Chapter 1

Introduction

1.1 On 20 September 2018, the Senate referred the provisions of the 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 to the Economics Legislation Committee for inquiry and report by 9 November 2018.[1] As the bills are directly related to one another, all three bills are to be dealt with together in this inquiry report.

1.2 The primary bill under examination in this inquiry, the Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018, contains the major substantive changes to the tax system. The two shorter bills complement the aim of the primary bill through relatively minor alterations to existing tax law. Accordingly, the majority of the analysis and comment will be on the primary bill.

1.3 In essence, the introduction of these bills is to protect the integrity of Australia's corporate tax system by neutralising the tax benefits delivered by staples and other structures, and ensuring active business income is taxed at the top corporate rate.[2]

1.4 On the 20 September 2018, the Hon. Stuart Robert MP, Assistant Treasurer, gave his second reading speech for the three bills. Speaking specifically about the primary bill, the Assistant Treasurer explained:

> Most taxpayers comply with Australia's tax rules and pay their fair share of tax here. However, some foreign investors have been using complex arrangements known as stapled structures and other broader tax concessions to extract profits from Australian businesses almost tax free. This is done by converting trading income into more favourably taxed passive income in land-rich sectors such as infrastructure.
>
> Combined with existing tax concessions for foreign pension funds and sovereign wealth funds, some foreign investors can achieve tax rates well below 15 per cent on all their Australian business income—in some cases, tax free. These tax benefits are only available to foreign investors and place Australian investors and businesses at a competitive disadvantage. Because these concessions are only available to foreign investors, it results in a two-tiered tax system that distorts investment decisions and biases investment towards land-rich industries…

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1 *Journals of the Senate*, No. 121, 20 September 2018, p. 3843.

2 Second reading speech, the Hon. Stuart Robert MP, Assistant Treasurer, *House of Representatives Hansard*, 20 September 2018, pp. 32–33.

> Hundreds of millions in revenue is being forgone. Left as is, this could grow in the order of billions.
>
> The measures in this bill build on the government's work in protecting the integrity of Australia's corporate tax system.[3]

Conduct of the inquiry

1.5 Submissions to the inquiry closed on 11 October 2018. The committee received 16 submissions and one public hearing was held. The submissions are listed in Appendix 1 of this report. Witnesses who appeared at the public hearing are listed in Appendix 2.

Acknowledgements

1.5 The committee thanks all submitters and witnesses who provided evidence to the inquiry.

Scope and structure of the report

1.6 The report consists of two chapters:

- Chapter 1 (this chapter) provides an overview of the inquiry and provides a background to the bills and a summary of the bills' main provisions; and
- Chapter 2 details the views on the bills as received in submissions and oral evidence to the inquiry as well as the committee's views and recommendations.

Overview of the bills

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

1.7 The explanatory memorandum (EM) to the bill states that the purpose of the Treasury Laws Amendment (Making Sure Foreign Investors Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018 (the 'Fair Share of Tax' bill) is to neutralise the tax benefits of stapled structures and prevent trading businesses from accessing a 15 per cent tax rate on active business income distributed to foreign investors. It also ensures that foreigners that invest in Australian agricultural and residential property do not get a tax advantage over domestic investors.[4]

Schedules to the Fair Share of Tax bill

1.8 The bill consists of five schedules:

- Schedule 1—Non-concessional Managed Investment Trust (MIT) income
- Schedule 2—Thin capitalisation

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3 Second reading speech, the Hon. Stuart Robert MP, Assistant Treasurer, *House of Representatives Hansard*, 20 September 2018, p. 32.

4 Second reading speech, the Hon. Stuart Robert MP, Assistant Treasurer, *House of Representatives Hansard*, 20 September 2018, p. 33.

- Schedule 3—Superannuation funds for foreign residents withholding tax exemption
- Schedule 4—Sovereign immunity
- Schedule 5—Contingent amendments relating to definition of provide affordable housing

Summary of amendments

1.9 **Schedules 1 and 5** to this bill amend the *Income Tax Assessment Act (ITAA) 1997*, the *ITAA 1936* and the *Tax Administration Act (TAA) 1953* to improve the integrity of the income tax law for arrangements involving stapled structures and to limit access to tax concessions for foreign investors by increasing the MIT withholding rate on fund payments that are attributable to non-concessional MIT income to 30 per cent—that is, at the rate equal to the top corporate tax rate.[5]

1.10 An amount of a fund payment will be non-concessional MIT income if it is attributable to income that is:

- MIT cross staple arrangement income;
- MIT trading trust income;
- MIT agricultural income; or
- MIT residential housing income.[6]

1.11 Transitional rules apply to fund payments that are attributable to existing investments. If the transitional rules apply, the existing MIT withholding tax rate of 15 per cent will continue to apply until, broadly:[7]

- for MIT cross staple arrangement income relating to a facility that is not an economic infrastructure facility—1 July 2026;
- for MIT cross staple arrangement income relating to a facility that is an economic infrastructure facility—1 July 2034;
- for MIT trading trust income—1 July 2026;
- for MIT agricultural income—1 July 2026; and
- for MIT residential housing income—1 October 2027.[8]

1.12 **Schedule 2** to this bill amends the *ITAA 1997* to improve the integrity of the income tax law by modifying the thin capitalisation rules to prevent double gearing structures.[9]

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5 *Explanatory Memorandum*, p. 10.

6 *Explanatory Memorandum*, p. 10.

7 *Explanatory Memorandum*, p. 11.

8 *Explanatory Memorandum*, p. 11.

9 *Explanatory Memorandum*, p. 79.

