January 2, 2008

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Re: October 30, 2007 OECD Public Discussion Draft on Tax Treaty Issues Related to REITs

Dear Mr. Owens:

I. Introduction

These comments are submitted on behalf of the undersigned eight commercial real estate organizations around the world that represent real estate investment trusts (REITs) and other real estate companies. These organizations were pleased to participate as part of the informal technical group organized by the OECD and charged with analyzing the potential issues in the application of tax treaties to REITs and with preparing suggestions for addressing these issues through alternative tax treaty provisions related to REITs.

We commend the OECD for undertaking this important project. We fully support the Report on Tax Treaty Issues Related to REITs which was released by the OECD as a public discussion draft on October 30, 2007. We look forward to the finalization of this report and the inclusion in the Commentary of the OECD Model Tax Convention of alternative provisions regarding REITs that countries may consider incorporating in their bilateral tax treaties.

We are submitting this comment letter on the public discussion draft in order to supplement the public dialogue regarding the discussion draft with additional background information regarding the increasing globalization of REITs, the common distinguishing features of REITs across countries, and the key characteristics of REITs and REIT investors that support the proposed tax treaty treatment of income and gains of foreign investors in domestic REITs.

II. Globalization of REITs

The first REIT regime was established in the United States in 1960. The newest REIT regimes were enacted in the United Kingdom in 2006 (effective on January 1, 2007), Italy in December 2006 (effective on July 1, 2007, with implementing regulations finalized in December 2007) and in Germany in early 2007 (retroactively effective on January 1, 2007). Today, there are REIT regimes in North America (the United States and Canada), Europe (Belgium, Bulgaria, France, Germany, Italy, the Netherlands, and

the United Kingdom), the Middle East (Israel), Asia (Hong Kong, Japan, Malaysia, Singapore, South Korea, Taiwan and Thailand), and the Pacific (Australia and New Zealand). Many other countries such as India, Indonesia, the People's Republic of China, the Philippines and South Africa are actively discussing the possibility of enacting REIT legislation.

As is noted in the OECD discussion draft, as of June 2006, the global market capitalization of REITs was $608 billion. Investment in real estate more generally, and REITs in particular, is growing rapidly. The equity market capitalization of global REITs and listed real estate equities increased over the period from 2002 to 2006 at a compound annualized growth rate of 23%.[1]

Investment in global real estate in 2006 was up 38% from 2005, which itself was a record year. Global real estate investment in 2006 was almost double the 2003 level. Moreover, the 2006 investment increase was spread throughout all geographical regions. The growth in cross-border and inter-regional investment in real estate has been even more dramatic. In 2006, cross-border real estate investment represented 42% of the total, up from 34% in 2005. Inter-regional investment, in which the purchaser or seller is from a geographic region other than the region where the property is located, represented 29% of the 2006 total, up from 23% in 2005.[2]

REITs offer investors both strong returns and significant diversification benefits. The diversification benefits of REITs are further enhanced with international investment. Indeed, real estate investment, with exposure to both domestic and international property, has become an integral component in a balanced investment portfolio for individual and institutional investors, and real estate investment through REITs allows individual investors in particular to participate in the growth potential of large-scale real estate projects . For the period from 1990 to 2005, the compounded annual return on global REIT investments was 8.95%. Over the same period, the compounded annual return on North American REIT investments (consisting largely of U.S. REITs, which is the longest-standing REIT market) was 15.17%. These returns are higher than the returns on many other traditional investment classes.

In addition, over the same period, global REIT investments had low correlation with the traditional asset classes of corporate debt and equity. For example, the correlations between global real estate and U.S. bonds and stocks ranged from 0.04 to 0.22. Moreover, the correlations between North American real estate and non-U.S. bonds and stocks were -0.01 and 0.28 respectively. The data shows that investors can improve the risk adjusted performance of their portfolios by including global REIT investments along with traditional stock and bond investments.[3]

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[1] Ibbotson, Commercial Real Estate: The Role of Global Real Estate Equities in Strategic Asset Allocations, November 2006.
[2] Jones Lang LaSalle, Global Real Estate Capital, 2007.
[3] Ibbotson, Commercial Real Estate: The Role of Global Real Estate Equities in Strategic Asset Allocations, November 2006.

III. Common Distinguishing Features of REITs

The precise structure of the REIT vehicle is different in different countries. For example, the entity form that is used for the REIT vehicle can differ. In some countries, REITs are structured as companies. In other countries, REITs are structured as trusts. Moreover, the REIT regimes in some countries allow for the use of more than one different type of entity.

