# Parliamentary Joint Committee on Corporations and Financial Services

## Inquiry into the Tax Laws Amendment (Clean Building Managed Investment Trust) Bill 2012

October 2012

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# Duties of the Committee

Section 243 of the *Australian Securities and Investments Commission Act 2001* sets out the Parliamentary Committee's duties as follows:

(a) to inquire into, and report to both Houses on:

(i) activities of ASIC or the Panel, or matters connected with such activities, to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; or

(ii) the operation of the corporations legislation (other than the excluded provisions), or of any other law of the Commonwealth, of a State or Territory or of a foreign country that appears to the Parliamentary Committee to affect significantly the operation of the corporations legislation (other than the excluded provisions); and

(b) to examine each annual report that is prepared by a body established by this Act and of which a copy has been laid before a House, and to report to both Houses on matters that appear in, or arise out of, that annual report and to which, in the Parliamentary Committee's opinion, the Parliament's attention should be directed; and

(c) to inquire into any question in connection with its duties that is referred to it by a House, and to report to that House on that question.

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# Abbreviations

| | |
|---|---|
| CPPIB | Canada Pension Plan Investment Board |
| EM | Explanatory Memorandum |
| GBCA | Green Building Council of Australia |
| ITTA | *Income Tax Assessment Act 1997* |
| MIT | Managed investment trust |
| MIS | Managed investment scheme |
| NABERS | National Australian Built Environment Rating System |
| SMF | Sustainable Melbourne Fund |

# Recommendations

**Recommendation 1**

3.19 The committee recommends that paragraph 1.28 of the Explanatory Memorandum be amended to state:

> Therefore, buildings such as those built on top of previous foundations or on top of shared car parking facilities will not be considered to have commenced construction until works on the lowest level of the building commences.

**Recommendation 2**

3.21 The committee recommends that the following sentence be added to proposed subsection 12-430(2) of the bill:

> The commencement of construction does not include any works preparing the site for construction and works undertaken below the lowest level of the proposed building.

**Recommendation 3**

3.43 The committee recommends that the bill be passed.

# 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

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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).

# Chapter 2

## The provisions of the bill

2.1 The provisions of the bill can be divided into the following areas:

- changing the rate of withholding tax for clean building managed investment trusts (MITs);
- defining a 'clean building MIT' and a 'clean building'; and
- consequential amendments to the *Income Tax Assessment Act 1997* and the *Taxation Administration Act 1953*.

2.2 This chapter outlines these amendments.

### Amending the rate of withholding tax

2.3 As discussed in chapter 1, the bill's amendments will provide for a final withholding tax rate of 10 per cent on fund payments from Clean Building MITs made to foreign residents in information exchange countries. To this end, the concessional MIT final withholding tax rate is prescribed in paragraph 4(1)(a) of the *Income Tax (Managed Investment Trust Withholding Tax) Act 2008* and paragraphs 12-385(3) and 12-390(6) of Schedule 1 to the *Taxation Administration Act 1953*.[1]

2.4 The Explanatory Memorandum clarifies how the bill would alter current MIT withholding tax arrangements. It is proposed that:

- fund payments that are not from a Clean Building MIT will be subject to a final withholding tax rate of 30 per cent. Where a recipient is in an information exchange country listed in Regulation 44E of the *Taxation Administration Regulations 1976*, the final withholding tax rate will be reduced to 15 per cent (see chapter 1); and
- fund payments that are from a clean building MIT will also be subject to a final withholding tax rate of 30 per cent. Where a recipient is in an information exchange country listed in Regulation 44E, the final withholding tax rate will be reduced to 10 per cent.[2]

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1 Explanatory Memorandum, p. 7.

