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Submission on build to rent tax concessions

25 July 2024

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Re: Treasury Laws Amendment (Build to Rent) Bill 2024 and Capital Works (Build to Rent Misuse Tax) Bill 2024

Dear Senate Economics Legislation Committee

Introduction

Thank you for the opportunity to provide a submission on the *Treasury Laws Amendment (Build to Rent) Bill 2024*, and the *Capital Works (Build to Rent Misuse Tax) Bill 2024* (collectively, the **Bills**), which were introduced to the House of Representatives on 5 June 2024.

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

Background

On 9 April 2024, Treasury released Exposure Draft Legislation reflecting draft versions of the Bills. Treasury engaged in consultation with industry from 9 April 2024 to 22 April 2024. Ashurst provided a submission in respect of the Exposure Draft Legislation, which is publicly available.

The Bills represent an improvement from both a technical (being the drafting of the provisions) and policy (in the sense that the tax settings should encourage a

greater level of foreign institutional investment) perspective from the Exposure Draft Legislation released by Treasury. However, there are a number of issues with the Bills as currently drafted which must be addressed if the underlying policy objective of meaningfully encouraging institutional investment in the housing sector is to be achieved.

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

- (a) Key policy issues in relation to the Bills; and
- (b) Technical drafting issues in the Bills.

In respect of item (a) above, these issues demonstrate that the tax settings of investment in build to rent (**BTR**) should be aligned to a greater extent with the current managed investment trust regime, to achieve the underlying policy objective of the Bills. In respect of item (b) above, these issues are "technical" in that they identify drafting deficiencies within the Bills that will prevent the legislation from operating as intended. We consider issues raised under both items to be important.

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

We would welcome the opportunity to discuss our submission with this Committee to improve the workability of the Bills and enable these Bills to increase Australia's housing supply.

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Part 1: Key Policy Issues

General comments

We have set out our submissions on policy issues in respect of the Bills 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 from the full concessions provides no incentive for those assets to include an affordable housing component, creates an unlevel playing field between taxpayers, and adversely impacts investor sentiment as tax settings are capitalised into the value of existing assets. Accordingly, the concessions in the Bills should be expanded to include assets that were operational or under construction on or before 7:30pm on 9 May 2023.
2. 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, or other Australian real estate sectors, without the onerous requirements to achieve a 15% managed investment trust (**MIT**) withholding tax rate. This includes, for example, investing in commercial office buildings, or even obtaining a further reduced rate of 10% by investing in clean buildings, which we note the Government intends on expanding to include data centres and warehouses per Budget 2023-2024.

In our view, these issues means that the concessions will ultimately not materially fully contribute to the Government's National Housing Accord ambitions possible.

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 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 context of the concessional measures as outlined in the Explanatory Memorandum to the Bills (**Explanatory Memorandum**) specifically notes that the

intention of the Bills is to address Australia's housing supply and affordability crisis and aims to increase rental stock and affordable tenancies. The Explanatory Memorandum notes that more Australians are renting, and those Australians are renting for longer. The Explanatory Memorandum further states that *"[i]ncentivising 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 BTR sector is a *"nascent industry in Australia, meaning there is significant scope for BTR developments to contribute to increasing housing supply."* We agree with these concerns, and the potential opportunities to encourage BTR developments.

However, the departures in the Bills from the Government's Budget announcement (discussed in detail below) harm investor confidence, and this is amplified as a consequence of the historical uncertainty created by various Governments in respect 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 halted 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

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*, paragraph 275-10(4C)(b).

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 Tax in Australia and Other Measures) Bill 2018*, had the effect of doubling the MIT withholding tax rate on income and capital gains from most forms of housing (to 30%), other than certain preferred forms of housing (such as student accommodation (where it is classified as commercial residential premises)). 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 had deterred investment and new supply in Australia's housing market, despite the Government's so-called commitment to housing affordability.** In our view, the Bills' inconsistencies with the Government's Budget announcement risks doing the same thing.

We submit that in order to achieve the underlying policy objective of increasing the housing supply, the concessional elements of the Bills must be made consistent with the Government's original announcements and the historical positions of the Labor Party, and the eligibility requirements to access the concessional measures must be made less restrictive. Without amendments to the proposed measures, foreign institutional capital will continue to preference other Australian asset classes which provide less restrictive and more concessional tax treatment, or investments in other jurisdictions.

