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11th March 2013

The Hon David Bradbury MP
Assistant Treasurer
Care of:
Manager
International Tax Base Unit
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Submission on the

Removal of Capital Gains Tax Discount for Foreign Individuals

Dear Sir,

Further to my previous submission dated 22nd May 2012, I wish to provide further information to support our request for the Government to strongly reconsider the implementation of this change that will affect all Non-Resident investors in Australia, including our valuable Expatriate community.

It was a welcome relief for this matter to finally be released as Draft legislation and allow for public comment.

I note the key objectives of this proposed legislation being:

- To remove the CGT Discount provisions on Capital Gains for periods of residence out of Australia for any taxpayer realising a gain on Taxable Australian assets including Australian property, small business and private company investments.
- To allow gains made prior to the announcement date of 8th May 2012 to continue to enjoy the discount afforded to all Australian taxpayers, resident and non-resident alike.
- To all gains made post 8th May 2012 a pro-rata discount for periods where the taxpayer is a resident in Australia.

I further confirm the proposed revenue estimated in the 2012 Budget papers from the change to be an increase of A$55m over four years.

I further note that the Assistant Treasurer has stated that “The discount is not necessary to attract investment from non-residents into these assets” on his website media release of the announcement of the exposure draft.

In this submission I am requesting that the Government re-consider its intention to remove the CGT Discount for Foreign Individuals and not proceed with the proposed changes.

If this cannot be achieved, then it is important that changes are considered including:

- Excluding Australian Citizens & Permanent Residents from the definition of "Foreign Individuals".
- Provisions to allow a new migrant a full Principal Residence Exemption on Australian property he acquires while still a Foreign Individual and subsequently moves into on his migration to Australia.
- Introduce an indexation provision to ensure only real gains are subject to the undiscounted gain.

I make this request based on a genuine, well researched and thorough analysis of the impact of this change to the economy of Australia. It is extremely likely that we would experience a reduction in activity in a number of sectors including small business investment and especially the construction industry in Australia which is well supported by foreign investors.

This support is vital to ensuring projects move from concept to reality, creation of economic activity, maintaining and expansion of employment, addition of vital property supply and generation of important government revenues.

It is our hope that the factual assessment of this valuable sector can lead to the realisation of its strategic importance to the Australian economy, and an understanding that it should remain under the current tax structures which are fair and reasonable.

In doing so Australia will be able to properly announce to the world that we welcome Foreign Investment and understand the importance to our economy sufficiently to ensure that any taxation impositions are kept at a fair level that balances the merit of the contribution, opportunity for safe reliable gain and reasonable tax cost that is equal or better than any other country of opportunity.

Foreign Investor Activity

Australia enjoyed another good year of Foreign Investor activity with a modest increase in the number of approvals for residential purchases, 9,567 in 2012 compared with 9,375 in 2011, and the value of these was slightly lower, A$18.32bn in 2012 compared with A $18.64bn in 2011[1].

