



21 May 2007

The Secretary  
Senate Standing Committee on Economics  
PO Box 6100  
Parliament House  
Canberra ACT 2600

Dear Sir

**Inquiry into the Provisions of the Tax Laws Amendment  
(2007 Measures No.3) Bill 2007**

Thank you for the opportunity to submit to the standing committee's review.

This submission addresses the bill's treatment of Australian trust distributions to non-resident trustees.

**Introduction and Solution**

1. The Government has introduced legislation that will impose a 30% non final withholding tax on earnings from real estate investment. **This is double the rate applied by other countries.**
2. 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.
3. 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.
4. The solution is to **withdraw the withholding tax component of the current bill** while a **genuine discussion** about revenue implications and opportunities takes place.
5. The Property Council proposes a **15% final rate**, with a commitment to further rate cuts in the future.

**The Voice of Leadership**

LEVEL 1 11 BARRACK STREET SYDNEY NSW 2000  
PH 02 9033 1900 - FAX 02 9033 1966 - ABN 13 008 474 422  
Email [info@nat.propertyoz.com.au](mailto:info@nat.propertyoz.com.au) - [www.propertyoz.com.au](http://www.propertyoz.com.au)

  
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*of Australia*

6. **It is critical that Treasury reveals their analysis of reform options.** It would be a **tragedy to pass legislation that hurts one of Australia’s fastest growing export industries on the basis of inaccurate Treasury estimates.**

**Background**

- 1. A fund which invests exclusively in real estate is called a REIT or Real Estate Investment Trust. Australia is one of three original REIT markets. The other two are the US and the Netherlands
- 2. **Australia’s REIT market has been highly successful.** It is the world’s second largest, valued at more than \$140bn. It holds more than \$50bn of assets offshore and has attracted more than \$40bn in foreign investment.
- 3. On the back of our success many countries introduced a REIT regime to attract investment. Today, more than two dozen countries have REITs.
- 7. **Withholding tax rates are critical to attracting and retaining foreign investment** into real estate funds. This is because, unlike companies, REITs are required to distribute all of their income regularly.
- 8. **The Government’s proposal is clearly out of step with our competitors.**

Global REIT withholding taxes (under typical tax treaty)		
Country	Withholding Rate for Portfolio investors	15% or Less
Australia	30%	X
Canada	15%	✓
France	15%	✓
Germany	15%	✓
Japan	7%	✓
Netherlands	15%	✓
Singapore	10%	✓
UK	15%	✓
USA	15%	✓

9. Foreign investors have told Australia’s real estate fund managers that if the proposed measures go forward they will reconsider their Australian investments. This response will jeopardise:

- **\$40bn in foreign investment;**

- Investment returns for more than one million **domestic investors** and every major Australian superannuation fund;
- **Australia's competitive advantage** as a funds management hub for the region; and,
- Government revenue.

## **Our Policy**

10. The Property Council recommends a final **15% withholding tax on Australian sourced taxable income distributed from a widely held REIT to a foreign portfolio investor**. A final 15% rate:
- puts Australia's withholding tax rates on a similar footing to other advanced REIT markets, in particular the United States;
  - places foreign pension funds on an equal footing to domestic superannuation funds;
  - aligns the withholding rate for distributions of rental income to dividend distributions under Australia's tax treaties;
  - is administratively efficient; and,
  - protects Government revenue.

We attach a copy of the Econtech study into the cost of withholding tax reforms that would place Australia on an internationally competitive footing.

The Property Council is keen to provide its evidence to the Senate Committee at its hearing on 1 June.

Yours sincerely



**Peter Verwer**  
**Chief Executive**  
**Property Council of Australia**  
*pverwer@propertyoz.com.au*  
Mobile: 0407 463 842

**Attached:** Budget Costing of a Proposal to Reform Withholding Tax on Property Income Distributed by Listed Property Trusts to Non-Residents by Econtech

**BUDGET COSTING  
OF A PROPOSAL TO REFORM  
WITHHOLDING TAX ON PROPERTY INCOME  
DISTRIBUTED BY LISTED  
PROPERTY TRUSTS TO NON-RESIDENTS**

This report was prepared for  
Speed and Stracey Lawyers  
by Econtech Pty Ltd.

18 April 2006

Econtech was commissioned by Speed and Stracey Lawyers to provide a budget costing of a proposal to reform withholding tax on property income distributed by listed property trusts to non-residents. This report sets out Econtech's findings. Econtech makes no representations to, and accepts no liability for, reliance on this work by any person or organisation other than Speed and Stracey Lawyers. Any person, other than Speed and Stracey Lawyers, who uses this work does so at their own risk and agrees to indemnify Econtech for any loss or damage arising from such use.

