PROPERTY COUNCIL of Australia

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Assistant Secretary
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The Treasury
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Dear Kerry

Global agreement on corporate taxation: Addressing the tax challenges arising from the digitalisation of the economy

The Property Council welcomes the opportunity to provide comments to the Treasury consultation paper titled *Global agreement on corporate taxation: Addressing the tax challenges arising from the digitalisation of the economy*, released in October 2022.

The Property Council of Australia champions the industry that employs 1.4 million Australians and shapes the future of our communities and cities. Property Council members invest in, design, build and manage places that matter to Australians: our homes, retirement villages, shopping centres, office buildings, industrial areas, education, research and health precincts, tourism and hospitality venues and more.

We recognise the Government's commitment to implementing the OECD's two-pillar solution agreed on through the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting. Our comments focus on Pillar Two and specifically the measures and rules which set an effective global minimum corporate income tax rate of 15 per cent for large multinationals.

Our submission highlights the critical need for Australia's implementation of Pillar Two Global anti-Base Erosion (GloBE) Rules to replicate the OCED's proposed exemptions for real estate investment vehicles (REIVs) and investment funds. These entities are tax-flow through vehicles and are not subject to corporate tax at the entity level. The Australian equivalent of REIVs and investment funds are Managed Investment Trusts (MITs), Attribution MITs (AMITs), and Corporate Collective Investment Vehicles (CCIVs), and all these entity types should therefore be exempt from the Pillar Two rules.

The submission also makes recommendations and seeks clarity regarding other aspects of Pillar Two implementation, such as:

- Clarifying the treatment of a stapled group under the GloBe rules;
- Establishing *de minimis* amounts to determine which entities should be included within the scope of the new rules;
- Commencing the new rules no earlier than income years starting on or after 1 July 2024 – and not before the rules commence operation in in other countries; and

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- Recommending against the introduction of a Domestic Minimum Tax.

The Government should recognise that compliance costs will be a significant issue for businesses that are impacted by the implementation of Pillar Two in Australia. We strongly agree with the policy objectives of minimising complexity and compliance costs, and many of our comments are set out with this outlook in mind.

While we appreciate the OECD is yet to finalise the framework, it is important that there is clarification of how the rules will work in an Australian context as early as possible to provide the business sector sufficient lead time to prepare for their introduction.

We would be keen to continue engaging with Treasury on further details of this important work. Please contact Kosta Sinelnikov on 0422 168 720 and ksinelnikov@propertycouncil.com.au or myself on 0400 356 140 and bngo@propertycouncil.com.au to arrange a meeting at your convenience.

Yours sincerely

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Property Council submission

Global agreement on corporate taxation: Addressing the tax challenges arising from the digitalisation of the economy

1. Carve-outs for Real Estate Investment Vehicles and Investment Funds

The GloBe model rules provide for exclusions for certain types of entities (Article 1.5.1 of the model rules), including:

- An Investment Fund that is an Ultimate Parent Entity; or
- A Real Estate Investment Vehicle that is an Ultimate Parent Entity.

Criteria to define an Investment Fund and a Real Estate Investment Vehicle (REIV) are also set out in the model rules.

Investment Fund definition

Article 10.1.36 of the model rules defines an Investment Fund as an entity having the following criteria:

> *(a) it is designed to pool assets (which may be financial and non-financial) from a number of investors (some of which are not connected);*
>
> *(b) it invests in accordance with a defined investment policy;*
>
> *(c) it allows investors to reduce transaction, research, and analytical costs, or to spread risk collectively;*
>
> *(d) it is primarily designed to generate investment income or gains, or protection against a particular or general event or outcome;*
>
> *(e) investors have a right to return from the assets of the fund or income earned on those assets, based on the contributions made by those investors;*
>
> *(f) the Entity or its management is subject to a regulatory regime in the jurisdiction in which it is established or managed (including appropriate anti-money laundering and investor protection regulation); and*
>
> *(g) it is managed by investment fund management professionals on behalf of the investors.*

These criteria are most consistent with Australia's definition of a MIT or AMIT, which rely in part on the definition of a managed investment scheme (MIS) as set out in Section 9 of the *Corporations Act 2001* (such as the pooling together of assets or contributions, and being used to produce some sort of benefits to the members/investors). MITs and AMITs are also required to be widely held.