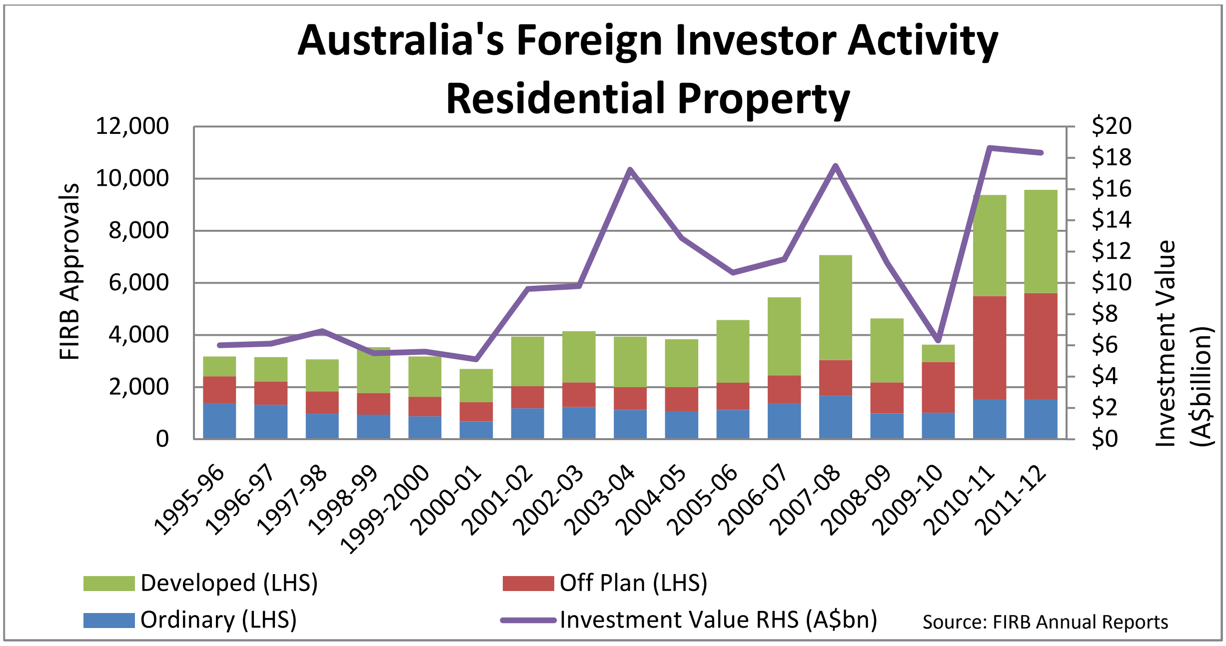
The 2012 result would not have been greatly impacted by the announcement of the CGT Discount removal as it only occurred on 8th May 2012 while the reporting period covers July 2011 to June 2012.

Furthermore, the delay in the release of the exposure draft and limited publicity on the announcement would mean that the impact of the change will be felt more in the current reporting year as well as next.

As a result, the two good years experienced in financial years 2011 and 2012 should not be regarded necessarily as a "new level" of activity and the impact of this proposed

[1] FIRB Annual Report 2011-12

change could quickly reverse the good ground made in building Australia's reputation as a destination for investment for foreign nationals.



Despite this significant amount of foreign investor activity for two years in a row, and with Australia enjoying record low interest rates, this has failed to have a large lift in property values which only increased 2.1% for the 12 months to 31st December 2012[1].

This shows that this foreign activity underpins our market and allows sensible and continual new supply to satisfy the demand of a rising population that has again reached 1.6% annual increase[2].

I once again wish to caution the Government very strongly against this change as it has the potential to significantly and adversely impact in many ways including:

Diminished Foreign Investor Activity

Since the announcement we have been actively seeking comment directly from the foreign investment community about their outlook on the introduction of this change.

We have attached our recent survey summary which, as at the 9th March 2013, has had over 1,100 signed on respondents who have volunteered their details. 95% of these currently live out of Australia, so they are indeed the very same people that this change will affect.

An overwhelming 99% have indicated that a higher Capital Gains Tax would discourage them from investing in Australian property.

This is in direct contradiction to the assertion by the Deputy Treasurer and may mean a drastic reduction in foreign investor activity and resultant Government revenue streams if the legislation become operative.

It also clearly demonstrates that this change will have a negative impact on Foreign Investor Activity.

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1 ABS House Price Indexes – Dec 2012, Weighted average of eight capital cities.

2 ABS Australian Demographic Statistics – June 2012

Value of Current Activity at Risk

Even a small reduction in activity would cost the Australian economy billions of dollars each and every year, with the potential revenue gain of only A$55 million over 4 years.

To gain some perspective, let us consider the value of Foreign Investor activity (including expatriates).

In the below table we have shown the current confirmed Foreign investor activity Australian in Residential property.

