Investing in Australian Real Estate

Tax structuring considerations

An introduction to key concepts

Key structuring issues

There are several key factors which should be considered in determining the appropriate tax structure for a foreign investment in Australian real estate.

What is the nature of the investment activity?

The nature of the investment activities to be carried out will give rise to differing tax outcomes. For example:

— **Buy and hold** will generally be considered a passive investment for income tax purposes such that a trust structure should be appropriate.

— **Develop and sell** will be considered a 'trading activity' for income tax purposes and, as such, will not be eligible for Managed Investment Trust (MIT) concessional tax rates or flow-through income tax treatment.

What is the exit strategy?

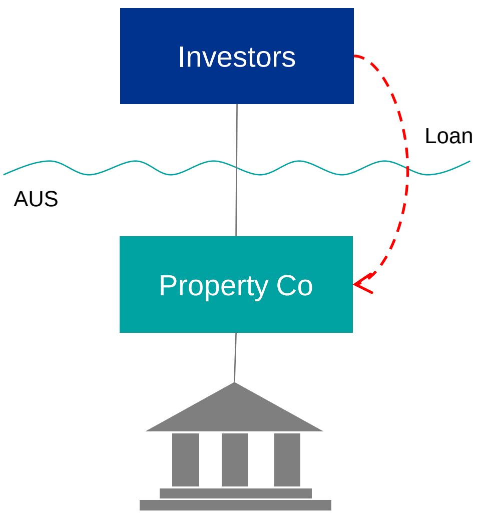
Who are the investors?

Which State jurisdictions duties and tax laws apply?

Typical real estate investment structures

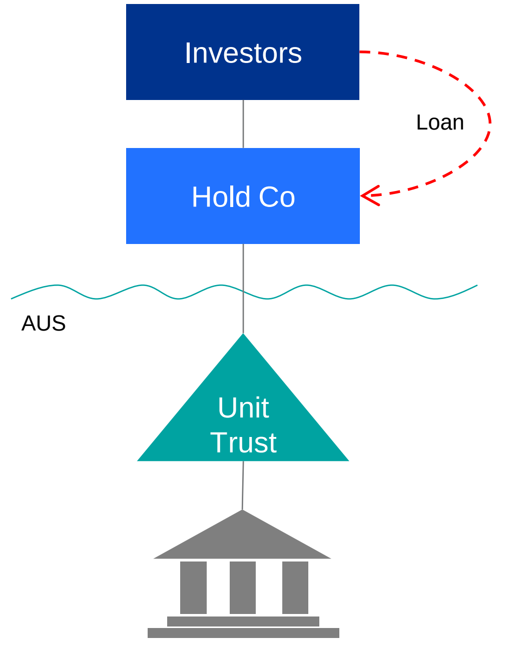
Set out below are high-level structures that are typically adopted for foreign investment in Australian commercial real estate

Company



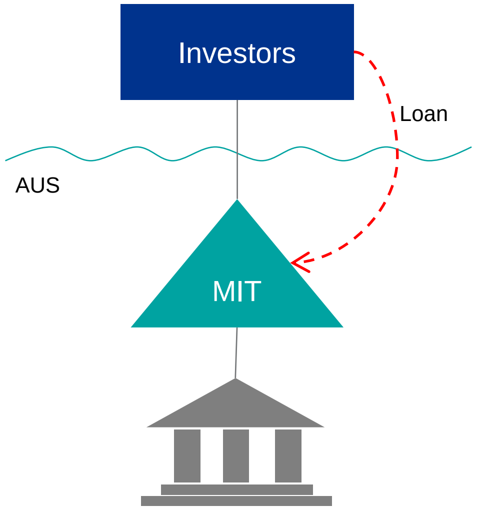
Typically not preferred as not the most tax efficient structure to hold passive real estate investments

Unit trust



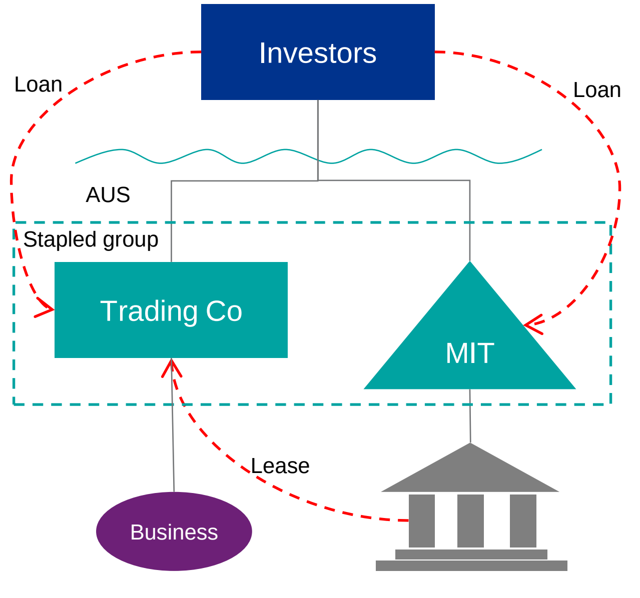
Commonly used to hold real estate investments by offshore investors as a Trust is treated as a flow-through vehicle for tax purposes

