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STANDING COMMITTEE ON ECONOMICS

**Reference: Tax Laws Amendment (2007 Measures No. 3) Bill 2007; Tax Laws
Amendment (Small Business) Bill 2007**

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**SENATE STANDING COMMITTEE ON
ECONOMICS**

Friday, 1 June 2007

Members: Senator Ronaldson (*Chair*), Senator Stephens (*Deputy Chair*), Senators Bernardi, Chapman, Hurley, Joyce, Lundy, Murray and Webber

Participating members: Senators Adams, Allison, Barnett, Bartlett, Boswell, Bob Brown, George Campbell, Carr, Conroy, Eggleston, Chris Evans, Faulkner, Ferguson, Fielding, Fifield, Forshaw, Hogg, Kemp, Kirk, Lightfoot, Ludwig, Marshall, Ian Macdonald, Sandy MacDonald, McGauran, Milne, Nettle, O'Brien, Parry, Payne, Robert Ray, Sherry, Siewert, Watson and Wong

Senators in attendance: Senators Bernardi, Hurley, Joyce, Murray, Ronaldson, Stephens and Webber

Terms of reference for the inquiry:

Tax Law Amendment (2007 Measures No. 3) Bill 2007:

WITNESSES

APPLEBY, Mr Daniel, Director, Speed and Stracey Lawyers.....	1
BROWN, Mr Colin Leslie, Manager, Costing and Quantitative Analysis Unit, Department of the Treasury	28
CALLAGHAN, Mr Mike, Executive Director, Revenue Group, Department of the Treasury	28
CALLAGHAN, Mr Mike, Executive Director, Revenue Group, Department of the Treasury	38
CALLAGHAN, Mr Mike, Executive Director, Revenue Group, Department of the Treasury	40
COLES, Mr Tony, Specialist Adviser, Department of the Treasury	38
COMLEY, Mr Blair, General Manager, Business Tax Division, Revenue Group, Treasury	40
COOKE, Mr Trevor, Executive Director, International and Capital Markets Division, Property Council of Australia.....	1
GILBERT, Mr Richard, Chief Executive Officer, Investment and Financial Services Association.....	1
LE, Mr Alexander, Policy Officer, Department of the Treasury	28
PRYKE, Mr Kieran, Chief Financial Officer, The GPT Group	1
SPEED, Mr Robin, Director, Speed and Stracey Lawyers	1
WARD, Ms Linda, Adviser, Superannuation, Retirement and Savings Division, Department of the Treasury	38

Committee met at 9.31 am**PRYKE, Mr Kieran, Chief Financial Officer, The GPT Group****COOKE, Mr Trevor, Executive Director, International and Capital Markets Division, Property Council of Australia****GILBERT, Mr Richard, Chief Executive Officer, Investment and Financial Services Association****APPLEBY, Mr Daniel, Director, Speed and Stracey Lawyers****SPEED, Mr Robin, Director, Speed and Stracey Lawyers**

CHAIR (Senator Ronaldson)—Welcome. I declare open this meeting of the Standing Committee on Economics. This hearing has been convened to receive evidence in relation to the revisions of the Tax Laws Amendment (2007 Measures No. 3) Bill 2007. The bill is an omnibus bill that will implement changes to Australian taxation in a variety of areas. The committee received five submissions on schedule 10, two submissions on schedule 2, two submissions on schedule 4 and one submission on schedule 8. The hearing today will commence with a consideration of schedule 10, which has attracted the most comments and submissions. At the committee's discretion we may also hear from Treasury on schedules 4 and 8. The committee is due to report to the Senate on this bill on 6 June.

These are public proceedings, although the committee may agree to request to have evidence heard in camera or may determine that certain evidence should be heard in camera. I remind all witnesses that in giving evidence to the committee they are protected by parliamentary privilege. It is unlawful for anyone to threaten or disadvantage a witness on account of evidence given to a committee, and such action may be treated by the Senate as a contempt. It is also a contempt to give false or misleading evidence to a committee.

If a witness objects to answering a question, the witness shall state the ground upon which the objection is taken and the committee will determine whether it will insist on an answer, having regard to the ground on which it is claimed. If the committee determines to insist on an answer, a witness may request that the answer be given in camera. Such a request may, of course, also be made at any other time. I welcome the witnesses to these hearings. Do you wish to make an opening statement?

Mr Gilbert—I would like to thank the committee for convening this hearing today to hear our concerns. We believe they are very critical concerns and we are grateful that the parliament has an intense interest in this issue. Our concern is with schedule 10. Schedule 10 in a principle sense is about this issue: whether we have a flat and final tax rate which is competitive, has integrity and has a final particular view or characteristic, or whether we want a very uncompetitive withholding tax rate against which you can have deductions, which are messy, complex and not attractive to overseas investors. That is the principle.

Our submission talks about some of the design and technicality difficulties that the bill has, but the real focus for us is the 30 per cent withholding tax. It is just too high and too uncompetitive. We have put out this week, and we have sent to the committee, a document called *Policy options to increase Australia's export of funds management services*. It outlines the future direction of how this industry should be marketed offshore and provides a 20/20

vision on how to take the Australian economy beyond the resources boom. Obviously the 30 per cent rate in relation to this is in conflict with our document. We believe we need a whole-of-government approach. It is not just in tax—there are other issues—but tax is critical. This one is probably the most critical.

We will be putting out research in coming weeks to talk about the GDP impact of having a more competitive, transparent and integral system for tax. We look forward to sending that to you as well. Suffice to say that research will show that we can add considerably to the economic capacity of the economy by having a more competitive tax system. Our industry has a number of characteristics which do that. First of all, we have scale and spare capacity. Secondly, the rates of pay in our industry are higher than in other industries. The argument about substitution—about pulling resources from one industry to another—has largely dissipated because of the fact that we pay higher rates of pay. So we have a chance here to boost productivity in the economy and also to boost GDP.

Instead of potentially boosting GDP, schedule 10 does the opposite. We are getting feedback from our foreign investors that it is not a good move. Also—and we do not have any tangible evidence yet—if we do not get this right, it is possible that our real estate investment trust industry will move offshore. If it does not move offshore in its current state, we could well find that the new REITs which we set up in this industry are not set up in Australia but are set up in centres which do have a competitive rate of tax.

We believe the committee has a very vital contribution to make in the strength of the economy and also in relation to this particular measure. In order to be constructive here, we have a proposal to make as a principled proposal—that is, that foreign investors who invest in Australian managed funds should receive the same tax treatment as Australian investors would receive when they invest in those overseas countries' funds. We believe this measure would be competitive. We believe it would uphold the Australian sense of balance and fairness—that is, it has parity, mutuality and reciprocity. The third point, which I think is critical, is that this is something which the board of tax suggested in its report. That is my opening statement. I think Mr Cooke is going to follow me, and then Mr Speed, if that is okay.

Senator BERNARDI—In regard to that, is that a new proposal that you have put forward that is not in your submission? Is that what you have referred to?

Mr Gilbert—Yes. We have thought long and hard about this, and we thought that this would be a good thing to raise before the committee today. I think the Property Council agree with us. We believe this would be a circuit-breaker.

Senator BERNARDI—Before we can consider it, I would like to see a document. Have you got something you can table that we can have a look at while you are making your opening statements? It is introducing new material that is obviously important.

Mr Gilbert—We are happy to table that.

CHAIR—It really makes irrelevant the submission that we were going to consider. I am happy to take that on board but I think your submission had a number of other proposals. I presume that you have moved on from those. Is this now the proposal you wish the committee to consider?

Mr Gilbert—In an ideal world, it would be optimal for us to have the original submission upheld—that is, to bring the tax down to 15 per cent, or even 12½ per cent. But, if the committee is not able to agree on that, this might be an option for the committee to take forward to the government.

Mr Cooke—I echo Mr Gilbert's sentiments with respect to our pleasure that the committee is giving this matter due consideration and I fully support and endorse the comments that Mr Gilbert has made. I will try to add a little context and flesh, if you will. The Property Council is the industry body that represents the interests of the institutional segment of the real estate markets. It is probably important to outline some of the key characteristics of both the REIT investment vehicle and the Australian marketplace itself to try and provide you with a greater understanding of why this is such a critical issue for our sector. A REIT, or real estate investment trust, in the Australian context is a trust that derives most of its income from long-term investment in real estate. Importantly, it distributes all of that taxable income annually, regularly—a key distinguishing feature of such a company. It does not pay tax on the income that it distributes. Instead, the investors pay tax according to their personal circumstances.

There is no doubt that over a period of 35 years, in particular in the last 12 to 15 years, Australia has been a world leader in this space. We have built up a very strong sector, primarily on the back of a domestic focus. Particularly from about 1996, the sector has grown rapidly. We have securitised most of the real estate in Australia. We have the highest levels of securitisation in the world, and that has been on the back of a growing savings pool, primarily superannuation.

By about 2000, the sector had matured from a domestic context. Assets were securitised and capital was continuing to flow in. At the same time, of course, the rest of the world was embracing the REIT concept and similar models for real estate investment were being rolled out across the world. Today we have approximately two dozen competitors, whereas five years ago we would have had three. That is the important context for what we see as the competitiveness of Australia's withholding tax regime. Today we are the second largest real estate investment market in the world, second only to the United States. We have a listed sector worth approximately \$150 billion. To put it in context, that is 12 per cent of the market capitalisation of the Australian Stock Exchange. We are the most globally integrated of any real estate investment market in the world. We have approximately \$15 billion worth of assets that are held offshore, and approximately \$40 billion worth of foreign investment sits in this sector.

In terms of the way the market sits right now, it is critical to understand the rate of change. The UK market opened up on 1 January this year and is already the third largest. The German parliament passed REIT legislation last month. It will double the size of the European investment landscape within 18 months. Italy is following suit. In our own region, we have seen the size of the Japanese REIT market double in the last 18 months. Singapore, a small city of three million, has been highly effective in attracting investment capital into it. All of them are following a similar sort of course, and that is reducing regulatory barriers to investment capital and setting competitive tax rates. All of our competitors have a flat and final withholding tax rate, and all of them are at 15 per cent or lower. There is no doubt that

globally there is downward pressure on these withholding rates as countries enter into double tax agreements designed to increase capital flows.

It is our strong view that, unless the Australian government moves to reduce the withholding tax rate, to streamline it and make it more efficient by making it a final rate, the success of this sector will be in jeopardy. By that we do not mean just institutions in the sense of big business; there is approximately \$100 billion of Australian superannuation capital residing in this sector which will undoubtedly suffer if our competitiveness globally is not maintained. For that reason we support a 15 per cent final withholding tax. We believe that that would provide equity, align Australia's superannuation funds with domestic pension funds, align distributions from real estate investment trusts to unfranked corporate dividends as they are currently distributed and effectively put us on par with other major markets, including the United States.

We are not proposing a race to the bottom in terms of withholding rates; we respect the Australian government's need to raise revenue, and that is exactly why we are pegging this at a middle-of-the-road position. Similar to IFSA, in an effort to try and break through on this issue, to try and develop a consensus, we would support the proposal that is being put forward to you now—that is, that where an Australian investor would get the benefit effectively, under a tax treaty, of a reduced rate then the principle of reciprocity should apply. I conclude my opening statements here, and I would be happy to take any questions from the committee.

Mr Gilbert—Mr Speed does wish to make a statement, if that is all right, Chair.

CHAIR—Could you make that fairly short, please, Mr Speed, because we want to leave plenty of time for questions.

