Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

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4 July 2024

Dear Sir or Madam,

Inquiry into Treasury Laws Amendment (Build to Rent) Bill 2024 and Capital Works (Build to Rent Misuse Tax) Bill 2024
Submission by Public Sector Pension Investment Board

We thank you for the opportunity to provide a submission in respect of Schedule 1 of the *Treasury Laws Amendment (Build to Rent) Bill 2024* and the *Capital Works (Build to Rent Misuse Tax) Bill 2024* (together the **BTR Developments Bill** or the **Bill**).

This submission is made by Public Sector Pension Investment Board (**PSPIB**), a Canadian Crown corporation that invests amounts transferred to it by the Government of Canada for the pension plans of the Canadian Public Service, the Canadian Forces, the Royal Canadian Mounted Police and the Reserve Force. PSPIB has C$264.9billion of net assets under management as at 31 March 2024 and invests globally in a variety of asset classes, including natural resources, public markets, private equity, real estate, infrastructure, and credit investments.

We recognise the Government's overarching policy objective to increase housing supply in Australia through the construction of new Build-to-Rent (**BTR**) dwellings with an affordable component. BTR dwellings are becoming an integral part of the housing mix globally and are expected to make up a significant portion of housing stock in coming years. PSPIB has investments in BTR projects in countries such as UK, US and Australia and is seeking opportunities to increase its portfolio.

We have previously made a submission to Treasury in relation to the Exposure Draft Legislation on the proposed BTR concessions that were released on 9 April 2024 *(Treasury Laws Amendment Bill 2024: Build to rent developments* and the *Capital Works (Build to Rent Misuse Tax) Bill 2024* (collectively the **Exposure Draft Legislation**). We wish to acknowledge that some of the changes suggested in our previous submission to Treasury have been reflected in the BTR Developments Bill. The adoption of these changes was well received.

Having regard to the Government's stated policy objectives for this measure, which is to increase the supply of rental housing (including affordable tenancies) by encouraging institutional investment, we have one particular concern in relation to the Bill that we wish to highlight for the Senate Committee. Our concern relates to the operation of the proposed subsection 12-435(6) of Schedule 1 of the *Tax Administration Act 1953* (Cth) (**TAA**) as the provision restricts the ownership of an eligible BTR development in a manner that will effectively prevent institutional investors from accessing the concessional withholding tax rates on BTR developments. In its current form, the proposed subsection will therefore undermine the Government's policy objective.

As subsection 12-435(6) was only added to the Bill following the consultation period on the Exposure Draft Legislation, this is the first opportunity we have had to provide our submission on the operation of this provision. Please refer to our detailed submission below.

Submission: The Managed Investment Trust (MIT) withholding concession should be available where the fund payment is attributable to an active BTR development that is held indirectly through a chain of trusts

The proposed subsection 12-435(6) limits access to the concessional MIT withholding tax

The proposed subsection 12-435(6) addresses circumstances where the MIT withholding is applied by a trust that does not directly hold the eligible BTR dwelling (i.e., there is a chain of trusts). The requirements of the proposed subsection appear to have been included to limit eligibility of the concessional 15 per cent withholding tax rate to circumstances where the trustee of the trust that owns the eligible BTR dwelling is **also** the trustee of the relevant withholding MIT and each intermediary trust.

Paragraph 1.97 of the Explanatory Memorandum to the original version of the Bill before it was divided by the Senate on 27 June 2024 (*Treasury Laws Amendment (Responsible Buy Now Pay Later and Other Measures) Bill 2024* - the **EM**) explains the purpose of this subsection is to carve-out certain trusts from the concessional 15 per cent withholding tax rate to support the administration of the tax concession, in particular the BTR misuse tax.

As a consequence of the proposed subsection 12-435(6), the concessional MIT withholding tax rate will **not** apply in the following circumstances:

- Where there is more than one withholding MIT in a chain of trusts and the second withholding MIT makes a payment to a foreign resident investor that is attributable to income from the eligible BTR dwelling; or

- Where the BTR development is held in a sub-trust or through a chain of wholly owned trusts, as it is not legally possible to have the same trustee of each trust in a chain of wholly owned trusts (due to the doctrine of trust merger).

