# Labor and Democrat Senators' Dissenting Report

## Introduction

4.1 The Government Senators' report on the Tax Laws Amendment (2007 Measures No. 3) Bill 2007 recommended that:

- when negotiating double taxation treaties, the Government considers reciprocal withholding tax treatment for distributions to foreign residents from managed investment trusts; and
- the bill be passed.

4.2 Labor Senators and the Democrats' Senator can not fully support either of these recommendations. Recommendation 1 is a fall-back position that will be very slow to implement. It is not a practical solution in a fast moving capital market. It is better that a decision be made now. With regard to Recommendation 2, the bill has 10 schedules, of which 9 are supported, but the effect of passing schedule 10 of the bill unamended would be to impose a withholding tax rate of 30 per cent.

4.3 The committee's evidence from written submissions and the public hearing supports the Australian Labor Party's (ALP) policy of having a flat and final withholding tax rather than a deductible headline nominal rate, and the rate for the withholding tax being 15 per cent. The ALP believes that imposing a withholding tax of 30 per cent would act as a disincentive to foreign investment in Australian managed funds and Australian property trusts.

## The Government's 30 per cent withholding tax is uncompetitive

### *Funds industry disagreement with the Government's proposals*

4.4 The majority report noted that most of the submissions received by the committee related to Schedule 10 of the bill. All of these submissions argued that the 30 per cent 'headline' rate of taxation is a disincentive for foreign investors and recommended a flat and final rate of 15 per cent or less. They argued that this rate was consistent with Australia's main competitors for foreign investment such as Hong Kong, Singapore and Japan.[1]

4.5 In evidence to the committee, the Property Council of Australia (PCA) and the Investment and Financial Services Association (IFSA) both argued that the 30 per cent rate was a disincentive to foreign investors regardless of the various deductions

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1 See Investment and Financial Services Association (IFSA), Submission 6, pp 5-6; the 16 May 2007 letter addressed to the Treasurer, Mr Peter Costello MP, by the Business Coalition for Tax Reform; Real Estate Institute of Australia, *Submission 2*; The GPT Group, *Submission 3*; Barclay's Global Investors, *Submission 4*; MLC Limited, *Submission 11*; and Property Council of Australia, *Submission 5*.

that may be claimed to offset it. The Property Council of Australia's submission to the inquiry stated:

> If passed, this legislation will raise significant barriers to Australia's competitiveness as a manager of global funds. It will also be harder to build on our strengths as a regional financial hub.[2]

4.6 Mr Trevor Cooke, Executive Director, International and Capital Markets Division, Property Council of Australia noted:

> 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. For that reason we support a 15 per cent final withholding tax.[3]

4.7 Similarly, Mr Robin Speed, Director, Speed and Stracey Lawyers commented:

> The issue is what the rate of tax is that should be collected and whether it should be a final tax. All other countries in the world have not taken that approach… We have seen that foreign investors—whether it is a Dutch pension fund or a UK pension fund 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...[4]

### *Gearing an administrative disincentive*

4.8 Labor Senators and the Democrats' Senator acknowledge that foreign investors have the option of lodging an Australian tax return and gearing their investment to lower the 30 per cent headline rate of withholding tax. In practice, however, the need to gear is a disincentive for foreign investors to invest in the Australian market. Mr Robin Speed explained:

> 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.'…. 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… The great bulk of people out there simply do not do that and simply tune out.[5]

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2 Property Council of Australia, *Submission 5*, p 1.

3 Mr Trevor Cooke, *Committee Hansard*, 1 June 2007, p. 3.

4 Mr Robin Speed, *Committee Hansard*, 1 June 2007, p. 4.

5 Mr Robin Speed, *Committee Hansard*, 1 June 2007, p. 4.

4.9 Mr Richard Gilbert, Chief Executive Officer of the Investment and Financial Services Organisation, agreed that deductions on the 30 per cent headline rate are 'messy, complex and not attractive to overseas investors'.[6] These investors prefer to pay the final tax rate as they do in other countries. They are investing much larger sums in other countries where they do not have to structure their affairs, and are therefore reluctant to gear the relatively small sums they might invest in the Australian real estate market.[7]

4.10 Industry representatives all argued that the combination of a high headline rate, the absence of a final rate, and perceived administrative difficulties with gearing is enough to cause potential foreign investors in Australia to look elsewhere.