Specific Policy Issues

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

As a matter of tax policy, we submit that assets constructed prior to and assets under construction on or before 9 May 2023 should be eligible for the concessions. In respect of the analysis supporting not allowing these assets to obtain the concession, we note that the impact analysis states that these projects were considered "commercially viable" under the previous tax settings, and moreover that they *"therefore would not increase the supply of housing or affordable housing relative to the status quo"*. With respect, this position is incorrect for at least the following reasons:

- First, earlier projects were committed to in circumstances where the tax settings were not favourable for institutional investment in the housing sector. To the extent that the Bills are successful in increasing the supply of rental housing, that would be expected to depress rental prices (or, at least, slow the inexorable increase in rental prices). Accordingly, to suggest that these assets will remain "commercially viable" when the measures (if successful) have changed the commercial dynamics of the market, is inconsistent with the very purpose of the measures. Put another way, if the measures are successful in increasing the supply of rental housing, existing BTR operators will not only have to deal with the increase in supply; they will also be operating at a competitive disadvantage due to their assets being subject to higher tax rates.
- Second, the viability of projects undertaken prior to 9 May 2023 was often assessed taking into account anticipated changes in the tax settings (noting, in this regard, that Labor made the equalisation of tax settings for BTR assets part of their 2019 policy announcements and other similar reported comments).
- Third, extending the concessions to operational assets and assets under construction would evidently increase the affordable housing stock. For current BTR assets that are operational, it would be unusual to include an affordable housing component (given its adverse impact on investor returns). If these assets were able to access the concessions, and noting that the concessions can only be accessed by satisfying the affordable housing requirements, that would clearly increase the affordable housing stock. Similarly, there will be little incentive to offer tenants more long-term secure tenancies in BTR assets that are ineligible for the concessions.

With respect to the quantum of dwellings impacted, a report commissioned by the Property Council of Australia (**PCA Report**), which is highly referenced within the Explanatory Memorandum, 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 Bills miss the opportunity to increase affordable housing supply by approximately 2,300 affordable dwellings, and to ensure that tenants have the opportunity to obtain the security of a long-term tenancy in approximately 23,000 dwellings.

More generally, we note the following additional problems with not allowing these assets to access the concessions:

- 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, or 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.
- 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 the adverse treatment will lower the market prices of the assets. This, in turn, will impact investor sentiment on new BTR assets, as the pricing information available will suggest limited capital growth opportunities.
- It is unfair on taxpayers who were early movers in the BTR sector, and will discourage taxpayers more generally from being early movers when they are expecting tax changes. Many taxpayers made investments in the BTR sector based on 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. The Bills fail 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 by the Labor party 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 by investors, would only have worsened Australia's housing affordability issues.

- Finally, and more generally, this approach to tax policy 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. **Reduced MIT withholding rate concessions are overly restrictive**

The Bills are an improvement to the measures in the Exposure Draft in that the MIT withholding concessions now apply the concessional 15% MIT withholding tax rate to capital gains made in respect of active build to rent developments. However, the Bills exclude any other form of taxable income from being eligible for the MIT withholding tax concession, other than rental income and capital gains referable to the active build to rent development. This fails to capture other forms of income that may typically be derived through BTR assets, such as certain incidental service income. This position is not consistent with the Government's Budget announcement (again, which many taxpayers relied on in making investments), the MIT regime more generally (which generally only excludes certain specific items of income that are subject to separate withholding tax regimes, such as interest), and will materially increase tax compliance obligations as taxpayers will be required to formulate and apply apportionment methodologies for expenses.

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 incidental service income is treated in a different manner to rental income. Accordingly, taxpayers relied on the Budget announcement in making investment decisions, justifiably considering that income from operating a BTR development would be eligible for a 15% withholding tax rate.

The Bills should be amended to clarify that the exclusion from MIT residential housing income applies to all income amounts included in determining the withholding MIT's fund payments, noting that existing integrity measures (i.e., the requirement that the MIT is not a trading trust, and the safe harbours in section 102MB and 102MC of the ITAA 1936), should provide sufficient comfort to the Government that this concession would not be used to recharacterise trading income as passive income.