**CANBERRA HEAD OFFICE**

Econtech  
P.O. Box 4129  
Kingston ACT 2604  
Phone: (02) 6295-0527  
Fax: (02) 6295-8513  
E-mail:office@econtech.com.au

**SYDNEY OFFICE**

Econtech  
Suite 304, 66 Berry Street  
North Sydney NSW 2060  
Phone: (02) 9929-4700  
Fax: (02) 9929-4793  
E-mail: sydney@econtech.com.au

Web-site: [www.econtech.com.au](http://www.econtech.com.au)



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## i) Key Findings

- Econtech was commissioned by Speed and Stracey Lawyers to estimate the cost to the Federal budget of a reform proposal to reduce to an internationally competitive rate withholding tax on property income of Listed Property Trusts (LPTs) sourced in Australia and distributed to foreign investors.
- In May 2003 the Government announced that the rate of tax imposed on LPTs in respect of those distributions would be set at the company tax rate of 30 per cent. This rate, when implemented, would be subject to reduction under any double tax treaty subsequently entered into by Australia. The reform proposed is that rather than wait the many years to renegotiate each separate double tax treaty, Australian should unilaterally reduce the rate to an internationally competitive rate.
- The equivalent withholding tax rates that apply (or will apply) on property income of Australian investors in Japan, Singapore and the United States are only 7 per cent, 10 per cent and 15 per cent respectively. Further, the Australian withholding tax rates where the non-Australian investor is resident in a country which Australia has a double tax treaty is 15 per cent for unfranked dividends and 10 per cent for interest.
- Speed and Stracey Lawyers advise that in their opinion if from 1 July 2006 the 30 per cent rate remains, gearing will be used so that interest deductions will equal at least 60 per cent of LPT distributions to non-residents. This means that while the “headline” tax rate is 30 per cent, the average effective tax rate (after interest deductions) would be only 12 per cent. As part of the reform proposal, such interest deductions would no longer be allowed, so that the average effective tax rate would match the new “headline” rate. In that context, Econtech has been commissioned to cost the reform proposal under alternative internationally competitive tax rates of 15 and 12.5 per cent.
- Speed and Stracey advise that foreign investment in Australian LPTs stands at about \$11 billion. Econtech estimates that of this amount, about \$6.9 billion relates to Australian property assets of unit trusts, while the remaining amount relates to foreign property assets and to shares that are “stapled” to units in property trusts. Applying the current gross yield of Australian LPTs of 6.5 per cent to this invested amount, gives an annual income stream of \$450 million. Excluding about 33 per cent of this amount as “tax deferred” income, gives a final estimate for the current tax base of \$301 million.
- Applying the estimated average effective tax rate of 12 per cent to this tax base gives an estimate for annual tax collections of \$36 million. By comparison, introducing a new headline and effective rate of 15 per cent would raise \$45 million, a gain of \$9 million. Alternatively, a new rate of 12.5 per cent would raise \$38 million, a gain of \$2 million.
- The above results show the “direct” effects on the budget, and hence neglect any “indirect” effects arising from any behavioural responses to variations in the rate of withholding tax. In estimating indirect effects, Econtech has assumed that foreign investors in Australian LPTs would view a reform scenario with a readily available tax rate of 15 per cent, as broadly equivalent to the existing situation under which an effective rate of 12 per cent would only be achieved at the cost of arranging gearing. In that case, foreign investors might be content to maintain their current investment in LPTs of \$11 billion. Under this absence of indirect effects, the estimated gain to the budget under a new rate of 15 per cent, and no gearing, is confirmed at \$9 million.
- A new lower tax rate of 12.5 per cent could stimulate further foreign investment in Australian LPTs, increasing the tax base by 7.5 per cent or \$23 million. Under certain portfolio adjustment assumptions, this may displace a similar amount from the tax base for dividend income paid to foreign investors, which has a higher estimated average Australian tax rate of 24 per cent. This implies an indirect net loss in revenue from portfolio substitution of \$3 million. Combining this with the direct gain to the budget of \$2 million under this scenario, gives an overall net loss to the budget of \$1 million.

## 1) Introduction

Econtech was commissioned by Speed and Stracey Lawyers to estimate the cost to the Federal budget of a reform proposal to reduce to an internationally competitive rate withholding tax on property trust income of Listed Property Trusts (LPTs) sourced in Australia and distributed to foreign investors. Speed and Stracey Lawyers provided as background their report on “Australian Listed Property Trusts: Withholding Tax”.

The applicable withholding tax rate is presently 30 per cent<sup>1</sup>. By comparison, the withholding tax rate is only 15 per cent for unfranked dividends and 10 per cent for interest, provided the foreign investor is resident in a country for which Australia has a double tax treaty. LPT distributions, unfranked dividends and interest paid to foreign investors have the common characteristic that they are free of Australian company tax, so withholding tax is applied. Overall, the current withholding tax arrangements are slanted against foreign investment in Australian LPTs compared with foreign investment in Australian companies paying unfranked dividends<sup>2</sup>.

It is also reasonable to compare the withholding tax rates that are applied on foreign investment in Australia with the equivalent withholding tax rates that are applied on Australian investment abroad. Withholding tax rates that apply (or will apply) on property trust income of Australian investors in Japan, Singapore and the United States are only 7 per cent, 10 per cent and 15 per cent respectively<sup>3</sup>.

