is required, with the policy and responses being carefully formed with co-design between Treasury, the ATO and industry.

It must be acknowledged that the Australian market is mature and accordingly any new regime will have significant implications on the existing market.

The UK's REIT regime came into effect from January 01, 2007, when nine companies elected to become REITs. Currently, there are 36 listed REITs in the UK.

The UK regime[8] operates through a combination of both primary and secondary legislation and additional guidance. The primary legislation has since been rewritten to improve legibility and simplify the UK's tax legislation. Updated guidance to accompany the simplified legislation is long-awaited.

Amendments to the REIT rules, introduced in 2012, have made the UK REIT regime cheaper (entry charges have been abolished), generally more attractive (new REITs can list on AIM) and there is a three year grace-period for REITs to become widely held.

More recently again, the Government has introduced further amendments regarding UK REITs investing in other UK REITs. These amendments allow income from UK REITs investing in other UK REITs to be treated as income of the investing REIT's tax-exempt property-rental business, and permit REIT shareholders to be ignored for the purposes of considering 'close' status. These amendments have provided numerous benefits to the UK REIT regime, including investment diversification, cash management flexibility and tax simplification.

It should be noted that the UK REIT regime, like others, imposes restrictions which limit the amount of investment permitted in non-rental generating assets and the amount of non-rental income. The Australian market is smaller than that in many of the jurisdictions in which these REIT regimes have been introduced and accordingly introducing a REIT regime in line with global regimes would limit growth in the sector, which may not be appropriate given the size of our market (see also the response to question 9 below).

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[8] Refer Global REIT Survey 2016, Europe, United Kingdom - http://www.epra.com/media/UK_REIT_Survey_2016_1473932910386.pdf for overview.

8. What types of structures or arrangements, if any, should be excluded?

As outlined above, the Committees consider that any amendments should focus only on those that fall foul of the intention of the existing laws or where there is a clear policy reason for doing so.

In this regard, we note that the benefits to project financing of flow-through treatment have been recognised by government for a long time. In very brief summary:

(a) in Taxation Laws Amendment Bill (No 5) 1986, action was taken against certain redeemable preference share arrangements, by which tax loss companies (such as those in the early stages of a project) could make distributions which were non-deductible to the paying company and effectively non-taxable to the recipient – in 1986 that was seen as objectionable;

(b) subsequently, in 1988, the ATO issued Income Tax Ruling IT 2512, expressing the view that distributions on certain types of units by unit trusts in a loss position (such as a unit trust in the early stages of a project) should be treated as assessable income of the recipient;

(c) however, by 1992 the government, in introducing 'infrastructure borrowings' measures in Taxation Laws Amendment Bill (No. 3) 1992, recognised that 'infrastructure projects of the type specified typically have a long construction period and do not produce revenue for some years. This can mean that companies borrowing to develop such projects will not be able to obtain a deduction for interest costs in the year in which they are incurred. The measure will assist the financing of the projects by effectively allowing the borrowing company to transfer the benefit of its interest deduction to investors. **Such a transfer reduces the financing cost to the borrower.'** [Emphasis added]

That is, the tax consequences of measures which had been negated by legislative or administrative action were, by 1992, recognised as desirable in order to promote economic activity and development. Stapled structures as such normally involve flow-through treatment of 'equity' type investments, rather than the debt type investments dealt with by the measures referred to above, but it is interesting to note that they emerged as vehicles for infrastructure projects at about the time that the government had recognised the benefits for economic development and activity of the tax consequences of 'infrastructure borrowings'.

We are not aware of any reason why this longstanding policy position, and the consequent acceptance of stapled structures referred to near the start of this submission, should be reversed. For that reason, we suggest that any amendments should be narrowly targeted.

If the alternative is to amend the laws to affect all, other than a few that are excluded, we note and agree with the views adopted by the ATO in TA 2017/1 in relation to those that are excluded from the application of the Alert. That is:

(a) Australian real estate investment trusts which derive all or most of their rental income, directly or indirectly, from independent end-users; and

(b) privatisations of businesses which are effectively land.

Ultimately, the detailed policy analysis that this issue merits will probably reveal the desirability of providing for exclusion of certain other structures. For example, it may be considered that public infrastructure assets be able to be held in such structures, from a public benefit perspective.

9. If the tax advantages of stapled arrangements are removed, does Australia need a specific REIT regime to provide clarity for flow through tax treatment for real estate investments? If so:

a. What might be an appropriate measure and threshold for a designated maximum threshold for associated trading activities (e.g. percentage of profits, income or assets)?
b. Are there any global 'best practice' models for REIT regimes that should be considered?

There is insufficient time to properly consider and agree a solution without the risk of unintended consequences. Ideally, the Committees would have been afforded more time to consider such complex issues.