2 Explanatory Memorandum, p. 7.

## Definition of a 'clean building managed investment trust'

2.5 Proposed section 12-425 of the Taxation Administration Act contained in the bill will add the following definition of a clean building MIT:

> (1) A trust is a clean building managed investment trust in relation to an income year if during the income year:
>
> (a) it is a managed investment trust in relation to the income year; and
>
> (b) it holds one or more clean buildings (including the land on which the buildings are situated); and
>
> (c) it does not derive assessable income from any taxable Australian property (other than from the clean buildings or assets that are reasonably incidental to those buildings).
>
> *5% safe harbour for certain income reasonably incidental to a clean building*
>
> (2) A trust is not a clean building managed investment trust in relation to an income year if the assessable income of the trust that is derived from assets that are reasonably incidental to clean buildings is greater than 5% of the assessable income of the trust that is derived from clean buildings.
>
> (3) The regulations may specify kinds of assets that are, or are not, reasonably incidental to clean buildings for the purposes of this section.[3]

2.6 In terms of the reference to 'reasonably incidental' in proposed subsection 12-425(2), the EM states:

> Assets that could be considered 'reasonably incidental to' clean buildings include car parking facilities, telecommunications infrastructure attached to the building (mobile phone towers on top of a building) and advertising infrastructure (such as billboards).[4]

2.7 The EM also notes that a MIT will not be a 'clean building MIT' if it receives income from a non-clean building or non-incidental assets to the clean building it holds. It adds that this does not preclude a clean building MIT from holding and receiving income from assets that are not taxable Australian property, such as cash and shares. In this case, however, any income derived from these assets is not part of the clean building MIT's fund payment and therefore not subject to MIT withholding tax.[5]

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3 Proposed section 12-425 of the *Taxation Administration Act 1953*

4 Explanatory Memorandum, p. 8.

5 Explanatory Memorandum, p. 8.

### *Definition of a 'clean building'*

2.8 Proposed section 12-430 of the Taxation Administration Act will add the following definition of a 'clean building':

(1) A building is a clean building if:

(a) the construction of the building commenced on or after 1 July 2012; and

(b) it satisfies the requirements in subsections (3) and (4).

(2) For the purpose of subsection (1), the construction of the building is taken to have commenced at the time the works on the lowest level (including any basement level) of the building commence.

(3) A building satisfies the requirements in this subsection if:

(a) the building is a commercial building that is any of the following (or is a combination of any of the following):

(i) an office building;

(ii) a hotel for use wholly or mainly to provide short-term accommodation for travellers;

(iii) a shopping centre; or

(b) the building satisfies the requirements prescribed by the regulations for the purposes of this paragraph.

(4) A building satisfies the requirements in this subsection if:

(a) the building:

(i) has, and continues to maintain at all times during the income year, at least a 5 Star Green Star rating as certified by the Green Building Council of Australia; or

(ii) has, and continues to maintain at all times during the income year, at least a 5.5 star energy rating as accredited by the National Australian Built Environment Rating System (NABERS); or

(b) the building satisfies the requirements prescribed by the regulations for the purposes of this paragraph.

(5) For the purposes of subsection (4), if:

(a) a building has previously satisfied the requirements in that subsection; and

(b) the building then fails to satisfy the requirements for a period (the non-compliance period); and

(c) within 180 days after the first day of that failure, the building again satisfies the requirements;

treat the building as having satisfied the requirements during the non-compliance period.[6]

2.9 In terms of proposed subsections (1) and (2) above, the EM notes that existing buildings that are retrofitted or extended are not clean buildings.[7]

2.10 In terms of proposed subsection (3) above, the EM clarifies that 'incidental uses, such as a child care centre, limited retail and food outlets will not exclude the building from being an office building'.[8] Further:

- to be eligible as a hotel, a building must wholly or mainly provide short-term accommodation for travellers; and
- to be eligible as a shopping centre, a building must be predominantly used for retail purposes.[9]

2.11 In terms of proposed subsection (4) above, the EM states that only accredited NABERS ratings will be accepted. Given that these ratings are valid for 12 months, buildings must maintain a 5.5 star rating for each yearly assessment. However, a building may still be classified as a 'clean building' for a particular income year if it satisfies all of the relevant provisions, even if it has not had or maintained the minimum energy efficiency ratings required under the provisions in previous income years.[10]