Mr Speed—I will make some preliminary comments in relation to the bill. Firstly, a comment of congratulations: there is no doubt that the bill, in relation to the custodian provisions, is a world leader. It is generally not recognised that almost all investments in Australia from overseas, and even in Australia, are held through custodians. This is the first time that we are aware of that any country in the world has attempted to deal with the difficulties that holding investments through custodians poses. Treasury on this occasion, in the industry's view, has provided an excellent mechanism for dealing with the framework of custodians. So, on behalf of the custodians, we would like to have that formally recorded: the excellent work which Treasury did and which the government did which this bill reflects.

Secondly, I will make some preliminary comments in relation to the point at issue here—that is, the contrast between the 30 per cent general tax and the 15 per cent or alternative tax at a fixed rate. The issue there is that only under one double tax treaty that Australia has entered into—that is, with the US—is there any express reference to distributions from property trusts. That is a one-way street in the sense that it deals solely with Australians who invest in the US. That provides—that is, the US provided in that amendment to the double tax treaty in 2001—relief for when Australians invest in the US. That relief was provided at the express request of this industry and the express request of Treasury and of the Australian government, as the Americans intended to have a 30 per cent withholding tax. When they realised the position of the major investor that Australia was in the US, they reduced their rate

from 30 per cent to a 15 per cent final tax. But that is the only provision that you will find in any double tax treaty that Australia has entered into.

The other countries have had no need to enter into it, in the sense of investing in those countries, because those countries have unilaterally fixed a withholding tax rate lower than what it might otherwise be and which might be otherwise expressed in the treaty. So, for example, the withholding tax rate in Japan is seven per cent; in Singapore, 10 per cent; and, in the Netherlands, 15 per cent. Normally you would find those sorts of provisions reflected in the double tax treaties. But that really has been avoided because all the governments in the world basically have accepted that the way to proceed in relation to REITs and listed property trusts is domestically to fix a rate which is a final rate. The reason for that I think is fairly obvious—that is, it is obviously impractical to collect tax from foreigners unless you do it at the source. All countries in the world have found that you must collect the tax from the source; otherwise, no taxes effectively can be recovered from the foreigners. This bill recognises that. It recognises that the mechanism that REITs have and listed property trusts have for collecting tax should be exploited—that is, you should have the listed property trust or the REIT collect the tax. Obviously that is the most sensible way of proceeding.

The issue is what the rate of tax is that should be collected and whether it should be a final tax. The approach that is reflected in this bill is that it should be a general tax—that is, the investor is entitled to claim tax deductions in relation to that. All other countries in the world have not taken that approach. They have all said that the correct approach to take is a final withholding tax of 15 per cent or less. That is the balance. The balance is here: do you have a general tax of 30 per cent, for which you claim deductions, or do you have a tax of 15 per cent, which is a final tax? What is the difference? I will explain that from the coalface, because we are at the coalface every day dealing with foreign investors. We have seen that foreign investors—whether it is a Dutch pension fund or a UK pension fund—are all gearing their investments in Australia. So the net result is that they say to us: what is the tax rate you have in Australia? We say, ‘The rate is 30 per cent.’ They are obviously amazed by that because it is so out of kilter. They say, ‘We’re about to put \$100 million into Australia.’ You have to understand that these calls come in once a week to our office, so they are multiplied across Australia. They say to us—and to every other tax adviser—‘We have \$10 million, \$50 million, \$100 million coming in. What is the withholding tax rate?’

Most of these investors are foreign pension funds. Foreign pension funds pay no tax anywhere else in the world. So, as soon as you say, ‘You’re going to be hit with a 30 per cent withholding tax,’ they say, ‘Gee, that’s a major problem for us. If it was 10 per cent, like Singapore, we can live with it, but we can’t live with 30 per cent.’ The next question—which automatically comes by way of a telephone call—is: ‘To what extent can we gear it so that we can claim a tax deduction?’ The next question is: ‘Can you organise a company in Delaware so that we can structure our investments?’ So you have a superannuation fund at the top, it lends the money to a Delaware company and the Delaware company invests. The net result of that is that the rate of tax is significantly below the withholding tax rate of 15 per cent because they can gear it under our thin capitalisation rules at 75 per cent. So, effectively, by doing that they are paying less Australian tax.

So you ask: if they can do that, what is our concern? Our concern is that that applies to the big pension funds, which are prepared to do that. There is also a large range of investors into Australia, which are not the big pension funds. They simply will not do that. As soon as they are faced with a 30 per cent withholding tax, they will not lodge an Australian tax return. You just do not do that. If you are an Australian and you want to invest in the biggest area in America, which is Simon—which is almost as big as Westfield—you are not going to lodge an American tax return. You just do not do that. You will not gear. The only people who will, therefore, gear are the large investors into Australia. From the market's point of view—from a listed property trust point of view—it is crazy to cater for those people because they switch hats—they are in, out, all over the place. The industry wants long-term investors—the clever, sophisticated people who can afford our services. They simply gear all the time. They say: 'Isn't this strange? This is a quaint country; it has this nonsense rule, but we'll fix it. We'll get around it.' The great bulk of people out there simply do not do that and simply tune out.

The question is: do you follow what the rest of the world has or do you remain the odd man out, with a 30 per cent tax? As far as the modelling is concerned, we say both will produce the same amount of tax at the end of the day. But, in doing that, you have to understand that there is a legitimate debate about exactly to what extent people will gear. We do not know what people are going to gear, nor do Treasury. So there will always be a debate about whether or not one will produce more or less than the other. It is a bit like saying: should we or should we not have a double tax treaty? When you have a double tax treaty you do not ask: are those nonresidents going to get a better deal than us? Because, if you did that, no double tax treaty would ever get signed. In essence, double tax treaties try to work out the equity between foreigners and us: do the foreigners get an equitable deal relative to what Australians get? This has got nothing at all to do with giving foreigners a free kick. This is all to do with double tax treaties and the fact that you cannot measure it in terms of dollars. What you simply have to ask is: 'Are foreigners being treated equitably relative to Australians?'

CHAIR—Mr Speed, we have had nearly half an hour of opening statements and the senators do have questions.

Mr Speed—Sure, in question time I can deal with those matters.

Senator JOYCE—I understand that we are at 30 per cent and all the other nations are at 15, with Japan at seven. My question really goes to the fact that withholding tax is a cyclical thing; if they are entitled to it they can claim it back.

Mr Speed—In their home countries, sometimes they get a credit for it. If you are a pension fund, where you are paying zero tax, which are the large investors, then they cannot claim it back.

Senator JOYCE—So for taxable entities overseas it is a timing issue; for others it is a taxing issue. For pension funds, predominant investors in industry, it is a disincentive unless they have the capacity to use a Delaware instrument or something like that to get around it?

Mr Speed—It is not just a timing issue, because to get your refund out of Australia you have to lodge a tax return. Whilst it may seem odd, the truth is that they do not want to do it. It is an administrative problem for them and they will not do it. If they have an alternative, they will not do it. They would prefer—

Senator JOYCE—Just to pay the tax.

Mr Speed—They would prefer to pay the final tax. When you are dealing with them day to day they say, ‘We do not want to lodge a tax return. Just tell us what the final tax is. We know what it is; we will bear that cost—end of story.’

Senator JOYCE—But we need to tell them 30 per cent.

Mr Speed—They will say, ‘We’ve got to report you.’

Senator JOYCE—You have silence at the end of the phone.

Mr Speed—Yes.

Senator JOYCE—I want to run through what are probably other macro issues that go off at a bit of an angle, but I am sure that, for a lot of people who are tuned into this—who obviously have nothing to do on a Friday morning—they are questions that they might want to know about. If we put further encouragement, further stimulus, into the housing market or into the investment market and into the construction market, which is obviously the benefactor, does that filter out to have effects on housing prices and other people and the regular mums and dads trying to buy a house out on the street? Who wants to answer that?

Mr Cooke—It is probably important to recognise that at this stage residential real estate forms part of a securitised REIT, so what we are really talking about in the Australian context is shopping centres, office buildings and industrial, including logistical and warehousing. This is emerging in areas such as child care, aged care and other areas where there is a need for capital to be injected to provide product to the market, but in terms of detached dwelling residential property it is just simply not in this space.

Senator MURRAY—What about infrastructure?

Mr Cooke—The infrastructure funds are a separate matter. We share similar characteristics to infrastructure funds but they do operate under different rules. They have different taxing considerations. And I would not purport to be an expert on infrastructure funds.

Mr Gilbert—Can I add one point there. I think the relevant point for domestic housing, residential, is that we need in this country as much capital as we can get in order to keep that interest differential down. If we do not get that right, rates could be affected upwards.

Senator JOYCE—If we reduce withholding tax from 30 down to 15—and 15 is basically what you are pitching at to try to get some sort of parity between us and the other major investment nations—is that going to present any sort of discrimination against the Australian investor?

Mr Speed—It does not produce any discrimination against the Australian investor. Really, I think, without labouring it, you need to look at those pages that I gave you in the summary. If we take the first page, what we tried to do is to compare a US investor who is investing into an Australian fund and an Australian investor. You see that what happens is that there is parity and equity between those investors. Effectively what happens is the US investor will get a credit for whatever tax is paid here and the converse. So when you look at Australian investors, you have to say that Australian investors today are investing in Australian property trusts; they are also investing in foreign REITs through Australian property trusts. That is the

comparison between the two. How are we treated when we go to the US? If we are treated in the same way that they are when coming here, I would suggest that was parity and that the foreigner was not getting any advantage.

Senator JOYCE—That sounds like a logical argument.

Mr Pryke—The other aspect in the comparison to a domestic investor and an offshore investor under this regime is to understand the impact that the inflow of offshore capital into our market has had in recent years. That has been very much new capital coming into the market and pushing up prices on the equity of the various stocks that are listed on the exchange, and that has been to the benefit of our domestic investor base. That is still 75 per cent of our investor base—largely domestic superannuation funds. They have been very much a beneficiary of this external capital coming into the market. That capital has made Australian property trusts very competitive internationally, as Trevor mentioned. We have been able to acquire real estate activities around the world, and that has supported the strength of this industry domestically. If we are uncompetitive in a global capital market—and, as Robin has said, these guys simply look at the 30 per cent rate, and a big chunk of the market says, ‘It’s too hard; I’m not going to go to the trouble of working out a better way to invest in Australia’—then there will be an exiting from our market that will have a detrimental impact on the returns that our domestic investor base are receiving, it will make us less competitive internationally and our capacity to deliver returns to our domestic investor base will be impacted negatively.

Senator JOYCE—What is the size of your market in Australia?

Mr Pryke—The market capitalisation of the property trust sector is around \$150 billion. In the order of \$40 billion of that has come from offshore.

Senator JOYCE—What is the quantum of withholding tax? Can you put a figure on that?

Mr Speed—The study that was provided by Econtech was to the effect that, of the actual distributions that were going to be taxed in Australia per annum, about \$300 million was going out to foreigners. So, if you say \$300 million was going to foreigners and apply a tax rate of that at 30 per cent, that is \$90 million in tax each year subject to them claiming a tax deduction on it.

Senator JOYCE—I am working out what the budgetary cost is to us. It is about \$90 million.

Mr Speed—It is about \$90 million, assuming that no foreigner claims a tax deduction for gearing. So the question is: how much is he going to gear to bring it down to a different rate? If he gears to the extent of 50 per cent and the \$90 million tax comes down to \$45 million, you might as well have a tax rate of 15 per cent.

Senator JOYCE—I understand that. I understand totally your position, but there are two arguments. In the bigger picture of things, in a trillion dollar economy it is not a big cost to Treasury. But, on the other side of things, it does not appear to be a huge cost to them either. Is it big enough to change their investment strategy?

Mr Speed—Of that there can be no doubt.

CHAIR—That may well be arguable.

Mr Speed—Can I answer that?

CHAIR—No, because I am going to ask you some questions shortly.