We note that the FIRB only collects data on activity by Foreign Nationals, and does not include Australian Citizens or Permanent Residents living out of Australia. This is a significant buyer pool and we have estimated that their activity is at least equal to Foreign Investor activity for the sake of discussion.

When it is noted that there are almost 900,000 Australians living abroad[1], this assumption could indeed be underestimated, but no data is available to formally confirm this. Our company has been active in this market since 1995, so we feel that we are well placed to assess this potential market through constant personal contact with thousands of Expatriates each year.

Item	Estimated Annual Value	Estimated Annual Revenue Value
Sale Value of New Property by Foreign Investors Activity[2]	$18.32bn	
Estimated GST Revenue on Above[3]		$1.67bn
Estimated State Government Stamp Duty revenue[4]		$0.53bn
Estimated Total Expatriate Buyer Activity[5]	$18.32bn	
Expatriate Investor Activity in New property acquisitions[6]	$4.58bn	
Estimated GST Revenue on Above		$0.42bn
Estimated State Government Stamp Duty revenue[7]		$0.75bn
Estimated Direct GST & State Government Revenue		**$3.36bn**

The Federal Government does not collect these revenue streams, as GST flows directly to the States through the allocation formula and Stamp Duty is directly collected by the States.

Regardless, GST is a very important Federal collection as it takes the pressure of the Federal Government's other income streams, if the State Governments are sufficiently funded through GST collections.

In recent times this has become an area of concern as GST Revenues to the States are not expanding sufficiently, so any potential threat to this income base should be treated seriously before action.

[1] Department of Foreign Affairs & Trade – December 2001

[2] Residential Sales to Non-Residents – Source FIRB Annual Report 2011-12.

[3] Estimated at 1/11th to account for GST at 10%, no adjustment for Margin Scheme made.

[4] Estimated at 4.5% average rate excluding Victoria Sales which allow "Off Plan" concessions.

[5] Estimated Expatriate acquisition of equivalent to Foreign Buyer activity based on SMATS business experience of buyer trends.

[6] Estimated at 25% of the value of foreign investor new purchase activity from SMATS business experience.

[7] Estimated Expatriate Buyer activity to be equivalent to Foreign Investor activity. A 4.5% average stamp duty rate used, less an allowance for "Off Plan" concessions in the same ratio as non-residents.

I will leave the Government to calculate for itself the economic flow on effect and value of all the important construction jobs, property services, and investor support that generates many additional billions of dollars worth of economic benefit to Australia including:

- PAYG Income tax collections from people employed directly and indirectly from the construction activity created through Foreign Investor purchases which have to be on brand new property under our FIRB Guidelines.
- Company profits from projects with sales to Foreign Investors.
- Employment and profits from support industries to the construction industry including Architects, Designers, Manufacturing, Advertising, Property Management, Property Maintenance, Banking, Legal & Local Council services.

If there is just a 5% loss of activity in solely the residential property market alone, then this could equate to a contraction of activity in the order of almost A $2 billion per year, significantly more than the estimated A$55 million of additional revenue over 4 years if the exposure draft becomes law.

This doesn't include other key areas that will also be equally impacted by this change to remove the Capital gains discount on Investment by Foreigners in other current taxable assets including Australian Small Business, Medium Enterprise Activity & Non-Public company investment.

Impact of Reduction in Activity

In assessing the merit of bringing this proposed removal of the CGT Discount to reality, the Government should closely consider the full impact of this proposal before committing to its future.

Remember always, the potential revenue of A$55 million over 4 years as a guide to whether the potential cost is warranted.

Sheer scale of those impacted

This change will not be a minor one. It will impact millions of people and will be extremely difficult for the Australian Taxation Office to effectively police.

This is because the Exposure Draft seeks to reduce the discount on any Australian Taxable Asset where the owner has spent time living abroad since 8th May 2012. As such it will impact:

- The estimated 900,000 Australians currently living overseas (according to the 2001 Estimate from the Department of Foreign Affairs and Trade).
- The over 200,000 Australians that leave Australia[1] each year to spend some time working or living overseas before eventual return that will now have their discount reduced for the period they lived abroad,
- The over 200,000 Migrants that come to Australia[2] each year and may have acquired their future home prior to arrival and hence will have their discount reduced for the period they held the asset prior to migrating.

