Investment & Financial Services Association Ltd
ACN 080 744 163

5 June 2007

Mr Peter Hallahan
Committee Secretary
Senate Economics Committee
Department of the Senate
Parliament House
CANBERRA ACT 2600

Dear Peter

Re: Schedule 10 of *Tax Laws Amendment (2007 Measures No.3) Bill 2007* ('TLAB No.3')

Thank you again for both the opportunity to address the Senate Committee, on Friday 1 June, and to engage in a stimulating and open discussion on withholding tax on distributions from managed funds.

During the hearing, a number of matters were raised which require explication, by way of an additional submission. Please find further information a number of matters below.

1. Comparative REIT withholding Rates

During the course of the hearing, it was discussed that the withholding rate imposed on Japanese and Singapore Real Estate Investment Trusts (REITs) would increase in 2008 and 2010 respectively. Ernst & Young, authors of the Global REIT Report, have now confirmed the following.

Japan
Under Japan's domestic law, withholding is currently imposed at 7% on portfolio distributions by listed REITs. It is a final tax. The 7% rate was effectively introduced as an interim measure unilaterally setting a maximum withholding at 7%, rather than wait to renew treaties.

The withholding rate will be set as a headline 15% final tax from April 2009. The 15% rate will be a maximum rate for portfolio REIT investments, as the rate may be reduced under double tax treaties.

In 2006 Japan finalised a new treaty with the UK, under which the REIT withholding tax was reduced to 5% for non-portfolio investments and 0% if the investor is a superannuation fund. Further treaties are expected to be negotiated on the same basis.

Singapore
Under Singapore law, the current rate is 10% (0% for non-resident individuals). This is a final tax.

Level 24, 44 Market Street, Sydney NSW 2000 | Ph: 61 2 9299 3022
Email: ifsa@ifsa.com.au | Fax: 61 2 9299 3198

The Singapore government has announced that, subject to extension of the current 10% rate, the rate will be the relevant corporate rate of 18% from February 2010. Singapore corporate tax is subject to numerous reductions and concessions which can bring the effective rate significantly below 18%.

The withholding after 2010 will also be a final tax, if implemented, but will be subject to reduction in double tax treaties.

2. Treasury gearing assumptions

Treasury stated at the hearing that they had made no allowance for gearing, in preparing their costings, on the basis that they were not aware that foreign investors have actually lodged Australian tax returns in the past. An Australian tax return must be lodged to obtain the gearing deduction.

Treasury also stated that foreign investment into Australia managed investment trusts made through a wholly owned Australian subsidiary "would not be relevant".

The market in Australia does not distinguish between foreign investment made directly, or made through structured foreign subsidiaries, or structured Australian subsidiaries. It is commonplace in the market for structured investments by foreign residents to be made through a special purpose geared Australian subsidiary. The Australian subsidiary will lodge a tax return to offset the managed investment trust income with gearing deductions.

Structured Australian subsidiaries are relevant to any consideration of the incidence of gearing foreign investments. Treasury is correct that the withholding tax does not apply to such structures – which is the precise reason the structure is used – but such subsidiaries are not "irrelevant" to the question of whether, and to what extent, foreign investors gear their investment into Australian funds.

The evidence from the market is that such structures are commonplace and achieve the foreign investor's goal of investing in Australian funds at an overall competitive rate of tax, once gearing and other deductions offset the tax payable on the distribution. Mr Cooke from the Property Council of Australia confirmed during the hearing that in his survey of the foreign investments made or organised through investment banks, no investment was ungeared – that is, all of the foreign investments made utilised gearing structures of some sort.

Therefore, the costing of the proposal needs to be made with the full knowledge and evidence of what is happening in the market. Gearing must be incorporated in the assumptions.

It is of note that other structuring mechanisms, such as hybrid securities and other financial instruments that convert the return from a property trusts to interest (subject to 10% withholding tax, or 0% for foreign superannuation funds), would not require the non-resident investor to lodge an Australian tax return at all.

Level 24, 44 Market Street, Sydney NSW 2000 | Ph: 61 2 9299 3022
Email: ifsa@ifsa.com.au | Fax: 61 2 9299 3198

3. Expectations of non-resident investors

At the hearings, a question was raised as to why investors had formed expectations the 30% rate would reduce to 15% on a reciprocal basis.

The terms of reference for the Board of Taxation's Review of International Tax Arrangements included specific instructions to review Treasury's Consultation Paper: Review of International Taxation Arrangements. The Treasurer stated that the review of the Treasury Paper "should form the basis of consultations to be undertaken by the Board" (Treasurer's letter to Board of Taxation, 22 August 2002).

The Treasury Consultation Paper: Review of International Taxation Arrangements included discussion of various measures to promote Australia as a global financial services centre (Chapter 4) and included discussion of internationally competitive rates of Australian tax (albeit not specifically by reference to managed fund distributions to non-residents), taking into account international tax trends (Chapter 1).