Senator MURRAY—A basic principle I have accepted throughout my 11-year tenure in the taxation portfolio for my party is that we should be as competitive as possible with tax rates worldwide. That is one of the reasons I accepted the reduction from 36 per cent to 30 per cent for the corporate tax rate, which government consistently indicate keeps us broadly pegged with OECD countries. Your evidence is that this proposal breaches that principle which the government has established for the corporate tax rate in terms of the withholding tax rate. That is the first principle we have to get over. The second issue is one I am sure there is no problem with, but I want to have an answer to it. If the government were to accept your submission—and that is a big ‘if’—and accept the flat and final tax recommendation of 15 per cent, are there any opportunities for arbitrage which then emerge between the corporate tax rate and the withholding tax rate?

Mr Speed—There is no opportunity for arbitrage that I can think of because in essence the listed property trust is obviously distributing all of its income out. The Australian residents are being taxed on that in the normal way, so I do not think there is an opportunity for arbitrage.

Senator MURRAY—I would not either, and I accept that response. Let me move on, unless you have an alternative view. The second point that I want to explore with you is that I think Mr Cooke wrongly said that you are reaching for the midpoint. You are actually accepting the high point, aren't you? Let me put it directly: there is no other country with a withholding tax higher than 15 per cent.

Mr Gilbert—Correct.

Mr Speed—That is correct.

Senator MURRAY—So it is not the midpoint. You are recommending the highest point.

Mr Speed—Precisely.

Senator BERNARDI—I think you should clarify, the final—

Senator MURRAY—Yes, the flat and final tax.

Mr Speed—Yes, you are exactly right. The US and the Netherlands have the two highest. The Netherlands's is about to come down to a very low sum, so effectively the US has the highest rate. In our area, you are down to 10 or seven per cent.

Senator MURRAY—You are people of experience, but I really focus my question on Mr Speed because Mr Gilbert and Mr Cooke represent associations, whereas Mr Speed represents customer dealings on a direct basis. You would confirm, wouldn't you, Mr Speed, that the capital investment market is a fast-moving, quick-decision market—you have money available that you want to invest and you make that decision. Therefore the headline rate—regardless of the fact that you might be able to structure your affairs to bring down the headline rate—has a very important chilling effect in the sense of the psychology of it.

Mr Speed—It has a dramatic chilling effect.

Senator MURRAY—Is that accurate?

Mr Speed—That is 100 per cent accurate. The person on the other side of the phone cannot understand the 30 per cent rate. It has a dramatic chilling effect on any investment into Australia.

Senator MURRAY—I doubt that you can answer this question, but let's give it a go. Excluding the United States, where we have a specific provision with the double tax treaty, what is the lowest, in your view, that somebody could achieve from a 30 per cent headline rate—what is the lowest effective tax rate they could get to by utilising deductions?

Mr Speed—The truth is that it depends on how aggressive the advisor is. He can easily get down to a rate of 12 per cent without any difficulties at all. He can get down to 12 or 10 per cent without what I might call being aggressive from a tax planner's point of view. If he was really aggressive it would not surprise me if he could get down to five per cent. But the normal rule would say he would get down to 12 or 10 per cent, or around that sort of range.

Senator MURRAY—My little finance mind says this: if the result of going to 15 per cent actually encourages more investment than this measure will discourage, and if in fact you force people to pay 15 per cent who might otherwise pay 12 per cent by re-gearing, the treasury will actually make more money than they will by putting it at 30 per cent.

Mr Speed—Yes.

Senator MURRAY—Is that a reasonable proposition?

Mr Speed—I should say two things. That is my belief; however, when we asked Econtech to report on that, they put their economic hat on and talked about a series of indirect effects, which, I must say, confused me. The simplicity of it was that it would increase investment. But in their report they deal with whether or not there are any indirect effects, and I am sceptical about that.

Senator BERNARDI—For the committee's benefit, I would like to disclose that Mr Cooke and I have been friends for a long time. We had businesses dealings before I got into parliament. It does not mean that I am going to treat him with any more respect than he deserves.

Senator MURRAY—He says you treated him with disrespect before!

Senator BERNARDI—Senator Murray, I promise that it will be consistent.

CHAIR—Thank you for putting that on the record, Senator Bernardi.

Senator BERNARDI—I would like to get on the record—and I am happy to take the answer from Mr Gilbert, Mr Cooke or Mr Speed—that you represent two different types of investors. One is a sophisticated professional investor base—pension funds, mutual funds and international institutional investment—and the other is private investors. Would you like to deal with the impact on private investors first, or are you more concerned about the impact on professional investors?

Mr Gilbert—The industry clearly deals with institutions. That is how international finance works, but Mr Speed is closer to the advice part of it.

Mr Speed—I do not think it matters which one you deal with first.

Senator BERNARDI—Let us talk about institutional investment. I find it a little tough to believe that an international fund manager cannot get their head around the difference between a 30 per cent withholding tax and a 15 per cent final rate. These are very smart people. Also, by your own admission, a sophisticated investor can construct vehicles in which to get benefits to reduce their tax rate. How do you respond to that?

Mr Speed—I think there are two answers to that. You said that you found it difficult to believe that they could not get their mind around it. Obviously, they get their mind around it in two seconds. That is not an issue. They get their mind around it; they fully understand it.

Senator BERNARDI—So they do.

Mr Speed—There is no doubt about that. The question is whether they are motivated to do anything. We have a range of investors who say: 'Hold on'—and you have to understand the terms of the dollars they talk about; they talk about investing \$100 million upwards—'We've got a billion dollars in Japan where we do not have to structure. You tell me why we should be putting \$100 million in Australia and having to structure. You're the only country in the world where we have to structure.' It is not a matter of saying to them, 'Look, they understand the problem; they understand that there is a way around it,' because—and this may be surprising—a lot of them simply say: 'We're not going to have that hassle. Why would we have that hassle for Australia?' You say to them, 'This is that.' They say: 'That's fine. Now we want to sign off to say that we are not possibly guilty of any tax avoidance.' Then you go into all of that debate with them.

Senator BERNARDI—The current withholding tax in regard to these investments ranges from 29 per cent to 47 per cent.

Mr Speed—Perhaps if I could explain that because it is a little complicated. Foreign investment in Australia in this sort of fund started in 2000. The provisions were so complicated that, from 2000 to 2003, virtually no foreigner who came through a custodian paid tax enlisted property trusts, because the system did not work for a whole series of reasons. One of the problems that Treasury have—and you will hear from them—is that there is no real experience in relation to this problem and, therefore, for the first time foreign investors are being told with certainty that 30 per cent will be withheld on their investment from 1 July.

CHAIR—It was almost impossible to identify what the entities were?

Mr Speed—Not only was it impossible to identify the entities—you are right, that was one problem—but also there was a massive problem when you invested through a custodian, because you did not know whether or not division 6 of the tax act applied. The result in practice was that on most occasions custodians did not withhold the tax. So from 2000-03 you had the build-up where foreigners, generally speaking, paid no withholding tax in Australia.

Senator BERNARDI—Due to compliance.

Mr Speed—Due to compliance and the mess of the provisions. It is not the fault of Treasury; it is not the fault of the tax department.

Senator BERNARDI—This bill offers some immediate clarification and—

Mr Speed—No question.

Senator BERNARDI—It is positive.

Mr Speed—It is very positive.

Senator BERNARDI—Explain to me the retail sector. You have real estate investment trusts or, as they are called in Australia, listed property trusts such as Westfield, the GPT Group, Mirvac and Stockman. You also have unlisted property trusts in various things, which are known as managed funds. Foreign investment in this country in any listed entity has grown significantly over the years. Companies issue fully-franked dividends. It is taxed at source at 30 per cent and then it is up to the foreign shareholder to determine what they do with those franking credits. Why should your listed property trust industry be treated any differently from other companies in that regard?

Mr Speed—I think the answer is that we are asking to be treated as a look-through vehicle—and look-through vehicles are treated basically the same way throughout the world. We are not asking for any special treatment. It has been the policy of this government, and every government, to treat look-through passive vehicles as being look-through vehicles—that has been the policy evermore. You could say: ‘We should not have any look-through anymore. We should impose a tax in Australia of 30 per cent. All listed property trusts should be taxed at 30 per cent.’ That is an economic argument—in which case, you would wipe the whole industry.

Mr Pryke—One thing that is largely overlooked is the competitiveness that property trusts have at an international level and the way in which we now have a vast amount of offshore assets. Westfield, GPT Group and a number of other domestic property trusts have invested in offshore assets. There is roughly \$50 billion worth of offshore real estate held by domestic property trusts.

CHAIR—And growing.

Mr Pryke—The income from those assets is coming back here and being distributed—and 75 per cent of our capital is held by domestic institutions and individuals. That is flowing straight into their hands as taxable income. So our competitiveness is adding to our capacity to enhance our returns and deliver that back in the form of a taxable distribution to our investors in Australia.

Senator BERNARDI—How has your industry grown since 2003?

Mr Pryke—Off the top of my head, I think the market capitalisation in the sector around 2003 would have been less than \$100 billion, and we are now in the vicinity of \$150 billion.

Senator BERNARDI—It has grown by 50 per cent in four years. The fact that they have to pay withholding tax—

Mr Gilbert—No, that is the point—they have not been.

Senator BERNARDI—I was told before that, between 2000 and 2003, no-one was paying withholding tax.

CHAIR—Since 2004 they have been—after the commissioner’s decision.

Mr Speed—A settlement was entered into in relation to it, so the cut-off date is a little bit vague. But, in essence, it was about 2003 or 2004.

Senator BERNARDI—But it has grown by 50 per cent and they have been subject to this withholding tax regime.

Mr Speed—Over the total period.

Senator BERNARDI—But it does not seem to have impeded foreign investment.

Mr Speed—No—and that is a good question. The answer, I think, is that, for the last 18 months, during which these representations have been made, we have fielded calls from people every day, and they have thought the government was going to reduce the rate to 15 per cent.

CHAIR—Why would they possibly have thought that?

Mr Speed—I think it is the only rational conclusion anybody could come to. You just cannot come to any view. Any other view has to be extremely contrary to the policies of every other country in the world.

Mr Cooke—I think it is also important to recognise the changing nature of the investment landscape since 2003—in particular, sitting here in 2007 and looking forward to 2010. There is a worldwide structural oversupply of capital to meet the existing stock that is available for investment. There is a worldwide hunt for investment stock, and Australians have been at the forefront of that. But investors are being presented with a substantially increased choice, because other nations have embraced a weak regime—and I have mentioned the UK, Germany, Italy, Japan, Singapore, Hong Kong, Korea and others—while at the same time imposing lower tax rates on it. So, yes, the point is taken that foreign investors had limited choice, but they have increasingly had more choice. The other way of looking at it is that, since 2003, they have had more choice as to where they are going—and that will continue to be the case. For example, we have several listed property trusts in Australia whose assets are 100 per cent offshore. The question is: ‘Do I get my Japanese exposure by investing in Australia as a global investor, or do I get it by going into Japan direct?’ Tax—

CHAIR—You would not be in Japan at the moment, though, would you?

Mr Cooke—We have three Japan-only listed property trusts. There is about \$2 billion worth of deals that are publicly in the pipeline right now in addition to those. Babcock & Brown, Galileo and Rubicon are the three that are already listed. Japan is a centre. There is a significant amount of cross-border flow going on right now between Japan and Australia in this space: Japanese capital investing in and Australian trusts investing in Japanese stock. As a global investor, it should be recognised that the greatest area of growth going forward is going to be global funds. There are not necessarily going to be institutions coming in direct and via custodians but there are going to be global securities funds riding on the back of increased savings worldwide that are going to be looking to invest. Withholding tax on the basis that the income is 100 per cent distributed regularly becomes a real cost to the bottom line.