When the settlement presently being finalised is announced, most foreign investors will realise that tax at 30 per cent is payable on property trust distributions from Australian LPTs. Speed and Stracey Lawyers advise that in their opinion if from 1 July 2006 the 30 per cent rate remains, gearing will be used so that interest deductions will equal at least 60 per cent of LPT distributions to non-residents. This means that while the “headline” tax rate is 30 per cent, the average effective tax rate (after interest deductions) would be only 12 per cent. As part of the reform proposal, such interest deductions would no longer be allowed, so that the average effective tax rate would match the new “headline” rate. In that context, Econtech has been commissioned to cost the reform proposal under alternative internationally competitive tax rates of 15 and 12.5 per cent.

In that context, Econtech has been commissioned to cost the reform proposal under alternative internationally competitive tax rates of 15 and 12.5 per cent. A rate of 15 per cent would match that currently applied to unfranked dividends under double tax treaties. A rate of 12.5 per cent is midway between the withholding tax rates that apply (or will apply) on property income of Australian investors in Singapore and the United States and midway between the withholding tax rates that apply in Australia on unfranked dividends and interest paid to foreign investors. Table 1.1 shows the existing and alternative scenarios that are modelled in this report.

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<sup>1</sup> Speed and Stracey Lawyers, 2006, p. 69

<sup>2</sup> Franked dividends distributed to foreign investors have already been subject to Australian company tax of 30 per cent and hence are free of withholding tax.

<sup>3</sup> *ibid.* pp. 47-63



**Table 1.1**  
**Existing and Alternative Withholding Tax Scenarios**

	existing	15% tax	12.5% tax
"Headline" Withholding Tax Rate	30.0%	15.0%	12.5%
Gearing - share of FIA-LPT not subject to withholding tax	60.0%	0.0%	0.0%
Average Effective Withholding Tax Rate	12.0%	15.0%	12.5%

In modelling the reform proposal, this report assumes that the same withholding tax rate is applied to all foreign investors. It therefore does not take into account the recommendations of Speed and Stracey Lawyers<sup>4</sup> that a higher rate of 30 per cent be applied on non-portfolio investors and a lower rate of zero be applied to tax exempt investors. This simplifying assumption reflects the limited timeframe and information for this report.

The tax base for withholding tax on property trust income of Listed Property Trusts (LPTs) sourced in Australia and distributed to foreign investors is estimated in section 2. This provides the platform for undertaking the budget costing of the reform proposal in section 3.

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<sup>4</sup> *ibid.* pp. 2-3

## 2) The Tax Base

This section estimates the tax base for withholding tax on property trust income of Listed Property Trusts (LPTs) sourced in Australia and distributed to foreign investors. This involves identifying the appropriate asset base, estimating its income stream, and then isolating off the “tax deferred” component of that stream.

The first step in this analysis is to identify the appropriate asset base which attracts the withholding tax that was identified above. This withholding tax is applied to the non tax-deferred income from Australian property assets of unit trusts that is distributed to foreign investors. So the appropriate asset base will be the level of foreign investment in Australian property assets of unit trusts. Table 2.1 shows the steps involved in identifying this asset base.

**Table 2.1**  
**Foreign Investment in Australian Property Assets of Property Trusts**

FIA: Aust. LPTs (\$ million)	11,000
stapled shares proportion	9.4%
FIA: Aust. LPTs - shares (\$ million)	1,030
FIA: Aust. LPTs - units (\$ million)	9,970
share of Aust. LPT invested overseas (\$ million)	31.1%
FIA: Aust. LPTs units invested o/s (\$ million)	3,100
FIA: Aust. LPTs units invested in Aust. (\$ million)	6,871

Speed and Stracey Lawyers<sup>5</sup> estimate that foreign investment in Australian LPTs amounts to about \$11 billion, as shown in the top row of Table 1. Of this amount, about \$6.9 billion (or \$6,871 million as shown in the bottom row of Table 1) relates to Australian property assets of unit trusts. The remaining amount (\$4,129 million) relates to foreign property assets and to shares that are “stapled” to units in property trusts. This is based on the assumptions in Table 1 that 9.4 per cent of the value of LPTs is in stapled shares, and that 31.1 per cent of LPT assets are invested overseas, and therefore are not subject to Australian withholding tax. Both of these shares are calculated in Table 2.3, which uses data on the 23 LPTs included in the ASX200.

The second step is to estimate the income stream received from this asset base. Table 2.2 shows that applying an estimated gross yield of 6.5 per cent (which is also calculated in Table 2.3) to the asset base of \$6.9 billion, gives an annual income stream is \$450 million.

**Table 2.2**  
**Tax base for Withholding Tax on property income of LPTs**

annual yield Aust. LPTs	6.5%
annual income stream for FIA: Aust. LPTs units invested in Aust. (\$ million)	450
tax-deferred share for Aust. LPTs units invested in Aust.	32.9%
current tax base (\$ million)	301

The final step is to isolate off the tax-deferred component of this income. The tax-deferred share is estimated at about 33 per cent in Table A1 of the Attachment, based on data for Australian LPTs that hold no offshore property assets. Excluding the tax-deferred component, gives a final estimate in Table 2.2 for the current tax base of \$301 million.

