Chapter 1

Introduction and background to the bill

Referral of the bill

1.1 On 11 October 2012, the House of Representatives referred the Tax Laws Amendment (Clean Building Managed Investment Trust) Bill 2012 ('the bill') to the Parliamentary Joint Committee for Corporations and Financial Services ('the committee'). The Assistant Treasurer's office requested that the committee report by 29 October 2012, to enable parliamentary debate on the bill during the sitting week commencing on that day.

Conduct of the inquiry

1.2 The committee sent invitations to 36 organisations offering the opportunity to make a submission by Wednesday 24 October 2012. The committee received 6 submissions, as listed in Appendix 1.

Acknowledgements

1.3 The committee thanks those organisations that made submissions to the inquiry within the tight timeframe.

Overview of the bill

1.4 The bill reduces the final rate of withholding tax on fund payments from Australian Clean Building Managed Investment Trusts (MITs) made to foreign investors in information exchange countries. For fund payments made to these investors, the bill would cut the withholding tax rate from the current rate of 15 per cent to 10 per cent.

Key terms relating to the bill

1.5 The bill itself defines a 'clean building' and a 'clean building managed investment trust' (see chapter 2). It is useful here to clarify the meaning of:

- a 'managed investment trust' (MIT);
- a 'fund payment';
- an 'information exchange country'; and
- the National Australian Built Environment Rating System (NABERS), upon which the bill defines a 'clean building'.

1.6 A trust is a MIT in relation to an income year if, among other things, it is a 'managed investment scheme' (MIS) as defined by section 9 of the *Corporations Act 2001*.[1] Section 9 of the Act lists the following features of a MIS:

(i) people contribute money or money's worth as consideration to acquire rights (interests) to benefits produced by the scheme (whether the rights are actual, prospective or contingent and whether they are enforceable or not);

(ii) any of the contributions are to be pooled, or used in a common enterprise, to produce financial benefits, or benefits consisting of rights or interests in property, for the people (the members) who hold interests in the scheme (whether as contributors to the scheme or as people who have acquired interests from holders);

(iii) the members do not have day-to-day control over the operation of the scheme (whether or not they have the right to be consulted or to give directions).

1.7 Section 9 of the Corporations Act also defines a MIS as a time-sharing scheme. For an entity to be classified as an MIS, it must have more than 20 members.[2]

1.8 The Explanatory Memorandum (EM) defines a 'fund payment' as a distribution of income and capital gains from taxable Australian property by an Australian MIT. The trustee of an MIT is required to withhold an amount from a fund payment it makes to an entity whose address is outside Australia. The EM also clarifies that the concessional final withholding tax rate of 10 per cent does not apply to dividends, royalties, foreign sourced income and capital gains and losses from assets that are not taxable Australian property.[3]

1.9 An 'information exchange country' is one that is listed in Regulation 44E of the *Taxation Administration Regulations 1976*. These are countries and territories with which Australia has effective exchange of information arrangements to assist the

1 Bernard Pulle, Barbara Harris and Paige Darby, Tax Laws Amendment (Election Commitments No. 1) Bill 2008, Income Tax (Managed Investment Trust Withholding Tax) Bill 2008, Income Tax (Managed Investment Trust Transitional) Bill 2008, *Bills Digest Nos 145–147*, Parliamentary Library, 18 June 2008, pp. 5–6.

2 Section 9, *Corporations Act 2001*

3 Explanatory Memorandum, p. 6.

enforcement of domestic tax laws. There are currently 59 countries listed in this regulation.[4]

1.10 NABERS is a national rating system that measures the energy efficiency, water usage, waste management and indoor environment quality of a building. It uses information such as utility bills to assess a building's performance against a star rating scale from one to six stars. A six star rating demonstrates market-leading performance, while a one star rating means the building or tenancy has considerable scope for improvement. NABERS is managed nationally by the NSW Office of Environment and Heritage, on behalf of Commonwealth, state and territory governments.[5]

Background to the bill

1.11 The bill should be seen in the context of broader reforms to withholding tax arrangements for non-resident investors in Australian MITs. The current government has halved the withholding tax rate for non-resident investors in MITs. If enacted, the bill would cut the final withholding tax rate from 15 per cent to 10 per cent for fund payments to investors in Australian 'clean building' MITs who are foreign residents in information exchange countries.