The Committees warn against trying to impose an international REIT regime onto the Australian market. Australia has a mature real estate investment industry compared to other jurisdictions which often have associated asset, or income, restrictions. Forcibly imposing such a narrowly-defined REIT regime on the Australian would have significant implications, including the forced demerger of existing REITs, the restructure or transfer of their assets or the triggering of refinancing obligations. Furthermore, seeking to implement an entirely new regime is likely to add complexity and add new challenges for participants and possibly require restructuring with its attendant costs.

Moreover, taxation of the REIT sector underwent significant change when the MIT tax regime was implemented on 1 July 2016. This regime, which was developed by industry Government, Treasury and the ATO through a detailed, and considered, process, includes a specific arm's length rule to address Government's integrity concerns regarding cross-stapled structures. It should also not be forgotten that the general anti-avoidance rule in Part IVA has in recent years been amended to allow for its easier application by the Commissioner and therefore remains a powerful tool for the Commissioner to apply against artificial and contrived arrangements.

When considering a MIT tax regime in 2009 the Board of Taxation specifically recommended against enacting a dedicated REIT regime.[9]

[9] Review of the Tax Arrangements Applying to Managed Investment Trusts, A Report to the Assistant Treasurer, Board of Taxation 2009, refer paragraphs 2.41 to 2.44 and Recommendation 6.

Instead, the Committees support a review of the active/passive activity test in Division 6C aimed at modernising the rules (which have been in place for over 30 years) with regard to the changing expectations of consumers, international investors and government from the real estate investment industry.

10. If Australia did not introduce a specific REIT regime, what are some alternatives for providing greater clarity to taxpayers to distinguish between acceptable and non-acceptable fragmented structures with common economic owners?

As has been outlined above, the Committees consider that there is currently a suite of measures in Division 6C, the MIT tax rules, the AMIT regime and Part IVA (among others) which appropriately manage the types of structures under review.

That said, the Committees note throughout this submission that there can be amendments to certain parts to provide greater clarity to taxpayers or to perhaps provide a clearer framework in which these structures can operate. While there may be a case for legislative reform, that should be a matter for discussion on a co-design basis with Treasury, the ATO and industry.

Areas that the Committees consider could be the subject of co-design discussions are:

- the definition of eligible investment business – this could be slightly amended or there could be a wholesale reform to redefine activities and perhaps assets that are considered acceptable.[10] A model for discussion may also include one which allows for future development, for example the ability to add activities/assets where policy shifts. We consider that there are a number of areas where there is current uncertainty, in particular in infrastructure and property related activities such as renewables, student accommodation and hotels to name a few where the assets are predominantly land based and therefore, in our view, within the existing policy of 6C which could be specifically included in a reformed definition;
- the 25% and 2% safe harbours and 'incidental' test – these often result in disagreement between taxpayers and the ATO and as part of the overall review could be clarified to provide less opportunity for disputation; and
- targeted integrity measure – as outlined elsewhere in the submission, if specific areas are of concern which it is considered Part IVA would have difficulty addressing, some discussion around a discrete integrity measure may be appropriate. It would need to be clearly drafted to ensure that it operated appropriately and did not, by breadth of drafting, effectively nullify the operation of other rules such as the MIT regime.

11. If the tax advantages of stapled arrangements are removed, does Australia need specific concessions for critical infrastructure investment?

The Committees consider that this is a political decision.

[10] This has been the subject of some consideration by the Board of Tax and seems to be supported in some ways, refer Board of Taxation Report to the Assistant Treasurer on Review of the Tax Arrangements Applying to Managed Investment Trusts in August 2009, paragraphs 3.19 to 3.25.

We note that where there has been thought given to specific concessions or limitations in tax laws, concerns arise in relation to defining the class of arrangement or taxpayer and compliance burden – the Committees refer, for example, to paragraphs 4.4 to 4.10 (inclusive) of the Board of Tax's report to the Assistant Treasurer on the Review of the Thin Capitalisation Arm's Length Debt Test dated December 2014.

12. If Australia does need such concessions for critical infrastructure investment, what should be the form of those concessions?

We refer to comments above.

13. If tax laws are amended to remove the tax advantages of stapled arrangements, what impact do you consider this would have on the Australian economy, including the cost of capital, level of investment and price of assets? Please include any supporting evidence.

We refer comments above.

As the Board of Tax noted in its consideration of tax arrangements applying to Collective Investment Vehicles,[11] Australia's tax regime is not competitive compared to that of other jurisdictions in its overall approach to encouraging foreign investment. If there was a policy shift to affect the tax treatment of stapled structures, there needs to be a corresponding development of alternative tax flow through vehicles to attract increased capital investment.

At present REITs can be seen to underpin the property industry's significant contribution to the Australian economy (with a market capitalisation of $133 billion per February 2017), not to mention the retirement savings of some 14.1 million Australians who invest in REITs either directly or through their superannuation funds.

14. To what extent would alternative measures, such as a higher percentage of trading business permitted to be carried out by Division 6 trusts ameliorate these impacts?