<sup>5</sup> *ibid.* p. 28

**Table 2.3**  
**Selected Statistics on LPTs in the ASX200**

ASX code	mkt cap \$m	o/s assets %	gross yield %	div cents	distns cents	gross div \$m	distns \$m	total \$m
BJT	511	100%	5.5	0.0	10.1	0	28	28
BWP	600	0%	6.2	0.0	12.4	0	37	37
CER	821	52%	7.7	0.0	12.2	0	64	64
CNP	5,459	10%	5.3	0.0	35.5	0	291	291
CPA	1,562	0%	7.0	0.0	9.6	0	109	109
DRT	4,133	19%	7.3	0.0	10.8	0	302	302
GAN	3,918	0%	5.5	0.0	10.8	0	217	217
GPT	8,531	0%	5.8	0.0	24.4	0	492	492
GSA	1,171	100%	8.0	0.0	10.1	0	94	94
IIF	1,868	7%	6.8	0.0	15.3	0	127	127
IOF	1,537	31%	7.2	0.0	10.3	0	110	110
IPG	3,402	0%	7.5	0.1	16.6	2	253	255
MCW	2,425	78%	7.6	0.0	15.1	0	184	184
MDT	1,113	100%	8.6	0.0	10.7	0	96	96
MGQ	7,743	15%	5.2	0.0	27.1	0	400	400
MGR	3,806	0%	8.6	12.7	19.1	159	167	326
MOF	2,719	45%	8.2	0.0	11.4	0	222	222
MPR	1,046	100%	9.5	0.0	11.8	0	99	99
MXG	2,529	0%	7.3	0.0	22.0	0	184	184
SGP	9,065	0%	6.4	8.6	31.5	163	417	579
TSO	677	100%	7.8	0.0	17.8	0	53	53
VPG	758	0%	7.3	0.0	10.1	0	55	55
WDC	30,463	61%	6.4	10.5	96.1	263	1,682	1,945
Total	95,857					587	5,685	6,272
Wt Average		31.1%	6.5			9.4%	91%	100%

Notes:

1. Distributions are defined to include foreign tax credits.
2. Gross dividends ('gross div') include franking credits, while dividends ('div') do not.

### 3) Budget Costings

As discussed in the Introduction, this report examines the cost of a reform proposal to reduce (to an internationally competitive rate) withholding tax on property income of LPTs sourced in Australia and distributed to foreign investors. The analysis examines two alternative scenarios involving internationally competitive tax rates of 15 and 12.5 per cent (as outlined in Table 1.1). This section uses the estimated tax base from Section 2 to calculate the costs of these alternative rates.

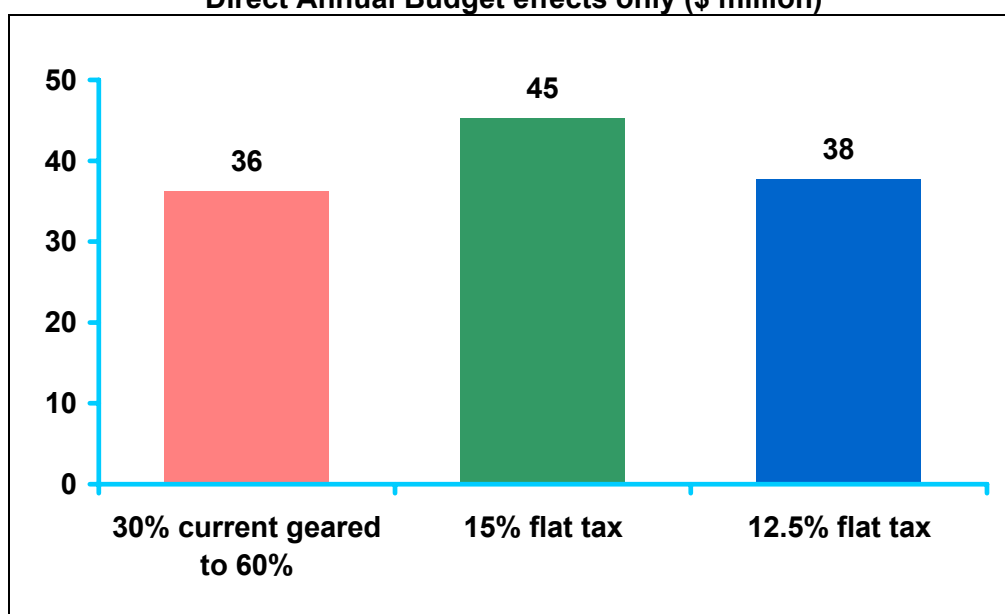
There are two parts to the budget effects of a proposal such as this. The first is the “direct” impact of changing the rate of taxation, which is calculated by simply applying alternative effective average tax rates to the current tax base. The second is the “indirect” impact, which examines the impact of any behavioural responses to variations in the rate of withholding tax. These two effects are now discussed in turn.

#### 3.1) Direct Impact on the Budget

Chart 3.1 estimates the amount of withholding tax collected from foreign investment in Australian LPTs, under the current and two alternative tax rates.

Applying the estimated current average effective tax rate of 12 per cent to the tax base of \$301 million gives an estimate for current annual tax collections of \$36 million. By comparison, introducing a new headline and effective rate of 15 per cent would raise \$45 million, a gain of \$9 million. Alternatively, a new rate of 12.5 per cent would raise \$38 million, a gain of \$2 million. These results are extended in Chart A3 in the Attachment, to include estimates of the impacts under a number of additional alternative tax rates.