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

We understand subparagraphs 43-153(1)(d) and (e) are intended to ensure that at least 10% of dwellings within a build to rent development are affordable dwellings and that the affordable dwellings are comparable to non-affordable dwellings by reference to the number of bedrooms and floor space.

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:

- 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 to natural persons).
- Second (and alternatively), the Bills 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 concessions require that there be at least as many or more comparable non-affordable dwellings as there are comparable affordable dwellings, and this applies in respect of each "test dwelling", with each affordable dwelling being a test dwelling. A comparable dwelling is a dwelling of at least the same size or 110% of the size, with the same number of bedrooms. We understand that the purpose of this requirement is to ensure that the affordable dwellings are not concentrated in the dwellings of the smallest size or with the fewest bedrooms. However, this requirement creates perverse outcomes. To take an example, assume the dwellings in a BTR complex are as follows:

Apartment type	Number of affordable dwellings	Number of non-affordable dwellings
Two bedrooms, 80 square metres	4	46
Three bedrooms, 95 square metres	4	46

Apartment type	Number of affordable dwellings	Number of non-affordable dwellings
Three bedrooms, 100 square metres	10	0

In this scenario, the 10 three-bedroom, 100 square metre apartments will fail the requirements for a "test dwelling" (as there is no comparable non-affordable dwellings), and consequently the entire asset will fail, notwithstanding that over 10% of the dwellings are affordable dwellings, and notwithstanding the affordable dwellings are the largest dwellings. The Bills should be amended to provide that this requirement is satisfied if an affordable dwelling has the same number of bedrooms, and has floor space equal to 85% to 115% of the floor space of comparable non-affordable dwellings. Specific rules could be introduced to prevent double counting of comparable non-affordable dwellings.

- Affordable dwellings must be tenanted by eligible tenants by reference to any legislative instrument released by the Minister under section 12-153(3). Previously, in respect of the Exposure Draft, a draft the Policy Fact Sheet noted that in applying the income thresholds, an owner of a build to rent development would be required to assess the initial and ongoing tenant eligibility. Although it was not entirely clear, it was implied that if a tenant subsequently were ineligible, the conditions in paragraph 43-153(2)(a) 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 intended to be tested continuously, BTR assets will need to have a much higher proportion of affordable tenancies, to operate as a buffer if one tenant's income increased. This is simply not a workable solution (and we understand it will be sufficiently adverse to returns to counteract the concessions). The rules will need to be considered in the context of the potential legislative instruments the Minister may issue, for example by ensuring that income levels should only be tested on a historical basis at the date of signing the lease. This could be effected by amendment section 43-153(2)(b) to read "having regard to the circumstances of the tenant in respect of the income year prior to the signing of the lease, any requirement determined under subsection (3) in force at the time the lease is signed is met." We note that this is consistent with the approach adopted in respect of how market rent is to be determined, noting that paragraph 1.57 of the Explanatory Memorandum

states that that market value of the dwelling is generally determined at the time the lease is entered into.

3. **Affordability requirements and interaction with State/Territory Laws**

We also note that the affordability requirements need to be considered in the light of State and Territory-based concessions for BTR assets. A number of States and Territories have introduced tax concessions for investments in BTR assets, primarily in respect of the application of various stamp duty and land tax surcharges. The application of a further regime that mandates certain requirements in order to access tax concessions risks creating a spaghetti bowl effect, where labyrinthine rules and regulations, sometimes additive, sometimes conflicting, will deter institutional investment.

The Impact Analysis for the BTR developments notes that States and Territories have different approaches in defining "affordable housing". In addition, States and Territories have different approaches to determining the circumstances in which concessions are available for BTR assets. To take some examples:

- In New South Wales, the land tax concession for investment in BTR assets requires that the dwellings are managed by a single entity, with on-site access to management, and that a significant proportion of labour force hours spent on construction involves persons belonging to certain classes of workers. These requirements bear no analogue in the Federal requirements, meaning that taxpayers will be required to meet both sets of requirements to be eligible for relevant concessions.
- Certain Queensland concessions relating to BTR assets require the tenants of 10% of the dwellings to not only satisfy an income test, but also an asset test, and that the tenant is an Australian citizen or permanent resident. Because of certain differences between the Federal requirements and the State requirements, including the Federal requirement that each type of dwelling has a comparable non-affordable dwelling, the Federal requirements are likely to drastically increase the cost of satisfying the State requirements.