The Committees support amendments to the definition of eligible investment business in Division 6C as part of any reforms to the taxation arrangements involving stapled structures.

If a decision is taken to treat stapled structures as a single entity, the Committees are of the view that additional safe harbours should be introduced to provide certainty to existing structures which do not inappropriately 'fragment' a single business.

To provide appropriate flexibility to Government, the Committee considers that these safe harbours can be drafted into regulations in a similar way to the proposed new debt/equity aggregation rules. This will permit the Commissioner of Taxation to progressively include appropriate structures within the ambit of the safe harbour rule where the ATO has addressed its concerns with particular structures and will also provide taxpayers with the clarity that the tax treatment of long term arrangements will not change.

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[11] Board of Tax report to the Assistant Treasurer dated December 2011 on Review of Tax Arrangements Applying to Collective Investment Vehicles.

Separately, the Committees also consider that the definition of eligible investment business could be expanded to include any income derived predominantly by making available land and fixtures, even if it is not technically “rent”. This could include (or could be deemed to include) incidental operational income, such as licence income and parking income, rather than taxpayers relying on safe harbours to exclude such incidental income from the definition of eligible investment business. This will provide additional certainty to taxpayers dealing with Division 6C issues.

Examples of businesses which could benefit from specific nomination are shopping centres, hotels and student accommodation.

The Committees also consider that the existing 2% and 25% thresholds could be reviewed with the intention of increasing them as part of a package to ensure that any proposed amendments do not inappropriately impact on taxpayers with low risk arrangements.

15. Are there any specific sectoral impacts that should be considered?

The Committees submit that this is a policy matter.

16. Would the impact be different for new and existing investment and entities? If so, how?

The Committees submit that both existing and new investments would be affected. Existing investments would have the additional complexity and cost of dealing with a change, which may necessitate refinancing or structural changes (including divestments).

17. What is the typical term of external third party finance for stapled groups?

[It would be relatively normal for the first financing for an infrastructure stapled group to run for a period covering at least the construction phase and the first couple of years of operation. Subsequently, any refinancings required would typically have a term of at least 5 years. However, it is important to note that such infrastructure stapled groups are likely to depend upon the ability to access external third party financing, by way of such refinancings, for decades.

18. Should pre-existing structures and instruments issued prior to any new taxation laws be grandfathered?

While the Committees acknowledge Treasury's comments in the Consultation Paper that grandfathering rules have the potential to cause particular issues, we submit that there will clearly be a need to grandfather existing conventional structures from any imposition of tax on the trust side of the staple.

As noted above, financial modelling by lenders to infrastructure stapled structures assumes flow-through tax treatment of the trust side of the staple. That modelling will be reflected in the financial covenants, and definitions of events of default, built into the financing documents. A transfer of tax liability from investors to project entities on the trust side of the staple is highly likely to cause events of default or similar breaches of financing terms in project entities that are otherwise well capable of meeting their commitments to their external financiers. This will involve significant cost, particularly with the costs of advisors required to assist with what would involve changes to contractual arrangements.

19. What is an appropriate transition period and transitional arrangements for existing staples?

Although, as noted above, an infrastructure stapled group will typically refinance its external debt throughout the course of a project, the continued viability of such entities is highly likely to be heavily dependent on being able to obtain replacement finance on viable terms. Thus, if it were proposed to place some time limit on grandfathering of existing projects (which we do not support), then such a time limit needs to be calculated to take into account long-term modelling of the debt profile of the project, with proper consideration of the likelihood of being able to obtain necessary refinancings if the tax burden in respect of the project is transferred from the investors to the project entities.

Furthermore, the consequences of amending the law to impact existing structures from a sovereign risk perspective cannot be over emphasised. Unfortunately Australia has in recent years suffered from an increased reputation of being a risky place to invest by many foreign investors for reasons including the doubling of the MIT concession to 15%, cancellation by States of projects once awarded, the recent interactions with FIRB in relation to imposition of tax conditions and FIRB's initial approach to infrastructure investments post the release of the ATO Taxpayer Alert 2017/1.

The Committees refer Treasury to the time taken to design and introduce the MIT regime, including subsequent AMIT rules, as a guide on timing.

20. What would be the types of compliance and other transaction costs (such as stamp duty) of undertaking such a restructure? Should specific tax relief be provided to facilitate a restructure?

As has been noted throughout the submission, there is the potential for significant costs with a policy and any legislative change in this area.

It is submitted that to the extent that there is policy change, tax relief should be made available. This would need to extend to State taxes.

Even then, there would still be significant cost to business. There would be internal and external costs in negotiating with debt and equity financiers / investors, parties on contractual matters (e.g. covenants, change of control provisions, change of law provisions, etc), break or other refinancing fees and fees for specialist advisory support.

If you have any questions in relation to this submission, in the first instance please contact the undersigned on 07 3233 8950 or via email: tdyson@mccullough.com.au.

Yours faithfully

Teresa Dyson, Chair
Business Law Section