[1] ABS Australian Demographic Statistics, June 2012 Overseas Departures

[2] ABS Australian Demographic Statistics, June 2012 Overseas Arrivals

- The over 450,000 International Students in Australia[1] that rely on Foreign Investors to provide accommodation or have their foreign based parents acquire a property during the period of study.

Hence this change has the impact to penalise well over two million Australians within the next 6 years alone. Add to this the many thousands of Foreign investors as well and we have an extremely large pool of adversely affected taxpayers.

It is unlikely the Australian Taxation Office will be able to manage the compliance cost of this within the estimated revenue gain value, nullifying any potential benefit to the country.

This may well be an unintended consequence, but the fact that so many people will be impacted in an adverse manner should be re-thought.

To minimize this impact, perhaps it could be considered that if the change proceeds that it should be amended to:

- Remove of Australian Citizens and Permanent Residents from the definition of "Foreign Investor".
- Consider concessions to allow a new migrant that subsequently makes a property his Principal Residence fully entitled to the discount.

This would improve the integrity of the proposed change, albeit that we strongly believe it is best cancelled, and save significantly on the compliance cost.

Economic Value

A small reduction in Foreign Investor and Expatriate Activity is difficult to quantify but could be billions of dollars each year and result in:

- Greatly reduced new building construction due to delays in achieving finance pre-sales requirements,
- Lost jobs through diminished activity across all aspects of the property & construction industry,
- Greatly reduced Revenue to State & Federal Governments from loss of GST, Stamp Duty, PAYG & Company profits tax.

Social Value

Foreign investment into Australian property provides a valuable social dividend that includes:

- Increase of rental property opportunities for Australia which keeps the market in balance and ensures affordable accommodation is available.
- Relieves the pressure of an increasing population on the property market by supporting additional supply into the market. This is a result of the requirement to buy brand new property under FIRB Regulations.
- Underpins construction activity when the domestic market has been soft due to economic uncertainty. This has been the case in Australia over the past two years, so we have greatly benefited from the continuation of Foreign Investor activity and ensured jobs were not lost in the construction industry during this period.

[1] Australian Education International – Research Snapshot May 2011, International Student Numbers 2010

- Creates valuable relationships between Australia and other nations and enhances our global reputation as a safe and welcoming investment opportunity.
- Investment is often the first step in many foreign investors considering a potential migration option. This can become a significant contributor in Foreign nationals choosing Australia over other countries.

Less New Construction

Many people underestimate the current policy that requires Foreign Nationals investing in Australian Real Estate to acquire new property.

This benefits our community in many ways including:

- The expansion and regeneration of our society through newly constructed, modern homes being readily available for rental due to the continued absence of an offshore owner.
- The support for projects that require a certain level of pre-sales to gain finance approval and begin the construction phase.
- The creation of new suburbs, apartments and communities supported in some way from foreign investment.

The local Australian market can at times be wary of “off-plan” sales as they like to see it completed. Foreign buyers are often far more willing to purchase at the early stages and therefore are a key element in the successful realisation of many construction projects in Australia.

The importance of the Foreign Investor cannot be underestimated to the Australian Construction industry.

To give some perspective of its value I have summarized the economic value in the below table.

	FY 2006	FY 2007	FY 2008	FY 2009	FY 2010	FY 2011	FY 2012
Total Value of New Residential Building[1]	$29.4bn	$31.1bn	$32.65bn	$34.2bn	$37.2bn	$39.5bn	$37.1bn
FIRB Approved Residential Real Estate[2]	$10.7bn	$11.5bn	$14.1bn	$11.3bn	$6.3bn	$18.6bn	$18.3bn
Foreign Investor Ratio	36.2%	37.0%	43.1%	33.0%	17.0%	47.2%	49.3%

The high level of Foreign Investment into the new build market has underpinned stability in the industry and added significant value to the Australian economy.