***The Government's costing of reducing the rate to 15 per cent is inaccurate***

4.11 Labor Senators and the Democrats' Senator do not believe that the cost of reducing the rate to 15 per cent estimated by Treasury is accurate. No credibility can be attached to the $100 million cost Treasury estimated as it does not assume any gearing and Treasury does not appear to know how much is currently raised through withholding tax collections from non-residents.

4.12 Treasury admitted that they do not assume any gearing in their costing which, in the Labor and Democrats' Senators' view, inaccurately results in an overestimation of the cost of reducing the withholding rate to a flat and final rate of 15 per cent.

4.13 Mr Mike Callaghan of Revenue Group in Treasury said in relation to the $100 million cost:

> The key assumption is one of gearing. In that estimate there is no allowance for gearing.[8]
>
> 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.[9]

4.14 This confirms that investors do not wish to engage with the complexity and compliance cost of claiming deductions and putting in tax returns. It is also in stark contrast with industry claims. Mr Cooke of the Property Council of Australia stated 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

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6 Mr Richard Gilbert, *Committee Hansard*, 1 June 2007, p. 1.

7 Mr Robin Speed, *Committee Hansard*, 1 June 2007, pp 11 – 12

8 Mr Mike Callaghan, *Committee Hansard*, 1 June 2007, p. 22.

9 Mr Mike Callaghan, *Committee Hansard*, 1 June 2007, p. 22.

> them were not gearing. All of them were using some level of gearing—all of them.[10]

4.15 Further, when questioned on the amount of withholding tax from non-residents collected by the Government used in the costings, Mike Callaghan stated that the information:

> It is not published—a detailed breakdown.[11]

4.16 The Property Council of Australia's submission stated that:

> The Government's **approach is based on inaccurate Treasury costings**. Treasury says an internationally competitive withholding tax rate will cost more than $100 million a year, while industry says it will not impact on current revenues and could **increase tax income** over the medium term.[12]

4.17 This evidence leads Labor Senators and the Democrats' Senator to believe that very little weight can be put on Treasury's costings.

## Labor's alternative

4.18 The ALP proposes to halve the 30 per cent withholding tax on distributions from Australian managed funds to non-resident investors. This proposed 15 per cent rate is at the upper end of relevant international rates. It will place Australian fund managers in a much better position to be able to compete to manage the global pool of managed funds, which is tipped to reach $60 trillion over the next three years.

4.19 Funds under management in Asia are expected to grow by 14 per cent per year over the medium to long term. Australia is well placed to capitalise on this growth, but only if Australia lifts the competitive impediments to our funds management industry.

4.20 Australia's fund management industry is well regarded across the globe and is well placed geographically to become the financial hub for the Asia-Pacific region. A 30 per cent withholding rate could hamper the potential growth of our funds industry which is irresponsible as more funds under management in Australia mean more export dollars. The Government's uncompetitive withholding tax regime is one of the key obstacles that will be lifted under Labor's policy.

4.21 Given the complexity and compliance costs of the Government's proposed tax regime would impose, Labor will also abolish the need for overseas investors paying withholding tax to lodge a tax return and claim debt as a deduction by making the flat rate a final rate. This flat and final tax rate will remove a significant burden that has

10 Mr Trevor Cook, *Committee Hansard*, 1 June 2007, p. 11.

11 Mr Mike Callaghan, *Committee Hansard*, 1 June 2007, p. 23.

12 Property Council of Australia, *Submission 5*, p. 1.

threatened to hold back Australia's funds management industry from capitalising on the growth of funds under management in the region.

## Conclusion

4.22 Labor Senators and the Democrats' Senator do not support the Committee's recommendation that when negotiating double taxation treaties, the Government considers reciprocal withholding tax treatment for distributions from managed investment trusts. Labor Senators and the Democrats' Senator believe that for Australia's fund industry to be as competitive as possible, a flat and final 15 per cent tax should be imposed for distributions to foreign residents from managed investment trusts.

**Senator Ursula Stephens**
**Deputy Chair**
**ALP, New South Wales**

**Senator Annette Hurley**
**ALP, South Australia**

**Senator Ruth Webber**
**ALP, Western Australia**

**Senator Andrew Murray**
**Dem, Western Australia**