KING&WOOD MALLESONS

Level 61
Governor Phillip Tower
1 Farrer Place
Sydney NSW 2000
Australia

T +61 2 9296 2000
F +61 2 9296 3999

www.kwm.com

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Secretary
Standing Committee on Economics
House of Representatives
PO Box 6021
Parliament House
Canberra ACT 2600

Via email: economics.reps@aph.gov.au

Dear Secretary

Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012
Submission in relation to the proposed increased in Managed Investment Trust withholding tax

We refer to the *Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012* which was introduced into the House of Representatives on 24 May 2012 (the "**Bill**") and the opportunity provided by the Standing Committee on Economics of that House to lodge a submission in respect of the Bill.

By way of background, the Bill implements the 2012-13 Federal Budget announcement by doubling the Managed Investment Trust ("**MIT**") final withholding tax from 7.5% to 15% on fund payments made in relation to income years that commence on or after 1 July 2012. In this regard, the increased rate is proposed to apply to all future fund payments including in respect of those investment structures which were put in place by eligible foreign investors prior to 7.30pm (AEST) on 8 May 2012 (being, the time of the announcement of the proposed doubling of the MIT withholding tax rate).

We set out our submission in relation to the Bill below.

1 Submission

1.1 In summary, we submit that:

(a) ***The increased rate should not apply to existing MIT structures established prior to 7.30pm (AEST) on 8 May 2012 (being, the time of the announcement of the proposed doubling of the MIT withholding tax rate).***

We make this submission for the following reasons:

(i) In circumstances where existing structures are not grandfathered, the measure will have unfair retrospective application. This is because the increase in the MIT withholding tax rate will apply to foreign capital which has already been invested by eligible foreign investors in Australia in reliance upon the (then) express Government policy to apply an MIT withholding tax rate of 7.5%.

This express Government policy was specifically developed and implemented to "*attract* [emphasis added] and retain foreign investment" (see paragraph 1.8 of the Explanatory Memorandum which accompanied the *Income Tax (Managed Investment Trust Withholding Tax) Bill 2008*).

(ii) In particular, many eligible foreign investors have already invested into Australian MITs based on the expectation that the reduced rate of 7.5% would apply over the term of their investment. Many of these foreign investors may not have made the investment if a higher rate of withholding (such as the proposed 15% rate) applied for the life of their investment on the basis that it would not have been commercially feasible to do so (or other jurisdictions may have been pursued instead). Accordingly, we submit that the proposed measure will have unfair retrospective application on the basis that existing foreign investors have modelled their investment profiles and made specific investment decisions (as well as various representations to their ultimate investors or financiers in disclosure documents etc) based on the application of the 7.5% withholding tax rate.

(iii) Based on the above, foreign investors are indicating to us that they are becoming increasingly and seriously concerned about tax and other legislative risk in Australia (commonly referred to as "sovereign risk") in connection with establishing or investing in MITs, as well as in connection with investing in Australia, more generally (see our further observations below). This is clearly contrary to the policy intention of the MIT measures, as well as the Government's focus on establishing Australia as a regional financial centre.

(iv) Finally, it has long been well accepted that, except to prevent a mischief, citizens and other taxpayers should not be adversely affected by legislation which either has, or has the potential to have, retrospective effect. Therefore, we see no reason why the proposed increase in the MIT withholding tax rate should be imposed retrospectively.

(b) ***Further, we submit that the proposed increase in the rate of MIT withholding tax should be reconsidered more broadly.***

In this regard, we submit that:

(i) The MIT withholding tax rate should remain at 7.5% for eligible foreign investors (consistent with the initial and unqualified Government policy outlined above); or

(ii) If that initial Government policy has changed, then the MIT withholding tax rate should be increased to 10% (rather than 15%) for prospective structures relating to eligible foreign investors on the basis that a 10% rate is consistent with the rate of withholding tax which would typically apply to interest payments under an alternative debt investment.

Setting the MIT withholding tax rate at 10% would generally avoid the need to consider more complex funding arrangements based on various commercial considerations such as whether to invest in units (equity) in the MIT, or alternatively whether to invest by way of a mix of debt and/or equity (e.g. combination of equity units and debt notes). If the increased rate of MIT withholding tax of 15% was implemented as proposed, and a debt/equity mix was adopted by the MIT, eligible foreign investors could be expected to suffer a blended rate of Australian tax which is less than the proposed 15% (on a pure unit holding (equity) investment).

We therefore submit that the MIT withholding tax rate should be increased to 10% (rather than 15%) in circumstances where the initial Government policy has changed in order to remove the arbitrage between the Australian tax treatment of equity and debt investments in an MIT which will exist for withholding tax purposes.

2 Further observations

2.1 As noted above, primarily due to the way in which the MIT regime has been developed, foreign investors are indicating to us that they are becoming increasingly and seriously concerned about tax and other legislative risk in Australia in connection with establishing or investing in MITs, as well as in connection with investing in Australia, more generally. This is a direct consequence of:

(i) an apparent shift in policy by the Government surrounding the MIT regime (after its proper enactment);

(ii) the lack of any articulation of any policy driving the shift (which seems to be a function of the Government's political promise to ensure a fiscal surplus); and

(iii) most importantly, the measure has the potential to have an unfair retrospective effect on existing investments made by eligible foreign investors (as outlined above).

2.2 Foreign investors are concerned that the significant amount of foreign capital that has already been invested in Australian real estate under the existing terms of the MIT regime is being retrospectively adversely affected.

3 Concluding comments

3.1 We consider that the adoption of the above recommendations are necessary for the reasons outlined above.

3.2 Thank you again for providing the opportunity for us to make a submission in relation to the Bill.

If you have any questions in relation to the above, please do not hesitate to contact either me or my colleagues below.

Yours sincerely

Richard Snowden
Partner
T +61 2 9296 2193
richard.snowden@au.kwm.com

Andrew Clements
Partner
T +61 3 9643 4089
andrew.clements@au.kwm.com

Cory Hillier
Senior Associate
T +61 2 9296 2248
cory.hillier@au.kwm.com

Kai-Chen Lamb
Senior Associate
T +61 3 9643 4145
kai-chen.lamb@au.kwm.com