2.12 The EM also states that:

- where the building is an office building, it will need to achieve a 5.5 star energy NABERS rating for the base building only, in order to be eligible as a clean building; and
- where the building is a shopping centre or a hotel, the building will be required to achieve a 5.5 star energy NABERS rating, as base building ratings do not currently exist for these buildings.[11]

2.13 In terms of proposed subsection (5) above, the EM notes that where an MIT re-establishes its energy efficiency requirements within the 180 day grace period, the trust will be considered to have been a clean energy building for the entire period.

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6 Proposed section 12-425 of the *Taxation Administration Act 1953*

7 Explanatory Memorandum, p. 9.

8 Explanatory Memorandum, p. 10.

9 Explanatory Memorandum, p. 10.

10 Explanatory Memorandum, p. 11.

11 Explanatory Memorandum, p. 11.

Where the minimum standard is not met within the 180 day period, the MIT trust will be considered ineligible as a clean building MIT from the date that it first failed to meet the efficiency requirement (not the 180 day expiry date).[12]

## Consequential amendments to the Income Tax Assessment Act 1997

2.14 Division 995 of the *Income Tax Assessment Act 1997* (ITAA) sets out various definitions relevant to the Act. The bill proposes to insert subsection 995-1(1) into the ITAA defining clean building according to the meaning given by section 12-430 of Schedule 1 to the Taxation Administration Act (see paragraph 2.8). It also inserts the meaning of 'clean building MIT' into subsection 995-1(1) of the ITAA according to the meaning given by section 12-425 in Schedule 1 of the Taxation Administration Act (see paragraph 2.5).

2.15 The bill amends the *Income Tax (Managed Investment Trust Withholding Tax) Act 2008* to give various terms the same meaning as in the ITAA. These terms are: clean building managed investment trust; entity; fund payment; income year; and information exchange country.

## Consequential amendments to the Taxation Administration Act 1953

2.16 The bill proposes amendments to section 12-375 of Schedule 1 of the Taxation Administration Act. Firstly, the bill would add the following italicised words to the end of the last paragraph in this section:

> Where there is an obligation to withhold, the applicable withholding rate is determined by the nature of the country or territory in which the recipient's address, place for payment or residency is located *and whether the trust is a clean building managed investment trust*.

2.17 Secondly, the bill would insert the following sentence at the end of section 12-375:

> A managed investment trust is a clean building managed investment trust if it is a managed investment trust that holds one or more clean buildings and does not derive assessable income from any other taxable Australian property (other than certain assets that are reasonably incidental to a clean building).

2.18 The final chapter of this report examines stakeholders' views on the bill's provisions, particularly proposed sections 12-425 and 12-430 of the Taxation Administration Act.

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12 Explanatory Memorandum, p. 12.

# Chapter 3

## Views on the bill

3.1 The final chapter of this report canvasses submitters' views on the proposed legislation. Stakeholders expressed concern that the meaning of a 'clean building' in proposed section 12-430 and the meaning of a 'clean building managed investment trust' in proposed section 12-425 of the *Taxation Administration Act 1953* are drafted too narrowly. Their concern is that eligible international investors will be restricted in the type of 'green buildings' for which that would be eligible for the 10 per cent final rate of withholding tax. These restrictions, they argue, would distort the investment incentives by allowing only certain investments in clean buildings to be eligible for the lower tax rate.

3.2 This chapter examines the evidence received by the committee on the following aspects of these proposed sections:

- the exclusion of retrofitted buildings from the definition of a 'clean building' in proposed paragraph 12-430(1)(a) of the Taxation Administration Act;
- how the commencement of construction of a clean building is defined in proposed subsection 12-430(2);
- the exclusion of building extensions and mixed purpose buildings in proposed subsection 12-430(3);
- the operation of the energy rating requirement in proposed subsection 12-430(4); and
- the incidental assets that eligible managed investment trusts (MITs) are entitled to hold in proposed subsections 12-425(1) and (2).