1.12 In June 2007, Labor Senators on the Senate Economics Committee authored a dissenting report for that committee's inquiry into the provisions of the Tax Laws Amendment (2007 Measures No. 3) Bill 2007. That report stated:

> The ALP proposes to halve the 30 per cent withholding tax on distributions from Australian managed funds to non-resident investors. This proposed 15 per cent rate is at the upper end of relevant international rates. It will place Australian fund managers in a much better position to be able to compete to manage the global pool of managed funds, which is tipped to reach $60 trillion over the next three years.[6]

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4 They are: Argentina; Bermuda; Canada; China; Czech Republic; Denmark; Fiji; Finland; France; Germany; Hungary; India; Indonesia; Ireland; Italy; Japan; Kiribati; Malta; Mexico; Netherlands; Netherlands Antilles; New Zealand; Norway; Papua New Guinea; Poland; Romania; Russia; Slovakia; South Africa; Spain; Sri Lanka; Sweden; Taipei; Thailand; United Kingdom; United States of America; Vietnam; Antigua and Barbuda; British Virgin Islands; Isle of Man; Jersey; Gibraltar; Guernsey Belize; Cayman Islands; The Commonwealth of the Bahamas; Principality of Monaco; The Republic of San Marino; The Republic of Singapore; Saint Kitts and Nevis; Saint Vincent and the Grenadines; Anguilla; Aruba; Belgium; Malaysia; Turks and Caicos Islands; Cook Islands; Macau; Mauritius; and the Republic of Korea.

5 National Australian Built Environment Rating System, http://www.nabers.gov.au/public/WebPages/Home.aspx (accessed 18 October 2012).

6 Labor and Democrats Dissenting Report, *Senate Standing Committee on Economics report into the Tax Laws Amendment (2007 Measures No.3) Bill 2007 [Provisions]*, Canberra, 6 June 2007. p. 34. See Bernard Pulle, Barbara Harris and Paige Darby, Tax Laws Amendment (Election Commitments No. 1) Bill 2008, Income Tax (Managed Investment Trust Withholding Tax) Bill 2008, Income Tax (Managed Investment Trust Transitional) Bill 2008, *Bills Digest Nos 145–147*, Parliamentary Library, 18 June 2008, pp. 5–6.

1.13 During the 2007 federal election campaign, the Australian Labor Party promised to lower the level of withholding tax on certain MIT distributions to foreign resident investors:

> Labor will make Australian managed investment funds even more attractive to non-resident investors by relieving the tax burden. Labor's initiative will see the current 30 per cent withholding tax on distributions from Australian managed funds to non-resident investors halved to 15 per cent.[7]

Decreasing the withholding tax rate from 30% to 7.5%

1.14 In response to the Global Financial Crisis, in the 2008–09 federal budget, the government decided to reduce the rate of withholding tax from a non-final rate of 30 per cent to a final rate of 7.5 per cent on certain distributions from Australian managed investment trusts (MITs) to foreign resident investors. In making this announcement, the Treasurer, the Hon. Wayne Swan MP, stated:

> ...these arrangements will make Australia's withholding tax rate one of the most competitive in the world, and provide a significant boost to Australia's ability to compete globally.[8]

1.15 In June 2008, the *Income Tax (Managed Investment Trust Withholding Tax) Act 2008* imposed a rate of tax for:

(a) an entity that is a resident of an information exchange country of:

(i) 15% for fund payments in relation to the income year following the first income year starting on or after the first 1 July after the day on which the *Tax Laws Amendment (Election Commitments No. 1) Act 2008* receives the Royal Assent; or

(ii) 7.5% for fund payments in relation to later income years; or

(b) otherwise—30%.[9]

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7 The Hon. Simon Crean MP (then Shadow Minister for Trade and Regional Development), *A strong future for Australia's exports*, Media Release, Canberra, 21 November 2008.

8 The Hon. Wayne Swan MP, 'Establishing Australia as a Regional Financial Hub', *Media Release*, Canberra, 13 May 2008.

9 An entity is a resident of an information exchange country if:

(a) the entity is a resident of that country for the purposes of the taxation laws of that country; or

(b) if there are no taxation laws of that country applicable to the entity or the entity's residency status cannot be determined under those laws:

(i) for an individual—the individual is ordinarily resident in that country; or

(ii) for another entity—the entity is incorporated or formed in that country and is carrying on a business in that country.