The above amounts do not include any Australian Expatriate activity, which is not recorded by FIRB as permission is not required for Australian Citizens or Permanent Residents.

[1] ABS Building Activity, Australia

[2] FIRB Annual Reports – Residential Approvals for Developed & For development

The sharp increase in the above Foreign Investor Ratio is not just as a result in the lift in Foreign investor activity, but further amplified by a reduction in domestic buyer activity as well.

Had Australia not achieved the level of foreign sales success in the past then many projects that have now been completed may well have remained purely a concept.

This is especially true during the Global Financial Crisis, where even though new buyer activity reduced, the past “off plan” sales remained and settled allowing property stock expansion and safe guarding jobs of the construction industry.

Had this been building for building sake, then Australia’s residential vacancy rate would have skyrocketed in a similar manner to China and the USA which would be harmful to our market and future economy. This is clearly not the case for Australia.

Regardless of the perception of the merit of foreign investment in the public domain, the fact remains that these properties were critically required as evidenced by the low level of vacancy across the major Australian cities of Sydney 2.5%, Melbourne 2.0%, Brisbane 1.7% and Perth 1.8%[1].

Many Australian residents do not realise that Foreign Investors can only acquire new property and mistakenly think that they are pushing prices up. The truth is quite the opposite as the level of Foreign investor activity actually keeps prices stable as supply and demand remain in balance.

It is fair to say that had we not experienced the current level of Foreign Investment into the Australian property market, we would be experiencing a critical shortage of quality residential property to accommodate the growing Australian population and this would have dire upward price pressure in the open market.

Ironically this would be preferred by foreign investors and locals alike that already own Australian property, but would be extremely detrimental to the greater Australian community requiring sensible affordable housing.

It would seem somewhat unfair to now penalise this section of the market that has protected our property industry and satisfied the rental demand when the local market could not.

Discouraging ongoing Foreign Investor activity could quickly lead to a crisis where fewer projects are completed and new accommodation falls behind the demand from a rising population fuelled equally by net births and migration.

A crisis that the proposed revenue gain of A$55m over 4 yours could not possibly fund.

Australia’s Reputation in the Asian Century

The removal of this discount is in direct contravention to the Federal Governments objectives under the “Australia in the Asian Century” White Paper.

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[1] Real Estate Institute of Australia – Real Estate Market Facts September 2011

This White Paper has accurately captured the spirit of opportunity for Australia with continuing and strengthening relationships in the expanding Asian region.

I personally have operated business in Asia since 1995 and been able to facilitate the support structure of Foreign Investors to report and properly fulfil their Australian taxation obligations.

This has not been an easy task, with a great reluctance on the part of many Asian investors to appreciate the importance of tax compliance and an overwhelming negative perception of our taxation system.

I have spent almost 20 years explaining that our system is indeed "fair" as a foreigner is treated in the main equally to an Australian, not with-standing that non-resident tax rates start at such a high level. In fact our starting tax rate for non-residents is higher than most countries highest marginal rate.

We have been able to successfully impart this message and ensure that many thousands of foreign investors dutifully lodge their annual returns and fully comply with our tax regulations.

Our tax system has received special attention in the Asian White Paper with it being identified as a National Objective[1], which I quote:

Australia's tax and transfer system will be efficient and fair, encouraging continued investment in the capital base and greater participation in the workforce, while delivering sustainable revenues to support economic growth by meeting public and social needs.

The removal of this CGT discount will for the first time create different tax rules for Australian residents and non-residents and will send a very poor message about Australia's willingness to achieve an "efficient and fair" tax system.

This is especially dangerous when you consider that in 2011-12 65.74% of FIRB approvals for foreign investment came from the key Asian countries[2].

