PFA
Property Funds Association

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Property Funds
Tax and Accounting 101

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Tax 101

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Introduction

- The Australian tax system provides significant opportunities to maximise the after tax returns for both local and offshore investors

- Trusts are effective tax vehicles in Australia for property fund managers:

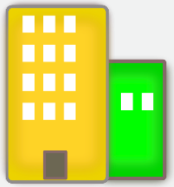
  - Offers “flow through” tax treatment – CGT discount concession is preserved

  - Can provide “tax deferred” distributions. I.e. where cash distributions greater than taxable income in the Fund

  - Government has provided tax concessions for trusts to attract offshore capital to promote the building of the Australian financial services industry

- Investor communications on the tax implications for investing in the Fund is an important consideration for setting up a Fund

Property Funds Life Cycle



FORMATION

- Set up the right tax effective structure
- Minimise transaction costs - GST and duty
- Effective investor communications

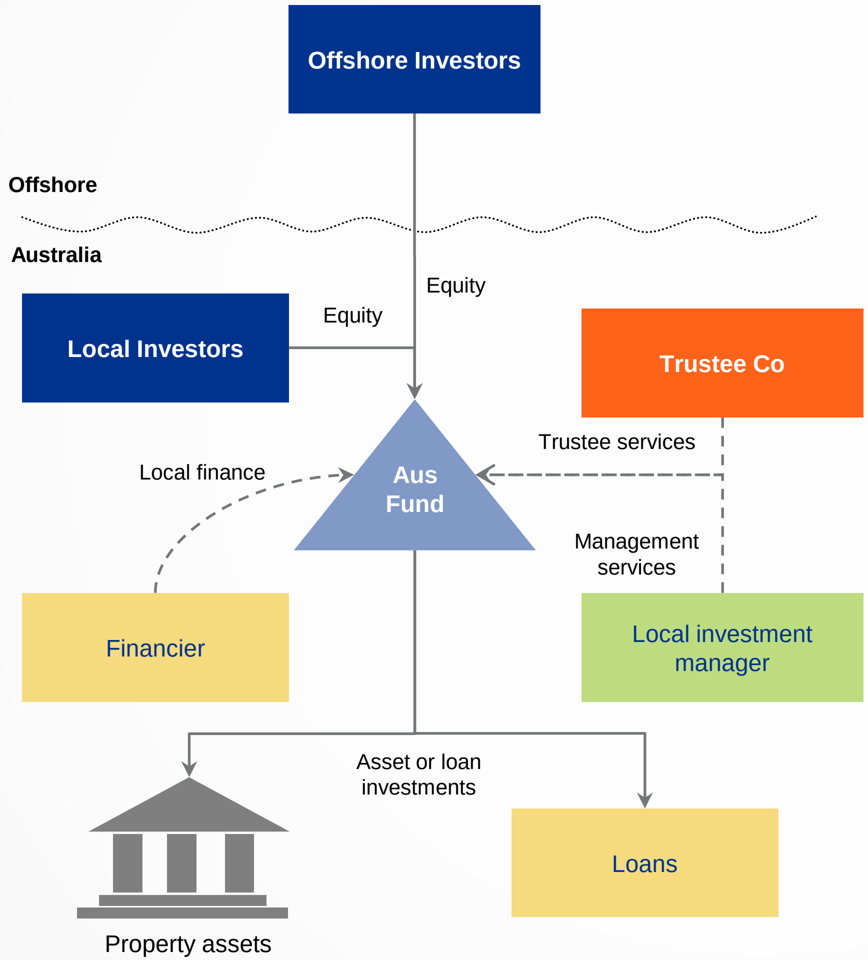
HOLD

- Maximise after tax returns – tax deferred, tax depreciation, offshore investor loans
- Preserve any tax losses
- Timely and accurate tax statements

EXIT

- Minimise tax on divestment of assets
- Clear communication on rollover or redemption process
- 10% foreign resident withholding from 1 July 2016