**Chart 3.1**  
**Tax collected under alternative LPT Withholding tax rates:**  
**Direct Annual Budget effects only (\$ million)**



The above results only show the direct effects on the budget, and hence neglect the indirect effects arising from any behavioural responses to variations in the rate of withholding tax. The following section explains these behavioural responses and examines the total impact on the budget when these responses are included.

### **3.2) Total Impact on the Budget**

In addition to the direct effects calculated above, the budget cost of the alternative tax rates will also involve indirect effects. These indirect effects are the result of the reduced withholding tax rate leading to an increase in the level of foreign investment in Australian LPTs. This section examines the total impact under the alternative rates of 15 per cent and 12.5 per cent, as discussed in the previous section.

#### **15 per cent scenario**

To estimate the indirect effects, Econtech has assumed that foreign investors in Australian LPTs would view the reform scenario with a new rate of 15 per cent, as broadly equivalent to the existing situation. As discussed in the introduction, under the existing situation, an effective rate of 12 per cent is only achieved at the cost of arranging gearing, and so might be regarded as equivalent to a readily available rate of 15 per cent in the reform scenario.

In that case, foreign investors might be content to maintain their current investment in Australian LPTs of \$11 billion. Hence there is no change in the level or type of foreign investment in Australia. Thus, the total estimated gain to the budget under a new rate of 15 per cent, and no gearing, is confirmed at \$9 million.

#### **12.5 per cent scenario**

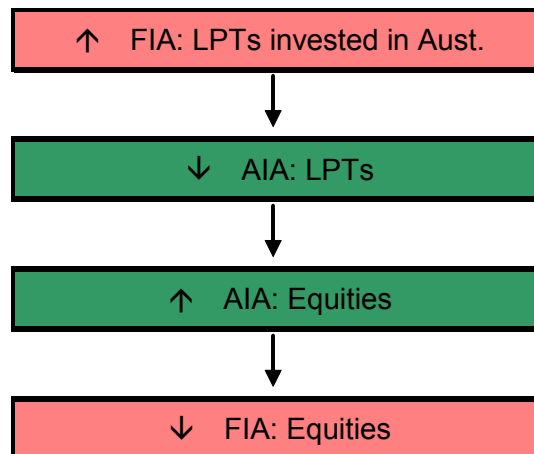
In contrast, a new lower tax rate of 12.5 per cent rather than 15 per cent is likely to stimulate further foreign investment in Australian LPTs. While any estimate of the extent of this increase in foreign investment is subjective, it is unrealistic to assume that there is no increase.

One way of developing a rule-of-thumb for the possible response in foreign investment in Australian LPTs is to consider the hypothetical case where the withholding tax were abolished instead of set to 15 per cent. It is not unreasonable to suppose that foreign investment in Australian LPTs might then increase by close to 50 per cent, because this would still leave foreign penetration of the Australian LPT market below foreign penetration of the Australian equity market.

Using this as a rule-of-thumb, a new tax rate of 12.5 per cent rather than 15 per cent might boost foreign investment in Australian LPT units invested in Australia by 7.5 per cent, which would lead to a similar increase in the tax base. Thus, the lower tax rate might increase the tax base from \$301 million (as estimated in Section 2) to \$324 million, an increase of 7.5 per cent or \$23 million. This expansion in the tax base would boost LPT withholding tax collections under this scenario from the estimate of \$38 million reported in Chart 3.1, to \$41 million, a gain of \$3 million.

However, this is only part of the story. The increase in foreign investment in Australian LPTs is likely to lead to portfolio reallocation effects. Figure 3.1 illustrates a plausible set of responses by foreign and domestic investors. These portfolio responses are based on the reasonable assumptions that Australian investors are the “marginal” investors in Australian LPTs while foreign investors are the “marginal” investors in Australian equities. These assumptions and their implications in Figure 3.1 are now discussed.

**Figure 3.1**  
**Portfolio Substitution under alternative tax rates**



Notes:  
 FIA = Foreign Investment in Australia  
 AIA = Australian Investment in Australia

As noted above, Australian investors are assumed to be the marginal investors in Australian LPTs, implying that the size of this asset class is determined by their investment decisions. This seems likely given that Australian investors have as much as 85 per cent ownership of Australian LPTs<sup>6</sup>. This reflects the fact that LPTs are to some extent a distinctive Australian investment class, with the Australian property industry far more securitised than in overseas markets. Thus, LPTs are a well developed asset class in Australia, but are only an emerging asset class internationally. As such, it is Australian investors that are likely to determine the overall level of investment in Australian LPTs.

With Australian investors determining the overall level of investment in Australian LPTs, and no change in taxation proposed for these investors, this means that the total level of investment in Australian LPTs should remain steady. Thus, the increase in foreign investment in Australian LPTs is expected to displace a similar amount of Australian investment in Australian LPTs, as shown at the top of Figure 3.1.

With no change to taxation of Australian investors, the overall level of domestic savings is unlikely to change. Thus the reduction in Australian investment in LPTs is likely to be offset by an increase in Australian investment in other asset classes, most obviously equities. Thus, the displaced Australian investment in LPTs is expected to shift to equities, as shown in the middle of Figure 3.1.