One option to resolve this would be to create a safe harbour, whereby the Federal BTR tax concessions would be available where State or Territory-based BTR concessions are satisfied.

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Part 2: Technical Issues

1. The Bills have the effect that that two (or multi) tiered trust structures cannot access the MIT withholding concession

The mechanism through which rental income and capital gains is taxed at the concessional 15% MIT withholding tax rate does not apply appropriately in the context of common real estate investment structures, such that most fund structures will not be eligible to access the concessions.

By way of background, it is common for real estate investment structures to comprise of a number of trusts, which would commonly include (at least) a Head Trust and an Asset Trust (typically, multiple Asset Trusts). The Asset Trust holds the title to the land, while the Head Trust holds the units in the Asset Trust. It is also not uncommon for structures to contain a Head Trust, Mid Trust, and Asset Trust. The principal reason for this is that it assists in obtaining third party finance at different levels (e.g., asset-specific debt at the Asset Trust level or portfolio-level debt at the Mid Trust level), without investors being required to provide security (as typically security would be granted over the equity in the borrower, which is below the top level of the fund structure, being the Head Trust).

Unfortunately, the requirements to access the MIT concessions appear to prohibit this. In particular, the scheme of the relevant parts of the legislation operates as follows:

- Section 12-450 of Schedule 1 to the *Taxation Administration Act 1953* (Cth) generally sets out the definition of MIT residential housing income, which is treated as non-concessional MIT income (subject to 30% withholding tax when a fund payment is paid to a non-resident);
- New subsection 12-450(5) provides that an amount is not MIT residential housing income where the amount is, or is referable to, a payment of rental income under a lease of the dwelling, or the amount is, or is attributable to, a capital gain from a CGT event in relation to the dwelling (noting there is another subparagraph that applies to capital gains in respect of membership interests), and that amount related to a dwelling in an "active build to rent development". Note that there are certain other requirements contained in this subsection;
- However, for the purposes of the application of the 30% rate that applies to non-concessional MIT income (being subparagraph 12-385(3)(a)(iii)), new subsection 12-450(5) is disregarded (and, therefore, those amounts will be non-concessional MIT income) under new subsection 12-385(6) where:

- The trustee (the **withholding trustee**) does not own the dwelling; and
- Another entity (the **intermediary**) receives a payment that would otherwise be covered by new subsection 12-405(5) (the **intermediate payment**); and
- The fund payment is referable to the intermediate payment; and
- Any of the following apply:
 - The intermediate payment is a fund payment to which the section applies; or
 - The intermediary is not a trust; or
 - **The intermediary is a trust, the trustee of which is not the person who is, or the persons who are, the withholding trustee.**

In a standard fund structure, the withholding trustee will be the trustee of the Head Trust. The Asset Trust will not be a withholding MIT. In addition, the trustee of the Asset Trust will be different to the trustee of the Head Trust, as otherwise there would be a trust merger (there being no separation of legal and beneficial ownership in this case). Because the trustees are not the same (noting they cannot be as a matter of law), this provision will apply, which will have the effect of disregarding the provision pursuant to which the relevant amounts are prevented from being non-concessional MIT income.

The key impact of the above is that almost all common real estate investment structures will not be able to access the concessions. The Explanatory Memorandum at paragraph 1.97 notes that this is intended to support the administration of the tax concession in particular the BTR misuse tax. Presumably, this is intended to prevent the Commissioner from needing to raise two assessments to recover the BTR misuse tax. However, the manner in which administrative ease is preserved renders the concessions useless for most BTR structures.

2. Misuse tax is effectively a penalty

The current formulation of the build to rent misuse tax may result in 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 broadly 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. 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 could ultimately end up in a worse position than if they had simply not sought to qualify for the concessions or opted in.

