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Stapled Structures Overhaul – Impacts on Foreign Investors in Australia

Who Is Affected?

The Treasury has released its Stapled Structures Integrity Package, which will impact foreign investors with stapled structure arrangements, as well as foreign pension and sovereign wealth funds and investors in agricultural trusts.

There will be less impact on domestic investors and stapled structures will remain a tax effective way for them to hold property and infrastructure assets.

Why Are the Changes Being Made?

The Treasury is concerned with businesses characterizing trading income as passive income in order to receive more favourable tax rates and the concessions currently available to foreign pension and sovereign wealth funds.

What Are the Changes and How Will They Work?

Access to the 15% Managed Investment Trust (MIT) Rate

Foreign investors will no longer benefit from the concessional (15%) MIT rate in respect of income derived from "cross staple" transactions under the changes. Instead, they will be subject to the higher company tax rate of 30%. However, the MIT rate may continue to apply if either:

- The stapled entity receives rent from third parties and this is passed through as rent to the trust
- Only a small proportion of the gross income of the trust relates to cross staple payments

The new rules are intended to apply from 1 July 2019, but there is a seven-year transitional period for foreign investors with committed investments made before the date of the announcement (27 March 2018). The new measures also allow certain critical infrastructure projects with assets held in a stapled structure to take advantage of the MIT rate under a generous exemption period of 15 years. After the exemption period, the company tax rate will apply.

The measures will likely have an impact on hotel, student accommodation and retirement village stapled groups which have significant foreign investors. However, due to the seven-year transitional period, there may be sufficient time for these groups to restructure their arrangements such as to receive rent from arm's length third parties.

Crack Down on Double Gearing

The changes aim to prevent excessive use of debt through chains of trusts and partnerships. To achieve this, the threshold that determines associate entity equity/debt for the purpose of the thin capitalization rules will significantly decrease from 50% to 10% or more. This change will apply from 1 July 2018.

Limiting Foreign Pension Fund Withholding Tax Exemptions

Currently, wide-ranging withholding tax exemptions apply to many foreign pension funds. It is proposed that these exemptions would be limited to dividends and interest paid on investments in which the foreign pension fund has a non-portfolio interest (less than 10% and with no influence over decision making). There will be a seven-year transitional period for investments held at 27 March 2018, during which the withholding tax exemptions will remain available.

Changes to the Sovereign Immunity Tax Exemption

At present, the ATO grants concession to foreign government investors on income from non-commercial investments. There is no legislative framework governing this concession and is based on ATO practice. Under the measures, the government will create a legislative framework governing the sovereign immunity exemption that limits the eligibility of the exemption to passive income where sovereign investors have less than 10% ownership and have no influence over the entity's decision making. The changes will apply from 1 July 2019, but existing investments may be covered by an up to seven-year transitional period.

Farm Land

Under the changes, rent from agricultural land will not qualify as eligible investment business income which will impact on both foreign and domestic investors and may result in some agricultural land owning trusts becoming public trading trusts (taxed as companies).

Conclusion

While the announced changes are significant and will likely have a great impact on new investments made by sovereign wealth and overseas pension fund as well as foreign investors into stapled structures, the reasonably generous transition periods will allow existing structures to prepare for the changes and potentially change the nature of their arrangements to fall outside these measures.

New funds should consider how their arrangements can be structured to give domestic and foreign investors the best available tax outcome. In many cases this will still involve the use of a stapled structure, but there may need to be some changes to the arrangements with third parties or the degree of control by foreign pension or sovereign wealth funds. However, existing funds may be able to wait until full details of the proposal are revealed before considering any changes as existing arrangements will largely be covered by the transitional rules.

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