16 October 2018

Committee Secretary
Senate Standing Committee on Economics
Department of the Senate
PO Box 6100
Parliament House
CANBERRA ACT 2600

Dear Secretary

Inquiry into Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2018 and related Bills – submission on managed investment in housing & agricultural land[1]

The Financial Services Council (FSC) welcomes the opportunity to make submissions on the following Bills referred to the Senate Economics Committee (referred to as '**The Bills**' in the remainder of this submission):

- Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018
- Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2018; and
- Income Tax Rates Amendment (Sovereign Entities) Bill 2018

The FSC's submission specifically relates to managed investment in residential housing and agricultural land. The FSC is not making a comment on other components of the Bills.

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in Australia's largest industry sector, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing almost $3 trillion on behalf of more than 14.8 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

Managed investment in residential housing

The FSC welcomes the policy in the Bills stating that managed investment trusts (MITs) can invest in residential housing, specifically Build-to-Rent housing. As the FSC indicated in our submission to the

[1] This submission largely reflects an FSC submission to draft versions of these Bills. This earlier submission is available from: https://fsc.org.au/resources/resource-detail/?documentid=5e4a3c88-a79e-e811-815d-e0071b686a81

Government of 5 October 2017,[2] there are substantial benefits to permitting this type of investment, in particular Build-to-Rent is likely to be an important solution to Australia's housing affordability and supply problems.

Permitting Build-to-Rent also means MITs can invest in 'mixed use' developments that involve some element of residential investment. There are many investments by Australian funds, offshore and locally, that are mixed use property developments. This may for example include apartments above a shopping centre, which can sometimes be a requirement of a local council. In some cases, the residential investment may be a small part of the total investment.

Nevertheless, the FSC has concerns about the approach taken in the Bills to impose a higher withholding tax rate on Build-to-Rent. In the FSC's view this is unnecessary and inappropriate, for the following reasons:

- Build-to-Rent properties are likely to reduce rent pressures, making renters better off.
- This measure is not protecting revenue. The Government would currently be receiving almost no revenue from Build-to-Rent as the asset class is nearly non-existent in Australia.
- If Build-to-Rent expands, then any revenue impact of a lower withholding tax rate would be offset by factors including:
    - The costs to governments from rent assistance and social housing is likely to decline (as noted earlier, Build-to-Rent is likely to reduce rent pressures).
    - If prospective home owners instead choose to rent long-term in a Build-to-Rent property, then the impact on government budgets is likely to be positive as home ownership is significantly tax preferred over rental properties. A Build-to-Rent property would generally be subject to capital gains tax and state land tax, while home owners generally do not pay these taxes.
- The Build-to-Rent sector is well developed in some other countries, such as in the USA and UK, and Australia needs to support, not penalise, the participation of foreign managers and investors with substantial expertise in this sector.
- If Build-to-Rent expands in Australia, this will mean the one missing domestic managed investment asset class (residential property) will at last be available in volume to local and foreign investors. This will aid diversification and allow investors to gain exposure to residential property without having to buy a property directly.
- There is no clear policy rationale to have a higher withholding tax rate on managed investment in housing compared to commercial property such as office and retail — particularly commercial accommodation such as hotels.
- This tax differential is likely to show up, in part, as higher rents for tenants in these properties. A tax penalty causing higher housing rents is, on the face of it, an inequitable and unintended consequence.

An FSC member has also raised a concern that the classification of student accommodation as residential housing for this measure could deter investment in this sector. Student accommodation investments serve to ensure that foreign students can access purpose built accommodation and supports the ability for Australia to earn export income. In the absence of student accommodation, foreign students add to demand for affordable housing, which adds further price pressure to this sector and may encourage unauthorised subletting with consequential health and safety risks.

[2] See: https://fsc.org.au/resources/resource-detail/?documentid=871c03b3-93f6-e711-812b-480fcff12ac1

Discouraging investment in student accommodation may undermine other efforts to encourage export income from foreign students.

Managed investment in agricultural land

The FSC also does not support the proposals contained in the Bills to impose a higher withholding tax rate on MIT investment in agricultural land. Overall, the government has not provided a convincing policy rationale for these measures. Some of the FSC's concerns are similar to the concerns with Build-to-Rent, while some are specific to agricultural land. These concerns are outlined below.

Policy

- The proposal will disadvantage Real Estate Investment Trusts (REITs) holding agricultural land compared to all other REITs. There is no clear policy rationale to have a higher withholding tax rate on managed investment in agriculture compared to commercial property such as office and retail.
    - This tax differential is likely to show up, in part, as higher rents for these properties. There is no clear rationale why rents for agricultural properties should be higher than for other commercial property. For example, it is unclear why supermarket chains will potentially have lower rents than their fresh produce suppliers. This appears to be another unintended consequence of the legislation.
- The Government has indicated it is interested in promoting managed investment into agriculture through superannuation funds, in particular by instituting a Parliamentary Inquiry into this issue — the Standing Committee on Agriculture and Water resources inquiry into barriers to superannuation fund investment in Australian agriculture, announced 24 May 2018. In this context, it is inconsistent to *encourage* managed investment into agriculture *inside* super on the one hand, to provide much needed capital for the industry, while *discouraging* managed investments *outside* of superannuation on the other.
    - More particularly, imposing higher withholding tax rates on foreign investors in agriculture through MITs is likely to indirectly constrain superannuation investment in agriculture. This is because the co-investors in the types of MIT funds which a superannuation fund is likely to invest in agriculture in are likely to be foreign investors, who may be deterred from such investment as a result of the proposals in these Bills.
- If the government is concerned about foreign ownership of agricultural land, then the issue is better dealt with through foreign investment rules. In addition, the issues often raised with foreign ownership of farms usually relate to land that is wholly owned by a particular foreign investor, or a particular related group of foreign investors; these concerns do not apply across the board to widely held MITs.

Drafting concerns

The FSC is also concerned with the proposal in the draft legislation that a higher tax rate would apply to land that could 'reasonably be used' for carrying on a primary production business (see EM at paragraph 1.182). This would mean land actually being used for a different, non-agriculture, purpose could have the higher tax rate imposed just because the land could alternatively be used for agriculture. This could catch any MIT owning urban fringe or regional property applied to a different use, only because the land could have been used for primary production.

- Any capital gain on vacant rural land would also likely have the higher tax rate apply, even if both the seller and buyer are not using the land for farming. Vacant rural land could be captured by this proposal even if it is being held pending commercial (non-farming) development.

General comment

The FSC is also concerned that the proposals contained in the Bills will mean added complexity in the withholding tax rates applying to MITs, with a different tax rate applying to some property investment, and various carve-outs and transitional rules applying to these tax rates.

Attached to this submission are briefs by PricewaterhouseCoopers and KPMG on the Bills which indicate some of the complexities in the different tax rates and the transitional arrangements.

Recommendation

The FSC recommends a higher proposed MIT rate should not apply to MITs investing in agricultural land or residential housing.

Please contact me with any questions in relation to this submission on [redacted]

Yours sincerely,

[redacted]

Michael Potter
Senior Policy Manager, Economics & Tax