Put simply, in order to comply with the requirements in subsection 12-435(6) and therefore access the concessional MIT withholding tax rate, the trust that owns the BTR dwelling must itself be a withholding MIT and make the fund payment directly to the foreign resident investor.

In our experience with investments in Australian real estate, such a direct ownership of BTR dwellings is unlikely to exist as Australian real estate investment structures typically include:

- The use of tiered trusts to aggregate the ownership of multiple properties within a single consortium or joint venture holding entity; and

- The use of separate holding trust and asset trust entities for each BTR development to ringfence the debt finance to the project and prevent the equity investors from being a party to debt documents (due to increased complexity).

As a matter of practice, the proposed subsection 12-435(6) will therefore prevent foreign institutional investors from accessing the concessional MIT withholding tax rate for eligible BTR dwellings and will be counterproductive to achieving the Government's policy objective.

To provide further context, we have included at Appendix 1 an example investment structure for Australian real estate and BTR investments that we would consider typical for institutional investors.

Identifying the administrative issue being addressed by subsection 12-435(6) of the Bill

As noted above, EM states that the carve-out from the concessional 15 per cent rate of tax is to support the administration of the tax concession, in particular the BTR misuse tax.

We understand the administrative issue being addressed relates to the assessment of the BTR misuse tax by the Commissioner of Taxation in circumstances where a BTR dwelling ceases to be an active BTR development and the relevant tax concessions need to be clawed back.

In this case, where (conceptually) each of the trusts in a chain of trusts has the same trustee, we understand the Commissioner of Taxation could issue an assessment for BTR misuse tax to the same trustee. Conversely, where there are multiple trustees between the BTR dwelling and the foreign resident that obtains the concessional withholding tax rate, we understand there is a concern that the Commissioner of Taxation would be required to trace through the chain of trusts and potentially issue multiple assessments in respect of any BTR misuse tax.

We understand that the requirement for the each of the trusts to have the same trustee has therefore been included in the Bill to allow the Commissioner to issue assessments to one trustee (rather than to multiple trustees). Whilst this approach could simplify the administration of the concession by the Commissioner of Taxation, for the legal and practical reasons outlined above, our expectation is that the requirement would prevent foreign institutional investors from benefiting under the concession and therefore undermine the ability to achieve the Government's policy objective of increasing institutional investment in Australian BTR and affordable housing.

Based on our experience with investments in other jurisdictions, we consider there to be alternative means of supporting the administration of the concession without impacting the ability for the concession to operate in practice. We have outlined these alternatives below.

Alternative 1: Increased disclosure in BTR notification requirements to support the Commissioner of Taxation's administration of the BTR misuse tax

The BTR Developments Bill includes notification requirements for a range of circumstances including where the BTR commences to be an active BTR development, where there is an expansion of an active BTR development, where there is a change of ownership in an active BTR development, and where a dwelling ceases to be an active BTR development. Notification of these events, including notification of any cessation of a dwelling being an active BTR development (which could trigger BTR misuse tax) is currently required within a 28-day period.

The requirement to notify the Commissioner of Taxation across each of these events, including where the BTR development ceases to be an active BTR development, should reduce the administrative burden on the Commissioner of Taxation as there is a positive obligation on the trustee to provide the relevant information within a 28-day period.

To further support the administration of the concession, in particular the BTR misuse tax by the Commissioner of Taxation, our submission is that the requirements in subsection 12-435(6) of the TAA be removed and replaced with some or all of the following:

- The existing notification requirements in the Bill could include a requirement for the trustee to disclose to the Commissioner of Taxation both the identity of any upstream trusts (and their associated trustees), and the percentage interest held in the underlying trust (including in the context of a BTR ceasing to be an active BTR development). The inclusion of details regarding upstream trusts (and trustees) should reduce the administration requirements for the Commissioner of Taxation in the context of producing assessments as the Commissioner should be able to identity the relevant withholding MITs (and trustees) that have accessed the concessional tax rates based on the trustee notifications.

