Investor Brief

Archer Capital: Allity

This request was submitted to CWC participant trustees by the Australian Council of Trade Unions (ACTU) on behalf of its affiliate, the Australian Nursing & Midwifery Federation (ANMF).

About Archer Capital

Archer Capital is an Australian private equity firm, with $2 billion in funds under management, specializing in leveraged buyouts in Australia and New Zealand. Since its inception, Archer Capital has closed over 35 acquisitions involving total aggregate funding in excess of $6 billion.

About Allity

Allity is Australia's fourth largest private for-profit provider of residential aged care services. Its 44 facilities provide services to approximately 3,700 residents in Australia through a mix of licenses. The portfolio also includes 300 retirement units, some of which are being converted into aged care beds. Allity is wholly owned by Archer Capital's Fund V.

What is the issue?

Allity appears to be involved in tax avoidance arrangements that could result in unforeseen future tax liabilities and possibly reduced access to government aged care subsidies. Allity had a total income of AUD $315.6 million in 2015-16. Publicly available data from the Australian Tax Office indicates that Allity has not paid corporate taxes over the past 3 years. Government funding through aged care subsidies accounted for 67% (AUD $224 million) of Allity's revenue in 2016-17.

A business model that entails a reduction in income taxes paid to government and a reliance on government infrastructure and social insurance schemes presents risks to investors.

The investment risk

Allity's tax minimisation arrangements and its reliance on government subsidies – both of which are sector-wide – have come under the scrutiny of the Australian Tax Office (ATO) and an Australian Senate Standing Committee. These aspects of Allity's business model raise a series of associated financial and governance risks to which its investors may be exposed.

In May 2018, the ANMF commissioned a widely-circulated research report into the tax practices of Australia's major aged care providers, entitled *Tax Avoidance by For-Profit Aged Care Companies: Profit Shifting on Public Funds*. It found that companies posted significant profits and government subsidies constituted 72% of their total revenue (AUD $2.17 billion of over AUD $3 billion). Allity is among the companies identified in the report.

The report led to the establishment by the Australian Senate Standing Committee on Economics of an Inquiry into *The financial and tax practices of for-profit aged care providers*. The Senate inquiry is ongoing and could result in changes to tax law and the conditions for accessing government subsidies.

In a newspaper article published in 2016, the Australian Tax Commissioner warned private equity groups "that their fondness for complex ownership structures will trigger some red flags' – and ATO attention". The article noted that some ownership structures used by private equity funds "load their investment targets with debt, enabling them to efficiently strip out profits and return them to their investors. With tax calculated on profit, investment losses can depress taxable income." The ANMF report suggests that this is the course of action Archer Capital has pursued with Allity.

Legal taxation liabilities or changes to subsidy arrangements resulting from this scrutiny could hold implications for Allity's capital gain value on realization.

Systemic risks

Company shareholders may experience gains in the short term by paying minimal corporate taxes while benefiting from state infrastructure and social security. Yet declining tax-based revenues to support basic infrastructure and services may contribute to social instability, which in turn holds implications for investors in the long term. The UN Principles for Responsible Investment (PRI) formed a tax taskforce in 2015 to actively address this issue and produced a set of materials articulating the business case for engagement on taxation, identifying key risks and opportunities, and proposing a framework for investor engagement with companies.[1]

Labour relations

The ANMF has been striving to achieve appropriate staff to resident ratios in the Australian aged care sector. Despite achieving strong profitability, providers have been reducing nursing staff, with severe consequences for aged care residents and staff.

Allity is currently negotiating for a new collective agreement with the ANMF Branch in New South Wales. The minimal pay increases on offer are being rejected by the union.

What can trustees do?

Trustees whose pension funds are invested in Archer Capital are kindly asked to take the following steps:

- Request that their fund, directly or through the relevant investment manager/s or engagement partner, engage with Archer Capital to discuss whether the company is meeting appropriate governance standards in relation to its ownership of Allity, and that Archer Capital engage with the managers of Allity regarding its sustainability given the risks (financial, regulatory and reputational) arising from its current tax practices.

- Request that a report be presented to the Board on the risks that Allity's business model poses to the fund's investment in Archer Capital.

- Request that the fund assess and report on whether the tax practices of Allity are consistent with the fund's own investment beliefs and ESG policy (and obligations if a PRI signatory or signatory to any other ESG accountability framework).

Note that if your fund is a PRI signatory, your management team may wish to utilise the PRI's May 2018 Investor Guide entitled *Evaluating and Engaging on Corporate Tax Transparency* to guide its expectations in relation to engagement with Archer Capital and in its subsequent engagement with Allity. The PRI requirements are consistent with the International Trade Union Confederation (ITUC) Global Union Call for Action for Pension Fund Responsible Tax Practices of 2014.

Trustees are also requested to report back to the CWC on the actions they have taken and the outcomes from raising the matter with their fund's management.

Media

The Guardian: Australian nursing home giants shifting millions in profits offshore, report finds

The Guardian: Aged-care providers to face inquiry over alleged tax avoidance.

ABC: Major aged-care profit machines dodging tax: report

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[1] Advisory Committees and Working Groups. PRI. https://www.unpri.org/about/advisory-committees#tax; Accessed on February 15, 2018.