Senator BERNARDI—We have three exclusively Japanese oriented investment vehicles listed here in Australia. We are not talking about the tax regime for foreign sourced income, are we? We are only talking about Australian sourced income.

Mr Cooke—That would lead to cost capital arguments in terms of the depth and breadth of the overall market here.

Senator BERNARDI—But if someone wanted to invest in Japan they could simply come here and put their money into an Australian domiciled trust that invested only in Japan. I think Babcock & Brown have a similar structure.

CHAIR—Their investment in Japan is under that—

Mr Cooke—Perhaps then a better example might be GPT Group. I will ask Kieran to speak to that in terms of where you have assets in both.

Senator BERNARDI—I accept that, but the opportunity would exist. If it was going to be such an impediment to your business, the opportunity would exist for GPT to split that vehicle or GPT into a number of separate entities to obtain tax benefits, wouldn't it?

Mr Pryke—The big issue though is the broad credibility of our market. The offshore specific trusts, the Japan specific trusts at this point in time, are relatively small: \$2 billion in the \$150 billion. But people do exist in those because of the comfort and confidence they have in our market generally.

CHAIR—Mr Pryke, the realities are that since 2002 you have had the demerger provisions. You can do the Babcock & Brown type arrangement. Just to take up Senator Bernardi's point, we are not talking about foreign investors into an Australian fund which is investing overseas, because the sources of those returns are not taxable, are they?

Mr Pryke—No, but those funds will not be viable in this market.

CHAIR—The realities are that we are talking about purely domestically sourced income. We are not talking about the Babcock & Brown type investments in Japan. You have the ability to take up the options of Babcock & Brown, which is purely foreign sourced investment. You have had the demerger ability since 2002 to split these assets up. I understand the pre-existing is potentially an issue, but you do have the ability to demerge those assets so that the foreign investments remain isolated, on which there is no tax payable—no withholding tax, no tax payable at all. We are talking about domestic investment only.

Mr Pryke—Okay. That is fine.

Mr Speed—You are talking about domestic source investment.

CHAIR—Yes.

Mr Pryke—At GPT we have exposure to Germany, the Netherlands, France, Denmark, the United States and a number of other jurisdictions. We are able to identify that income and carve that out of the regime. The dilemma becomes: if our cost of capital is impacted by investors looking at the 30 per cent rate on our domestic sourced income and that detracts from the attractiveness of GPT as an investment, then they will look at other markets. Since 2003 it is only just developing that they have other jurisdictions they can choose to invest in that are comparable with our domestic property trust market. That is emerging. The UK have only developed their REIT legislation inside the last six months, Germany equally just in the last couple of months. These markets are going to go past us. The amount of money available for those guys to develop similar product and invest it in our real estate or other real estate is enormous. If GPT's investor base chooses to sell our stock, our domestic investors will be harmed, we will be uncompetitive—

CHAIR—But this is a mature market in Australia, isn't it?

Mr Pryke—It is an extremely mature and sophisticated market.

Senator MURRAY—Just for clarification, doesn't the recommendation of Speed and Stracey in this document accommodate your point? As I understand that recommendation, it would leave the 30 per cent intact, except for those countries where the rate is a low and flat final rate—

Mr Pryke—Correct.

Senator MURRAY—which resolves the issue you are on about, in my view.

CHAIR—Certainly there are some other issues we can talk about.

Senator MURRAY—It introduces equity where there is an equivalent.

Senator HURLEY—I think collectively you have made good points about the 30 per cent—that it is the headline rate that people look at and that gearing does occur to a significant extent with people looking to invest in Australia. Just to clarify, would there be any investors who would be disadvantaged by abolishing the deductions and going to the flat rate?

Mr Speed—Yes, a group of people who—

Senator HURLEY—The people who are getting below the 15 per cent.

Mr Speed—Yes, excessive gearers.

Mr Gilbert—We have always said that our proposal is an integrity measure.

Senator HURLEY—Would you have any feeling for what kind of percentage that would be of the current investors?

Mr Speed—I do not think we have a feeling for that, and I think it is Treasury's problem to get an accurate feeling. All one can say is that, if you have sophisticated, rational investors, they will gear so as to reduce it down to a level they want it down to, and if it is open to them then you have to expect that they will come down to 15 per cent or less. But as to what percentage, I think no-one honestly will know the answer to that for three or four years because we do not have the track record to know because of the difficulties prior to now. So I do not think anyone can actually give you an answer except to say that, rationally, you would expect them to gear.

Mr Cooke—To supplement that, anecdotally, in speaking to the investment banks and others who are advising the institutions that are coming in, I can put it in the negative: none that they were dealing with were not gearing. No-one was coming in with 100—

Senator HURLEY—No-one was not gearing.

Mr Cooke—Nobody was not gearing. That is a statement I could make after speaking to all the major investment houses. It was a double negative, admittedly, but what I was trying to do was to be as accurate as possible in saying that, having spoken to all the major investment banks who are advising the institutions coming in and also the law firms, as far as that goes, none of them were not gearing. All of them were using some level of gearing—all of them.

Senator HURLEY—I know this is difficult, but would it be a conservative assumption to say that the gearing rate is about 45 per cent?

Mr Cooke—Australia's legislation will allow you to go to 75, and this is the irony, I guess, at one level. The system promotes the use of gearing.

Mr Speed—Perhaps if I could explain it this way: the investor usually has \$10 million to \$100 million to invest. It is easier for him to structure it so that it comes in via a loan. So it is not gearing like going to the NAB to ask for a loan; he is effectively using his own funds. So it is not like saying, 'Gee, I can do it for 40 per cent,' because as soon as he sets up his company he will do it to the maximum extent, because it is his own funds.

Senator BERNARDI—Are you advocating the abolition of negative gearing? Didn't we try that once before in this country with disastrous results?

Senator HURLEY—Be fair—we didn't interrupt you mob.

Senator JOYCE—Can I come back to that?

CHAIR—If you could just take a note of that, Senator Joyce, I will come back to that.

Senator JOYCE—Yes, I would like to come back to that.

Senator HURLEY—I have one further question, and this is just to make it crystal clear. In your view, that costing of \$100 million a year to lower the rate to 15 per cent would not be accurate given the circumstances regarding the kind of investment?

Mr Speed—The \$100 million, as we understand it, assumes no gearing, so we say: if you look at any national gearing it will come down to effectively the same as having a tax rate of 15 per cent.

Senator JOYCE—Following up one of Senator Hurley's points, which she put so well: are you saying that a foreign entity can basically contrive a platform by which they turn their equity position into a debt position so as to attain the tax deduction to cover themselves for the 30 per cent withholding tax? They are basically turning their equity position into a debt position. Are you aware that that happens?

Mr Speed—If you are not careful you will get me talking about Qantas and private equity—

Senator JOYCE—That is exactly what I want to get you to do!

Mr Speed—which I will go for two hours on!

CHAIR—Mr Speed, I make you a promise that you will not be addressing Qantas and private equity because Senators Murray and Joyce will have us here until five.

Senator JOYCE—Are you aware of that situation? I know it exists; I just want you to say it for the record.

Mr Speed—I can answer it in two ways. I can tell you what the marketplace is doing. It is doing two things. One, it is gearing, in your sense, in a contrived fashion. I do not use the word 'contrived', but it is gearing internally, as we call it. The latest development is that you are now having hybrid instruments coming into Australia. Hybrid instruments are converting a distribution which is subject to 30 per cent tax and calling it 'interest', because that is what rational people do.

Senator JOYCE—‘I will butt up against the thin capitalisation rules and then I will start hitting you with fees: I will get it out of you.’

Mr Speed—Exactly.

Senator JOYCE—Thank you very much. We will use that for that other inquiry!

Senator BERNARDI—I have one question for clarification, and I think it is for you, Mr Speed. You referred to pension funds and specifically a Dutch pension fund. That was just an example of how, because they pay no tax in their country, they are ineligible to claim the tax back.

Mr Speed—Correct.

Senator BERNARDI—Because there is no benefit to that.

Mr Speed—It is not like an imputation credit where we get a refund here in Australia; it is a different system.

Senator BERNARDI—I understand. Don’t most managed funds pass on tax paid to the individual, or they give a credit for the tax that has been paid anywhere in the world to their individual unit holders?

Mr Speed—They do. So if it is Westfield and it has paid US tax it gets passed through to the unit holder. That is correct.

Senator BERNARDI—In the case of your Dutch pension fund, the individual unit holder would get the same credit for any withholding tax in Australia?

Mr Speed—The credit is no use to you unless you have taxable income to match it against. You have to have a tax liability. Because it is a different system to Australia’s you have to have a taxable income you can match your credit to. They do not have any taxable incomes to match it against and they do not get a cash refund.

Senator BERNARDI—It is a pretty broad statement to say they do not because some of them may.

Mr Speed—They do not.

Senator BERNARDI—They may. If you are the beneficiary of a pension you may still have other income—

Mr Speed—It generally stops at a pension fund; it does not track through below the pension fund.

Senator BERNARDI—That was my question. Is it passed on to unit holders individually?

Mr Speed—It goes from property trusts to unit holders, which is a pension fund it does not track below.

Senator BERNARDI—That was my clarification.

CHAIR—I take you to a comment you made in answer to a question from Senator Bernardi about the 50 per cent inflow of funds over the last three years since the commissioner’s accommodation regarding the 30 per cent. You indicated that that money was

coming in premised on a 15 per cent rate. Has the government ever made any announcements about consideration of a 15 per cent rate?

Mr Speed—Perhaps I can answer you this way—

CHAIR—No. Can you answer my question? Has the government ever given any indication that it would accept a 15 per cent rate or that it was contemplating a 15 per cent rate?

Mr Speed—The answer to that is yes.

CHAIR—When was that?

Mr Speed—It appointed the Board of Taxation to look at it. The Board of Taxation recommended that there should be reciprocal rates of 15 per cent. The investors overseas were fully conscious that normally this government follows the Board of Taxation's review. It is true that this government did not say, 'We are going to follow that recommendation.' But it is true that it said of the Board of Taxation that it recommended the 15 per cent.

CHAIR—But the Board of Taxation was not set up to comment on a 15 per cent rate, was it?

Mr Speed—The Board of Taxation was set up exactly to do that. The Board of Taxation—

CHAIR—On the 15 per cent rate?

Mr Speed—The Board of Taxation was set up to work out how you should tax listed property trusts. It said listed property trusts should be dealt with on this basis, and it should have a withholding tax—so tick that off. Then it said: how should we deal with the rate? It said expressly the rate is 15 per cent.

CHAIR—But the Board of Taxation did?

Mr Speed—Yes, and I can give you the quote.

CHAIR—I know. I have got the quote; it was in your document. But did the government's brief to the Board of Taxation mention anything about the consideration of a 15 per cent rate?

Mr Speed—You are testing my memory. I cannot tell you. But what I can tell you is that it asked the Board of Taxation to review how listed property trusts should be taxed.

CHAIR—Which is an entirely different matter, with the greatest respect, Mr Speed. I am happy for that to be taken on notice, or Treasury might know. I suspect that the Board of Taxation was not given a brief to consider 15 per cent. On that basis, I am afraid that your comment—that the funds have been flowing in over the last three years following the commissioner's accommodation of a situation that did need addressing—does not stand up to any scrutiny. I put to you the fact that a 30 per cent withholding tax has not in any way impacted on the inflow of funds, because there has been a rapidly increasing amount of investment into foreign property.

Mr Speed—If you are asking me the question, 'Should the government be somehow embarrassed by the situation?' I am not putting to you that the government should somehow be embarrassed—

CHAIR—I did not put to you at all that the government would be facing embarrassment.

Mr Speed—No, but if somehow—

CHAIR—Please don't—

Mr Speed—Perhaps if I could answer your question—

CHAIR—Please don't comment like that.

