



## Tax Insights

### Foreign residents to be excluded from CGT main residence exemption

In the 2017-18 Federal Budget, the Australian Government announced its intention to restrict the CGT exemption available for the sale of a main residence, so it would not apply to foreign residents or “temporary residents” (mainly foreign nationals in Australia as holders of a temporary visa).

Exposure Draft (ED) legislation to implement this change was released for public consultation on 21 July 2017. Contrary to the announcement, it only removed the CGT exemption for foreign tax residents (so temporary residents who reside in Australia can continue to qualify for the CGT exemption).

On 8 February 2018, the Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018 (the Bill) was introduced into Parliament, containing the measures to enact the proposed amendments, which are substantially in line with the ED legislation.

When enacted, the measures in the Bill will apply to remove the main residence CGT exemption where the owner is a foreign resident when the sale contracts are entered into. The changes will apply to:

- all sales occurring after 30 June 2019, and
- any sales of residences before this date if purchased after 7:30pm AET time on 9 May 2017

The Bill also includes measures to:

- Modify the foreign resident CGT regime to clarify that, for the purpose of determining whether an entity's underlying value is principally derived from TARP, the principal asset test is applied on an associate inclusive basis, and
- Provide an additional CGT discount of up to 10 per cent if a CGT event occurs to an ownership interest in residential premises that has been used to provide affordable housing.

### Measures in the Bill

The legislation proposes to amend section 118-110 of the *Income Tax Assessment Act 1997* (ITAA 1997) with effect for CGT events occurring after 7:30pm ACT time on 9 May 2017. Although most CGT events will be straightforward disposals of property, the amendments will apply to all CGT events affecting dwellings, including compulsory acquisitions and deceased estates.

The legislative amendments will entirely remove the entitlement of foreign residents to full or partial CGT main residence exemptions in respect of CGT events occurring to dwellings that would otherwise qualify as their main residence. The other requirements for the CGT exemption (including the "temporary absence" concession, whereby a home can be rented out for up to six years without losing the CGT exemption) remain unchanged.

Notably, despite consultation, this proposal continues to be an "all or nothing" exclusion; unlike many other CGT exemptions, the Bill allows no scope to time apportion the CGT main residence exemption between periods of residence and non-residence during the ownership period.

For example, the Explanatory Memorandum to the Bill makes it clear that previously occupying the dwelling as a main residence during any period of Australian residence would not affect the outcome. Conversely, where an individual had become a foreign resident, but re-establishes Australian residency for taxation purposes before the relevant CGT event occurs, the full main residence exemption would apply (subject to the existing rules for a full or partial exemption).

The amendments in the Bill also ensure that the removal of the exemption extends to situations where dwellings are acquired from the deceased estates of foreign residents, and the rules affecting special disability trusts.

Transitional provisions are included as section 118-110 of the *Income Tax (Transitional Provisions) Act 1997* to grandfather the exemption for dwellings acquired before 7:30pm ACT time on 9 May 2017, and sold on or before 30 June 2019.

Notably to obtain the exemption under the transitional rules, the CGT event must occur on or before 30 June 2019, so it will be critical that for disposals the contract is entered into on or before 30 June 2019 (not settlement).

## Implications

After 30 June 2019, all capital gains or losses arising upon disposal of a foreign resident's main residence will need to be recognised for tax purposes without applying any CGT main residence exemption.

The proposed removal of the CGT main residence exemption for foreign residents for Australian tax purposes is likely to have a significant impact on individuals who relocate overseas for work purposes.

The change once enacted will in particular come as a "shock" to those Australian citizens and permanent residents who are already working overseas, and would want to take advantage of rising property values to sell their main residence whilst residing outside Australia as a foreign tax resident.

Under the rules now before Parliament, individuals who owned a main residence in Australia at 7:30 ACT time on 9 May 2017, and who fall into this category, will only have until 30 June 2019 to sell their homes and still access the main residence exemption.

Aside from this transitional rule, once enacted, the main residence CGT exemption will be completely lost if the individual is a foreign resident on the date of sale of the property. This means that Australian citizens and permanent residents who currently reside overseas will not be able to access any part of the exemption if the property is sold whilst they are living abroad and a foreign resident (for existing properties, sales after 30 June 2019).

However, if they were to return to Australia, recommence Australian tax residency, and then sell their property, all or part of the CGT exemption would be available to the extent that the other conditions for the exemption are met.

It is disappointing that the consultation process did not result in additional modifications to the ED legislation such as allowing a partial exemption for former Australian citizens and permanent residents in respect of periods they actually resided in the main residence.

These new rules will need to be considered carefully by foreign resident owners of Australian residential property.

The CGT liabilities at stake in these circumstances could be material given the significant increase in house prices in Australia over recent years, especially in Sydney and Melbourne.

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