### The exclusion of retrofitted buildings—proposed paragraph 12-430(1)(a)

3.3 The main area of stakeholder concern is the bill's exclusion of retrofitted buildings from the definition of a 'clean building'.[1] The EM states that existing buildings that are retrofitted or extended are not within the scope of the bill's provisions. It elaborates: 'a building which is substantially or significantly extended or retrofitted will not change its character from an existing building and are not clean buildings'.[2]

3.4 The Property Council claimed that the bill 'discourages' investment in green retrofit of existing buildings by only providing the incentive to entirely new

1 Proposed paragraph 12-430(1)(a) of the Taxation Administration Act

2 Explanatory Memorandum, paragraph 1.30.

constructions.[3] As a consequence, it argued that under the proposed legislation, owners will be encouraged to demolish existing structures and waste the building's embodied energy. The Property Council proposed that the bill should allow refurbishment and retrofit of existing structures to stop what it called 'perverse environmental outcomes'.[4]

3.5 The Green Building Council of Australia (GBCA) put the same argument.[5] In support of including retrofitted buildings within the proposed legislation, the GBCA noted:

- the demolition of existing buildings will result in the loss of embodied energy and the waste of materials and resources;
- the disincentive in the bill for retrofitting is at odds with the National Strategy on Energy Efficiency which emphasises upgrading buildings to improve energy efficiency;
- Green Star ratings can be attained for retrofitted buildings and there are many examples of energy-efficient refurbishments of heritage and existing buildings in Australia; and
- GST law recognises a substantially retrofitted building as new.[6]

3.6 The City of Melbourne argued in its submission that the bill's exclusion of retrofitted existing buildings 'has the potential to dis-incentivise improvements to existing building stock in favour of the construction of new buildings'. It drew the committee's attention to the programs that the City has currently in place to promote retrofitting of building stock. This includes the 1200 Buildings program which aims to retrofit two thirds of the City's commercial building stock over 10 years to improve energy performance.

3.7 The City of Melbourne proposed amending the bill to extend the 10 per cent withholding tax rate to existing buildings which undergo an energy efficiency upgrade after 30 June 2012. It proposed that the energy performance standard to which existing buildings would need to be upgraded should be different to that applied to new buildings. The City indicated that a relevant measure for existing buildings should:

- consider the base level of energy performance prior to retrofit, and the average level of energy performance typical of the given building type;
- be developed in consultation with industry and determined by regulation; and

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3 Property Council of Australia, *Submission 5*, p. 9.

4 Property Council of Australia, *Submission 5*, p. 9.

5 Green Building Council of Australia, *Submission 2*, p. 4; Green Building Council of Australia, *submission to Treasury*, 13 September 2012, p. 3.

6 Green Building Council of Australia, *Submission 2*, p. 4.

- be determined by regulation and subject to regular review to align with industry practice.[7]

3.8 The Sustainable Melbourne Fund (SMF) also critiqued the bill on the basis that it gives disincentives to invest in retrofitted buildings. It noted in its submission that the City of Melbourne is seeking to catalyse the environmental retrofit of 1200 non-residential buildings, representing 70 per cent of the commercial building stock within the municipality. To this end, environmental upgrade finance was introduced in 2011 to enable non-residential building owners to access capital to undertake environmental improvements. The SMF noted that it is the third party administrator of the environmental upgrade finance mechanism for the City of Melbourne's 1200 Buildings program.[8]

3.9 The SMF's submission detailed some of the potential cuts to energy costs and employment opportunities from the 1200 Buildings program. It noted that the combined opportunity of retrofit activity in the City of Melbourne, New South Wales and South Australia 'is estimated to be in the order of $4–$8 billion'.[9]

3.10 The SMF recommended amending the proposed definition of a clean building to include a building constructed prior to 1 July 2012 which has achieved an increased NABERS energy rating of 2.5 stars from the previous year.[10]

## Commencing construction of a 'clean building'—proposed subsection 12-430(2)

3.11 The second issue of stakeholder concern is the matter of defining at what point the construction of a clean building is deemed to have commenced. As chapter 2 of this report noted, proposed subsection 12-430(2) of the Taxation Administration Act states that 'the construction of the building is taken to have commenced at the time the works on the lowest level (including any basement level) of the building commence'.

