PROPERTY COUNCIL of Australia THE VOICE OF **LEADERSHIP**

30 January 2015

Committee Secretary
Senate Economics Reference Committee
PO Box 6100
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Committee

Inquiry into Corporate Tax Avoidance and Minimisation

Thank you for the opportunity to provide a submission to the Senate Economics Reference Committee's inquiry into corporate tax avoidance and minimisation (the Inquiry).

The Property Council is the peak body representing the interests of owners and investors in Australia's $670 billion property investment industry. The Property Council represents members across all four quadrants of property investment, debt, equity, public and private.

The property industry is critical to underpinning the retirement savings and economic prosperity of Australians. The industry supports 12.8% of the workforce and represents 11.5% of Australia's GDP.

This submission focuses on the Australian tax position of ASX-listed property groups.

Listed property trusts provide investors with the opportunity to invest in large scale property assets. It levels the playing field for all investors and helps ordinary Australians prepare for retirement.

Property trusts largely invest in property for the purpose of earning rental income (passive activities) on behalf of collective investors who pay tax on their share of the net income. Trading activities are taxed at the 30% company tax rate, and are typically undertaken by companies in a property group.

Property trusts do not normally conduct trading activities – if the trust carries on a trading business, *all* profits of the trust are taxed at the company tax rate, not just the profits from the trading business.

The rules ensure investors in a property trust pay tax on their share of the trust's taxable income, based on their own applicable tax rates, largely as if they held the property directly. The tax rate can be as high as 49% for Australian resident investors.

Under the tax rules, there are two main differences between direct investment and investment via a property trust:

1. Tax losses are trapped in a trust, and cannot be used by the investors of the trust to reduce their tax payable; and
2. A withholding tax regime applies for non-resident investors to ensure Australian tax is efficiently collected on the non-resident investor's share of the trust's Australian sourced net income.

This approach to tax is in line with the current government policy settings, which have been extensively reviewed by the Board of Taxation in numerous reports.

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The policy settings are also consistent with international guiding principles for collective investment vehicles. For example, the OECD commentary on the model tax convention discusses the importance of neutrality between direct investments and investments through a collective investment vehicle.

Further, both the Johnson Report and the recent Murray Financial System Inquiry have recognised, and championed, the critical importance of having tax flow through collective investment vehicles to attract international capital to Australia.

Collective property investment in Australia, from superannuation funds right through to managed investment trusts, use property trusts that are in line with globally accepted principles.

The property industry contributes $35.6 billion in taxation revenues to state and local governments. This represents about 46% of total revenue for state and local governments. The actual tax contribution of the industry is substantially higher if you take into account payment of income tax, GST and payroll tax.

This is a sophisticated and well tested tax system that is actively administered and subject to regular scrutiny by Treasury and ATO, in consultation with industry.

Australia's tax rules and integrity measures have recently been reviewed and are amongst the toughest in the world.

The Government's White Paper process on the 'Reform of Australia's Tax System', as well as the ongoing work by the OECD in relation to base erosion and profit shifting, provide further opportunities to review Australia's tax system. The Property Council will be actively involved in this process to ensure Australia remains an attractive destination for patient long term global capital.

The Property Council is available to discuss our submission with you further at your convenience.

Yours sincerely,

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PROPERTY COUNCIL OF AUSTRALIA

INQUIRY INTO CORPORATE TAX AVOIDANCE AND MINIMISATION

SUBMISSION TO SENATE ECONOMICS REFERENCE COMMITTEE
30 January 2015

INTRODUCTION

The property industry creates the homes we live in, the offices in which we work, and the shopping centres and recreational areas where we spend our leisure time.

The property industry employs 13% of the Australian workforce. It helps underpin the retirement savings and economic prosperity of Australia, with one in every two Australians having a stake in commercial property through superannuation and managed funds.

Importantly, the Australian property industry relies heavily on patient, long-term global capital to finance major investments which domestic investors either cannot or do not fund.

While Australia is only 2% of the world economy, it accounts for 5% of global investment activity.

ASX listed property trust groups are a key part of the Australian property industry.

Developing and maintaining a robust and globally competitive tax regime for managed investment trusts (which include property trusts) is essential to attracting global capital for the future prosperity of the Australian economy.

Maintaining property trust rules in line with international norms for collective investment vehicles is critical to remaining competitive and securing global capital for our economy.

Australia's listed property trust groups are collective investment vehicles which provide investors the opportunity to:

- invest in large scale real estate assets they could not own directly;
- trade their investments on a regulated market;
- diversify their investment portfolio to reduce the risk from market down turns; and
- benefit from the market experience and insights of professional asset managers.

ABOUT THE PROPERTY COUNCIL

The Property Council represents the $670 billion property investment industry in Australia.

The Property Council's 2,000 member firms and 55,000 active industry professionals span the entire spectrum of the property and construction industry.

Our members operate across all property asset classes - including office, shopping centres, residential development, industrial, tourism, leisure, aged care, retirement villages and infrastructure.