While the specifics of REIT structures vary, there are several key features of REITs that are common across countries. The possession of some particular features is required in order to qualify as a REIT under the country's REIT regime. Alternatively, the presence of other particular features may be attributable instead to more generally applicable regulatory regimes or to developed industry practice. The combination of the following key features serves to distinguish REITs from other forms of investment vehicles, including other forms of real-property-focused investments:

- First, REITs typically are not subject to entity level tax in their home countries on real property income that is distributed to investors. This result is provided for under the applicable tax laws of the REIT's home country and can be accomplished through any one of a variety of different mechanisms, such as the provision of an exemption from tax, the allowance of a dividends paid deduction, or the provision of flow-through treatment.

- Second, REITs typically are widely-held.

- Third, a majority of a REIT's assets typically consists of investments in income-producing real property.

- Fourth, a majority of a REIT's income typically is comprised of income and gains from investments in real property.

- Fifth, REITs typically distribute most of their income to investors on a current basis or within a specified time period after the year in which the income is earned. The laws of the REIT's home country may impose requirements as to the level and timing of distributions from a REIT. Alternatively, a REIT may be subject to disadvantageous tax treatment, such as the imposition of an additional level of tax that would apply if distributions are not made within a specified time at a specified level.

For many countries' REITs, these last three requirements may be summarized as the 75-75-90 percent rule, because those are the percentages that are used for the assets, income, and distribution requirements in many countries' REIT laws.

As noted in paragraph 31 of the discussion draft, the OECD expects that countries will incorporate in their bilateral tax treaties specific language, including an explicit

reference to their domestic REIT regimes, in order to ensure that REIT-related treaty provisions apply to their domestic REITs and the REITs of their treaty partners. Therefore, a single comprehensive general definition of a REIT would not be needed for tax treaty purposes. Use of explicit references to the particular countries' REIT regimes will accommodate the variation in specific features of the REIT structures in different countries.

However, an understanding of the key distinguishing features of REITs is useful to governments as they consider incorporation of REIT-specific rules in their bilateral tax treaties and as they consider the appropriate application of such provisions to the real-property investment vehicles of their treaty partners. Moreover, an understanding of these common distinguishing features is useful in understanding the structure of the alternative provisions for the tax treaty treatment of cross-border investors in REITs and in further considering the design of potential alternative provisions for the tax treaty treatment of cross-border investment by REITs.

IV. Key Characteristics of REITs and REIT Investors

The alternative tax treaty provisions with respect to REITs that are set forth in the discussion draft of the report reflect a bifurcated approach to the treatment of cross-border investment in REITs. This approach distinguishes between smaller investors, for whom an investment in a REIT may be a substitute for a portfolio investment in publicly-traded stock, and larger investors, for whom an investment in a REIT may be a substitute for a direct investment in the underlying real property held by the REIT.

Under this approach, a smaller investor should be subject to source-country tax on distributions from the REIT at the rate applicable to portfolio dividends, without regard to whether the distribution represents rental income derived by the REIT or represents capital gains derived by the REIT on its real property investments. Applying this same approach, the smaller investor should be subject to exclusive residence-country tax on any capital gains it realizes on the alienation of its REIT interest, just as would apply in the case of capital gains on alienation of a portfolio investment in other publicly-traded equity securities.

In contrast, under this approach, a larger investor in a REIT could be subjected to full source-country tax on distributions of both income and capital gains from the REIT. Moreover, the larger investor also could be subject to full source-country tax on any capital gains on an alienation of its REIT interests to the extent the source country's laws provide for such taxation.

We believe this bifurcation approach is the right approach for determining the tax treaty treatment of cross-border investments in a REIT (other than when a REIT from one country invests in a REIT in another country). Providing for full source-country tax on larger investors in REITs (other than an investor that is itself a REIT) is appropriate because such an investment can serve as a substitute for a direct investment in real

property. This treatment of such larger investors ensures that the source-country's right to tax income from real property located in the country is protected.

Providing for more limited source-country taxation of smaller investors in REITs also is appropriate. Providing for limited source-country withholding tax on distributions from a REIT and also exclusive residence-country tax on capital gains on alienation of a REIT interest reflects a recognition that a smaller investor in a REIT is in the same shoes as a portfolio investor in a corporate security. Such treatment will allow cross-border investment in REITs to flourish, providing investors with an important investment opportunity that can add valuable diversification to their portfolios. At the same time, such treatment will still provide substantial tax revenues to the source-country from the dividend withholding taxes.