This portfolio switch by Australian investors will only impact significantly on the budget if rates of return or tax rates differ significantly between shares and LPTs for Australian investors. These rates of return and tax rates are now considered in turn.

The first issue is the rates of return on LPTs versus equities. Table 2.3 (in Section 2) reported a weighted average gross yield of 6.5 per cent for Australian LPTs in the ASX200. However, this return includes both a taxable and tax-deferred component. In terms of both its economic interpretation and its taxation treatment, the tax deferred component is akin to a capital gain. Thus, when comparing LPT income yields to equity income yields, it is

<sup>6</sup> Total market capitalisation of Australian LPT is about \$85 billion, with foreign investors accounting for \$11 billion (Speed and Stracey Lawyers, 2006, pp13 and 27). This leaves over 85 per cent in Australian investors' hands.

widely accepted that only the non-tax deferred component should be included in the LPT yield. This gives an LPT income yield of 4.4 per cent, which is not dissimilar to the gross income yield from equity investments (including franking credits). Similarly, if the tax deferred component of LPT distributions is included with the normal capital gain, expected rates of capital gain from LPTs are not dissimilar to those for equities. Thus, portfolio switching by Australian residents from LPTs to equities is unlikely to significantly impact in an ongoing way on streams of income and capital gains, appropriately calculated.

The second issue is the tax treatments of LPTs versus equities. Under Australia's dividend imputation system, there is no major difference between the two forms of investment in the final tax take. While companies, unlike property trusts, are subject to company tax, this is largely refundable as a franking credit in the hands of the Australian shareholder. In broad terms, the intended end result is that the income of both companies and property trusts is taxed on an equivalent basis in the hands of the Australian owners.

Hence the rates of return (properly measured) and tax treatments are broadly comparable between property trusts and equities for Australian owners. This means that the portfolio switching by Australian investors from LPTs to equities shown in the middle of Figure 3.1 is likely to have only a minimal net indirect effect on the Federal budget.

The final issue is the likely impact of the increase in Australian holdings on equities on the Australian equity market. In contrast to Australian LPTs, foreign investors are widely considered to be the marginal investors in Australian equities. This is because equities are a mature market globally. Hence foreign investors have penetrated much further into the Australian equity market than into the Australian LPT market. With foreign investors determining the overall level of investment in Australian equities, and no change in taxation proposed for these investors, this means that the total size of the Australian equities market is unlikely to change. This implies that the increase in Australian investment in Australian equities is likely to displace a similar amount of foreign investment in Australian equities.

This is reflected in the bottom of Figure 3.1, which indicates that the expected increase in Australian ownership of equities is assumed to be offset by a reduction in foreign ownership. For foreign investors, the end result is that their increased investment in Australian LPTs is offset by reduced investment in Australian equities. This portfolio switch by foreign investors will be responsible for any significant indirect effects on the Federal Budget. This indirect budget effect will depend on any difference in the tax rates applied to the returns received by foreigners from Australian LPTs compared with Australian equities.

Under this scenario, the withholding tax rate on LPTs of 12.5 per cent is below the estimated average tax rate of 24 per cent applied to dividends paid to foreign investors<sup>7</sup>. Hence, while the estimated shift in foreign investors' income of \$23 million from Australian equities to Australian LPTs will add an estimated \$3 million to taxes collected from LPT income, this would be at the expense of a loss of \$6 million in taxes collected from share income. This implies a net negative indirect effect on the budget of \$3 million.

Combining this indirect loss to the budget of \$3 million, with the estimated direct gain to the budget of \$2 million, gives an overall net loss to the budget of \$1 million. Thus, even under a new withholding tax rate of 12.5 per cent, any impact on the Federal budget is expected to be minimal. Chart 3.2 summarises the total impact on the budget under each scenario once these indirect effects from portfolio substitution are included. This can be compared with Chart 3.1, which allows for the direct effects only.

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<sup>7</sup> The 24 per cent dividend tax rate is a weighted average of the 30 per cent company tax on grossed-up franked dividends and the 15 per cent withholding tax on unfranked dividends, based on a split of 60:40 between (grossed-up) franked and unfranked dividends.

**Chart 3.2**  
**Tax collected under alternative LPT Withholding tax rates:**  
**Total Annual Budget Effects (\$ million)**