In the case of CCIVs, the design features of a CCIV such as regulatory parity (to the extent possible) with the MIS framework and similar tax treatment as that of AMITs also align these vehicles with the Investment Fund criteria. It is also important to recall the policy objectives behind the introduction of the CCIV: to increase the competitiveness of Australia's managed funds industry internationally and attract offshore investment. Applying the Investment Fund exemption for CCIVs would undoubtedly align with those policy objectives.

Therefore, the incorporation of the Investment Fund exemption in Australia's rules can be simply achieved by exempting MITs, AMITs and CCIVs from Pillar Two rules as part of Australia's own implementation.

REIV definition

The REIV definition (Article 10.1.1) as set out in the model rules states:

> ***Real Estate Investment Vehicle*** *means an Entity the taxation of which achieves a single level of taxation either in its hands or the hands of its interest holders (with at most one year of deferral), provided that that person holds predominantly immovable property and is itself widely held.*

In the Australian context, all property trusts achieve a single level of taxation (unless the trust is a public trading trust), so many property trusts could be defined as REIVs provided they satisfy the two additional requirements in this definition.

Firstly, there is a requirement that the vehicle predominantly holds immovable property. We believe that this requirement could be satisfied by a property trust holding interests in property directly or indirectly through investments in other entities which hold immovable property.

Secondly, there is a requirement that the vehicle is widely held. In the commentary for the model rules, it seems reasonably clear that this is a "look through" test applied for this requirement. For example, where a property trust is owned 50% by another widely held property trust, and 50% by a widely held listed company, it would be regarded as "widely held". Similarly, ownership by a sovereign wealth fund, foreign pension fund or Australian superannuation fund in our view satisfies the widely held requirement.

Therefore, the incorporation of the REIV exemption in Australia's rules can be simply achieved by exempting, at a minimum, all MITs and AMITs under the REIV exemption. Other types of trusts that predominantly hold property assets may also fall under this definition provided that they meet the other requirements under the definition.

2. Clarifying treatment of stapled groups

Given the prevalence of stapled structures in the property sector, the application of GloBe rules to stapled structures needs to be clarified as part of Australia's implementation.

A typical Australian stapled property group is a multi-parented entity (in terms of the model rules), that comprises a property trust and a company. In this scenario, it is typically the company that prepares consolidated financial statements, that include both the company and the trust.

Broadly, it is assumed that under the model rules, whether Pillar Two applies to the stapled group would be determined by reference to the revenue shown in the consolidated accounts (that is, annual revenue of EUR 750 million or more). If the annual revenue is more than EUR 750 million, the Pillar Two rules would be applied separately to each ultimate parent entity that forms the stapled group.

If the trust side of the stapled group is an Excluded Entity (on the basis that it is either an Investment Fund or REIV), it would not be subject to the GloBe rules.

However, the company may be subject to the GloBe rules (in the same manner as other company groups).

Therefore, while revenue from the trust side of a stapled group may be included in calculating whether that group meets the revenue threshold, we believe that the model rules should only apply to the company side of a stapled structure and not to the trust side. We are seeking confirmation that the Government's view aligns with that of our industry on how the GloBe rules would apply to stapled groups.

3. Safe harbours

We note that Treasury's consultation paper mentions further work and broad stakeholder support for safe harbours within the implementation framework in order to reduce compliance and administration costs. We also support this approach.

One option for consideration is that there be a revenue *de minimis* amount to determine whether an MNE group is within scope, based on either a dollar amount or revenue percentage for an entity of the total revenues within the MNE group.

4. Extending the start date

We recommend that the Government puts in place an appropriate start date to give affected entities enough time to prepare for the new rules and ensure that Australia aligns itself with most other jurisdictions.

Given the complex nature of implementation and the large number of issues at an international level that remain outstanding (e.g. the OECD still working on an implementation plan which includes safe

harbours, the lack of IASB financial reporting guidance on Pillar Two), the earliest date at which Australia should adopt the regime is income years starting on or after 1 July 2024, and not before the rules commence operation in other countries.