3. Tenancy requirements

The eligibility requirement imposed by paragraph 43-153(1)(a) requires that each dwelling is available to the public to be tenanted by way of lease for a period of three years or more, or is currently tenanted by way of a lease that was offered for a period of three years or more. However, the Note to section 43-153 states that for the purposes of this requirement, a lease is still offered to the public for a period of three years or more even if a prospective tenant subsequently requests and the lessor accepts a shorter lease. This 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 for lease at the election of the tenant for terms of one year, two years, or three years. 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.

It also unclear whether this requirement would be satisfied where the tenant is offered the premises pursuant to a sublease. We note various submissions made to Treasury in respect the Exposure Draft Legislation advocated for the affordable housing component of a BTR development to be managed by community housing providers. Taxpayers may consider this a sensible and viable way to administratively deal with the lease and management of the affordable housing requirements imposed by the Bills, although we do not consider it should be a requirement. However, for those taxpayers who would like to have the affordable housing components managed by a community housing provider, the most common way for this to be effected would be for the

freehold owner to lease the affordable dwellings to the community housing provider, and then the community housing provider to sublease the relevant dwellings to the tenant. Based on our interpretation of the legislation, this is permitted – i.e., there is no requirement that the lease with the ultimate tenant is between the tenant and the freehold owner. We recommend that any changes required to facilitate this should be included in the legislation, and if no changes are required, comments should be included in the Explanatory Memorandum to confirm that this is permissible.

We note that the above may have more general application, as some BTR assets, as with other asset classes such as student accommodation, are commonly held within stapled structures. This is often done 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). It should also be clarified that this structure can meet the relevant qualification requirements (i.e., there is no requirement that the relevant lease is between the freehold owner and the ultimate tenant).

4. Different types of BTR developments

We are aware of certain taxpayers who are exploring alternative forms of BTR assets for apartment buildings, including (for example) horizontal BTR projects, where a new suburb (or part of a suburb) may be owned by institutional investors, and the land developed with housing available for rent. Horizontal BTR projects would provide greater diversity of types of housing in the form of different sizes of townhouses (or equivalent) as opposed to apartments.

In our view, it should be the case that horizontal BTR assets can access the concessions, noting that section 43-154A extends the meaning of "building" to include other buildings that are on the same or adjacent land. Further, we note paragraph 1.30 of the Explanatory Memorandum states that "[a] BTR development can also consist of more than one building on the same or adjacent land." However, this paragraph then refers to "towers" in the example provided. To provide clarity in this regard, we submit that an additional example should be included to confirm standalone dwellings (e.g., townhouses) on the same or adjacent land may be considered a single BTR development to make it expressly clear that horizontal BTR projects may access the concessions.

5. Conversion of buildings

The Bills as drafted do not make it clear whether a building that existed as at 9 May 2023 can be converted into a build to rent development. The Explanatory Memorandum appears to accept that other buildings (e.g., warehouses) can be

converted into a build to rent development that could access the concessions provided they satisfy the balance of the eligibility requirements (for example, see example 1.2 and paragraph 1.24 of the Explanatory Memorandum). However, it is not clear how the Bills achieve that outcome, as a pre-existing building will have capital works that commenced prior to 9 May 2023. If the intention is that buildings can be converted from a particular use to BTR assets, and qualify for the concessions (even when part of the capital works commenced prior to 9 May 2023), we recommend that the Bills be updated to make it clear that the relevant capital works referred to are the capital works arising as part of any conversion.

6. 74.9% rent threshold

We note that taxpayers may offer tenants a number of services or potential additions – 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,

7. Market rate of rent

The measures require that the affordable housing components are offered at an amount no more than 74.9% of the market value of the right to occupy the dwelling, and the Explanatory Memorandum provides that this requires a valuation exercise similar to that undertaken by charitable and social housing providers under Subdivision 38-G of *A New Tax System (Goods and Services Tax) Act 1999* (Cth).

In our view, this exercise could be drastically simplified, by allowing taxpayers to demonstrate the satisfaction of these requirements by comparing the average rent on comparable non-affordable dwellings (as defined) to the rent on each comparable affordable dwelling (again, as defined). Given the rent on comparable non-affordable dwellings is effectively the market rent taking into account the relevant features, including location, amenity value, size, number of bedrooms, etc., this will in most instances be the most straightforward way to demonstrate satisfaction of the affordable requirements. We recommend the Bills be updated to expressly permit this approach.