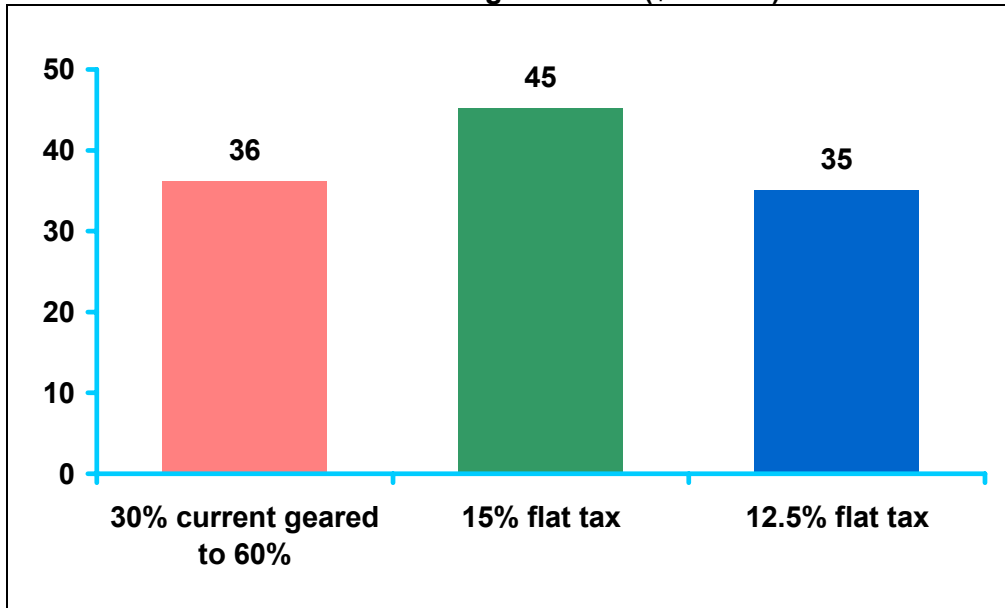


Table 3.1 shows the total impacts on Budget revenue under both the 15 per cent and 12.5 per cent withholding tax rate scenarios, compared with the present situation. The detailed calculations underlying these estimates can be found in Table A2 in the Attachment. Further, Chart A3 in the Attachment extends these results, showing the total impact on the Federal budget of a number of additional alternative tax rates.



**Table 3.1**  
**Budget Revenue Impacts**

	15% flat tax	12.5% flat tax
Direct (without portfolio effects)		
W/holding Tax on LPTs (change, \$m)	9.0	1.5
Indirect (with portfolio effects)		
W/holding Tax on LPTs (change, \$m)	0.0	2.8
Tax on shares (change, \$m)	0.0	-5.4
<b>Total Tax Impact (change, \$m)</b>	<b>9.0</b>	<b>-1.1</b>

## **References**

Speed and Stracey Lawyers (2006), "Australian Listed Property Trusts: Withholding Tax", February.

*Web-sites*

[www.asx.com.au](http://www.asx.com.au)

[www.etrade.com.au](http://www.etrade.com.au)

web-sites of ASX200 listed property trusts

## Attachment

**Table A1**  
**Tax Deferred Distributions of Locally-Oriented, ASX200 LPTs**

	mkt cap	distns tax def	distns other	distns total	distns tax def	distns other	distns total	distns tax def
	\$m	cents	cents	cents	\$m	\$m	\$m	%
BWP	600	3.1	9.3	12.4	9.3	28	37	25%
CPA	1,562	4.5	5.1	9.6	50.9	58	109	47%
GAN	3,918	4.6	6.2	10.8	92.3	125	217	43%
GPT	8,531	11.0	13.4	24.4	221.0	271	492	45%
IPG	3,402	0.7	15.9	16.6	10.8	242	253	4%
MGR	3,806	7.7	11.4	19.1	67.3	100	167	40%
MXG	2,529	5.5	16.5	22.0	45.8	138	184	25%
SGP	9,065	7.2	24.3	31.5	95.7	321	417	23%
VPG	758	0.0	10.1	10.1	0.0	55	55	0%
<b>Total/Aver</b>	<b>34,171</b>				<b>1873.1</b>	<b>3,812</b>	<b>5,685</b>	<b>33%</b>