### *Comment on the draft bill*

3.12 In its submission to Treasury's consultation on the provisions of the draft legislation, the Canada Pension Plan Investment Board (CPPIB) argued that the definition in the draft bill of 'newly constructed' in proposed section 12-430 of Schedule 1 to the Taxation Administration Act is too narrow. CPPIB, an investor in a number of Australian infrastructure and property projects, claimed that the clarification in paragraph 1.20 of the draft EM is 'likely to result in a number of anomalies that would preclude worthwhile "clean building" projects from qualifying'.

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7 City of Melbourne, *Submission 4*, p. 3.

8 Sustainable Melbourne Fund, *Submission 3*, p. 1.

9 Sustainable Melbourne Fund, *Submission 3*, p. 2.

10 Sustainable Melbourne Fund, *Submission 3*, p. 2.

This paragraph stated that the commencement of the construction of the foundation occurs when ground is broken for the purpose of excavating to establish the building's foundations.[11]

3.13 CPPIB gave the following examples of worthwhile projects that it claimed would be exempt from the provisions of the draft bill:

- newly constructed buildings that form part of ongoing or planned urban renewal projects;
- projects that are developed in stages and where some of the stages of the development occur entirely after 1 July 2012;
- otherwise eligible new buildings that are constructed after 1 July 2012 above existing structures;
- a newly constructed building that is constructed on a common basement built as part of a phased development of a precinct; and
- projects where only preparatory works were undertaken before being abandoned prior to 1 July 2012. If new owners were to commence to start construction of a new energy efficient building after 1 July 2012, the project would not qualify.

3.14 The CPPIB proposed in its submission to Treasury that paragraph 1.20 of the draft EM be removed and a section inserted into proposed section 12-430 of the Taxation Administration Act to state that construction of the foundations excludes all preparatory work to the site.

3.15 In its submission to Treasury, the GBCA also argued that the draft bill would disqualify a range of buildings that 'should reasonably be considered eligible'. It argued that if the policy intention is to create an incentive to invest in newly-constructed energy-efficient buildings, this intention would still be met where significant works have not yet been undertaken and projects meet other requirements.[12] The GBCA claimed:

> Using the date of practical completion, or of Green Star or NABERS Energy certification, is more likely to create an incentive to invest in newly-constructed energy-efficient buildings without creating an additional layer of bureaucracy connected to the date on which foundation work was started.[13]

11 Draft Explanatory Memorandum, paragraph 1.20.

12 Green Building Council of Australia, *Submission to Treasury*, 13 September 2012, p. 3.

13 Green Building Council of Australia, *Submission to Treasury*, 13 September 2012, p. 3.

### *The amendment to proposed subsection 12-430(2)*

3.16 The committee highlights the fact that proposed section 12-430 of the Tax Administration Act has been amended following Treasury's consultation on the draft bill. Proposed subsections 12-430(1) and (2) now define a clean building as one where the construction occurred on or after 1 July 2012 and where construction 'is taken to have commenced at the time the works on the lowest level (including any basement level) of the building commence'.[14] Further, paragraph 1.27 of the current EM states:

> ...any works preparing the site for construction and works undertaken below the lowest level of the proposed building do not represent the commencement of construction for the purposes of this measure. This includes any excavation, environmental remediation or site stabilisation works.[15]