As countries consider the incorporation in their bilateral tax treaties of REIT-specific treaty provisions reflecting this bifurcation approach, there are several important characteristics of REITs and REIT investors that serve to support the proposed treatment of smaller investors in REITs. First, because an investment in a REIT reflects mixed attributes of both equity and debt investments, it is appropriate for the tax treaty treatment of income and gains (both gains realized by the REIT itself and gains realized by the investor from a disposition of the REIT investment) with respect to REIT interests to reflect both these attributes. Second, because REITs have very high levels of income distribution as compared to other corporate entities, the amount of source-country tax collected through tax on dividend distributions also is high even with the application of a treaty reduced rate of tax. Third, because REITs are widely-held, it would be impractical to attempt to impose source-country tax on capital gains from a disposition of a REIT interest by a smaller investor. Each of these points is discussed in more detail below.

A. Mixed Equity-Debt Attributes

An equity investment in a REIT has blended attributes of both debt and equity. The market increasingly views real estate investments as a distinct asset class because of the high income yields that combine the attributes of both stocks and bonds.

Much of the income of REITs is rental income pursuant to lease agreements. Thus, the future income of a REIT is known with a significant degree of certainty in advance. Moreover, because of the REIT distribution requirements, the amount of dividends that will be paid by a REIT also is known with a significant degree of certainty in advance. This certainty as to future returns is an attribute usually associated with a debt investment. The REIT investor also can profit from increases in the REIT's stock price, which can be based on a number of factors such as expectations of future rental growth. This potential for additional returns is an attribute associated with an equity investment. Thus, an investment in an equity interest in a REIT can be viewed as having both equity and debt investment characteristics. Indeed, as noted above, the hybrid

nature of a REIT produces low correlations with both bonds and other equities, making REITs a useful tool to form fully diversified investment portfolios.[4]

Article 11 of the OECD Model Convention provides for a level of withholding tax on income from debt securities that is lower than the level of withholding tax on income from portfolio equity investments in Article 10. Moreover, the reduced level of withholding tax is provided for income from debt securities even though such income effectively is not subject to source-country tax at the entity level.

In addition, Article 13 of the OECD Model Convention provides that gains on cross-border investments in debt securities are subject to exclusive residence-country tax and are exempt from source-country tax. While Article 13(4) allows the imposition of source-country tax on the gains of foreign investors on dispositions of certain corporate shares, this narrow source-country taxing right applies only to equity interests and not to debt or other interests. The fact that an equity interest in a REIT has features that are analogous to the features of a fixed-income security further supports both the provision of reduced source-country tax on income on REIT interests and the provision of exclusive residence-country tax on gains on dispositions of REIT interests.

B. High Levels of Income Distribution

As noted above, one of the key distinguishing features that define a REIT across jurisdictions is the fact that REITs are subject to requirements regarding the prompt distribution of income to investors. REITs distribute most of their income to investors either on a current basis or within a prescribed time period after the year in which the income is earned.

Because of these requirements, REITs have very high levels of income distribution as compared to other corporations. The dividend withholding taxes applicable to REIT distributions thus yield a substantial level of source-country tax with respect to the REIT, notwithstanding the fact that REITs typically are not subject to entity-level tax in their home country. Moreover, the high distribution levels for REITs mean that a substantial portion of an investor's return with respect to a REIT will be in the form of distributed income. Comparing an investment in a REIT with an investment in another corporate entity, the percentage of the total investment return that consists of income is substantially higher for the REIT investment and the percentage of total investment return that consists of share appreciation is correspondingly substantially lower for the REIT investment.

Data from the United States (which is the country with the longest REIT history) illustrates this point. For the period from 1972 to 2006, income represented an average of 57.1% of the total return for U.S. REITS in the FTSE NAREIT Equity REIT Index. For

[4] *See* Correlations of Property Stocks with other Asset Classes, (EPRA May 2007), available at http://www.epra.com/media/EPRA_BIB_april_2007.pdf.

the same period, income represented an average of just 28.2% of the total return for the securities in the Standard and Poor's 500 Index and 26.4% of the total return for the securities in the Dow Jones Wilshire 5000. Thus, the proportion of the total return on a REIT investment that consists of income, which is subject to source-country withholding tax, is more than twice as high as the proportion for other corporate investments. Moreover, the average income return for the REIT index for the 1972-2006 period was approximately two and a half times the average income return on these two corporate equity indices, which further increases the total collection of source-country taxes on such investments.

Data from Canada shows that the income returns of Canadian REITs similarly represent a significant portion of the total returns from a Canadian REIT investment. For the period from 2000 through April 2007, income represented an average of 55.41% of the total return for Canadian REITs.