Structure 1: Trust



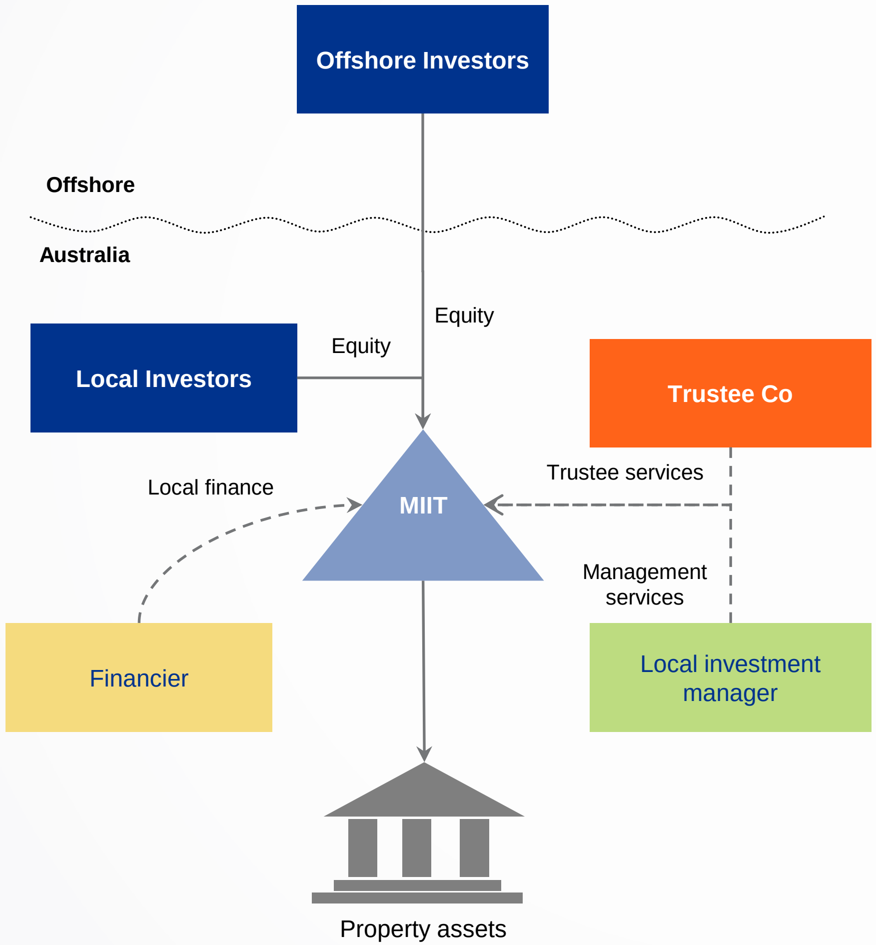
Key tax points

- An Australian unit trust is a flow through vehicle for tax purposes and is a common and well understood vehicle to acquire property in Australia
- Ability to use a Trust to pay "tax deferred" distributions
- Trust protects ability to flow through CGT discount to local investors
- Flow through tax treatment can also be of value if the Aus Fund derives interest income and pays this to offshore investors – offshore investors subject to 10% final interest withholding tax only. Mortgage funds currently popular for developers needing funding

Typically used :

- For simple single asset property funds with a small number (E.g. less than 25) investors
- Passive investments – i.e. property for passive rental holding
- Mortgage / debt funds
- For joint venture arrangements between a local and offshore investor

Structure 2: “Managed Investment Trust”