The property industry by numbers

- Pays **$35 billion p.a.** in property-specific taxes;
- Manages **$670 billion** in investment assets;
- Provides **1.3 million** jobs (12.8% of the total workforce);
- Contributes **$148 billion** in direct economic activity;
- Represents **11.5%** of Australia's GDP;
- Supports **49** ASX listed property groups, with total market capitalisation of **$104.7bn**.

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1. HOW IS PROPERTY TAXED?

Profits from property are taxed in the country where the property is located.

Australia's tax rules ensure that Australia receives the tax owed to it from Australian property investments.

Property trusts invest in real property for the purposes of deriving passive rental income that is then passed on to investors who pay tax on their share of the net income at their own individual tax rate.

In addition to income tax on rental income, the Australian property industry pays a myriad of state and local government taxes such as stamp duty, land tax, rates and charges.

In 2012-13, the Australian property industry contributed nearly $35.6 billion in taxation revenues to state and local governments. This represents about 46% of total revenue for state and local governments.

2. WHAT IS A STAPLED STRUCTURE?

Most of the ASX-listed property groups operate in a stapled structure to ensure there is a clear separation between passive rental activities (typically under a trust) and active trading activities (typically under a company).

Ordinarily, in Australia, unit trust structures are used as collective investment vehicles. This structure allows individual investors to pool their money so they can buy properties they otherwise could not afford if they invested on their own.

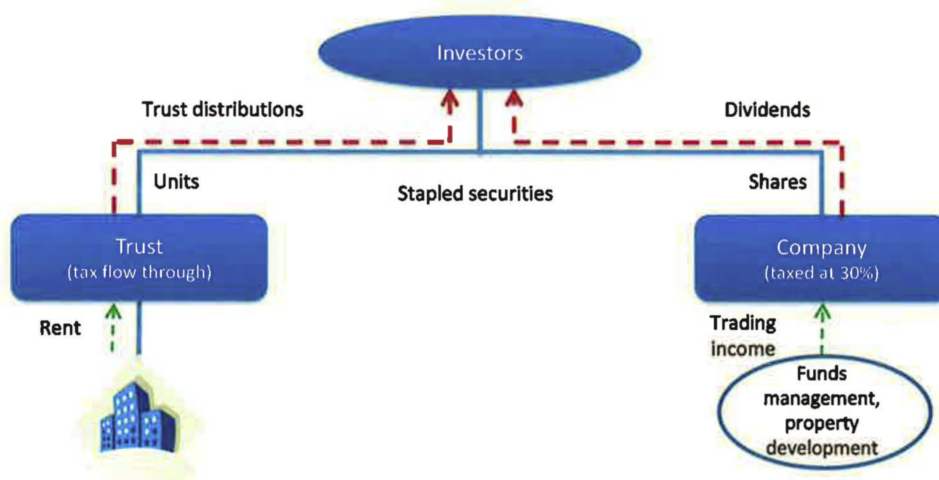
These property trusts do not normally conduct trading businesses.

A property trust that conducts a trading business is taxed on *all* the profits of the trust (including passive rental income) at the company tax rate, not just the profit from the trading business.

More typically, any trading activity that may be essential to managing a particular property investment is undertaken in a company, and taxed at 30%. This would include external funds management or development of property for sale.

From an investors view point this is a single investment. From a taxation and legal view point this is an investment in the securities of 2 or more separate entities that can only be traded together as one investment (the "stapled security").

This is illustrated in the diagram below:



The stapled structure is consistent with the way other regimes across the world tax trading activities carried on by collective investment vehicles. For example, the United States allows property groups to have a "taxable REIT subsidiary" which pays corporate tax on its active income.

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3. HOW ARE AUSTRALIA'S LISTED PROPERTY GROUPS TAXED?

Australia does not have a separate tax regime solely for real estate investment vehicles.

Listed property trusts will typically be "managed investment trusts" (MITs) for Australian tax purposes.

MITs are effectively taxed on a flow through basis. This means that the net rental income from the MIT flows annually to the investor, who then pays tax on their share of the net income, at their individual tax rate.

Companies (or trusts carrying on a trading business) in the stapled group are taxed on their profits at the company tax rate.

The Board of Taxation's October 2008 Discussion Paper, *"Review of the Tax Arrangements Applying to Managed Investment Trusts"*, noted a core policy principle underpinning the trust taxation regime is:

> *"The tax treatment for trust beneficiaries who derive income from the trust should largely replicate the tax treatment for taxpayers as if they had derived the income directly."* (at para 1.7)

However, under the rules, there are two main differences between direct investment and investment via a property trust:

1. Tax losses are trapped in a trust, and cannot be used by the investors of the trust to reduce their tax payable; and
2. A withholding tax regime applies for non-resident investors to ensure Australian tax is efficiently collected in respect of the non-residents share of the Australian sourced net income of the property trust.

The Australian tax rules for MITs have been subject to detailed review in recent years by Treasury, ATO and all sides of Government (most recently, as part of the Board of Taxation review into MITs in 2008).