No protection from Inflation Effect on Gains

When the Federal Labor Government introduced Capital Gains Tax in 1985 there was an acknowledgement that some of any Capital Gain was a result of inflation and therefore that portion was excluded from Capital Gains Tax through an indexation allowance.

This was removed in 1999 when the Liberal Party introduced the current CGT Discount. It was considered that the discount would adequately compensate for the fact that no indexation provision was made.

If the proposed discount is removed from Foreign Investors then an inequity will return that will mean that investors are unfairly taxed on full gain rather than real gains after inflation.

[1] Australia in the Asian Century, Australian Government, Chapter 5.6 Building a strong, fair and sustainable tax and transfer system

[2] FIRB Annual Report 2011-12, Table 2.11 Approvals by country of investor in 2011-12 – industry sector

Fairness to Australian Citizens Living Abroad

Should this proposed change come into law, one of the most alarming consequences will be its impact on Australian expatriates.

This group of Australian's has been identified as valuable by the Government through the Asian White Paper National Objective #14 where it seeks to have one-third of board members with deep experience in Asia[1].

This change will no doubt have a potentially damaging impact on the Government's intention to encourage mobility of Australians to seek opportunities in Asia and other international centres, as any Australian will be penalised for time spent abroad through a reduction in their rightfully entitled CGT Discount for any periods of living or working overseas.

This will have a flow on affect to Australian companies seeking to deploy key executives overseas as there may be a need to compensate them for the disadvantages of this proposed change in CGT Discount treatment.

The introduction of this change is considered extremely harsh for our Australian expatriate community that builds Australia's international business reputation and strengthens the future of Australia with improved skills and experience on their eventual return to Australia.

This is best demonstrated when you consider an extreme anomaly in this law.

An Australian living in Australia and investing in a foreign country will be entitled to the 50% discount on any gains made abroad, however an Australian living overseas will be denied the discount if he chooses to invest in his home country of Australia.

This seems extremely unfair and encourages the outflow of valuable investment capital away from Australia rather than back to Australia where it is very welcome and indeed necessary.

Alternative Capital Allocations

With the prospect of higher taxation on investment returns, there is no doubt that foreign investors will consider all other options available to them.

This may be to review other countries of opportunity or other classes of assets.

Assuming Australia is still considered preferential to other markets, there is another anomaly as a result of this change that will influence the investment choices.

With investment in the physical and tangible property sector now being discouraged through the proposed reduction in the CGT Discount, alternatives will be sought by foreign investors.

This may include re-direction of funds into the Australian stock market, where foreign investors currently enjoy a Capital Gains Tax free investment regime.

[1] Australia in the Asian Century, Australian Government, Chapter 6 Asia-capable workplaces

This would be detrimental to the Australian economy as capital placed into this sector does not necessarily make any valuable or physical contribution.

If profits are made through direct listed shares, this capital can be quickly and easily extracted from Australia, without tax, and returned to the country of investors residence.

It does not create any jobs, property stock or any other tangible residual value to Australia and may be very temporary in the period of investment holding.

On the other hand, when foreign investors acquire an Australian property it creates a physical improvement with job creation, construction activity, rental stock and ongoing residual incomes for many years as it is considered a long term hold investment.

Government Revenues

As previously mentioned any reduction in activity of Foreign Investors will inevitably have an adverse impact all levels of Government - Federal, State & Local.

This could affect the budgets of each group and impact on services in the greater community.

Since my original submission in May 2012, nothing has changed to make me reconsider this request to maintain the CGT Discount for Foreign Investors and expatriates.

I have had the ability to talk to many thousands of people (including the 1,100 who have signed my petition to support by submission) who invest in Australia while living abroad and I am absolutely sure that their investment decisions will be affected by the removal of the current CGT Discount.

Even a small amount of contraction at this current level of activity will cause significant detrimental effect to many parts of the Australian economy.

At a time when mining is now slowing it's growth contribution, we simply cannot afford to take the chance as the risk to revenue is much greater than the potential increase of tax collections.