3.17 In its submission to this inquiry, the GBCA supported the provision that building will be taken to have commenced construction when the works on the lowest level begins. It noted that this will allow for previous site preparation and remedial works as well as instances where a new building is constructed on top of an existing structure such as a car parking facility, public infrastructure, building or previous foundations.[16]

### *Technical issues relating to 12-430(2)*

3.18 Both the GBCA and the Property Council identified that the word 'not' was omitted from the EM relating to this issue of when construction of a building will be taken to have commenced.[17]

### Recommendation 1

**3.19 The committee recommends that paragraph 1.28 of the Explanatory Memorandum be amended to state:**

> **Therefore, buildings such as those built on top of previous foundations or on top of shared car parking facilities will <u>not</u> be considered to have commenced construction until works on the lowest level of the building commences.**

3.20 The Property Council also recommended that the bill should specifically state that commencement of construction does not include 'any works preparing the site for construction and works undertaken below the lowest level of the proposed building'.

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14 Proposed subsection 12-430(2) of the *Taxation Administration Act 1953*

15 Explanatory Memorandum, paragraph 1.27.

16 Green Building Council of Australia, *Submission 2*, p. 3.

17 Green Building Council of Australia, *Submission 2*, p. 6; Property Council of Australia, *Submission 5*, p. 8.

While this is clear from the EM, the committee agrees with the Property Council that the bill should make explicit reference to 'preparing the site for construction'.

**Recommendation 2**

**3.21 The committee recommends that the following sentence be added to proposed subsection 12-430(2) of the bill:**

> **The commencement of construction does not include any works preparing the site for construction or works undertaken below the lowest level of the proposed building.**

***Including extensions—proposed subsection 12-430(3)***

3.22 However, the GBCA argued that the definition of a clean building does not go far enough. Specifically, it claimed that the definition should include major building extensions that can be demonstrated as being distinct from the original building, such as a new wing added to an existing facility, or major retrofits.[18] The Property Council also supported including extensions in proposed section 12-430.[19]

3.23 In this context, the GBCA drew the committee's attention to the Green Star rating system's eligibility criteria for both 'functionally autonomous' buildings and 'building extensions'. It listed seven criteria under the Green Star system by which a project can qualify for assessment as a building extension, and recommended that these requirements be included in the legislation.[20]

***Restrictions on the types of eligible buildings—proposed subsection 12-430(3)***

3.24 A related concern raised by stakeholders is the bill's definition of a 'clean building' in terms of an office building, a hotel or a shopping centre (proposed subsection 12-430(3)). The GBCA argued that limiting eligibility for the 10 per cent withholding tax to these buildings 'will mean that many significant investment opportunities will be lost'. It noted that many offices, hotels and shopping centres include a range of other facilities and mixed used that would mean they are ineligible.[21]

3.25 The GBCA recommended that the legislation be amended to include offices, hotels and shopping centres which can demonstrate that at least 80 per cent of their Gross Floor Area is comprised of the space type relevant for that use. It noted that the

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18 Green Building Council of Australia, *Submission 2*, p. 3.

19 Property Council of Australia, *Submission 5*, p. 14.

20 Green Building Council of Australia, *Submission 2*, p. 4.

21 Green Building Council of Australia, *Submission 2*, p. 4.

Council would 'be pleased to work with Government' to assist in defining this threshold.[22]

3.26 However, the committee believes that the GBCA's concerns may be overstated. The EM states that in terms of an office building:

> ...incidental uses, such as a child care centre, limited retail and food outlets will not exclude the building from being an office building. In each case, whether or not a building is considered to be an office building is a question of fact. For example, a distribution centre that stores goods and has an office component is not an office building under ordinary concepts. This is regardless of whether the distribution centre is currently in use or not.[23]

3.27 The EM adds:

> To be eligible as a hotel, a building must wholly or mainly provide short-term accommodation for travellers. To be eligible as a shopping centre, a building must be predominantly used for retail purposes. However, a shopping centre would ordinarily include facilities such as cafes and restaurants. Such associated facilities would not preclude a building from being considered a shopping centre.[24]

3.28 The committee believes that these explanations are reasonable. It is appropriate that clean building MITs deriving assessable income from offices, hotels and shopping centres that incidentally include amenities such as community facilities and affordable housing are eligible for the 10 per cent withholding tax rate. The committee notes, however, that a threshold of the type proposed by the GBCA should be considered if, following the passage of the legislation, there is doubt or disagreement as to what constitutes an 'incidental' use of a building.

