Reforms to Australian stapled structures that may have an impact on foreign investors

The Australian government has announced details of an integrity package relating to Australian stapled investment structures that may increase the rate of Australian withholding tax from 15% to 30% for some foreign investors on distributions from their investment in those structures. Corrs Chambers Westgarth, Taxand Australia, explains the background to the integrity package and its possible impact on investors.

Stapled investment structures are a common form of investment vehicle in the Australian market, particularly where the assets of the vehicle are property intensive. They typically involve an investor acquiring a share in a company and an interest in a unit trust that are each “stapled” so that they cannot be separately traded. This structure potentially allows, where eligible, flow through tax treatment for passive investments which are typically held by the trust and income in respect of active business assets (typically held by a company or a trust that is taxed like a company) taxed at the company level. More recently, eligible trusts may be taxed under the managed investment trust (**MIT**) regime, which in most stapled structures generally results in foreign resident investors being subject to a final withholding tax rate of 15% on the “passive income” and the 30% corporate tax rate for the “active income”.

The Australian government has formed the view that there has been significant growth in the number of stapled structures that seek to re-characterise active trading income into more favourably taxed passive income which is taxed at the lower 15% rate. In addition, the use of the stapled structure was viewed as being introduced into more diverse business sectors than was traditionally the case with resulting increase in the re-characterisation of income.

During the early consultation phase prior to the announcement of the integrity package, the Australian Treasury also highlighted a perceived lack of concessions in comparable jurisdictions (eg. United Kingdom, United States and Canada) that were similar to those offered by the typical Australian stapled structure. However, those comparisons are difficult considering the underlying differences in the respective taxation regimes. Any such comparison should also recognise Australia’s position as a material importer of foreign investment capital.

The integrity package includes:

- An increase in the MIT withholding rate on ‘active business income’ from 15% to 30% (subject to certain transitional measures and exceptions set out below)
- Lowering the thin capitalisation associate test from 50% to 10% or more to prevent the use of ‘double gearing structures’
- Limiting the withholding tax exemption for foreign pension funds to interest and dividend income derived from portfolio like interests
- Enshrining in legislation the administrative sovereign immunity tax exemption for non-commercial investments and limiting it to portfolio-like interests of less than 10% and only where the sovereign investor cannot influence key decision-making of the portfolio entity

- Excluding from ‘eligible investment business’ income (ie ‘passive’ income) rent and capital gains derived by a MIT from agricultural land, meaning that such income will be ineligible for the MIT concessional withholding rate of 15%

The bulk of the integrity measures will commence on 1 July 2019, subject to some exceptions and transitional rules set out below.

A level of transitional relief has been proposed for existing investments, being a general 7 year period (other than the thin capitalisation changes). The changes to the MIT withholding rate will also be deferred for 15 years for existing economic infrastructure stapled structures. In addition, a 15 year concession will be available for new investment in economic infrastructure assets approved by the Government to ensure that these assets remain attractive investment opportunities to non-resident investors (noting Australia is a net importer of capital). Structures that are backed by third party rental arrangements (eg. the commercial and retail sector) should also be protected. The thin capitalisation measures will be excluded from this transitional relief and will commence from 1 July 2018, which may be just enough time for investors to take advice and potentially restructure their holding arrangements.

Taxand’s Take

The announcement reflects a clear shift in policy as to the taxation of foreign investors. However, it leaves a number of unresolved questions that will not be resolved until legislation has been drafted, possibly for further consultation on key aspects. From a commercial perspective, there are some unresolved questions around how the transitional provisions and exemptions will apply to existing stapled structures (including the after-tax return) and what impact the rules may have on the brownfield investment market, particularly in the M&A space and the impact of such transactions on the ability of structures to remain eligible for transitional relief. There will clearly be an impact on the pricing of new investments and the modelling of existing investments. From a tax perspective, there is limited time for investors to address any adverse impact on their thin capitalisation position and any restructuring of investments in property-rich stapled structure may involve a potential stamp duty cost. The measures also put into some doubt the continued effectiveness of any private binding tax ruling obtained by an investor in a stapled structure on the basis that such rulings cease to be binding where there is a substantial change in law. This may leave investors who have obtained a favourable ruling on a structure prior to the integrity measures in a potentially unprotected position against future tax risk. Investors should continue to monitor these changes as they are further developed.