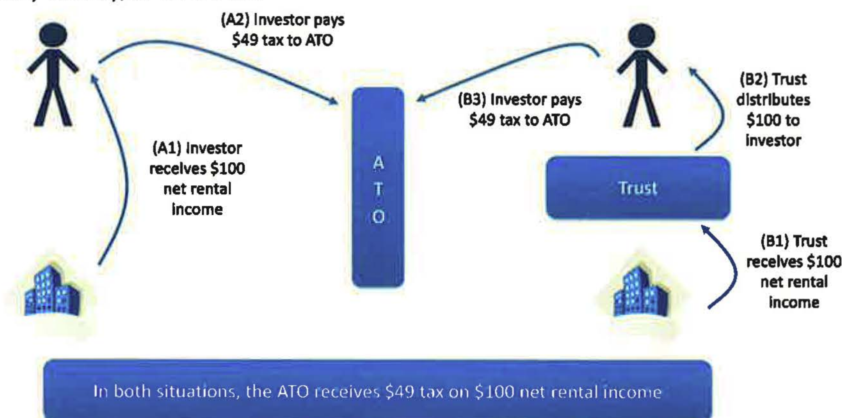
The Australian Government is currently refining Australia's MIT tax rules to enshrine industry practice, provide more certainty for investors and help cut the red tape burden for MITs and Government.

Australian investors

Australian resident trust investors must include their share of the trust's annual taxable income in their income tax return.

An Australian individual investor can pay anywhere up to 49% tax on this income, depending on their personal tax position. This is far higher than the company tax rate.

The diagram below is a simple illustration of the tax outcomes for an Australian resident individual investor (subject to 49% tax rate) investing in property directly, or via a trust.



Non-resident investors

To ensure the efficient collection of Australian tax, non-resident investors in MITs pay a final withholding tax on their share of the MIT's Australian sourced taxable income.

Australia imposes withholding tax rates of either 15% for non-residents from an Exchange of Information (EOI) country, or 30% for all other investors.

The 15% MIT rate was introduced for EOI countries because the ATO has access to additional information on these investors (under the relevant government treaties).

As noted in the Board of Taxation's 2010 discussion paper "Review of the tax arrangements applying to Collective Investment Vehicles" (when discussing the former 7.5% rate):

> *"The objective [of the MIT withholding tax regime] is to collect an appropriate amount of revenue on a source basis without discouraging or creating tax impediments to mobile foreign investment in Australia." (at para 2.37-2.38)*

The MIT withholding tax rate was doubled to 15% in 2012. This is higher than a number of competing withholding tax regimes in Asia. The House of Representative Standing Committee on Economics, however, reviewed the amending bill and concluded that the 15% rate was competitive with comparable OECD countries at the time.

Maintaining a competitive low withholding tax rate is critical to ensuring Australia attracts more patient long term global capital.

Effective tax rate of listed property groups

Given rental income from a trust is taxed at the investors' personal tax rate, it is misleading to exclude the tax paid by investors on that income when calculating the effective tax rate of a stapled group.

Any effective tax rate calculation for listed property groups, must include the tax paid by the investors on the net rental income.

4. HOW DO AUSTRALIA'S RULES COMPARE INTERNATIONALLY?

Australia's tax treatment of property trusts is consistent with international guiding principles for collective investment vehicles.

In 2010, the OECD issued a report on the Tax Treaty Treatment of Collective Investment Vehicles which said:

> *"Most countries have dealt with the domestic tax issues arising from groups of small investors who pool their funds in collective investment vehicles (CIVs). In general, the goal of such systems is to provide for neutrality between direct investments and investments through a CIV."* (at para 6.8)

In many overseas jurisdictions, collective investment vehicles are technically companies for tax purposes. However, the tax regimes in these jurisdictions operate in a way to effectively treat the company as a tax flow through vehicle.

For example, the United States "Real Estate Investment Trust" (REIT) regime achieves neutrality between direct investments and collective investments by giving the REIT a tax deduction for distributions of its income, and requiring that it distributes virtually all of its taxable income. Therefore, tax on passive rental and other income is paid at the investor level, not the REIT level.

For Australian unit trusts, the investor (foreign or domestic), must pay tax on their share of the trust's taxable income.

Both the Johnson Report and the recent Murray Financial System Inquiry have recognised, and championed, the critical importance of having tax flow through collective investment vehicles to attract international capital to Australia

Australia has a robust tax system and the integrity measures have recently been reviewed and are amongst the toughest in the world.

For example, the thin capitalisation safe harbour limit has been reduced from 75% to 60%. In addition, Australia's rules are more restrictive than comparable countries in several ways including:

- exclusion of investments in foreign companies from the Australian safe harbour calculation; and
- application of Australian thin capitalisation rules to all debt, not just related party debt.

Australia has also tightened its general anti-avoidance provisions (Part IVA) and amended the foreign dividend exemption to ensure debt-like interests do not benefit from the concession.

The Government's White Paper process on the 'Reform of Australia's Tax System', as well as the ongoing work by the OECD in relation to base erosion and profit shifting, provide further opportunities to review Australia's tax system. The Property Council will be actively involved in this process to ensure Australia remains an attractive destination for patient long term global capital.

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