12 April 1999

Dr A Preston
Secretary
Review of Business Taxation
Department of Treasury
Parkes Place
CANBERRA ACT 2600

Dear Dr Preston,

## A Platform for Consultation – Treatment of Tax Preferences

I refer to the two previous Lend Lease submissions on the second discussion paper ***"A Platform for Consultation".***

In each submission Lend Lease has made reference to the treatment of "tax preferred" income both for business entities and other taxpayers. Set out in this submission is Lend Lease's detailed reasoning on our proposed treatment of tax preferred income.

In Lend Lease's view the treatment of tax preferences should be determined primarily with regard to issues of consistency and competitive neutrality. Specifically:

- Where tax preferences are retained for individuals then Lend Lease submits they should also be retained for Collective Investment Vehicles ("CIVs"). This is based on the contention that the tax treatment of an individual should be applied to CIVs.
- Where tax preferences are retained for stand alone superannuation funds then Lend Lease submits they should continue to apply to all forms of superannuation investment including via life companies and pooled superannuation trusts ("PSTs").
- If, however, tax preferences were to be removed for **all** taxpayers, then in Lend Lease's view, that would be preferable to a situation where tax preferences remained only for individuals, but not for CIVs or superannuation investors.

If taxpayers are not treated consistently as between individuals and CIVs then wealthy individuals who have the capacity to invest directly will be advantaged over the less wealthy who invest via pooled vehicles.

If tax preferences are not treated consistently for superannuation investors, whether they be DIY funds, industry funds, PSTs or life company superannuation, then superannuation funds which invest directly will be advantaged over superannuation funds which invest in pooled vehicles such as CIVs, PSTs and life policies. If a superannuation fund were disadvantaged, that fund would change its investment philosophy to that of direct investment. Unless the treatment is extended to CIVs, the trustees of superannuation funds will change their investment philosophy to one of direct investment. The investment by superannuation funds and the superannuation business of life companies in CIVs is extensive.

Whether tax preferences are retained for business entities is a separate issue and one that is linked to the proposal to reduce the corporate tax rate towards 30%. Lend Lease has commented on these issues in detail in our second submission.

## Tax Preferred Income

To clarify our position we refer to tax preferred income as a benefit for tax purposes resulting in reduced taxable income compared to accounting profit. The benefit can be permanent difference (eg the indexation component of CGT) or a timing difference (eg accelerated depreciation). Tax preferred income may also include income that is taxed in a foreign country.

Tax preferred income includes:

- Building allowance
- Accelerated depreciation
- CGT Indexation component
- Research and development expenditure
- Tax exempt foreign income
- Foreign income for which foreign tax credits are available

Accelerated depreciation and building allowance are the most commonly understood forms of tax preferred income and take the form of a tax free and tax deferred component of distributions made from property trusts. Property trusts and/or equity trusts may also distribute a tax free amount being the difference between the cost base and the indexed cost base of an asset that has been sold during the period. This is referred to as the indexation component of the capital gain.

There are few circumstances where tax preferences arising from an accelerated deduction for research and development have relevance for individuals, superannuation investors or CIVs.

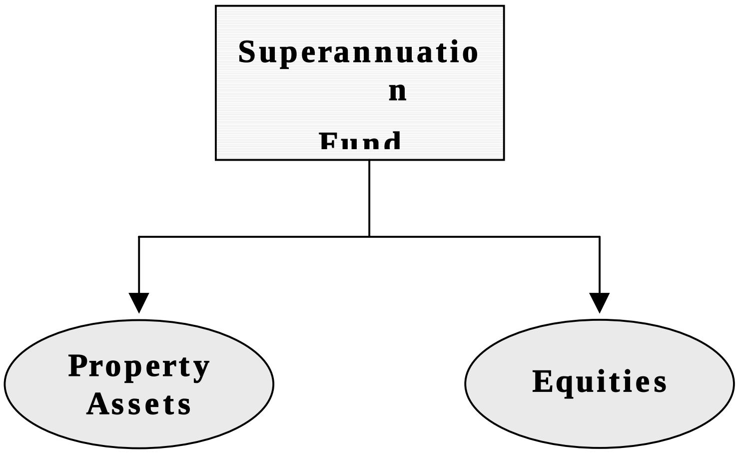
The treatment of exempt foreign income and taxable foreign income for which a foreign tax credit is available is relevant for CIVs that provide investors with international equity exposure. The exempt income or foreign tax credit is reflected in a component of the distribution to unitholders in a trust that derives income from foreign equities.

Set out below are illustrations of the different ways in which tax preferences can arise for superannuation investors investing directly or via pooled investment vehicles.