1.13 For the purposes of determining associate entity debt, associate entity equity and the associate entity excess amount under the thin capitalisation provisions, a trust (other than a public trading trust) or partnership that is an associate of the other entity referred to in the relevant provisions will be an associate entity of that other entity if the other entity holds an associate interest of 10 per cent or more in that trust or partnership.[10]

1.14 In addition, in determining the arm's length debt amount, an entity must consider the debt to equity ratios in entities that are relevant to the considerations of an independent lender or borrower.[11]

1.15 **Schedule 3** to this Bill amends the *ITAA 1936* to improve the integrity of the income tax law to limit access to tax concessions for foreign investors by limiting the withholding tax exemption for superannuation funds for foreign residents.[12]

1.16 Therefore, a superannuation fund for foreign residents will not be liable to withholding tax on amounts of interest, dividends or non-share dividends it receives from an Australian entity only if:

- the income derived by the superannuation fund is exempt from income tax in the country in which it resides;
- the superannuation fund has a portfolio like interest in the entity that pays the dividends, non-share dividends or interest to it; and
- the superannuation fund does not have influence (either directly or indirectly) over decisions that comprise the control and direction of the operations of the entity that pays the dividends, non-share dividends or interest to it.[13]

1.17 **Schedule 4** to this bill amends the *ITAA 1936* and the *ITAA 1997* to improve the integrity of the income tax law to limit access to tax concessions for foreign investors by codifying and limiting the scope of the sovereign immunity tax exemption.[14]

1.18 An amount of ordinary income or statutory income of a sovereign entity will be non-assessable non-exempt income (NANE) if, broadly:

- the amount is a return on a portfolio-like membership interest, debt interest or non-share equity interest in an Australian company or MIT; and
- no member of the sovereign entity group has influence (either directly or indirectly) over decisions that comprise the control and direction of the operations of the Australian company or MIT.[15]

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10 *Explanatory Memorandum*, p. 79.

11 *Explanatory Memorandum*, p. 79.

12 *Explanatory Memorandum*, p. 86.

13 *Explanatory Memorandum*, p. 86.

14 *Explanatory Memorandum*, p. 94.

15 *Explanatory Memorandum*, p. 94.

1.19 An amount of ordinary income or statutory income that is NANE of a sovereign entity is also exempt from withholding tax.[16]

1.20 Unless another provision in the *Income Tax Rates Act 1986* applies to set a different rate, a sovereign entity will be liable to pay income tax on its taxable income at a rate of 30 per cent—that is, the rate equal to the top corporate tax rate.[17]

Income Tax (Managed Investment Trust Withholding Tax) Amendment Bill 2018

1.21 This bill has only one schedule which makes amendments to the *Income Tax (Managed Investment Trust Withholding Tax) Act 2008*. These amendments ensure that fund payments that are attributable to non-concessional MIT income will be subject to MIT withholding tax at the top corporate tax rate.[18]

Income Tax Rates Amendment (Sovereign Entities) Bill 2018

1.22 This bill has only one schedule, which makes amendments to the *Income Tax Rates Act 1986*. These amendments will result in sovereign entities paying a taxable income rate of 30 per cent unless another existing rate or sovereign immunity applies.[19]

Commencement

1.23 Commencement of the bills will be on Royal Assent; however the amendments apply from various times depending on circumstances. In some cases, transitional rules apply to appropriately protect existing arrangements from the impact of the amendments.[20]

Financial impact

1.24 The EM states that, as a package, the 2018–19 Budget measure 'Stapled structures—tightening concessions for foreign investors' is estimated to have the following gain to revenue over the forward estimates period, as outlined in Table 1.[21]

Table 1: Financial impact over the forward estimates period

2018-19	***2019-20***	***2020-21***	***2021-22***
$30m	$80m	$125m	$165m

16 *Explanatory Memorandum*, p. 95.

17 *Explanatory Memorandum*, p. 95.

18 Second reading speech, the Hon. Stuart Robert MP, Assistant Treasurer, *House of Representatives Hansard*, 20 September 2018, p. 34.

19 Second reading speech, the Hon. Stuart Robert MP, Assistant Treasurer, *House of Representatives Hansard*, 20 September 2018, p. 34.

20 *Explanatory Memorandum*, p. 3.

21 *Explanatory Memorandum*, p. 3.

Regulation impact on business

1.25 According to the EM, the compliance costs of the package of measures in Schedules 1 to 5 in the primary bill overall involve a low compliance cost impact, comprising a medium implementation impact and a low increase in ongoing compliance costs.[22]

1.26 In summary, the package of measures in the primary bill comprehensively tackles the various tax settings that are combined with stapled structures to deliver low tax rates to foreign investors and is the most effective option in providing significant revenue protection.[23]

1.27 Moreover, the EM argued that domestic investors will not be disadvantaged when competing for investment under the current tax settings.[24]

1.28 According to the EM, some marginal projects could potentially be affected due to the higher withholding tax rate faced by foreign investors. Although tax can have a significant impact on investment decisions, tax is only one of many factors that investors consider in their investment decisions. There are a multitude of other factors that investors consider, such as the regulatory, political and social environment of their investment.[25]

1.29 The EM argued that the net benefits derived from the significant revenue protection and removal of distortions provided by the package outweigh concerns about increased complexity and compliance costs, as well as the potential impact on investment.[26]

Compatibility with human rights

1.30 The EM states that these bills are compatible with human rights as they do not raise any human rights issues.[27]

22 *Explanatory Memorandum*, p. 6.

23 *Explanatory Memorandum*, p. 6.

24 *Explanatory Memorandum*, p. 6.

25 *Explanatory Memorandum*, p. 6.

26 *Explanatory Memorandum*, p. 6.

27 *Explanatory Memorandum*, p. 152.