Increasing the withholding tax rate from 7.5% to 15%

1.16 In May 2012, the government announced in the federal budget that it would increase the rate of withholding tax for non-residents in MITs to 15 per cent. Budget Paper No. 2 (2012–13) stated that this decision will return the withholding tax for MITs to the level of the original 2007 election commitment, adding $260.0 million to revenue over the forward estimates period (2015–16).[10]

1.17 The Assistant Treasurer, the Hon. David Bradbury MP, explained that the Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012:

> ...ensures that Australians can collect a fair return on investments in Australia, while remaining an attractive destination for international investment. These measures will mean that Australia's withholding tax rate is equal to or better than most comparable nations. This move is consistent with the Henry Review's recommendations on location specific rents.[11]

1.18 In evidence to the House of Representatives Standing Committee on Economics, the Chief Executive of the Property Council of Australia, Mr Peter Verwer, criticised the proposal to increase the rate to 15 per cent. As he told the committee:

> ...the sorts of investments that foreign investors were attracted to...were five and six green star buildings, every single one of them—because they would not accept anything less. The sorts of infrastructure projects that they were looking at as well is exactly the sort of money that we want. This was an elegant, bold, brand statement that Australia made—that we are 7½ per cent final. Many of the sorts of advisers to the private sector could have structured the effective rate down even lower, but they did not. Why? It was just simpler. It was clean, and it had the impact of drawing in the world's savings.[12]

1.19 The Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2012, along with the Tax Laws Amendment (Managed Investment Trust Withholding Tax) Bill 2012, received Royal Assent on 29 June 2012 after being passed in the Senate with the support of the Australian Greens. Section 4 of the *Income Tax (Managed Investment Trust Withholding Tax) Act 2008* currently states:

> (1) The rate of income tax imposed by this Act is:
>
> (a) if the entity is a resident of an information exchange country:

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10 Budget Paper No. 2, p. 31, http://www.budget.gov.au/2012-13/content/bp2/download/bp2_consolidated.pdf (accessed 17 October 2012)

11 The Hon. David Bradbury MP, Assistant Treasurer; The Hon. Mark Dreyfus MP, Parliamentary Secretary for Climate Change and Energy Efficiency, 'Withholding Tax Rate Bill Wins Senate Support', *Joint media release*, 27 June 2012.

12 Mr Peter Verwer, Chief Executive, Property Council of Australia, House of Representatives Standing Committee on Economics, *Committee Hansard*, 4 June 2012, p. 34.

(i) 15% for fund payments in relation to the income year following the first income year starting on or after the first 1 July after the day on which the *Tax Laws Amendment (Election Commitments No. 1) Act 2008* receives the Royal Assent; or

(ii) 7.5% for fund payments in relation to later income years starting before 1 July 2012; or

(iii) 15% for fund payments in relation to later income years starting on or after 1 July 2012; or

(b) otherwise—30%.

The Clean Building MIT amendment

1.20 On 27 June 2012, the government announced it will introduce subsequent legislation to support investment in the construction of new energy efficient commercial buildings. The Tax Laws Amendment (Clean Building Managed Investment Trust) Bill 2012 ('the bill') would provide a final withholding tax rate of 10 per cent on fund payments from eligible Clean Building MITs made to foreign residents in countries with which Australia has effective exchange of information.[13]

1.21 For the concessional 10 per cent rate to apply, the MIT must invest in new energy efficient office, hotel or retail buildings that commenced construction on or after 1 July 2012. The trusts may hold limited assets incidental to these buildings such as car parking facilities, telecommunications infrastructure or advertising billboards. To be treated as an energy efficient building, a building must obtain and maintain either a 5 star Green Star rating or a 5.5 star NABERS rating.[14] The concession will also be available for retail centres and non-residential accommodation that meet equivalent standards. The government has announced that these criteria will be reviewed after three years 'to ensure that the measure continues to apply to buildings that are above the average level of energy efficiency'.[15]

1.22 On 16 August 2012, the government released exposure draft legislation on Clean Building MITs. Treasury called for submissions on the draft legislation and explanatory material by 13 September 2012.

1.23 Treasury received five submissions, one of which was confidential. The public submissions were from the Canada Pension Plan Investment Board, Green Building Council Australia, the Property Council of Australia and the Property Funds

13 Explanatory Memorandum, p. 5.

14 The Hon. David Bradbury MP, Assistant Treasurer, Second Reading Speech, *House of Representatives Hansard*, 10 October 2012, p. 11.

15 The Hon. David Bradbury MP, Assistant Treasurer, Second Reading Speech, *House of Representatives Hansard*, 10 October 2012, p. 11.

Association.[16] Chapter 3 of this report discusses some of the evidence contained in these submissions.

Structure of the report

1.24 This report has three chapters. Chapter 2 sets out the provisions of the bill while chapter 3 presents stakeholders', and the committee's views on the bill.

16 Treasury, Clean Building MITs concessional tax rate, *Consultation*, http://www.treasury.gov.au/ConsultationsandReviews/Submissions/2012/Clean-MITS-10-per-cent-concessional-tax-rate/Submissions (accessed 17 October 2012).