Mr Speed—Perhaps if I could answer your question as you have dealt with mine. The situation is that when having the Board of Taxation make that recommendation foreigners were quite conscious that the government did not have to follow that, and the government did not suggest that it was going to follow that. The government did not leave people to believe it. I would not put that to you.

This government did not say, as a result of that recommendation, 'It will be followed.' It was silent; there is no doubt about that. So a foreigner cannot say the government misled him. There is no basis for saying that whatsoever. However, I think it is fair to say that a lot of people overseas thought as a result of that that is how the government would do it. I wouldn't put it any higher than that.

CHAIR—I am sorry, Mr Speed: it is a nice way of turning around my discussions with you, but there has been no question of misleading at all. I am surprised that you have actually thrown that into the argument; in fact, I am disappointed that you have thrown that into the argument. The realities are that there has been a rapid inflow of funds in the last three years and there has been no indication—there might have been an indication commercially but from the government there has been no indication—of a 15 per cent rate. What I am putting to you is that we have seen a large inflow of funds and a quite dramatic increase in the level of investment overseas

Mr Pryke—Part of the reason for that is that for a large part of that time frame there have only been two sophisticated REIT markets in the world: the United States and Australia.

CHAIR—Absolutely.

Mr Pryke—That landscape is changing.

CHAIR—Can I put this to you. Consider if someone were to say, to support this 15 per cent proposal—I am not sure whether we are still discussing that or whether we are actually talking about this now but I will work on the basis that we are still talking about the 15 per cent proposal—this:

... greater investment would ... flow into Australia for Australian funds managers to invest globally. For example, a Japanese resident could place their funds for management with an Australian funds manager for investment in an appropriate third country market ...

The implication of that quote is that, by taking it down to 15 per cent, you would see greater investment flowing into Australia and this was an example of what might happen. The bottom line is that that Japanese investor is not paying any tax at the moment, are they?

Mr Speed—I am not sure what your question is.

CHAIR—In that example a Japanese resident 'could place their funds for management with an Australian funds manager for investment in an appropriate third country market'. They are not paying tax on that now, are they?

Mr Speed—No. That is correct.

CHAIR—To make that comment would indicate that the person who made it is unaware of what the current taxation system is.

Mr Cooke—It is important to recognise that the investor is investing in the securities of the REIT. It is not investing in the property. How that REIT is deriving its income to maximise a return to the unit holder is a different question that needs to be addressed. The taxation that applies to the Australian sourced income becomes whatever component, in the case of GPT. It might be that 60 per cent of its distribution is from Australian sourced income.

CHAIR—But we talked about that before, didn't we?

Mr Cooke—Certainly.

CHAIR—The issue for GPT is the pre-existing aspect of that and how that is treated. But if they are stand-alone, if you do a Babcock & Brown or you use the demerger provisions, then you get around that issue, don't you, quite simply.

Mr Cooke—'Quite simply' would be where I would make the difference.

CHAIR—That is probably an inappropriate choice of words, but it is a commercially available option, isn't it?

Mr Cooke—Is it possible? Yes. Is it commercially viable? We would submit that it is doubtful.

CHAIR—One would assume that the government only changed the demerger provisions in 2002 because someone was requesting it.

Mr Cooke—With the greatest respect, I do not think it had anything to do with what was happening in our sector. The issue is one of critical mass for the sector, and our success has been predicated upon our ability to attract substantial amounts of capital, irrespective of source, to create that critical mass to keep things like the cost of capital down. It is that efficiency—it is our ability to create a funds management hub in the space—that will drive our future success. It is important for me to stress once more that what we are looking at is not what got us here today. We acknowledge that there are significant reforms undertaken by government that got us to where we are today. What we are talking about is an ongoing reform agenda to ensure the competitiveness of the sector in the future.

The point we are trying to make is that that landscape is rapidly evolving. There will be a sure flow of capital coming into the sector for a long time to come based on demographics and worldwide savings. Whether or not we are able to retain the competitive advantage that we have built up over a period of time will in large part be driven by the taxation rate that applies to the investor. That is why withholding tax for foreign investors on Australian sourced income becomes an important component of that. No-one is—I think it is fair to say at least we are not—crying, 'Chicken Little, the world will fall', but our position will be substantially eroded and our ability to compete internationally will be eroded. The message that a headline rate of 30 per cent sends—the signal that it sends to an investor, irrespective of their ability to structure in—will dampen our competitiveness.

CHAIR—Why should the Australian taxpayer effectively subsidise foreign treasuries? You have the ability with the demerger opportunities, you have the ability, as Babcock & Brown have done, to set up new trusts which are exclusively foreign investment based. The ability is there. The demerger is there. The ability to set up a trust like Babcock & Brown is there. So we are actually talking about an inflow of funds into a mature Australian market. When you cut everything else away, that is what we are talking about.

If you do not choose to take advantage of the demerger availability, if you do not take advantage of the opportunity to do what Babcock & Brown has done, quite frankly that is your issue and there is no reason that the Australian taxpayer should be subsidising that. So, if you put that to one side, we are talking about investments into Australia. It is a mature market so the only outcome of that, potentially, is going to be rapidly increased property prices in Australia. The greatest beneficiary of that is going to be you. So you will actually deny the ability of Australian residents to potentially invest themselves in these areas, and you will get the benefit of rapidly increased capital gains.

Mr Speed—Your first question was: why should we subsidise foreigners? Can I answer that for you. The reason is that every other country subsidises Australians. When we invest in the US, they give a rate which is lower than ours. They subsidise us relative to their own people. It is exactly the same as under a double tax treaty. Every double tax treaty works the same way. You shake your head, but I do not think you can understand.

CHAIR—Sorry?

Mr Speed—I said: you shake your head, but I do not think I am explaining it to you properly. When you invest in a country like Japan, which has a seven per cent rate, it is subsidising Australians. Do you agree with that? It is subsidising Australians.

CHAIR—No, I do not agree with that.

Mr Speed—If you do not agree with that then you do not agree with the first proposition—that we are subsidising foreigners—because it is the same side.

CHAIR—They have a 7.5 per cent rate. You are asking us to cut our rate, so you are effectively asking us to cut our rate from 30 per cent to 15 per cent. Japan has a 7.5 per cent—

Senator WEBBER—No.

Senator Murray interjecting—

Senator WEBBER—Yes, it is 15 per cent flat.

Mr Speed—I am not asking you to do that. I am not asking you to cut anything. I am not asking you to cut it.

CHAIR—Well you are asking—

Senator JOYCE—I think the chair at the start of his conversation was right in saying that we have had an anecdotal statement that this will have a major effect on the Australian economy, even though it is already a mature market. We want some empirical evidence rather than anecdotal. I can make an anecdotal statement that it will not. Where is the empirical evidence to back this assertion up?

Senator MURRAY—But you are not a market participant and they are.

Senator JOYCE—They should be able to provide it to me.

Senator MURRAY—They have.

Senator JOYCE—Where?

Senator MURRAY—Mr Speed and Mr Pryke have both given you market evidence.

Senator JOYCE—That the market is going to suffer?

Senator MURRAY—Yes. Now you either accept that or you do not.

Senator JOYCE—The empirical statistical analysis of what we have done—

CHAIR—Where's the evidence?

Mr Gilbert—Senator, we would not be here today unless this was an issue for our members. We have statements from AMP, Vanguard, MLC and Barclays Global Investors that it is a genuine concern to this industry. We want to grow this industry in the Asian market. We are going to lose it if we do not have good, strong, competitive rates.

Senator BERNARDI—Could I suggest, Mr Gilbert, that I think you have made your points in this. I do not want to pre-empt anyone's questions, but we are going over old ground now, aren't we?.

Senator MURRAY—Can I go on to a new tack please, Mr Chair? There is not much time left.

CHAIR—Can I ask one further question.

Mr Cooke—I have just one supplement. I just want to be clear, so that it has been stated on the record, that there is an appreciation that Australia's real estate investment trusts do not derive the benefit of tax treaties, unlike companies and the like. So, Senator, to take your point about a 30 per cent franked dividend going back, the foreign investor can of course claim treaty relief. Treaties do not apply to Australia's real estate investment trusts, and that is why the 30 per cent domestic rate is so important. Under treaties the rates are always reduced for interest, dividend and royalty income—for example, with Australia's 42 tax treaty partners. We have had to focus on the domestic rate here because of legal technical issues, which I will not bore you with, about the status of trusts under treaties. We rely upon the domestic rate setting. So, to be clear, I just want to make sure that that is at the front of everyone's mind.

CHAIR—Mr Speed, can I just go back to your comment about Japan. We are not asking Japan to alter their rate, are we?

Mr Speed—No, but what we are saying is that we will have a different rate to Japan—'You, Japan, will treat our investors, Australians, one way, but when the Japanese come here we will treat you differently. That is the difference. So, in that sense, you asked me, 'Are we subsidising?' and I was explaining that effectively Japan is subsidising Australians and we have to reciprocate.

CHAIR—No, I did not say that. You used the word 'subsidising'. I said we are effectively providing a tax cut—

Mr Speed—But you used the word 'subsidising'.

CHAIR—to foreigners by transferring, potentially, the taxing right out of Australia to foreign treasuries.

Senator MURRAY—But we do that all the time.

Mr Speed—That is the way double tax treaties work.

Senator JOYCE—We should not.

Mr Speed—But we do.

Senator MURRAY—They are double tax treaties. Of course we should.

CHAIR—They may well be, but is that any justification for doing more of it?

Senator MURRAY—Of course.

CHAIR—Why?

Senator MURRAY—That is why we do double tax treaties. It is an issue of equity. Either you are going to be a troglodyte and say, ‘No foreign investment,’ or you are going to say, ‘Foreign investors will be treated on an equivalent basis with Australian investors.’

CHAIR—But that surely is a decision made on a case-by-case basis as to how you are going to accommodate those sorts of agreements and those sorts of treaties, where there may or may not be some mutual benefit. But—

Senator MURRAY—Can I go in a different direction, Mr Chair? We do not have much time.

CHAIR—All right, you go and we will come back.

Senator WEBBER—And I have a question.

Senator MURRAY—I think this question is a useful addition—and, by the way, this is a fantastic debate.

Senator JOYCE—I am interested that you call people troglodytes.

Senator MURRAY—I apologise. You people are being properly tested, and I like that. The regime that is before us, as the witnesses have told us, is an excellent improvement. So the issue is about rates, not about the regime and the way it is managed and administered. I want to ask you about compliance costs and complexity. It seems to me we have three propositions. We have the government’s proposition of a 30 per cent headline rate, which, on the evidence you have given us, can be reduced through restructuring to an effective rate of 12½ per cent. The second proposition we have is the original proposition put in the submission, which was for a 15 per cent flat and final tax—everybody pays it, there are no arguments and no deductions, and that is it. The third proposition is that the 30 per cent rate applies unless there is a double tax treaty with another country or a reciprocal situation where the rates will be equivalent to those of the other country. Is that an accurate characterisation of the three?

Mr Speed—Yes.

Senator MURRAY—Just outline for the committee the respective compliance costs and complexities which affect the investor with respect to all three. Let me give you my summation. As I understand it, with item 1, which I have outlined and which is the

government's position, you can only reach a 12½ per cent effective real rate if you restructure, create entities and put in tax returns, all of which is something any rational person would not want to do. With the second option there is none of that. With the third option you still have the possibility that, if you are not engaged with a country where there is a tax treaty or a reciprocal arrangement, you are going to have to go through that first. So it seems to me the original proposition you put before us is the cleanest and most effective from a compliance, cost and complexity point of view. Is that an accurate summation?