In its 2003 Report, the Board of Taxation made 17 recommendations for "Promoting Australia as a Global Financial Services Centre" (Chapter 4), including:

> "*Recommendation 4.8A:*
>
> *The Board recommends that withholding tax on net rental income of property trusts be set at a flat rate of 30 per cent, subject to treaty reduction to 15 per cent on a reciprocal basis."*

The Government adopted 14 of the 17 recommendations in Chapter 4. In his May 2003 announcement, the Treasurer stated he would "set the rate of tax on rental income distributed by property trusts to non-residents at the company tax rate" - effectively adopting the Board's recommendation 4.8A, without referring specifically to, but without rejecting, the second part of the recommendation – that the rate be reduced to 15% on a reciprocal basis. The Treasurer went on to state that the design of the legislation would be the subject of consultation with the business community.

The Government has consistently adopted at least 75% of the recommendations of the Board of Taxation. Those not adopted are typically expressly rejected. The Financial Services Centre recommendations not adopted (Recommendations 4.1(c), 4.3 and 4.8B) were expressly rejected. The 15% reciprocal reduction was not rejected.

It was therefore open to the business community, including non-resident investors, to form an expectation that the 15% reciprocal reduction was accepted as part of the headline rate, and that the 30% rate would be reduced to 15% for residents of reciprocating counties. Only the design of the law would be the subject of consultation.

Level 24, 44 Market Street, Sydney NSW 2000 | Ph: 61 2 9299 3022
Email: ifsa@ifsa.com.au Fax: 61 2 9299 3198

It is a matter for government to set the withholding rate generally at 30%. That rate might be reduced in double tax treaties negotiated after the introduction of the Bill. It is suggested that the 15% reciprocal reduction for investors in double tax treaty countries be made unilaterally in Australia's domestic law to bring Australia into line with its treaty partners now, rather than wait to renegotiate each treaty over many years.

4. Industry recommendation on the withholding tax regime

At the hearings we provided a further document setting out our suggested recommendation, which we have refined that recommendation following the hearing. Our recommendation is as follows:

> *It is recommended that the TLAB No. 3 be enacted and that the withholding tax be a flat final tax at the rate of 15% for residents in a country which has a double tax treaty with Australia and which country (whether under the treaty or domestic law) imposes a final withholding tax of not more than that rate on like distributions to Australia residents.*

The recommendation could be readily implemented in Australia's domestic law, without requiring each of Australia's double tax treaties to be renegotiated.

The *Taxation Administration Regulations 1976* currently provide (at Regulation 40), for adoption of treaty rates for withholding from dividends paid to non-residents. Please find Regulation 40 included in Appendix A.

A regulation such as Regulation 40 would require only simple modifications to accommodate the Recommendation. Withholding from managed investment trust distributions under the withholding measures in Schedule 10 of TLAB No. 3 would be subject to a final withholding tax of 15% of the net Australian sourced income distributed, if paid to an investor in a "double tax country" where that country (whether under that double tax treaty or under its domestic law) imposes a final withholding tax of no more than 15% on similar distributions from its managed funds to Australian residents. 30% withholding would apply to all other distributions.

We hope the information above is of assistance to the Committee in its deliberations. If you require further information, please do not hesitate to contact me on (02) 9299 3022.

Yours sincerely

Richard Gilbert
Chief Executive Officer

Level 24, 44 Market Street, Sydney NSW 2000 | Ph: 61 2 9299 3022
Email: ifsa@ifsa.com.au | Fax: 61 2 9299 3198

APPENDIX A

TAXATION ADMINISTRATION REGULATIONS 1976 - REG 40

Dividend payments

(1) The amount to be withheld from a dividend to which section 12-210 of Schedule 1 to the Act applies is:

(a) if an address mentioned in paragraph 12-210 (a), or a place mentioned paragraph 12-210 (b), of Schedule 1 to the Act is in a tax sharing country and the relevant international tax sharing treaty applies to the dividend -- an amount calculated at the rate provided for in the treaty; and

(b) if paragraph (a) does not apply, but that address or place is in a double tax country -- an amount calculated at the rate provided for in the relevant double tax agreement; and

(c) if paragraphs (a) and (b) do not apply -- an amount equal to 30% of the amount of the dividend.

(2) The amount to be withheld from a dividend to which section 12-215 of Schedule 1 to the Act applies is:

(a) if a foreign resident mentioned in paragraph 12-215 (1) (b) of Schedule 1 to the Act is a resident of a tax sharing country and the relevant international tax sharing treaty applies to the dividend -- an amount calculated at the rate provided for in the treaty; and

(b) if paragraph (a) does not apply, but that foreign resident is a resident of a double tax country -- an amount calculated at the rate provided for in the relevant double tax agreement; and

(c) if paragraphs (a) and (b) do not apply -- an amount equal to 30% of the amount of the dividend.

(3) However, paragraphs (1) (b) and (2) (b) do not apply in relation to a dividend that is:

(a) paid to a resident of the United States of America; and

(b) included in a class of dividends that is exempt from tax under the law of that country.

Level 24, 44 Market Street, Sydney NSW 2000 | Ph: 61 2 9299 3022
Email: ifsa@ifsa.com.au | Fax: 61 2 9299 3198