**Structure of Superannuation Investments**

There are three methods by which a superannuation fund may invest members' funds.

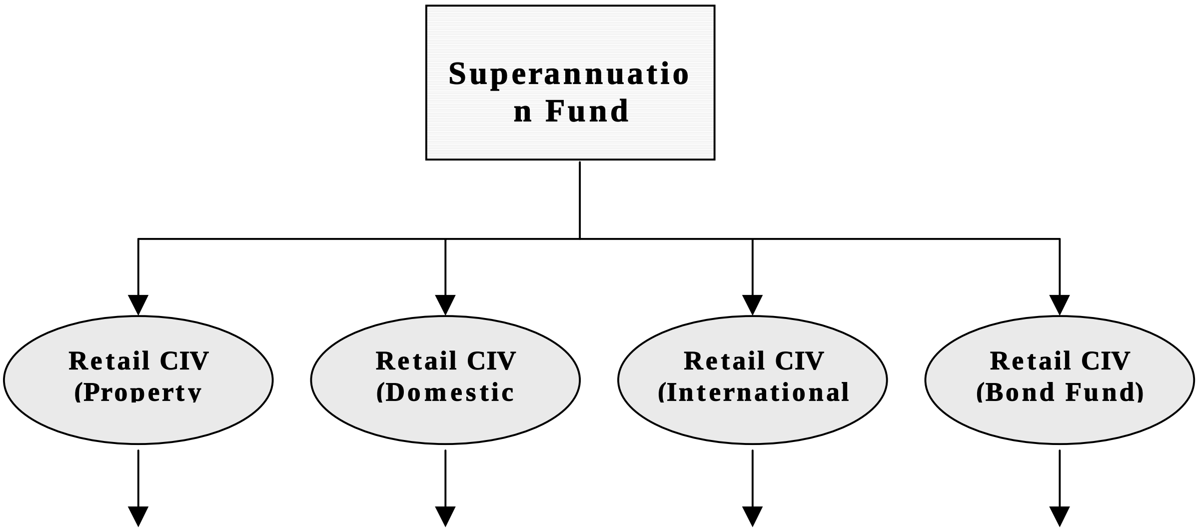
1. **Direct Investment**
Investment by a corporate or industry fund directly into property or equities where the fund has sufficient scale to be able to diversify and manage its own investments. A superannuation fund will ordinarily invest in a diverse portfolio of assets – we have only used 2 assets classes here for the purpose of illustration.

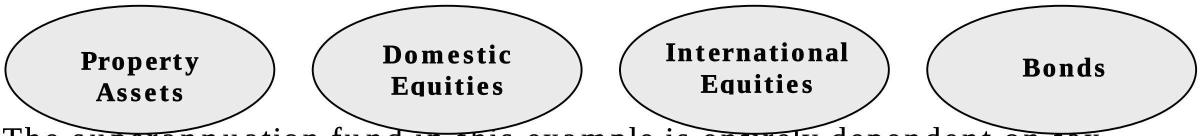



Under current proposals, as we understand them, the superannuation fund in this example would enjoy the benefits of tax preferences flowing from building allowance and accelerated depreciation and through tax preferences which accrue on equities including CGT indexation component and tax exempt foreign dividends and foreign tax credits.

2. **Indirect Investments**
Funds which do not have sufficient scale are able to achieve the diversity they require through investment by means of CIVs. Depending on the size of the superannuation fund, the investment in the CIV may be at the retail or wholesale level. Wholesale CIVs have lower fees but require minimum investments, often in excess of $500,000. Large industry or corporate funds may also invest via CIVs to gain access to specialist investment expertise or for reasons of efficiency. We have limited the investments by the superannuation fund to 4 classes of assets for the purpose of illustration.