Managed investment trust



Commonly used to hold real estate by offshore investors that can satisfy widely-held requirements as the 15% MIT withholding is a concessional tax rate

Stapled investment



Commonly used to hold real estate that may be used for the purpose of 'trading activities' and is widely-held, however the taxation treatment of stapled structures is currently being changed in Australia.

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Summary of income tax implications

<table>
<tr><th></th><th colspan="8">Typical inbound real estate structure options</th></tr>
<tr><th>Tax attributes</th><th colspan="2">Structure 1: Company</th><th colspan="2">Structure 2: Trust</th><th colspan="2">Structure 3: MIT</th><th colspan="2">Structure 4: Staple***</th></tr>
<tr><td>Tax rate</td><td colspan="2">30%</td><td colspan="2">Flow-through (i.e. taxable amounts should flow to investors)</td><td colspan="2">Flow-through (i.e. taxable amounts should flow to investors)</td><td colspan="2">30% on trading income
Flow-through on rental and interest income</td></tr>
<tr><td rowspan="6">Withholding taxes: Payments to non-resident company</td><td>Dividends from untaxed profits</td><td>30%</td><td rowspan="2">Distributions of rental income and capital gains</td><td rowspan="2">30%</td><td rowspan="2">Distributions of rental income and capital gains</td><td rowspan="2">15% / 30%**</td><td rowspan="2">Distributions of rental income and capital gains</td><td rowspan="2">15% / 30%**</td></tr>
<tr><td>Dividends from taxed profits</td><td>0%</td></tr>
<tr><td>Interest*</td><td>10%</td><td>Interest*</td><td>10%</td><td>Interest*</td><td>10%</td><td>Interest*</td><td>10%</td></tr>
<tr><td rowspan="3">Royalties*</td><td rowspan="3">30%</td><td rowspan="3">Royalties *</td><td rowspan="3">30%</td><td rowspan="3">Royalties *</td><td rowspan="3">30%</td><td>Dividends from untaxed profits*</td><td>30%</td></tr>
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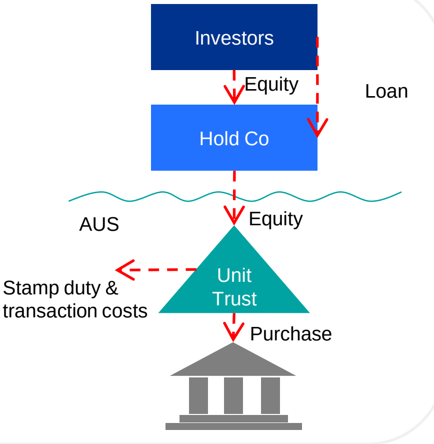
<tr><td>Foreign resident investor tax filing obligations</td><td colspan="2">No Australian tax filing obligation</td><td colspan="2">Australian tax filing required</td><td colspan="2">No Australian tax filing obligation</td><td colspan="2">No Australian tax filing obligation</td></tr>
</table>

* May be lower if subject to Double Taxation Agreement.
** 15% MIT withholding tax rate available to foreign residents in a country with which Australia has an Exchange of Information Agreement.

Lifecycle of unit trust investments

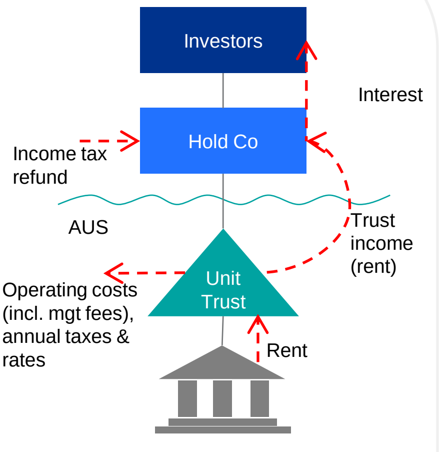
Acquisition

- Transfer duty (rate depends on State)
- GST - 10%,



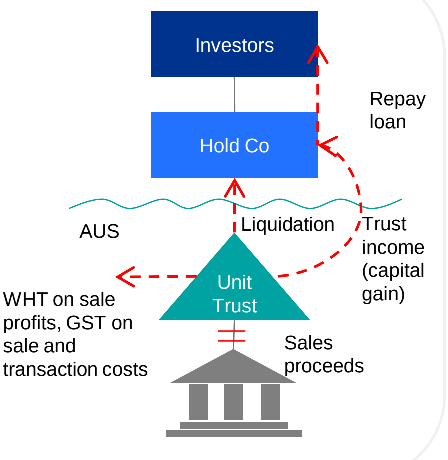
Holding period

- Trust is treated as a flow-through entity
- Non-resident WHT imposed on taxable income of Unit Trust
- GST
- Land tax is levied on the owner of the land (with a foreign owners surcharge