***The energy rating requirement—proposed subsection 12-430(4)***

3.29 The GBCA also commented on proposed subsection 12-430(4), relating to the requirement of a 5 Star Green Star rating or a 5.5 NABERS rating. It claimed that it is aware of 'many examples' of projects that initially had no commitment to achieve an energy rating, but had subsequently sought and achieved a rating as the project progressed. The GBCA thereby foresaw a situation under the bill where a building without the requisite energy rating would not qualify for the 10 per cent withholding tax if construction commenced prior to 1 July 2012, despite the project managers subsequently achieving a rating. The GBCA argued that, if amended, the bill could be a 'powerful incentive' for projects in their early stages to achieve better environmental outcomes.[25]

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22 Green Building Council of Australia, *Submission 2*, p. 4.

23 Explanatory Memorandum, p. 10.

24 Explanatory Memorandum, p. 10.

25 Green Building Council of Australia, *Submission 2*, p. 4.

## Income from other (incidental) assets—proposed section 12-425

3.30 Another issue raised in submissions to both this inquiry and the Treasury consultation on the draft legislation relates to proposed section 12-425 of the *Taxation Administration Act 1953*, which defines a clean building MIT.

3.31 The draft bill did not contain a safe harbour for income incidental to a clean building. The GBCA argued in its submission to Treasury that the draft legislation would require investors to quarantine clean building investments in MITs from ineligible income streams. It noted that these streams might include advertising hoardings, communications towers, parking arrangements, affordable housing or other units, or childcare centres.[26]

3.32 The Property Council also identified problems with the draft legislation's definition of a clean building MIT and argued the case for the bill to include tracing provisions. It argued that the draft bill would disqualify clean buildings that earn incidental income and disqualify mixed used developments.[27]

3.33 The CPPIB argued in its submission to Treasury that the requirement that the concessional rate apply to MITs that only hold energy efficient buildings should be removed. It argued that the proposal unnecessarily restricts property funds from investing in a property portfolio that includes clean energy efficient buildings as well as other buildings.[28]

### *The amendment to the draft bill*

3.34 The committee emphasises that the bill in its current form has been amended to allow for some incidental assets in the operation of a clean building MIT. Chapter 2 explained that the bill defines a clean building MIT as a trust that does not derive assessable income from any taxable Australian property (other than from the clean buildings or assets that are reasonably incidental to those buildings). The bill proposes a 5 per cent safe harbour 'for certain income reasonably incidental to a clean building'. A trust is not defined as a clean building MIT if the assessable income of the trust derived from assets that are reasonably incidental to clean buildings is greater than 5 per cent of total assessable income derived from clean buildings.

3.35 The GBCA supported this amendment, stating:

> ...supports the changes made to the Bill which now allows that clean building MIT fund payments may consist of income and capital gains from clean buildings and assets that are 'reasonably incidental' to those buildings. Assets that could be considered 'reasonably incidental' include car parking

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26 Green Building Council of Australia, *Submission 2*, p. 2.