Mr Speed—That is completely accurate. The others are put as alternatives so that you can understand the 15 per cent. What you say is 100 per cent accurate.

Mr Cooke—I will supplement that, because what we have given you is an industry answer. We have also had this exact conversation with the Commissioner of Taxation. We specifically put the question to the commissioner: 'Would you prefer a flat and final withholding tax regime to administer or would you prefer the retention of a non-final regime?' I indicated to the commissioner that I wanted to be able to make a statement in the public domain about that. He was adamant that he would prefer a final withholding tax regime. So you have both industry in terms of the people involved in administering it and the government's own ATO unanimous in their support of a final withholding tax regime.

CHAIR—We are having a very spirited debate about something that I do not think we are all going to end up wanting to get anyway.

Senator WEBBER—This really has been a fascinating debate. First of all, Mr Gilbert, I have a question from my friend Senator Stephens, who has had to rush off to another meeting. She noticed that you mentioned in your opening remarks that there was new research being completed in the near future. She was wondering when that would be available and who was doing it.

Mr Gilbert—That is being done by Lateral Economics. It is looking at the global impact on GDP of a growing financial sector and an exporting financial sector. It should be available in the next week. I also alert the committee to the fact that we are also doing further research which should be coming out in the next month to inform the parliament.

Senator WEBBER—I am sure Senator Stephens and the rest of us would be most keen to read what research you have available before we debate a bill.

Mr Gilbert—Absolutely.

Senator WEBBER—That would inform our deliberations, I am sure.

Mr Gilbert—UBS will also be releasing some material next week on the same issue. They are an investment bank that is dealing with overseas customers and clients, and it is concerned about this issue. It is going to be putting out material as well, which I think will be deadset, anecdotal and market based material.

Senator WEBBER—I must admit this is a market that until this morning I had not given a great deal of thought to. But I am sure all of us here want to try and maintain the sustainability of the Australian market as much as possible. Senator Ronaldson has referred to the Australian market as being a mature market. I was particularly taken with your comments about the development of the market in the UK and Germany and the taxation regimes there,

the anticipated size of that market and the impact we think it will have on investment in Australia. Can I get some comments on that?

Mr Pryke—The UK market, in the space of some six to nine months, is now the third largest in the world. German REIT legislation has only just emerged; it is the largest economy in continental Europe. Our guesstimate is that it has the potential to be fourfold the size of the Australian market in a relatively short period of time. These are all factors where it is hard to gather empirical evidence about what it will be, what the investment community's approach to those markets will be. Our market has a fantastic advantage in the level of sophistication, the quality of management within it, the transparency that exists within the way real estate has been securitised here, but other environments are catching up very quickly. As to the headline withholding tax rates, if I am a fund manager sitting in New York and I am looking at a real estate exposure on the global stage and I have a choice to invest in Australian property trusts or emerging UK REITs, or in Germany or Korea—and as I understand it India is emerging with REIT legislation and there is talk of China and a whole raft of places—I simply look at the table in the submission in terms of relative withholding tax rates and say, 'Gee, Australia smells hard; I will look somewhere else.'

Senator WEBBER—Particularly when you are looking at developments in Europe, there would not be the other impacts in terms of concerns about some of the developing markets in Asia in terms of legislative framework.

Mr Pryke—You are seeing much easier cross-border capital flows. There is no question about that. From our perspective, our issue is maintaining our cost of capital, keeping our industry competitive in that global environment. The issue there is: if I have got offshore investors in our market and they can move their capital anywhere else in the world that they choose on a given day, the simple fact of having more sellers than buyers in a market on a given day is that the value will decline, we will become less competitive and other markets will be the beneficiary of that.

Mr Cooke—The alternative scenario, which is a completely legitimate one, is that if the cost of capital rises here the primary listing moves. If you think about a globally integrated real estate market in Australia, where 40 per cent of your share registry is sitting offshore and 60 per cent of your assets are sitting offshore, the compulsion to remain within Australia as your primary listing disappears, particularly if barriers are thrown up to maintaining it here. As I keep stressing, in an environment where 100 per cent of the income is distributed regularly, tax is a real barrier.

Senator WEBBER—Thank you.

Senator BERNARDI—I have one last question for you, Mr Cooke. You mentioned treaties. In reading the document that was given to us this morning, I see that the final recommendation is that foreign investors are afforded the same reciprocal basis as the foreign country's tax treatment of Australian residents. Whilst I am sympathetic to that sort of proposal, it has a big hole in it in that some countries really do not have a tax regime of any substance. Whilst none of the ones that you are referring to here, such as the UK, the US and the Netherlands, are seen as open havens for tax evasions, it is a very big loophole to afford foreign investors the same rights as Australian investors.

Mr Cooke—The saving grace of that, of course, is the fact that the Australian government has chosen to negotiate a double tax agreement with that nation to ensure that. So what we are saying essentially is that, where the Australian government has enough confidence in the integrity of another nation to enter into a double tax agreement with that nation, that is the scope to which our measure would apply.

Senator BERNARDI—Which comes to the point that it would mean establishing a range of tax treaties or encapsulating this type of distribution with our existing tax treaty countries.

Mr Cooke—To clarify our submission—because this is unfortunately where we have to be a little bit technical for a minute—we have 42 double tax agreements in place at the moment. Interestingly, we are renegotiating Japan at the moment and asking them to reduce the rates, but every other regime globally, save Canada, uses a corporate vehicle as its primary structure for a REIT, and that corporate vehicle distributes dividends which are afforded the protection of the treaty. Because we use unit trusts as the principal vehicle, we have run into difficulties in terms of affording those vehicles tax treaty protection, save the example of the US in this particular case.

What we are saying is that, to use the UK as an example, the UK has a UK REIT; that REIT is structured as a company; it distributes dividend income to its investors; and that dividend income attracts a 15 per cent rate under the Australia-UK DTA. We would then afford UK investors in Australian LPT the same 15 per cent rate. It is mutuality on like-for-like comparable vehicles.

Senator BERNARDI—But it would necessitate elaborating or enhancing our existing treaty and taxation arrangements—

Mr Cooke—It could be done under domestic law.

Senator BERNARDI—That is something for Treasury. I get the point of what you are saying.

Mr Speed—You just put a floor in it, in the sense that—to address your concern—you would say that the rate cannot be less than 10 per cent. So you would put a floor in it.

Senator BERNARDI—I would rather see an established basis.

Senator JOYCE—You could look at the Tax Laws Amendment (2006 Measures No. 4) Bill 2006, which would be interesting. They have a great idea. What they do is make it tax free in the recipient country, or tax free in Australia, and apparently it will only cost us \$65 million one year and \$50 million every year after that. Maybe you could get the people who costed that bill to help you out. You would have a perfect argument about why you should go forward with this. At least you are leaving us with 15 per cent.

Mr Cooke—But that 15 per cent is analogous to corporate vehicles, to companies. That is what investors in Australian companies effectively pay.

Senator JOYCE—I am saying that there are two different approaches. On that thing we had the capital gains tax exemption for choses in action for any foreign company—like no tax at all. You are asking for a reduction from 30 to 15 per cent along a withholding tax. I have sympathy with you. What I do not have sympathy with is: how could we have possibly let that go through, if—

Mr Cooke—We would agree with that comment wholeheartedly.

Mr Speed—And bill No. 4 did not apply really to listed property trusts, because you are excluding real estate, aren't you?

CHAIR—I think we have rewritten the rules on tax debates today. It has been a very stimulating morning's activities, and I hope that people listening are viewing the issue of taxation far differently as a result.

Senator JOYCE—We are getting some emails. We are certainly confusing them.

CHAIR—That is the objective of these exercises! Of course, we are being very flippant. This has been a terrific debate. I appreciate the position you have put to us in this document, which we will consider. I appreciate the passion with which you have expressed your views and the rigour that has been put into those submissions. I thank you most sincerely for that.

Mr Gilbert—The feeling is very mutual, thank you, Senator.

CHAIR—We would be very happy for you to stay and listen to Treasury's comments on the matters raised.

[11.04 am]

BROWN, Mr Colin Leslie, Manager, Costing and Quantitative Analysis Unit, Department of the Treasury

CALLAGHAN, Mr Mike, Executive Director, Revenue Group, Department of the Treasury

LE, Mr Alexander, Policy Officer, Department of the Treasury

CHAIR—Mr Callaghan, have you been listening to the discussions this morning?

Mr Callaghan—Yes.

CHAIR—If colleagues are happy, I think it is probably best if we ask you whether you have any comments on the matters that have been raised by the Property Council this morning or indeed comments made by senators. Then I will throw the meeting over for senators to ask you some questions as well.

Mr Callaghan—The only comment I would make is that, as came out in the discussion this morning, the objective of this schedule is to simplify and streamline the existing withholding tax arrangements. It does replace multiple regimes and multiple rates with a more efficient collection mechanism regime and a single rate. The object is one of simplifying and providing more certainty and reducing compliance costs.

Senator MURRAY—And you were rightly complimented on that.

CHAIR—Are there any further matters, Mr Callaghan?

Mr Callaghan—No. We will take questions.

Senator JOYCE—We had some disturbing information this morning. We found out that there are entities constructed overseas that turn equity into debt to get around tax. Were you aware of that?

Mr Callaghan—As we discussed during estimates on Tuesday, a major focus is ensuring that you have a correct debt-equity treatment in your tax laws to try to ensure that instruments that should be treated as debt are treated as debt. We do have quite robust debt equity provisions in our law but, as we also discussed, there are things we are watching closely. We are monitoring developments and what is happening overseas in terms of reviews of this very matter.

Senator JOYCE—When I posed the question, Mr Cooke answered the question with laughter. I imagine he was telling me something that was quite obvious—that these people are quite proficient at constructing entities that turn equity into debt so as to get the negative-gearing aspirations clearly put forward. Are there other mechanisms that could be of concern to Treasury in your income-earning capacity?

Mr Callaghan—I am sorry; I am not with you.

Senator JOYCE—To get around tax.

Mr Callaghan—The debt-equity issue is a much broader issue than we are talking about on the measure here but it is one where we do have to have robust provisions in our law to

ensure that, with the development of hybrid instruments, only the debt instruments that are truly debt instruments are ones where you can claim the interest deduction.

Senator JOYCE—There is concern, obviously—that has been expressed by Treasury—that we are taking withholding tax from 30 per cent down to 15 per cent or whatever. However, I do not understand the logic of Treasury that we would have a concern with that but we do not have a concern with giving capital gains tax exemption to foreign entities who purchase and sell non-real property assets in Australia. I am referring, of course, to the Tax Laws Amendment (2006 Measures No. 4) Bill 2006, which gives capital gains tax exemption to foreign entities who invest in Australia. How can we give one person a rate of zero—and that was voted for and supported by Labor, by the way—and then have a problem with a bill reducing withholding tax from 30 per cent to 15 per cent?

Mr Callaghan—Are you asking me to comment on government policy on these matters? I can discuss the costings arrangements for them, but, if you are asking me to comment on government policy, that is the government policy.

Senator JOYCE—Okay. I will put it in technical terms. Is the tax loss from the deduction of the withholding tax greater than the tax loss from the capital gains tax exemption provisions that have been given to choses in action of non-real property assets?

Mr Callaghan—If you are looking at the dollar amounts, yes, they are different. I can explain how they are derived. I think that is the best contribution I can make.

Senator JOYCE—Which is the greater?

Mr Callaghan—On the public record the Treasurer has indicated that the proposal to reduce the withholding tax rate on distributions from managed funds from Australian real properties has been costed at \$100 million. That is greater than what is now the implemented law dealing with the CGT.

Senator JOYCE—You believe, from your investigations in the taxation department, that that is correct?

Mr Callaghan—The \$100 million is our best estimate of what the costs would be of reducing the withholding tax rate to 15 per cent.