Disposal

- Non-resident beneficiary WHT
- GST unless the disposal qualifies as a GST-free going concern.
- No income tax on loan repayment
- No income tax on liquidation (capital) proceeds



Funding considerations

Thin capitalisation

The withholding tax rate on returns of interest is generally 10% (in comparison to MIT withholding tax rate of 15%, non-beneficiary withholding tax rate of 30%, and corporate tax rate of 30%).

Inward investing entities: Foreign-controlled Australian entities or foreign entities that invest directly into Australia.

The maximum allowable debt of an inward investing entity is the greater of its 'safe harbour debt amount', the 'arm's length debt amount' and the 'worldwide gearing debt amount'.

The safe harbour debt amount is broadly equal to 60% of the total value of assets (as determined in accordance with Australian accounting standards) reduced by non-debt liabilities.

Funding considerations

Withholding taxes

The following table summarises relevant Australian withholding taxes pursuant to Australian domestic law.

Payment	WHT rate	Comments
Interest	10%	• Final tax • Nil WHT if paid to foreign superannuation funds and certain exempt entities • Nil WHT if interest on publicly offered debentures
Trust (non-MIT) distribution	30%	• Not a final tax. • Non-resident has Australian tax filing obligations • WHT is available as a credit to offset Australian income tax assessment
MIT distribution	15%	• Final tax • Reduced rate of 10% for income from 'green buildings' • 30% rate applies if distribution made to a resident of a country with which Australia has not signed an Exchange of Information Agreement
Dividends	30%	• Final tax • Nil WHT if dividend is paid out of taxed profits • Nil WHT if paid to foreign superannuation funds and certain exempt entities • Double Tax Agreements apply
Real property acquisition (from a non-resident)	12.5%	• Withholding regime applies to acquisitions of real property from non-residents valued at over AU$750,000. • Purchaser required to withhold from proceeds due to non-resident vendor • Not a final tax. • Non-resident has Australian tax filing obligations • WHT is available as a credit to offset Australian income tax assessment

MIT requirements and application

The MIT rules provide for concessional tax rates which can be beneficial to non-residents investing in Australian real property

Summary of MIT rules

Broadly, a trust can qualify to be a MIT if all of the following requirements are met:

- The trust is an Australian resident
- A substantial proportion of the investment management activities are carried out in Australia
- The trust is a Managed Investment Scheme under the Australian Corporations Law
- The trust is widely-held .To satisfy this requirement, the trust must be either listed in Australia or have 25 members (for a wholesale fund) or 50 members (retail fund). Certain types of investors may be deemed to be more than one investor.
- The trust is not closely-held. To satisfy this requirement, the top 20 persons (for a retail fund) or 10 (for a wholesale fund) must collectively hold less than a 75% interest in the MIT, excluding certain eligible widely-held investors
- A foreign individual (i.e. natural person) cannot hold an interest of 10% or more
- The trust cannot be a ‘trading trust’ in that the trust must undertake certain eligible investment activities (such as investing in land primarily for the purpose of deriving rent

Key benefits of MITs

The key concessional income tax implications of a MIT are:

- Withholding tax rate of 15% on distributions of MIT income
- MIT withholding tax is a final tax. As such, non-residents have no Australian tax filing obligations in respect of the receipt of MIT income

Stamp duty

Duty may be payable by a purchaser on a transfer of a direct or indirect interest in land.

Direct transfer of land

The acquisition of land will be subject to transfer duty in the State in which the land is located.

Transfer duty is generally calculated on the dutiable value of the land which is the greater of the unencumbered market value of the land and the purchase price The following table sets out the current top rate of stamp duty payable on the purchase of real property.

Foreign purchasers of residential land, including foreign controlled Australian entities, may be subject to an additional surcharge duty.

Indirect transfer of land

The acquisition of units in a landholding unit trust or shares in a landholding company will be subject to landholder duty (or land-rich duty in TAS) in the State in which the landholdings (held directly or indirectly) are located.

Landholder duty is generally calculated at the same rates on the value of the unencumbered market value of the landholdings.

ACT	NSW	NT	QLD	SA**	TAS	VIC	WA
5.00%	5.5%*	5.95%	5.75%	5.5%	4.5%	5.5%	5.15%