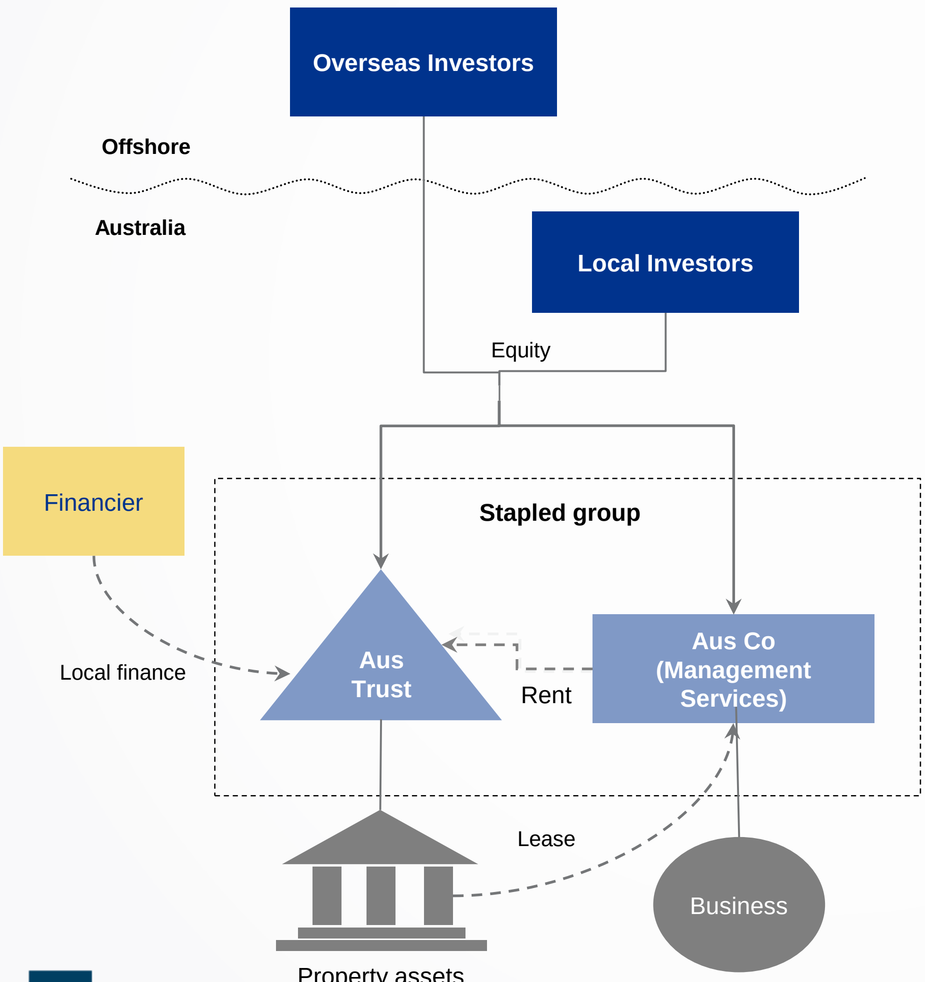
Key tax points

- An MIT structure was introduced by the Australian Government to attract offshore capital and promote the Australian Funds management industry.
- Provides concessional **15% MIT withholding tax** rate on income and capital gains distributed to non resident investors and CGT treatment certainty for local investors
- MITs can also consider to elect to be treated as a Attribution MIT – provides greater certainty over the administration of MITs and provides some further structuring opportunities
- Key requirements to be a MIT:
    - MIT Trust must be a widely held scheme;
    - MIT Trust must have substantial proportion of investment activities undertaken in Australia; and
    - Must be in relation to assets held as “passive assets” to assets

Typically used :

- Widey held / listed / retail passive asset holding funds

Structure 3: “Stapled Structure”



Key tax points

- A stapled structure arises where an investor purchases equity in say “ABC REIT” for $1 but legally gets 1 share in a Company and 1 unit in a Trust – i.e. “stapled” together
- This structure evolved in the REIT industry as the tax law can in certain circumstances treat a Trust be to taxed as a company if it is considered a “public trading trust”
- Therefore stapled structures are used to ensure that any “active trading activities” are undertaken in a separate company to protect the flow through treatment of the property holding trust

Typically used :

- Most complex and costly to set up and maintain, but widely used in Australia if there is sufficient scale (e.g. listed REITs)

Tax deferred "101"

- Arises as a result of differences between the earnings of the fund and its taxable income – primarily because of tax depreciation deductions (accounting standards for investment properties do not prescribe depreciation for book purposes)

- Income tax not payable on tax-deferred amounts, however these amounts reduce an investor's tax cost base in their investment. As a result, the tax liability is deferred until a capital gain (if any) is realised.

	Distributable Income	Taxable income	
Rental income	$1,750,000	$1,750,000	
Tax depreciation		-$625,000	
Property expenses	-$250,000	-$250,000	
Interest expenses	-$490,000	-$490,000	
	$1,010,000	$385,000	
	Tax deferred amount	$625,000	
	Tax deferred percentage	62%	
Marginal tax rate investor tax (49%)	$494,900	$188,650	
After tax return	$515,100	$821,350	159%

Investor communications

Offer Document

- Recommend some general comments on tax for investors

Tax statements

- Within 2 months yr end
- Accuracy of tax components is critical

Wind up / capital raisings

- Appropriate level comments on tax for investors – want to keep them happy for future capital raises

Accounting 101

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Accounting 101

- Mandatory audits required for registered Managed Investment Schemes (MIS)
- Although unregistered MIS may not require a mandatory audit (depending on size), from experience, the trustee / investment manager / investors may choose to have accounts audited for governance purposes
- Annual financial report, Directors' report and Auditor's report to be issued and lodged with ASIC within 3 months of year-end & distributed to members
- AFSL holder also subject to separate "compliance" audit
- After initial recognition, an entity that chooses the fair value model shall measure all of its investment property at fair value, *AASB 140, Investment Property*

Thank you

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