- Additionally, the beneficiary statements that are lodged with the Commissioner of Taxation as part of the annual trust tax return could include a specific disclosure requirement for any income attributable to a BTR dwelling that has accessed the concessional MIT withholding tax rate. This disclosure would allow the Commissioner of Taxation to identify and track the foreign resident beneficiaries that have utilised the MIT withholding tax concession and administer the assessment of MIT misuse tax. It is noted that paragraphs 1.101 and 1.102 of the EM appear to contemplate tax return disclosures in relation to BTR developments.

These paragraphs set out the specific reporting requirements for MIT fund payments that include rental income or capital gains in connection to BTR developments.

- To provide further comfort that such information will be appropriately disclosed, the BTR Developments Bill could also be amended to require that the trust that holds the BTR dwelling and has the obligation to notify the Commissioner of Taxation is itself a MIT. This would ensure that the trust is operated or managed by an entity that holds an Australian Financial Services Licence, or an authorised representative of a financial services licensee (as per the existing section 275-10 and 275-35 of the *Income Tax Assessment Act 1997* (Cth)), providing comfort that the trustee would operate to a certain professional standard with appropriate governance and oversight.

Through the combination of the BTR specific notification requirements and additional tax return disclosures, the Commissioner of Taxation should be able to access the information needed to determine the withholding tax benefits that need to be clawed back under the BTR misuse tax.

Leveraging this information, the assessment for BTR misuse tax could be issued to either:

- The trustee of the trust that owns the relevant BTR dwellings based on the total amount of the withholding tax benefits that have been accessed by beneficiaries of the trust directly or indirectly; or

- The trustee of each withholding MIT that makes a fund payment to a foreign resident beneficiary where the income or gain is attributable to an active BTR development.

In the circumstances where an assessment is issued by the Commissioner of Taxation to the trustee of the trust that holds the BTR dwelling that has ceased to be an active BTR development, the investors in the trust could allocate the cost between the beneficiaries based on the terms of the investor agreements or governance documents for the fund (i.e., the Commissioner would not be required to issue assessments to each individual beneficiary).

The above approach would be similar to the treatment of partnerships under Subchapter C of Subtitle F of the United States Internal Revenue Code (referred to as the **Bipartisan Budget Act – BBA – Partnership Audit Process**). In the United States, partnerships are common investment vehicles, and are often used by investors investing in U.S. projects (similar to the widespread use of trusts in Australia).

The BBA Partnership Audit Process rules were introduced following concerns regarding the United States Internal Revenue Service's (**IRS**) ability to audit partnerships. The amended rules in the United States effectively allow the audit (and any subsequent tax adjustments and tax liabilities) to occur at the underlying partnership level, rather than the IRS needing to engage and interact with each individual partner. The BBA Partnership Audit Process also allows for partnerships to elect to push out any tax adjustments and tax liabilities to its partners. In this context, the audit by the IRS still occurs at the partnership level, and the IRS is informed of the amounts being pushed out to the partners by the partnership through the issuance of statements. We have set out at Appendix 2 the key concepts of the BBA Partnership Audit Process.

This approach adopted by the United States could be replicated in an Australian BTR context where the BTR misuse tax rules are amended to allow the trustee to notify the Commissioner of Taxation of an allocation of the BTR misuse tax liability to foreign resident beneficiaries (but retaining the ability for the Commissioner of Taxation to issue a default assessment to the trustee of the relevant BTR dwelling to ensure collection by the Commissioner of Taxation). This election by the trustee could be aligned to the allocation of the concessional MIT withholding tax for the BTR dwelling where the notification and tax return disclosure requirements outlined above are adopted.

Based on the above, we submit that the limitations imposed by subsection 12-435(6) should be amended to remove the ‘same trustee’ requirement and allow for the 15% concessional tax rate to be available to foreign investors that hold their investment in the eligible BTR dwelling through a chain of trusts.

Additionally, the notification provided for in section 43-154 should be designed in such a way that the Commissioner has access to the necessary information needed to issue amended assessments to withholding MITs in tiered trust and/or consortium structures. This should assist in minimising the administration requirements for the Commissioner whilst also ensuring commercial market practice for institutional investments in Australian real estate can be maintained.

