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Tax Treaties Branch
Corporate and International Tax Division
Treasury
Langton Cres
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By email: RGCITDTaxTreatiesBranch@TREASURY.GOV.AU

Dear Sir/Madam

Expanding Australia's Tax Treaty Network

The Property Council welcomes the opportunity to provide comments to Treasury's consultation on expanding Australia's tax treaty network.

Double taxation agreements (DTAs) are an important mechanism within the tax framework which enable greater flows of investment and trade between countries while providing tax integrity to government and certainty to business.

We support the Government's initiative to expand the number of tax treaties in order to cover 80% of foreign investment in Australia and trillions of dollars in Australia's two-way trade and investment.

To achieve these purported aims, our tax treaty network should focus on expanding to markets that have strong trade and investment links with Australia. This is why we believe that Hong Kong should be one of the jurisdictions targeted for tax treaty negotiations in the short to medium term, as well as consideration of negotiation with other major economies such as Brazil.

The Government's work in expanding the tax treaty network also presents an opportunity to update existing treaties and agreements, most vitally our tax treaty with the US, which currently treats Australian institutional investors such as superannuation funds unfavourably compared with pension funds from other countries. Updating the Australia-US DTA would be highly beneficial to domestic businesses and investors.

Necessity for DTAs with Hong Kong and other major economies

Hong Kong is not only one of the most important financial and commercial hubs in the Asia-Pacific region but a significant trade and investment partner for Australia.

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Cross-border trade between Australia and Hong Kong was valued at $12.7 billion in 2020, according to Austrade data. Approved investment from Hong Kong into Australia accounted for $11.3 billion in 2019-20 according to the Foreign Investment Review Board, and the real estate sector alone accounted for $2.4 billion of that figure.

Despite Australia's long-standing DTA with China, that agreement does not extend to Hong Kong. The ATO's tax ruling TR 97/19 states that:

> *The operation of the Australia-China Double Taxation Agreement (DTA) does not extend to the Hong Kong Special Administrative Region following resumption of Chinese sovereignty over the territory on 1 July 1997.*

Thus, there is a unique opportunity to strengthen Australia's investment and trade relationship that we have with Hong Kong by beginning negotiations on a DTA.

It should be noted that Hong Kong has concluded a large number of DTAs with countries around the world, including the UK, New Zealand, and Canada. Without a comprehensive tax treaty on the table, Australia is potentially putting itself at a disadvantage against other capital-importing countries given the significant pools of capital which are managed in Hong Kong. Given the strengthened tax treaty integrity measures that have been introduced via the OECD's BEPS 1 initiatives, tax integrity concerns should no longer be an impediment to agreeing a DTA with Hong Kong.

We recommend that Treasury pursue negotiations with Hong Kong as a matter of priority with a view to entering into the treaty by 2023 as part of the Government's broader treaty expansion plan.

Treasury should also consider negotiating treaties with other large economies where no DTA is currently in place. One obvious example is Brazil, which is the world's eighth largest economy and which in 2020 accounted for $2.6 billion in two-way trade in goods and services with Australia.

Renewing our tax treaty with the US

Another area of focus that should be considered in order to improve Australia's existing tax treaty network is updating the Australia-US DTA, in particular with respect to how some Australia investors are treated for tax purposes. A couple of examples are provided below to illustrate where there is currently some ambiguity in the law and uncertainty for investors.

As a first example, Australian investors that deploy capital in the US market have unfavourable treatment relative to their peers from other countries in respect of real estate investment trust (REIT) dividends and interest amounts.

REIT dividends are subject to 15% withholding tax for most Australian investors (including superannuation funds) or 30% when an investor holds more than 10% ownership of the REIT, which would be the case in many scenarios where the REIT is a wholesale fund that raises funds from institutional investors like superannuation funds.

However, pension fund investors from many other countries such as Canada, the UK and the Netherlands are subject to a 0% withholding tax rate.

There is also uncertainty around how the treaty applies to entities that are treated as corporations for US tax purposes but trusts for Australian tax purposes. For example, the US is entitled to levy branch profits tax (BPT) on companies if they derive US-sourced capital gains.

The treaty limits the rate that the US applies with respect to BPT to 5% for an Australian company. However, where an Australian trust is treated as a corporation for US tax purposes and thus subject to US BPT, but treated as a trust for Australian tax purposes, there is uncertainty whether the Australia-US DTA would apply to limit the rate to 5%.

In addition, an update to the Australia-US DTA should clarify and expand the eligibility to the 5% dividend withholding tax in respect of dividends paid to a corporate shareholder with a 10% or more direct voting power interest (see s.10(2) of the DTA). This rate should be available in respect of payments made via fiscally transparent interposed entities such as trusts and partnerships.

The definition of 'company' should also be tied to the status of the relevant entity for US tax purposes. For example, a partnership which has elected to be treated as a corporation should be eligible to the 5% dividend withholding tax.

Newer features of Australia's tax system should also be included in any updated version of the Australia-US DTA, such as the Corporate Collective Investment Vehicle (CCIV) regime. With the Government's planned establishment of the CCIV regime by 1 July 2022 and the intention of the CCIVs to be a conduit for foreign investors into Australia, now would be an opportune time to include the CCIV framework as part of an updated DTA with our largest overseas investor.

The examples above highlight the complexity of the current agreement which can lead to unequitable outcomes for Australian investors, and the need to address investor uncertainty by updating the Australia-US DTA at the right time.

If you would like to discuss any aspect of this submission further, please contact myself on 0400 356 140 and bngo@propertycouncil.com.au or Kosta Sinelnikov on 0422 168 720 and ksinelnikov@propertycouncil.com.au.

Yours sincerely

Belinda Ngo
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