Senator JOYCE—And you believe that that is greater than the capital gains tax exemption measure?

Mr Callaghan—The dollar amount is bigger.

Senator JOYCE—That is very interesting.

Senator HURLEY—I would just like to continue on that topic. Does Treasury have any information about how much withholding tax is paid overseas by funds managed in Australia?

Mr Callaghan—That measure is not published separately. It is all caught within the total withholding tax measure, which is published, but it is not broken down.

Senator HURLEY—Are you able to give me that figure?

Mr Callaghan—I do not have it. It is not published.

Senator MURRAY—Has Treasury decided that?

Mr Callaghan—In terms of doing a costing—and a costing has been announced—we do estimate what the base is.

Senator HURLEY—But you are not able to give it to me?

Mr Callaghan—No.

Senator HURLEY—You referred to the \$100 million that you estimated was the cost of reducing the tax from 30 per cent to 15 per cent. What assumptions did you make in arriving at that figure?

Mr Callaghan—Going straight to the point which was discussed this morning, the key assumption is one of gearing. In that estimate there is no allowance for gearing. The reason for that is that we estimate it on the evidence we have in front of us. As was discussed this morning, if a foreign investor gears, if they want to claim the interest deduction they would have to lodge an Australian tax return. Very few foreign investors lodge an Australian tax return. As was pointed out, while there were difficulties in the collecting mechanism for a number of years, we have had withholding tax of around 30 per cent. For some foreigners, it has been higher. There has been a substantial inflow of foreign investment into Australian property trusts over this period, and they have not been lodging Australian tax returns. So it is not a prudent assumption to say that, all of a sudden, there would be a substantial increase in gearing and a substantial increase in lodging Australian tax returns, because that is not the behaviour we have observed.

I note that, in IFSA's submission to the committee, they attached a submission that they had put to Treasury in 2006, which advocated the introduction of a uniform withholding tax rate of 30 per cent. It pointed out previous problems in that there could have been the application of the not quoting a tax file number withholding rate, which is the top personal marginal tax rate, currently 46.5 per cent. They said that, even if that was applied, the foreigner could get the money back if they lodged an Australian tax return. They said foreigners would not be lodging Australian tax returns, even to get that money back. On the actual evidence we have heard and on the concerns that have even been expressed this morning that foreigners do not bother to lodge Australian tax returns, it was not a prudent assumption to say that there would be a substantial increase in the lodging of Australian tax returns to claim the interest deductions from gearings. So, as I said, we based it on the evidence we have before us.

Senator HURLEY—First of all, if the evidence is that foreigners do not appear to want to lodge Australian tax claims, does that not support the contention that, if you want to grow this particular market, it is better to have a flat effective tax rate than have the 30 per cent and make people lodge returns if they want to reduce their effective rate of tax?

Mr Callaghan—Again, as was discussed this morning, even though there have been withholding tax rates ranging from 29 up to 45 per cent, over this period there has been substantial inflow into Australia, so in that assessment of how competitive the rate is you can look at the evidence occurring now. On whether foreigners want to lodge the income tax return: of course that choice is always there, but I think you would look at the evidence that was discussed this morning of what we have seen in terms of the inflow of investment into Australian property trusts, notwithstanding the existing withholding tax arrangements, and then make a judgement on the competitiveness of the Australian property trusts. As was also

pointed out this morning, the withholding tax rate only applies to returns on Australian real property; it does not apply to the returns that come from Australian property trusts investing offshore. And, as discussed this morning, it is a mature market—over 70 per cent of Australian commercial property now is already securitised. The property trusts have indicated that it is difficult looking for expansion of real property in Australia. Their focus of activities is overseas. So, if the focus of activity is overseas, the returns that come from those investments overseas flowing through Australian property trusts to foreign investors are not subject to withholding tax.

Senator HURLEY—But you would not want to cut off an expansion of the Australian investment, would you? Even though you say it is difficult to obtain, you would not want to put a cap on it?

Mr Callaghan—Of course no-one wants to cut it off.

Senator MURRAY—Or cap it.

Mr Callaghan—Or cap it, of course.

Senator HURLEY—Do you accept the point then that the nature of the market is changing—

Senator MURRAY—Are you moving off costings?

Senator HURLEY—Yes.

Senator MURRAY—Could I follow on on costings before we leave that topic. Mr Callaghan, the explanatory memorandum says:

This measure is expected to increase revenue by \$10 million in the first year of its application. Thereafter, the measure is expected to increase revenue by \$15 million per annum.

Your evidence is that, if the 15 per cent flat and final withholding tax proposition were accepted, it would result in a reduction of \$100 million. What we are missing of course is the figure that you raise now, and you are not prepared to provide that?

Mr Callaghan—It is not published—a detailed breakdown.

Senator MURRAY—Yes, so it makes very difficult for us. The question I want to put to you is as follows. The evidence we had was that, at best, if you restructure, gear, create entities et cetera—whatever mechanisms you use—you could get down to a 12½ per cent real effective tax paid. And of course a 15 per cent flat and final tax is above that. So it seems to me that, if you are saying there would be a \$100 million loss, in reality most participants are paying a real withholding tax, after deductions, of way above 15 per cent. That is right, isn't it?

Mr Callaghan—That is right.

Senator MURRAY—So very few people—which I think is also your evidence, because you say very few put in tax returns—are structuring and gearing themselves to get down to 12½ per cent. Is my logic correct?

Mr Callaghan—Yes.

Senator MURRAY—So will you be able to track the effects of your changes? It seems to me that, on the one hand, we have a much improved regime, which the witnesses rightly complimented you on, and that must have real benefits for market participants. On the other, they are arguing that the 30 per cent headline rate will be a disincentive. How will you be able to monitor whether or not it is a disincentive—whether or not it is having a dampening effect? That is what I am concerned about. If we take the chance as a parliament and as a government—and I do not talk of myself as a government—of going with the government's policy and it has a dampening effect, how soon would we know, and how soon could you react?

Mr Callaghan—I think what you would be looking at is essentially the attractiveness or the flow of foreign investors into Australian property trusts. Of course, it is not going to depend solely on the tax regimes. As we know, in any flow of investments around the world, investors are always looking at after-tax returns and are also looking at other elements, including regulatory environment, certainty and a whole range of other elements. So, like everything, I think you would be looking at the overall competitiveness. It is going to be in terms of: is it attractive, is it attracting returns, interest and investment? But it is not just tax, and I think that if we look—

Senator MURRAY—I understand that. My question is: how quickly could you pick up the sensitivity?

Mr Callaghan—It is as good as the data comes.

Senator MURRAY—How frequently do you get that data?

Mr Callaghan—I am not sure, but certainly the industry itself would be picking it up immediately; it would have the information on the capital that is flowing into it. But we would be looking at more general aggregate data. It is like an annual event, I would imagine, but I have not got the details.

Senator HURLEY—We heard evidence that, when pension funds gear, they often do so through a wholly owned subsidiary company. Would you have picked that up in knowing whether the original company is lodging an Australian tax return?

Mr Callaghan—We know when they lodge. We get the information from the Australian Taxation Office if they are lodging an Australian tax return. What they are structuring, we do not know. So, in terms of whether they can reduce the effective rate, it is all dependent on them—

Senator HURLEY—No, I am not talking about the effective rate; I am talking about you picking up whether the pension funds are gearing.

Mr Callaghan—It is irrelevant. All we would be looking at is whether they are lodging an Australian tax return to claim a deduction. As we are saying now, very few foreigners lodge Australian tax returns to claim deductions. The argument—and one thing that can be the concern with a non-final withholding tax—is that foreigners do not like it; they do not want to lodge returns. The argument on gearing and a substantial increase on gearing is that all of them would have to start lodging Australian tax returns to claim the deductions.

Senator WEBBER—But if they are using a wholly owned Australian subsidiary as a vehicle then you would not know. Is that what you are telling me?

Mr Callaghan—If they are using a wholly owned Australian vehicle, withholding tax would not be relevant, because it is the Australian entity it would be going to, and then how that vehicle—

Senator WEBBER—In terms of the gearing?

Mr Callaghan—It would not be relevant.

Senator WEBBER—You say hardly anyone—

Mr Callaghan—Very few.

Senator WEBBER—Most of them do not lodge Australian tax returns. Is that in terms of the number or in terms of the percentage value of the market? I am just trying to—

Mr Callaghan—It is both; it is very few.

Senator WEBBER—So very few do that; they are an extremely small percentage of the market?

Mr Callaghan—That is right.

Senator WEBBER—Can you take on notice and advise us what the percentage is?

Mr Callaghan—That is information we get from the tax office, but we will take it on notice.

Senator HURLEY—In providing data to the committee in terms of the hundred million dollar figure and any other figure, it is obviously very difficult to assess what is going on if we do not know that base data of withholding tax paid and so on. Could you take on notice whether you could provide that to the committee?

Mr Callaghan—Certainly.

Senator HURLEY—I go to that question about the changing nature of this kind of market and the evidence we heard earlier this morning, which was that other countries are now entering this trust market and that the tax regime seemed to be much more attractive than the Australian regime. You have been talking about historical records and how you view that. Do you accept that the market is changing rapidly?

Mr Callaghan—It always is—yes, indeed.

Senator HURLEY—Did you factor that into discussion about what the withholding tax rate should be?

Mr Callaghan—You are asking me to comment on government policy.

Senator HURLEY—No, I am asking whether that kind of information was provided.

Mr Callaghan—I can relay the factors that we looked at in terms of doing the costing that went on the public record and comment on the other factors that were discussed this morning about the flow of funds from foreign investors into Australian property trusts which is taking place now. Yes, other countries are introducing their retail property trust sector. Many of them

are pointing to Australia as an example to follow. There are developments overseas that we are observing and monitoring.

Senator HURLEY—I guess that goes back to Senator Murray's point about how quickly you can respond if it does appear that the market in Australia is stalling or even losing funds because of that.

Mr Callaghan—That is something that you would be monitoring to see what is occurring. As I say, it does not simply come down to tax. Looking at the reports from the retail investment trusts—the world reports that the accounting companies put out—in terms of rates of return, in Australia in 2006 the return was about 18.5 per cent. It was the third highest. As I recall, South Africa and New Zealand were relatively very small. Part of the attractiveness of investing in retail property trusts in Australia is the overall rate of return, the overall performance, the overall performance of the economy et cetera. Investors would take into account the after-tax rate of return, not simply the tax rate. That applies when looking at any type of international competitiveness. You are looking at a range of factors. When looking at the flow of investment that is coming into Australian property trusts there could be a range of factors. It could depend on the state of the economy. A range of developments are occurring.

Senator HURLEY—What you are saying there, I guess, is that, while our rate of return is high, the government might as well gouge out as much tax as it can.

Senator WEBBER—You said that the developing markets were modelling themselves on the structure of our market, but they are not modelling themselves on our taxation regime, are they? They seem to have opted for a lower level.

Mr Callaghan—Just commenting on the international comparisons, I think what has been quoted this morning is 15 per cent. Looking at different structures overseas, you are not always comparing like with like. We have different organisational structures, different regulatory structures. When we look at the withholding tax arrangements we find that in Canada there is a 25 per cent withholding tax on foreign distributions but it is reduced in double tax treaties, generally down to 15 per cent. In the United States there is a 30 per cent withholding tax on distributions from estate investment trusts but it is reduced to 15 per cent for portfolio investments under its double tax treaties; so they start off much higher. Similarly, in Korea there is a 27.5 per cent withholding tax but they reduce it down in their double tax treaties. Japan has a seven per cent rate but it is scheduled to increase to 15 per cent after 1 April 2008. It only applies to listed property trusts. For unlisted property trusts it is 20 per cent. In Singapore, listed REIT is subject to 10 per cent, but this is temporary; it is scheduled to return to 20 per cent on 18 February 2010. So I think we have to be careful of these international comparisons.