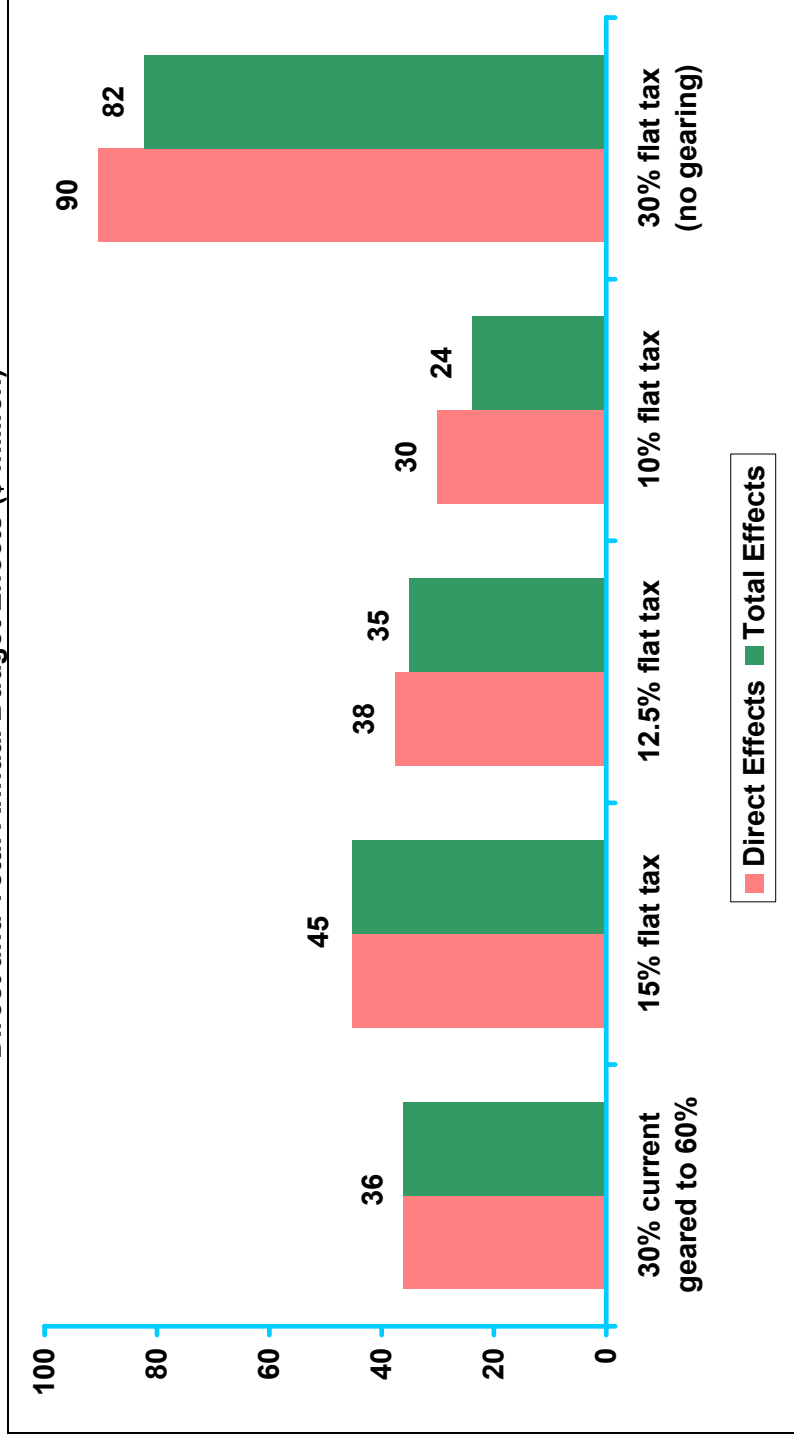
Notes:

1. Distributions are defined to include foreign tax credits.

**Table A2 - Revenue Modeling**

	existing	12.5% tax direct effects	15% tax direct effects	12.5% tax total effects	15% tax total effects
<i>withholding tax on LPTs</i>					
FIA: Aust. LPTs - units (\$ million)	9,970	9,970	9,970	10,486	9,970
of which:					
invested o/s (\$ million)	3,100	3,100	3,100	3,100	3,100
invested in Aust. (\$ million)	6,871	6,871	6,871	7,386	6,871
annual yield Aust. LPTs	6.5%	6.5%	6.5%	6.5%	6.5%
FIA: income for Aust. LPTs units investments in Aust. (\$ million)	450	450	450	483	450
tax-deferred share for Aust. LPTs units invested in Aust.	32.9%	32.9%	32.9%	32.9%	32.9%
FIA: non-def income for Aust. LPTs units investments in Aust. (\$ million)	301	301	301	324	301
reduction through gearing	60%	0%	0%	0%	0%
FIA: taxable income for Aust. LPTs units investments in Aust. (\$ million)	121	301	301	324	301
FIA: Withholding Tax on LPTs (rate)	30.0%	12.5%	15.0%	12.5%	15.0%
<b>FIA: Annual Withholding Tax on LPTs (\$ million)</b>	<b>36</b>	<b>38</b>	<b>45</b>	<b>41</b>	<b>45</b>
				4.3	
<i>portfolio substitution</i>					
FIA: Aust. LPTs - units invested in Aust. (\$ million)	6,871	6,871	6,871	7,386	6,871
FIA: Change in Aust'n shareholdings (\$ million)	0	0	0	-515	0
annual gross yield Aust'n shareholdings	4.4%	4.4%	4.4%	4.4%	4.4%
FIA: change in income on Aust'n shareholdings (\$ million)	0	0	0	-23	0
of which:					
franked (\$ million)	0	0	0	-14	0
unfranked (\$ million)	0	0	0	-9	0
FIA: change in company tax on franked dividend (\$ million)	0	0	0	-4	0
FIA: change in withholding tax on unfranked dividend (\$ million)	0	0	0	-1	0
<b>FIA: total change in tax on income of Aust'n shareholdings (\$ million)</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>-5</b>	<b>0</b>
<b>Total Tax Impact (\$ million)</b>	<b>36</b>	<b>38</b>	<b>45</b>	<b>35</b>	<b>45</b>

**Chart A3 - Tax collected under alternative LPT Withholding tax rates:  
Direct and Total Annual Budget Effects (\$ million)**



**Notes:**

- The Total Budget Effects are based on a simple 1:3 rule-of-thumb behavioural elasticity. That is, it is assumed that a 1 percentage point reduction (increase) in the tax rate leads to a 3 percent increase (reduction) in FIA<sup>8</sup> LPT's invested in Australia, relative to the level under a 15 per cent flat tax. For example, moving from 15% flat tax to 10% flat tax, increases FIA LPT's invested in Australia by 15%; or moving from 15% flat tax to 30% flat tax, decreases FIA LPT's invested in Australia by 45%.

<sup>8</sup> FIA = Foreign Investment in Australia