Submission in respect of Alternative 1:

The limitations imposed by subsection 12-435(6) should be amended:

- to remove the ‘same trustee’ requirement due to the implications under the doctrine of trust merger; and
- to allow for the 15% concessional tax rate to apply in structures that involve a fund payment that is attributable to another entity who is the owner of the BTR development.

Additionally, the notification requirement provided for in section 43-154, and tax return disclosures in respect of BTR dwellings that have accessed the concessional MIT withholding tax rate, should be designed in such a way that the Commissioner has access to the necessary information to issue assessments in tiered trust and/or consortium structures.

The legislation could also be amended to require that the trustee of the trust that holds the BTR development is itself a MIT. This would ensure that the trust is operated or managed by a financial services licensee (or authorised representative), providing additional comfort that tax obligations and disclosures (including the completion of all required BTR related notifications) will be undertaken appropriately.

This should assist in minimising the administration requirements for the Commissioner whilst also ensuring commercial market practice can be maintained.

Alternative 2: the subsection 12-385(6) carve-out does not apply to “controlled groups”

Another potential solution could involve the use of an ownership threshold. This would ensure that entities within a majority owned group are not impacted by the exclusion contemplated in subsection 12-435(6). This would allow income within controlled groups to flow through intermediaries (including withholding MITs) to the ultimate upstream withholding MIT that makes the fund payment to equity investors.

The administrative burden on the Commissioner should be significantly reduced where the rules contemplate a majority ownership threshold. The reasons for this are that:

- it is likely that ultimately, the Commissioner would only need to issue one amended assessment in the scenario where a BTR development ceased to be an active BTR development. That is, the BTR misuse tax could allow the Commissioner to issue an assessment to the trustee or beneficiary of the ultimate upstream withholding MIT within the controlled group; and
- any other information needed by the Commissioner should also be readily available given that all entities would be within the same controlled group.

Submission in respect of Alternative 2: The limitations imposed by subsection 12-435(6) should be amended to incorporate an ownership threshold that would permit income to flow up through the intermediaries (including withholding MITs) in a controlled group to the withholding MIT that ultimately makes the distribution to the foreign investor.

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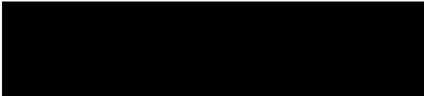
PSPIB values and appreciates the ability to provide our views through the consultation process.

Yours sincerely



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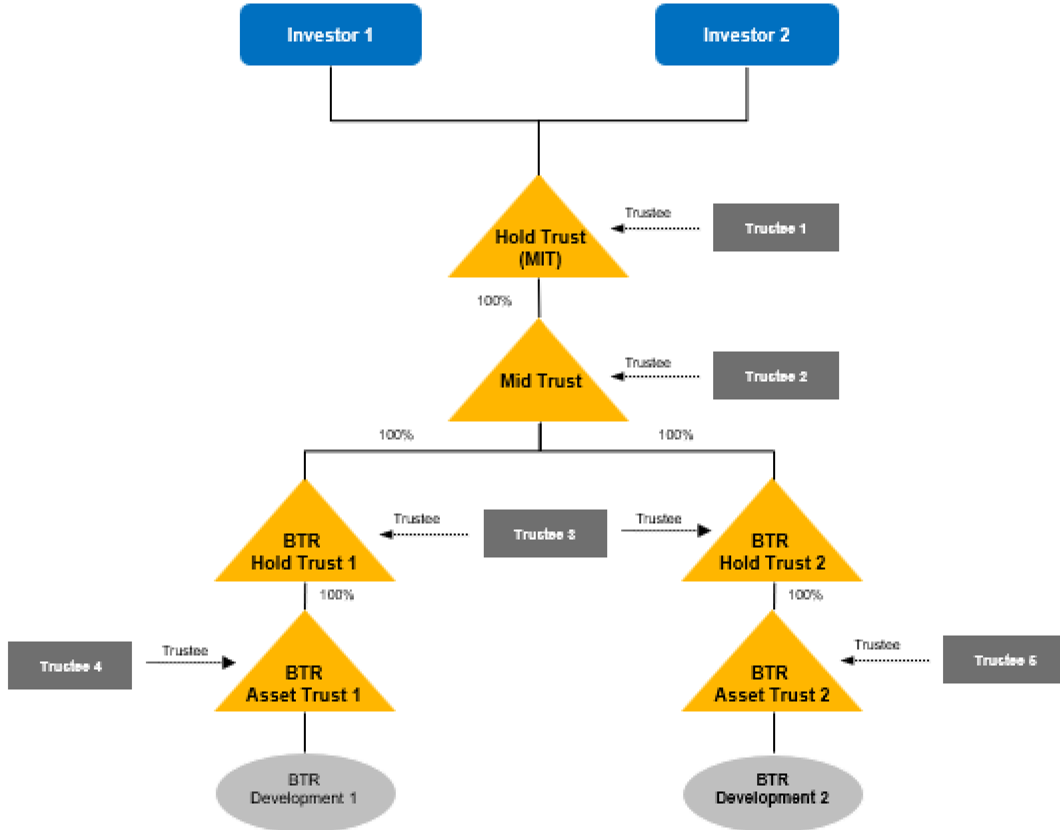
Appendix 1 – Example joint venture/consortium structure