Because of the high levels of income distribution for REITs, the withholding taxes collected on smaller investors at the portfolio dividend rate will be substantially higher than the withholding taxes that would be collected on other corporate investments. Thus, the source country will collect significant taxes with respect to the cross-border investment in a domestic REIT, notwithstanding the fact that the REIT is not subject to entity-level tax and notwithstanding the provision of a reduced rate of source-country withholding tax on distributions and exclusive residence-based taxation with respect to any capital gains on a disposition of a REIT interest by a smaller investor.

C. Interests Widely Held

Another one of the key distinguishing features noted above as defining a REIT across jurisdictions is the fact that REIT interests are widely held. The interests of a smaller investor in a widely-held REIT are no different than the interests of a small investor in any other portfolio security. The smaller investor's interest in the REIT investment cannot be tied directly to any of the real property held by the REIT.

Providing for exclusive residence-country taxation of gains on dispositions of REIT interests in the case of a smaller investor is the most practical approach. Attempting to impose a source-country tax on a cross-border investor that holds a small interest in a widely-held REIT simply is not practical. Moreover, the impracticality of enforcing such an assertion of taxing jurisdiction is further exacerbated by the fact that many REITs are publicly traded. Thus, an assertion of taxing jurisdiction over gains of smaller investors on the disposition of REIT interests would be unlikely to yield any significant collection of tax for the source country. However, if countries were to attempt to assert taxing jurisdiction pursuant to a tax treaty over gains of smaller investors on dispositions of REIT interests, the mere fact of such attempted assertion would have a substantial chilling effect on cross-border investment in REITs. On the other hand, providing in tax treaties for exclusive residence-country tax on smaller investors' gains on dispositions of REIT interests would not have any significant effect on the taxes

actually collected from cross-border investors and would allow cross-border investment in REITs to develop without this artificial barrier.

V. Further Work on Tax Treaty Treatment of Cross-Border Investment by REITs

With the adoption of REIT regimes around the world, cross-border investment by REITs will continue to become more and more important. This cross-border investment can take the form of a domestic REIT's investment directly in real property in other countries and a domestic REIT's investment in interests in REITs organized in other countries. Expansion into real property investments located in other countries provides diversification benefits for the REIT and its investors. Allowing this diversification by domestic REITs provides domestic investors with the option of achieving geographic diversification in two different ways. A domestic investor may choose to add to his portfolio investments in one or more foreign REITs. Alternatively, a domestic investor may choose to invest in a domestic REIT, with which the investor may be more familiar, that undertakes this geographic diversification for its investors. In order to provide flexibility for investors, it is important to consider how the tax obstacles to cross-border investment by REITs can be addressed.

The proposals presented in the OECD discussion draft will serve as a template for eliminating tax obstacles to cross-border investment in REITs. It will be very valuable to complete this work now and to incorporate into the Commentary of the OECD Model Tax Convention the alternative provisions set forth in the discussion draft. Once this work is completed, we encourage the OECD to turn its attention to the separate question of the tax treaty treatment of cross-border investment by REITs. In this regard, the OECD discussion draft includes some preliminary thinking regarding approaches for eliminating cross-border investment by REITs on which additional work on this issue can build. We urge the OECD to continue to work with the industry to further flesh out optimal approaches for the tax treaty treatment of foreign investment by domestic REITs. The development of a template for eliminating tax obstacles to cross-border investment by REITs, similar to the kind of template that is contained in the discussion draft with respect to the treatment of cross-border investment in REITs, would be very valuable for both investors and governments.

We strongly encourage the OECD to continue work on this important project. By being forward looking, the OECD has an excellent opportunity to help shape the thinking in this area in the relatively early stages of this international expansion of the REIT industry. We welcome the opportunity to continue to work productively with the OECD to develop solutions that facilitate international investment while also meeting the administrative needs of governments and their tax authorities.

VI. Conclusion

The real estate organizations that participated in the informal technical working group appreciated the opportunity to work cooperatively with the OECD on this important international investment issue. We commend the OECD for focusing on this issue at this time as several member countries are putting in place new REIT regimes. We fully support the conclusions of the Report on Tax Treaty Issues Related to REITs. Each of these REIT organizations, which are listed below, look forward to working with our home governments to accomplish the incorporation of REIT-specific provisions in a broad range of bilateral tax treaties around the world.

Respectfully submitted,

Asian Public Real Estate Association
Singapore

Association for Real Estate Securitization
Japan

Assogestioni
Italy

British Property Federation
United Kingdom

European Public Real Estate Association
Netherlands

National Association of Real Estate Investment Trusts
United States

Property Council of Australia
Australia

Real Property Association of Canada
Canada

cc: Jacques Sasseville