27 Property Council of Australia, *submission to Treasury*, p. 3.

28 Canada Pension Plan Investment Board, *Submission to Treasury,* 11 September 2012, p. 3.

facilities, telecommunications infrastructure attached to the building and advertising infrastructure.[29]

3.36 However, the Property Council argued that the 5 per cent limit on incidental income 'will unfairly penalise investors and is inconsistent with MIT rules under Division 6C of the Income Tax Assessment Act'. It noted that these rules allow trusts to effectively derive 25 per cent from a business reasonably incidental to the renting of land. The Council added that 'it is likely' that trusts complying with the MIT safe harbour will earn more than 5 per cent of income from a business reasonably incidental to a clean building.[30]

3.37 Both the GBCA and the Property Council noted that income and capital gains from any other land or building that do not meet the definition of a clean building cannot be included in a clean building MIT. Both argued that the government should consider a tracing provision to ensure that the correct taxation arrangements are applied only to eligible income streams within a MIT.[31]

## Committee view

3.38 The committee strongly supports the provisions of this bill.[32] It meets two key public policy objectives, namely:

- ensuring that Australia remains an attractive destination for international investment; and
- promoting the development of an energy efficient commercial building sector in Australia.

3.39 The bill entwines these goals, promoting Australia as a place that provides foreign investors with a tax-based incentive to invest in energy efficient commercial buildings. The bill is an excellent example of the government's determination to achieve a competitive taxation framework with beneficial environmental outcomes.

3.40 The committee commends the government for listening to stakeholders' concerns and making sensible and appropriate changes to the draft legislation. It is appropriate that the legislation allows for some incidental assets in the operation of a clean building MIT, and excludes site preparation and works below the lowest level from the point at which building is considered to have commenced. In this context, the committee highlights the views of the Canada Pension Plan Investment Board

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29 Green Building Council of Australia, *Submission 2*, p. 2.

30 Property Council of Australia, Submission 5, p. 5.

31 Green Building Council of Australia, *Submission 2*, p. 2; Property Council of Australia, *Submission 5*, p. 10.

32 The committee does draw attention to Recommendation 2 (above).

(CPPIB). The CPPIB, which recently decided to invest in the Barangaroo South Office development, stated in its submission to this inquiry:

> We believe this Bill will provide investors the certainty they need when making decisions to invest in new Clean Buildings. In particular, CPPIB welcomes changes in the Government's final Bill that:
>
> - provide further clarification of what constitutes a Clean Building, particularly to take account of new buildings located on reclaimed land or that form part of a wider urban renewal project;
> - allow Managed Investment Trusts (MITs) to derive non-qualifying income incidental to the Clean Building; and
> - allow a holding trust to hold investments in both Clean Building MITs and non-Clean Building MITs.[33]

3.41 The committee notes that the principal outstanding issue of concern relating to the bill is the apparent disincentive for investors to finance the retrofitting of established buildings. On this matter, the committee makes the following observations:

- first, the legislation would only be a disincentive in *relative* terms: a resident in an information exchange country who invests in new clean building MITs would be subject to a 10 per cent withholding tax; a resident in an information exchange country who invests in MITs that do not qualify under the legislation would be subject to a 15 per cent withholding tax. In other words, the bill is not an impost on foreign investors wanting to invest in MITs containing established buildings;
- second, and relatedly, since 2008 the overall level of withholding tax for an investor in an information exchange country has been reduced from 30 per cent to 15 per cent (see chapter 1);
- third, the government is aware that the vast majority of building stock is comprised of existing, older buildings, and already has in place programs to promote retrofitting and more efficient energy use in established buildings. The bill's focus on new buildings in no way harms the important contribution that retrofitting is making—and will continue to make—to achieving both environmental and commercial goals.

3.42 Finally, the committee believes that the 5 per cent safe harbour for certain income reasonably incidental to a clean building is appropriate. The threshold reflects the government's policy intent and should not be amended to align with the MIT threshold in Division 6C of the Income Tax Assessment Act.

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33 Canada Pension Plan Investment Board, *Submission 6*, p. 1.

**Recommendation 3**

**3.43 The committee recommends that the bill be passed.**

**Ms Deborah O'Neill MP**

**Chair**

# Appendix 1

## Submissions received

1. Shopping Centre Council of Australia
2. Green Building Council of Australia
3. Sustainable Melbourne Fund
4. City of Melbourne
5. Property Council of Australia
6. Canada Pension Plan Investment Board