Appendix 2 – treatment of partnerships under Subchapter C of Subtitle F of the United States Internal Revenue Code

The notion of providing the Commissioner with the relevant details at the underlying trust level, with subsequent flow-on implications for any upstream or consortium trusts, is conceptually similar to the treatment of partnerships under Subchapter C of Subtitle F of the United States Internal Revenue Code (referred to as the **Bipartisan Budget Act – BBA – Partnership Audit Process**).

We have set out below some key concepts of the BBA Partnership Audit Process and how this is conceptually similar to our suggestion in this Submission:

- The BBA Partnership Audit Process was introduced as part of Bipartisan Budget Act of 2015. It has been effective for fiscal years beginning after December 31, 2017. Partnerships are commonly used structures in the United States, similar to the way in which trusts are used in Australian holding structures.

- Generally, under the BBA process an adjustment to the calculation of tax and the assessment and collection of tax, for a US partnership occurs at the partnership level (and not at the partner level).[1] This can occur in scenarios where the **IRS** undertakes an audit and determines that an adjustment is required.

- To the extent that an adjustment does not result in an additional tax liability at the partnership level (referred to in the United States as an "imputed underpayment"), the adjustments to income are required to be taken into account at the partner level (and not the partnership level).[2]

- The partnership is also able to elect that any imputed underpayment is taken into account at the partner level (rather than the partnership level).[3] This is conceptually consistent with the approach suggested above in respect of the tiered trust and consortium structures for BTR assets – to the extent that the 15% concessional tax rate was prima facie available but during the relevant holding period the BTR development was no longer an active BTR development, any additional withholding tax would be payable by the relevant upstream withholding MIT trustees.

- From a tax administration perspective, the BBA Partnership Audit Process allows the IRS to undertake an audit in a more simplified manner (i.e., rather than dealing with the complexity of upstream partnership structures and dealing with various different partners/investors). The rules effectively shift the burden of managing any audit adjustments, and any subsequent tax liabilities, to the underlying partnership.

- A roadmap has been released by the IRS to explain the BBA Partnership Audit Rule process[4] (refer to hyperlink in the footnotes). The final element of this flowchart outlines the process when a final adjustment has been calculated – payment of the imputed underpayment by the partnership or a "push out" to the partners. Both the partners and the IRS are provided with statements that articulate the adjustments and any imputed underpayments (i.e., additional tax liabilities) where there is a "push out".

- The BBA Partnership Audit Rules do contemplate the payment of taxes by the underlying partnership itself, rather than upstream partners (except where the partnership makes a specific election to "push out" the imputed underpayment to partners).

[1] § 6221(a) of the Internal Revenue Code.
[2] § 6227(b)(2) of the Internal Revenue Code.
[3] Ibid.
[4] https://www.irs.gov/pub/irs-pdf/p5388.pdf