Senator MURRAY—Are these headline rates or flat rates?

Mr Callaghan—I am not sure.

Senator MURRAY—Can you come back on that, because it is important information you are giving us. That is a very material difference, as you would appreciate.

Mr Callaghan—I would make the point that—and I think the Property Council was saying it was under treaties—when we have not negotiated treaties, Australians investing there would be paying that higher rate. It is not just 15 per cent flat.

Senator MURRAY—I know you cannot comment on the policy side of it, but can you just clarify for us: the third proposition given to us—there were two before us and now a third has been given to us today—is that essentially the 30 per cent would apply unless there is a double tax treaty or a reciprocal arrangement. If the parliament were to follow that route, would it be necessary to put an amendment to the legislation saying that that would be the case, or is it automatically the case?

Mr Callaghan—From my understanding, I think it is premature. It is a policy decision for the government. If it chose—

Senator MURRAY—I am talking about the technical aspects.

Mr Callaghan—The way it normally goes is that you negotiate the double tax treaties first and then you make the legislative changes necessary to implement them.

Senator MURRAY—The technical point I am asking about is: is it possible to simply say that this prevails unless there is a double tax treaty or a reciprocal arrangement agreed between the government and another body? Is that unusual technically?

Mr Callaghan—I think that would be very unusual. You always have to have the amendments for the treaty to override the domestic law. So in many respects I do not think a drafter would want to go down that route and I do not think it would be of any material effect because you do have to put in the law to implement the treaty anyway.

CHAIR—Just to confirm that point, which I thought was important, in Canada—whether they are headline rates or otherwise—South Korea and elsewhere unless you are receiving a reduced rate under a double treaty arrangement you will be paying that full amount. So in Canada's case that would be 25 per cent. In Korea's case it would be 27 per cent.

Mr Callaghan—That is right. For Australian investors—unless we have a double tax agreement with them where we have negotiated that lower rate—only the lower rate in the double tax treaty applies if that treaty has been negotiated. If it does not, they have a higher rate.

CHAIR—You said that Japan are increasing theirs.

Mr Callaghan—On 1 April 2007 it was only a temporary seven per cent. It is going to 15 per cent on 1 April 2008. As I say, it only applies to listed property trusts. For unlisted trusts it is 20 per cent. Like all things, in the case of Japan if a foreign investor owns more than five per cent of a listed REIT then any capital gain is subject to Japanese tax at 30 per cent. So there are a lot of details in international comparisons. You have to look at those if you are comparing like with like.

Senator WEBBER—Including, as you are going to take on notice, establishing whether it is a flatline or a headline tax. Not knowing that makes it very difficult to make a comparison.

CHAIR—I do not know if that is necessarily right.

Senator WEBBER—The regime we are talking about here is very different to a 15 per cent flat tax.

CHAIR—I appreciate that the numbers might be different, but I do not know whether the principles of what can occur in Australia with effective rates makes that a reasonable argument. How long have we had these new arrangements with Japan? Are they only very recent?

Mr Callaghan—When it reduced to seven per cent?

CHAIR—No, the indication that they are going to increase it.

Mr Callaghan—I am not sure. We would have to take on notice when they announced the reduction.

CHAIR—I can only assume that it is very recent because I would have thought that the Property Council or IFSA would have brought that to our attention if it had been known for some time. I would like to ask you another question. I raised with the witnesses earlier that there was the potential for an effective transfer of revenue-raising ability from the Australian Treasury, and therefore effectively the Australian taxpayer, to foreign treasuries with a reduction in this rate. I would assume that if the domestic taxation rate somewhere internationally was 30 per cent, for example, and there had only been 15 per cent collected via withholding tax then the treasury in that foreign country would have the ability to tax that entity a further 15 per cent. Would that be correct?

Mr Callaghan—Yes, I think that is right.

CHAIR—So there is a transfer of revenue from Australian Treasury to a foreign treasury.

Mr Callaghan—Where you can get a foreign tax credit—and many countries give a credit for foreign tax paid—and if Australia reduces its tax on foreigners, that is essentially a transfer to the foreign treasury, because it does not have to give as large a credit for foreign tax paid. Lower Australian tax on foreigners where the foreigner can get a credit for the foreign tax paid is lower credit and a lower burden on the foreign treasury.

CHAIR—To put it simply: you have lower revenue in Australia and potentially you have increased revenue internationally in those respective treasuries.

Mr Callaghan—Where there is foreign tax credit that is the consequence of reducing.

Senator MURRAY—Obviously, if you know what the withholding tax income is now and what the increase in income is, you would have an idea of what the average real effective tax rate is. My question is: wouldn't it be simpler from a compliance and complexity point of view if the 30 per cent headline rate were simply reduced to the flat rate which you would deem to be the rate that applies? Let me invent a figure. Let us assume that it is 22½—because I do not know what it is. That then deals to some extent with the psychological problem that witnesses outlined, which is that people are affronted by a headline rate, and it gets rid of the need for entities and tax returns and everything else because that would be the flat rate. Why don't you just simply adopt a lower flat rate which realises the effective tax rate that is operating, because that must be the assumption you had in arriving at your withholding tax number?

Mr Callaghan—I think you are going into policy issues there, Senator. We now have a range of multiple rates in the sense that the rate goes up to 45 per cent. For a large distribution to a foreign individual, the withholding tax is 45 per cent; for companies, it is 30 per cent. The bulk or the average is now very close to the withholding rate of around 30 per cent, because that is the nature of the investors coming in. In terms of your comments about the relative merits of moving from a non-final to a final, in one sense there are swings and roundabouts. It removes the need to put in an Australian tax return. Foreigners are choosing not to put in that Australian tax return now—or very few are putting them in. You are taking away the option of those who want to put them in. If they want to claim a credit it would be removing that option. There are a number of factors that you will need to take into account. It is a policy decision as to whether you introduce a final or a non-final withholding tax.

Senator MURRAY—When you say the bulk is at 30 per cent now, are you telling me that the figure we are looking for is \$200 million and that, if you reduce the rate from 30 to 15, it is a \$100 million loss?

Mr Callaghan—Costings are \$100 million.

Senator MURRAY—I think I have a more accurate figure now, thank you.

CHAIR—Thank you, Mr Le, Mr Callaghan and Mr Brown.

Proceedings suspended from 11.38 am to 11.47am

CALLAGHAN, Mr Mike, Executive Director, Revenue Group, Department of the Treasury

COLES, Mr Tony, Specialist Adviser, Department of the Treasury

WARD, Ms Linda, Adviser, Superannuation, Retirement and Savings Division, Department of the Treasury

CHAIR—The next matter we are looking at is schedule 4—Superannuation of deceased military and police. Do you wish to make an opening statement, Mr Callaghan?

Mr Callaghan—No.

Senator WEBBER—In relation to the consultation process, I was moved by the submission from the United Firefighters Union of Australia. Was there any consultation with other emergency personnel other than those listed on this proposed change?

Mr Coles—No. Essentially, the measure is there to recognise the valuable and special arrangements that apply or are faced by members of the ADF, the police services and protective service officers.

Senator WEBBER—I will not go to policy issues but is this a change driven by government to recognise that there has not been a consultation process?

Mr Coles—I would not put it that way.

Senator WEBBER—I am not trying to, in any way—

Mr Coles—I think it is just the government recognising the special circumstances of members of the defence forces and the police, and the particular risks that they face in their day-to-day service to the people.

Senator WEBBER—I do not want in any way to denigrate the particular risks that those two undertake, but it seems to me that, these days, with Australia taking a more proactive role in our region, we do put other emergency personnel in harm's way, too. We have American firefighters who come and help us here; we send ours to New Zealand. When there are things like the tsunami, we do not just send in the Police and the Army. Or take the Bali bombings: a lot of health professionals, particularly from my home state of Western Australia, were sent to try and deal with those too.

CHAIR—I think we will take that as a comment. Mr Coles obviously cannot respond to that. It is a policy matter.

Senator WEBBER—Has Treasury examined the submission from the United Firefighters Union?

Mr Coles—Yes, we have.

Senator WEBBER—And have you looked at any potential costs there may be of extending—

Mr Coles—The costs?

Senator WEBBER—this legislation to other emergency personnel?

Mr Callaghan—No, because it is a policy issue.

Senator WEBBER—Right. Well, there is not a lot I can say about that then. The amendments as they stand are not that great, yet it would seem to me that we send even fewer of the others overseas. All I can do is to give you commentary.

Senator BERNARDI—We were grateful that they were involved. The amendments are not that major; is that what you mean?

Senator WEBBER—Yes, indeed: the financial costs rather than the physical costs are not that great. So it seems to me it would not be cost prohibitive to extend it to other people that governments of different persuasions send overseas. I cannot really say more than that.

CHAIR—There being no further questions, I thank you very much, Mr Callaghan. Mr Coles can be excused, and Ms Ward as well.

[11.51 am]

CALLAGHAN, Mr Mike, Executive Director, Revenue Group, Department of the Treasury

COMLEY, Mr Blair, General Manager, Business Tax Division, Revenue Group, Treasury

CHAIR—We will now deal with schedule 8—Forestry managed investment schemes. Is there any opening statement you wish to make, Mr Callaghan?

Mr Callaghan—No, there is not.

Senator HURLEY—For my information, why was the figure for the direct forest expenditure set at 70 per cent? How was that arrived at?

Mr Comley—That was a policy decision made by government. It reflected a balance between the desire to have investment funds directed into the forestry industry and a concern about excessive fees, commissions and other things that were not flowing into forestry.

Senator HURLEY—So it was not based on any particular statistical balance or any existing—

CHAIR—I think Mr Comley has to be very careful about answering that question because we are getting onto discussion of government policy.

Mr Callaghan—It did of course come after a long period of consultation on an earlier proposal.

Senator HURLEY—I have no particular comment on this area, except on areas you cannot comment on in terms of policy and why it was not extended to other types of primary industry. So I was just wondering if there was any basis for arriving at the 70 per cent; that is all. You have no further comment?

Mr Comley—No.

Senator HURLEY—I think in the submission received from the National Farmers Federation a series of objections were raised, mostly on the basis of it not being extended to other primary industries areas. Have you any comment to make on that?

Mr Callaghan—The National Farmers Federation?

Senator HURLEY—Oh, no—it was Mr McArthur or Macarthur.

Mr Comley—We were only aware of one submission, which was jointly signed by NAFI, TIMA, TPA and A3P.

CHAIR—They were supportive, Mr Comley, weren't they?

Mr Callaghan—Yes.

Mr Comley—They seemed to say there was a workable balance struck by the legislation.

Senator HURLEY—It was a submission that was supporting aspects of it. But was there any reason why the forestry industry, apart from the policy considerations, was identified as requiring this kind of extra support?

Mr Comley—I think that is a policy decision, to support a particular industry.

Senator HURLEY—It was entirely a policy decision.

Mr Callaghan—The government made the announcement and it stated the reasons in it.

Senator HURLEY—Okay. I do not think we are going to get any further on that then.

CHAIR—If there are no other matters, that brings these hearings to a close.

Senator BERNARDI—I have no questions.

Senator HURLEY—Could I just ask a quick question about schedule 1? Is that possible?

Senator BERNARDI—Is that on the agenda?

CHAIR—No, because that was not on the agenda; I am sorry.

Senator HURLEY—That is okay.

CHAIR—I again thank the secretary and staff. It has been a very long week. For you to have had this on top of your estimates responsibilities, I know the committee is very grateful. I again thank Hansard, and I thank those departmental officers and witnesses who have appeared before us today.

Committee adjourned at 11.56 am