26 October 2007

Bruce Fort
Multistate Tax Commission
444 North Capitol Street, NW, Suite 425
Washington DC 20001

bfort@MTC.gov

Dear Mr Fort

Re: Proposed Model Uniform Statute for Taxation of Captive REITs (Captive REIT Proposal)

Introduction

Thank you for the opportunity to comment on the Captive REIT proposal.

By way of background, the Property Council of Australia is the peak body representing the interests of owners and investors in Australia’s $320bn property investment sector. Our members are all of the leading institutional investors covering the entire real estate investment universe.

Importantly, our members include the major REITs that invest domestically and overseas including the US. The Australian REIT market is the second largest globally and represents:

- 12% of the world’s listed real estate assets;
- 10% of Australia’s Gross Domestic Product (GDP); and
- 12% of FTSE EPRA/NAREIT Global Real Estate Index.

More than 40% ($60bn) of Australian REIT funds is invested in overseas assets including the US.

Similarly, approximately 1/3rd or $40bn of money invested in Australian REITS comes from overseas. US investors hold on average 15% of the register of Australia’s major REITs.

The Issue

The Property Council supports the MTC’s efforts to ensure the integrity of its tax laws, however we submit that such measures must be careful to avoid unfairly and adversely targeting legitimate enterprises.

Our members are concerned that the Captive REIT Proposal definition (and exemptions), do not adequately cover Australian REITs.
As a starting point it is important to note that Australian Property Trusts are tax transparent and are deemed publicly traded entities in the US. A US Captive REIT held by an Australian Property Trust is not an arrangement that gives rise to potential tax abuse. It is simply the most efficient structure for Australian REITs to invest in US real estate.

While the substance of the MTC’s draft language is appropriate, it inadvertently does not properly categorise “Australian Property Trusts” as “qualified entities” because of non-material technicalities regarding distribution and the DPD. In addition, it may apply to many widely held but unlisted property trusts.

The proposal therefore could potentially deny the dividend paid deduction (DPD) for US REITs owned by Australian Property Trusts which are in themselves widely held.

This will impact Australian Property Trusts though a substantial increase in their state income tax liabilities, and significantly undermine the value of these vehicles.

The net effect will be to strip value from these investments.

In our view, the proposal can solve this problem by:

1) adding another provision at d(4) which deems LAPTs to fulfil the conditions for distribution and direct receipt of the dividend deduction; and

2) amending d(4)(d) to include widely held trusts.

Qualified Entities

The Captive REIT Proposal provides a general exception for Listed Australian Property Trusts (LAPTs) at d(3), however, it does not cater for all variations of Australian Property Trusts that may be unfairly caught under the proposal.

Many Australian Property Trusts are therefore required to seek exemption under d(4) as a Qualified Foreign Entity. However, many Australian Property Trusts that are intended to be brought within the ambit of the exception, cannot use the exception as they do not technically qualify under:

1) d(4)(b) “the entity receives a comparable dividend paid deduction” – technically, Australian Property Trust do not receive a dividend paid deduction as they are not taxed on “dividends” but distribute all income as a tax flow through vehicle. They cannot technically meet this criteria but are within the implied spirit as no tax is levied on the distributions in the hands of the Australian Property Trust.

2) d(4)(c) “the entity is required to distribute 85% of its taxable income” – in a strict sense no Australian Property Trust is “required” to distribute. They distribute 100% in all cases because they would
otherwise be subject to the highest marginal tax rate and the trust would be economically unviable.

These are effectively non-material technicalities.

We suggest that another provision is added to d(4) that effectively deems our trusts to fulfil the conditions:

"A unit trust created and resident in Australia under its income tax law shall be deemed to satisfy subparagraphs b and c of paragraph 4".

**Widely Held Wholesale Trusts**

Within the Australian tax system, Wholesale Property Trusts (direct investment vehicles which are not listed), have the same flowthrough tax status as LAPTs providing (relevantly), the units in the Trust are either:

1) owned by 50 or more unitholders; or

2) are offered to the public.

In these circumstances, the Wholesale Property Trust might technically fail d(4)(d) in the proposal, due to the smaller number of unitholders, yet still adhere to the spirit of the criteria, ensuring the excluded entity is widely held.

We consider that the proposal should amend d(4)(d) to focus on widely held as the necessary criteria.

Paragraph d(4)(d) should insert after "individUal" the following words "other than an entity that is directly or indirectly widely held".

A definition of widely held needs to be added along the lines of:

"The following entities shall be treated as widely held:

1. an entity the shares or beneficial interests of which are regularly traded on an established securities market;

2. an insurance company, a life insurance company or a bank;

3. an entity with more than 50 members none of whom own more than 10% of the voting power or value of the entity;

4. a pension or similar fund, membership of which is publicly available;

5. a State, subdivision or local authority thereof and any agency or instrumentality of such State;

6. a charity or not-for-profit body the income of which is exempt under the law of the State where it is created and resident; and

7. any other type of domestic or foreign entity specified in regulations."

The Property Council is confident that the majority of our concerns can be addressed in the proposal to enable us to give you our support.
We would be pleased to expand on any point we have raised. Please do not hesitate to contact me on (02) 9033 1900.

Yours sincerely,

Trevor Cooke

Executive Director, International & Capital Markets
Property Council of Australia