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Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018

Background
Taxation of business income for foreign investors is typically 30%. In 2008, legislation for managed investment trusts (MITs) was passed to provide concessions for foreign investors in MITs generating passive income and, after subsequent amendments, this concessional tax rate stands at 15%. Examples of passive income are interest and rent from property.

The intention of the concession was to provide an internationally competitive rate of taxation for foreign passive investors and to attract their investment via Australia's funds management industry. The concessions are intended for genuine passive income generated from MITs and specifically from real estate investment trusts (REITs), which are property trusts listed on the ASX.

Proposed Bill
An increasing number of foreign investors are using complex arrangements, called stapled structures, to convert business income into more favourably taxed passive income. The Bill refines the earlier legislation to prevent these arrangements and we commend this initiative.

One provision contained within the Bill is an increase in tax on MITs investing in agriculture to 30%, regardless of whether the income is passive rental income or business income.

Rural Funds Group (RFF)
RFF is a REIT listed on the ASX. It generates passive income by renting out farms in the same way as other REITs. The market capitalisation of RFF is $700 million and the value for the entire listed REIT sector is $116 billion. RFF has 15,000 mainly Australian retail and institutional investors, with 10% held by foreign institutional investors. It is the only REIT adversely impacted by the legislation.

Adverse impact of proposed Bill
In the Bill's present form, a 15% rate will continue for all REITs, while a 30% rate will apply to RFF – despite the fact that RFF is identical in all respects, specifically generating passive income from renting property assets.

In the absence of this amendment, foreign investors will sell their higher taxed RFF shares and buy shares in the numerous other REITs taxed at 15%. Consequently, no additional revenue will be raised.

The withdrawal of foreign investors will have the effect of raising RFF's cost of capital. This will cause RFF to seek higher rents which would adversely impact the farm businesses who rent RFF's assets. To the extent that market forces limit rent increases, RFF will generate lower returns that will adversely impact its Australian investors.

Almost all farms acquired by RFF have been acquired from families managing succession planning in their farm businesses. If RFF's investment activities are curtailed, it will not be able to buy farms as often or invest as much in their development and productivity improvement.

Proposed amendment to the Bill
An amendment to the Bill simply requires an exemption for REIT's that hold Australian agricultural land for rent. This amendment will have no adverse impact on net tax revenue. Proposed wording for this amendment is attached.

Conclusion
The Bill will effectively prevent the increasing leakage of taxation revenue caused by tax structuring in industries that generate business income. The concessional tax rate will continue to attract genuine passive foreign investment into Australian investment funds, including specifically REITs. The Bill should be amended to ensure that REITs investing in Australian agricultural property are not disadvantaged.

Proposed amendment to Section 12-448

Insert the following:

(6) Notwithstanding paragraphs 1 to 5 of this section, an amount is not MIT agricultural income if it is attributable to assets of:

(a) a *managed investment trust listed on the Australian Securities Exchange; and

(b) the *managed investment trust is classified as a Real Estate Investment Trust (REIT) under the Global Industry Classification Standard.

Notes re proposed clause:

1. The definition of MIT agricultural income in section 12-448 and the reference to it in this proposed paragraph (6) has the effect of limiting this exclusion to managed investment trusts that hold agricultural assets.
2. A reference to third party income is not required because the *cross staple arrangement income* provisions prevent entities listing to convert business income to passive income.
3. The reference to *managed investment trust is a tightly defined entity that may not have a single foreign resident owning more than 10% of the trust.
4. The requirement for the trust to be classified as a REIT further limits qualification for the exemption. In addition, it levels the playing field between REITs investing in agricultural property and REITs investing in office, retail or industrial property.