***(a) At the Retail Level***

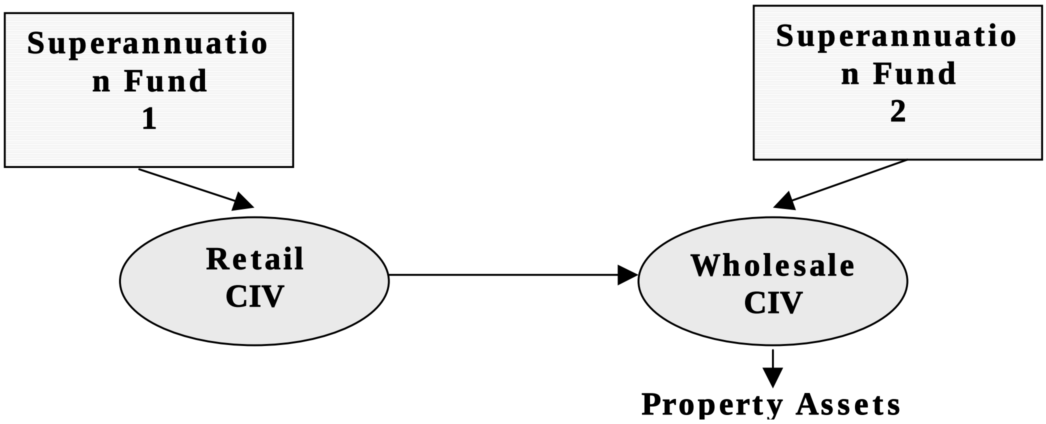





The superannuation fund in this example is entirely dependent on tax preferences flowing through the retail CIVs in order to enjoy the same advantages as the superannuation fund that invests directly.

### *(b) At the Wholesale Level*

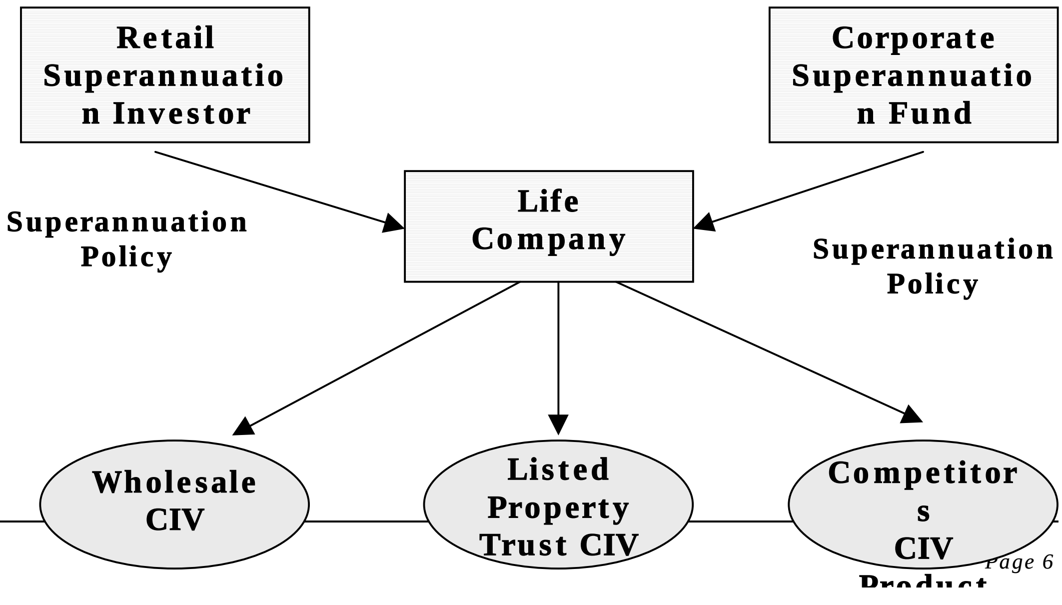
This example uses a wholesale CIV for property only. Wholesale CIVs are ordinarily able to be used across the full range of asset classes for investments made by superannuation funds.




Both Superannuation Fund 1 and 2 in this example are dependent on the tax preferences from the property assets flowing through the wholesale CIV (as well as the retail CIV for Superannuation Fund 1).

## 3. Investment via Tax Paid Entities

Superannuation investments are also made through entities providing tax paid products i.e. life company policies or PSTs. The life company (or PST) pools its superannuation moneys and invests them directly or via CIVs. This example uses a life company but would be consistent with pooling through a PST. In the following example we have limited the investment by the life company to 3 CIVs. These CIVs in turn will have other investors including other superannuation investors, other CIVs and individuals.




### Scale of Investments in CIVs by Superannuation Investors

It is difficult to estimate the extent of the investment in CIVs by superannuation investors however we have attempted to provide some perspective to the examples above.

### 1. Lend Lease / MLC /GPT

- More than 20% of all new business in our retail investment trust - The MLC Australia Trust represent investments by superannuation funds. The MLC Australia Trust has in excess of $3 billion of funds invested and is our single offering to the retail market. The funds invested in The Australia Trust by superannuation funds come almost predominantly from DIY superannuation funds which are able to take advantage of the wide range of portfolios that are available within the Trust. The investor profile of this trust would be typical of the profile for similar trusts in the industry.
- GPT (a listed property trust managed by Lend Lease) has $4.1 billion of property assets and 70,000 investors. Whilst it is difficult to be precise, it is reasonably estimated that in excess of 80% of its portfolio by value is held for individuals, superannuation investors or CIVs.
- Approximately $350 million of the $800 million of investments in Lend Lease's Wholesale CIV are held on behalf of superannuation funds
- Lend Lease Staff Superannuation Fund has 20% of its assets invested in the Lend Lease Wholesale CIV.
- MLC Limited (Lend Lease's wholly owned life company subsidiary) has:
  - $420m invested in the Lend Lease Wholesale CIV; and
  - $178m in Australian Prime Property Fund, an unlisted property trust which, under our proposed definition of a CIV, would itself be a CIV.