5. Domestic Minimum Tax

We believe that the introduction of a Domestic Minimum Tax should not be pursued in Australia. The introduction of such a tax would increase the tax compliance burden and compliance costs on businesses generally, without there being a strong case for any additional revenue raised.

Were a Domestic Minimum Tax to be established in Australia, then it should only apply to multinationals already within the scope of Pillar Two. This would minimise the additional compliance burden for businesses that have never been within the scope of OECD multinational tax initiatives (e.g. businesses that only operate in Australia).

6. Tax consolidated groups

There are a number of aspects in which the treatment of an Australian consolidated group under Pillar Two is not clear.

Ideally, the Australian tax consolidated group would be treated as a single Australian taxpayer, both from the perspective of inbound and outbound groups, rather than requiring a breakdown on the tax consolidated group into its constituent entities.

7. Other issues

A range of other issues that we have identified are discussed below.

Different fiscal years for parent entity and subsidiaries

One obvious complexity which should be considered by the Government is in the case of some subsidiaries of a parent having a different year end to the parent. It may be the case that the subsidiary has a different fiscal year, or it may be the case that it is required to prepare its tax return for a different fiscal year. In either of these situations, there will be issues in determining its tax position for the parent's fiscal year.

In many respects, in determining the application of the GloBe rules to a subsidiary, it may be easier to allow a choice of using either the parent's year end or the subsidiary's year end (as long as this choice is consistently applied).

Treatment of capital works deductions and timing differences in the property industry

The model rules for determining tax (Chapter 4) include complex calculations relating to timing differences, which includes the concept of Recapture Exception Accrual.

If an amount is a Recapture Exception Accrual, it is not necessary that the timing difference associated with it reverses within a five year period.

If a timing difference (other than a Recapture Exception Accrual) does not reverse within 5 years, it is treated as a permanent difference. As per Article 4.4.5, to the extent a deferred tax liability, that is not a Recapture Exception Accrual, is taken into account under this Article and such amount is not paid within the 5 subsequent fiscal years, the amount must be recaptured pursuant to this article.

In the context of the property industry, arrangements that extend beyond 5 years are quite common, and would include:

- ***Division 43 building allowance*** is a deduction allowed in relation to the original cost of a building, spread over a 40 year period;
- ***Leases***, where IFRS accounting creates timing differences over the period of the lease, to bring to account the effective rent after allowing for lease incentives; and

- ***Property development projects*** which may have lead times of many years from when entities are formed to hold the subsequent assets to the final completion and sale and/or leasing out.

This creates a substantial risk that Australia taxpayers that are within the scope of Pillar Two will face timing differences that do not reverse within 5 years and are not covered by the Recapture Exception Accrual.

We seek confirmation that:

- deductions for capital works under Division 43 (of the *Income Tax Assessment Act 1997*) fall within the Recapture Exception Accrual concept.
- there should be a specific inclusion in Recapture Exception Accruals for timing differences under leases that have a term greater than 5 years, where IFRS accounting treatment applies to the lease
- timing differences arising under development projects that exceed 5 years should also be included as Recapture Exception Accruals.

Country-by-country reporting

In the context that Pillar Two applies, it is not clear that country-by-country reporting would continue to be necessary. Removing the obligation to undertake country-by-country reporting by those entities within the scope of Pillar Two would reduce compliance costs.

Franking credits

It is unclear whether taxes under the IIR or UTPR will be frankable taxes. In our view, these should be frankable in order to ensure that double taxation isn't applied to the profits that are subject to the GloBe rules. This would be similar to tax paid under existing Controlled Foreign Company rules.

Top-up tax liability

As noted in the consultation paper, the model rules do not state how a top-up tax liability arising from the Undertaxed Payments Rule would be allocated among Constituent Entities.

In our view the top-up tax liability should not be joint and several amongst Australian Constituent Entities as this would create challenges if the entities were part of a tax sharing agreement, tax funding agreement or were seeking a 'clear exit' of specific group liabilities.

Disqualified Refundable Imputation Tax

It is critical that corporate tax imposed on Australian companies domestically would not be regarded by other countries as a Disqualified Refundable Imputation Tax.

While it seems reasonably clear that Australian corporate tax would not be Disqualified Refundable Imputation Tax, given the importance of this point, it would be sensible to confirm that no other countries take a different view.