In conclusion, it is our great hope that the Government can reconsider this proposed change and keep the current 50% Capital Gains Tax discount for all Australian taxpayers including the valuable Non-Residents & expatriates.

In doing so you will:

- Continue to protect and encourage the A$18 billion of incoming annual foreign investment flows into the Australian residential property market, generating over A $1.5 billion in annual GST revenue as well as valuable Stamp Duty for State Governments.
- Recognise the important contribution of Foreign Investors play in the property industry in bringing projects from concept to reality.
- Ensure continued increased supply of new housing stock to support and accommodate Australia's growing population.

- Maintain a level of fairness for Australians living abroad and ensures no discouragement for expatriates to seek to enhance Australia's business interests and reputation abroad.
- Continue to encourage Australian expatriates to maintain financial interests in Australia and remit their foreign earned capital to Australia.
- Ensure foreign investors can continue to play a valuable role in keeping housing supply in balance in Australia.
- Ensure that the Governments objectives in the Asian White Paper to create an "efficient and fair" tax system can be achieved.
- Protect thousands of jobs in the Australia's property and construction industry that need the support of foreign investors who under FIRB regulations must buy newly constructed property.
- Ensure that the modest expected revenue gain of A$55 million over 4 years, is not over shadowed by the potential billions of lost revenue as a result of reduced foreign investor activity.

This is not a request for lower taxes, rather a hope that the current taxation principles can be maintained to ensure a continued level of prosperity for Australia as we stand tall in international markets and show the world that are not only a safe and attractive investment choice, but also a fair one, respectful and appreciative of their decision to choose Australia to place their valued investment capital.

For all these reasons, it is sincerely requested that you, together with all members of Australia's Parliament, can join together to remedy this position and cancel the proposed removal of the Capital Gains Tax Discount for Foreign Individuals for the benefit of Australia as a whole.

Yours faithfully

Steve Douglas
Executive Chairman
SMATS Group

AussieProperty.com

Competition Survey Summary Report

Competition equals Stop The Changes To Capital Gains Tax On Non-Resident Taxpayers - Online Petition

Survey Results

1 Do you currently own an Australian Property

1	Yes	992	90%
2	No	107	10%

2 Do you currently live in Australia?

1	Yes	57	5%
2	No	1,045	95%

3 Please let us know your current situation

1	I Am An Australian Citizen/PR Living & Working Abroad	813	75%
2	I Am An Australian Citizen/PR Living In Australia	50	5%
3	I Am Intending To Migrate To Australia In The Future	32	3%
4	I Am Not Australian And Just Interested In Australian Property As An Investment	194	18%

4 Would higher Capital Gains Tax discourage you from buying an Australian property?

1	Yes	1,065	99%
2	No	16	1%

Country Of Residence Results

Australia	54	5%
Bahrain	2	0%
Bangladesh	1	0%
Belgium	2	0%
Bermuda	1	0%
Brunei	1	0%
Canada	8	1%
China	38	3%
Czech Republic	1	0%
Egypt	3	0%
France	1	0%
Hong Kong	201	18%
India	5	0%
Indonesia	24	2%
Japan	9	1%
Korea, South	1	0%
Kuwait	2	0%
Laos	2	0%
Macau	12	1%
Madagascar	1	0%
Malaysia	33	3%
Mongolia	1	0%
Nauru	2	0%
Netherlands	1	0%
New Zealand	1	0%
Norway	3	0%
Not Specified	34	3%
Oman	7	1%
Pakistan	1	0%
Philippines	5	0%

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Qatar	25	2%
Russia	1	0%
Saudi Arabia	6	1%
Singapore	318	29%
Sri Lanka	1	0%
Sweden	1	0%
Switzerland	12	1%
Taiwan	1	0%
Tanzania	1	0%
Thailand	25	2%
United Arab Emirates	133	12%
United Kingdom	87	8%
United States	35	3%
Vietnam	9	1%
Wales	1	0%