### 2. Superannuation Industry

The industry estimates there is in excess of $400 billion invested in superannuation funds of which a very significant percentage will be invested via CIVs.

### Need For Competitive Neutrality In Treatment Of Tax Preferred

It is Lend Lease's contention that incentives should not be provided through the tax system for business entities. Tax preferences should continue to be available for individuals, superannuation business and CIVs.

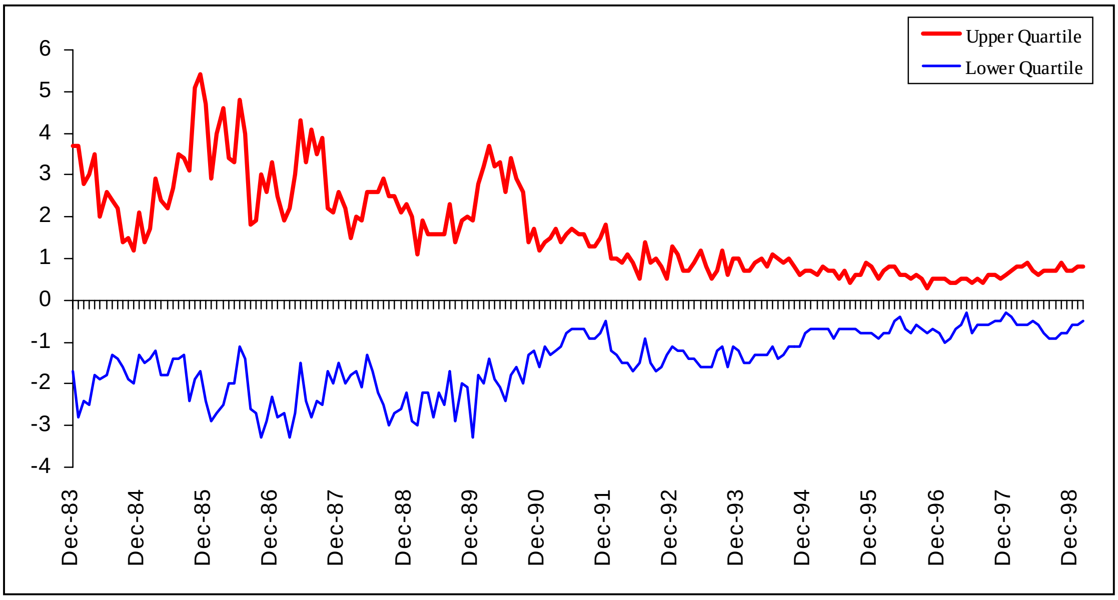
If tax preferences are not retained for CIVs, investors in superannuation funds that invest via CIVs will instead favour superannuation funds that invest directly.

Stand alone superannuation funds would have an absolute advantage over those funds that invest by means of CIVs. This advantage would exist for stand alone funds in relation to property investments (building allowance, accelerated depreciation and through the claw back of indexation), domestic equity investments (through the claw back of indexation) and investments in foreign equities (through the receipt of exempt foreign income and foreign tax credits).

Any change in the comparative advantage of one form of superannuation business over another will cause investors to switch between the entities involved. This argument is often countered (incorrectly in our opinion) by the contention that the differences would be small and not of themselves sufficient to cause trustees to decide to switch between one superannuation entity and another. We strongly submit that small differences, including those as small as 10 to 20 basis points, will be enough to cause investors to change between one form of investment and another.

The following graph illustrates the competitive nature of the funds management industry and the convergence of the performance by managers within the industry over the last 15 years.

**Convergence of Quartiles**
**Excess Returns Rolling 3 Year Periods - December 1983 to February 1999**
**(net of tax and fees)**




Given the size of the funds invested in superannuation and the increasing competitiveness of the industry, it is imperative that the tax system does not discriminate because of the way different superannuation funds are structured and invest. As CIVs are a critical part of the investment process for superannuation funds (and individuals) tax preferences should be available for individuals, all superannuation business and CIVs.

I would appreciate it if senior officers of Lend Lease were able meet and discuss this submission with you at your earliest convenience.

Yours faithfully,

**David Higgins**
Group Chief Executive