



Tax insights

Foreign resident CGT withholding regime



Snapshot

On Thursday, 3 December 2015, the last parliamentary sitting day for 2015, the Government introduced the *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Bill 2015* (the Bill) into parliament. The Bill contains a foreign resident withholding regime designed to boost compliance with Australia's capital gains tax (CGT) laws by foreign residents who dispose of direct interests in taxable Australian real property or indirect Australian real property interests. The proposed

measure imposes an obligation on the purchaser to remit 10 per cent of the total purchase price to the Commissioner of Taxation. The tax withheld/remitted is not a final tax – the foreign resident vendor will still be required to lodge an Australian income tax return and will receive a credit for the amount remitted by the purchaser.

The proposed measure is to apply to CGT events that happen on or after 1 July 2016, regardless of whether the asset is held on revenue or capital account.

Key points

The key points for the proposed measure are as follows:

The liability is entirely with the purchaser, not the vendor. The purchaser is to remit 10 per cent of the total purchase price to the Commissioner. To fund this liability the purchaser is permitted to withhold 10 per cent of the vendor's proceeds. Withholding will be problematic for non-cash transactions, such as instalment sales or scrip for scrip arrangements, and purchasers may find themselves exposed.

All vendors disposing of a direct interest in taxable Australian real property will be taken to be relevant foreign residents. Australian resident vendors will therefore need to apply for a **clearance certificate** from the Commissioner to confirm their Australian residency status, and then provide that to the purchaser by settlement day. Otherwise, the purchaser is compelled to withhold 10 per cent of the purchase price and remit that to the Commissioner.

For indirect interests in real property, vendors can complete one of two declarations that remove the purchaser's obligation to withhold 10 per cent of the proceeds. Firstly, Australian vendors may provide a **residency declaration** that confirms their residency status. Secondly, foreign vendors may provide an **interest declaration** to the purchaser confirming the asset being disposed of is not an indirect Australian real property interest.

There are a number of transactions excluded from the regime, and there is the ability for certain stakeholders involved to request the Commissioner to vary the withholding amount, including a variation to nil.

Background

The former Labor Government first announced this measure on 14 May 2013. On 6 November 2013, the Coalition Government confirmed that it would proceed with this measure and released a discussion paper for consultation in October 2014.

During the past two years, Treasury has undertaken a number of rounds of consultation to design and shape this measure into its final form.

Which assets are within this measure?

The measure applies to the disposal of any of the following assets, unless one of the specific exclusions applies:

- taxable Australian real property
- an indirect Australian real property interest
- an option or right to acquire such property or interest.

Excluded transactions

In order to reduce compliance costs, a number of transactions are excluded from this measure. Briefly, the excluded transactions are:

- disposals of direct interests in real property where the market value of the property is below \$2 million;
- on-market transactions conducted on an approved stock exchange or transactions conducted using a broker-operated crossing system. (The definition of approved stock exchange is proposed to be amended by regulation to include Chi-X);
- certain securities lending arrangements;
- transactions in relation to which an amount is already required to be withheld from a withholding payment (the non-final foreign resident withholding tax measure has residual operation only);
- transactions involving vendors who are subject to formal insolvency or bankruptcy proceedings.

An example of an arrangement that is subject to other Australian withholding measures may be a disposal by a managed investment trust with non-resident beneficiaries, however in practice a purchaser would likely still require a clearance certificate or residency declaration. Tax imposed on the trustee of a resident trust on a distribution to a non-resident under Division 6 is not an amount withheld from a withholding payment for the purposes of the exclusion.

In terms of navigating this measure, the rules differ depending on the type of asset being disposed of. The rules are effectively split into the following two streams:

1. direct interests in taxable Australian real property (TARP); and

2. indirect Australian real property interests, and an option or right to acquire TARP or an indirect Australian real property interest.

Direct interests in TARP

For the purposes of this measure, a direct interest in TARP is a direct interest in:

- real property situated in Australia (including a lease over land situated in Australia); or
- a mining, quarrying or prospecting right, (to the extent that the right is not real property), if the minerals, petroleum or quarry materials are situated in Australia; or
- company title interests under which shareholders have the right to occupy an apartment to which the company has legal title.

The above is referred to below as Withholding TARP.

Excluded Withholding TARP transactions

Disposals of Withholding TARP that have a market value of less than \$2 million are excluded from this measure. This is regardless of whether the property is commercial, residential, vacant land or leasehold. Originally, this exclusion was to be limited to residential property, but the definition of residential property was regarded as too complex for the range of purchasers that would potentially have obligations under this measure.

Clearance certificates

All vendors disposing of Withholding TARP will be taken to be foreign residents. This puts the obligation to address the residency issue on the vendor:

- where the vendor provides the purchaser with a 'clearance certificate', the purchaser is entitled to rely on it and no longer has an obligation to withhold;
- if the vendor does not provide a clearance certificate, the purchaser must remit 10% of the proceeds to the Commissioner, unless a variation has been issued or one of the other exclusions applies to the transaction.

Accordingly, a vendor who is an Australian tax resident will need to apply for a clearance certificate from the Commissioner to confirm that it is an Australian resident for the purposes of this measure. The vendor must provide the clearance certificate to the purchaser on or before settlement day.

The Commissioner intends to implement an automated process for issuing clearance certificates. Under this process, in straightforward cases certificates are expected to be issued within one to fourteen days. Less straightforward cases could take up to 28 days; and higher risk and unusual cases that require manual intervention are likely to take longer.

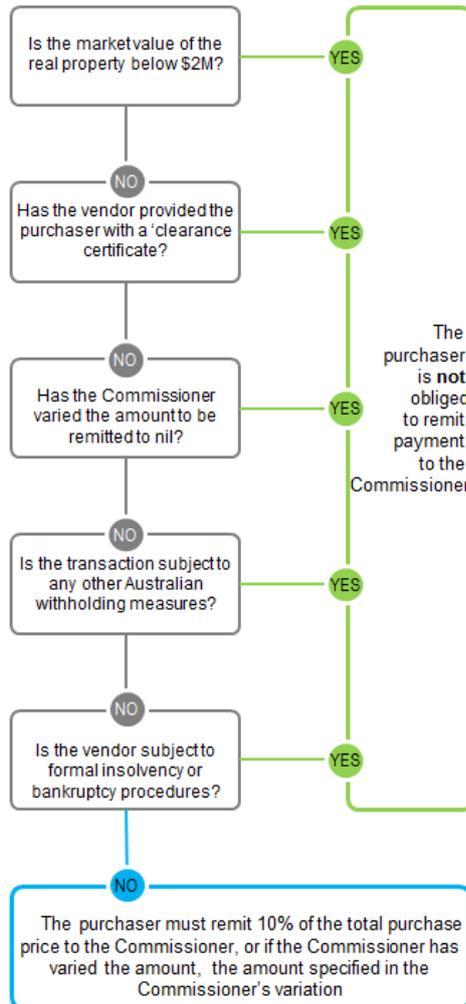
A vendor may apply for a clearance certificate at any time, even prior to the property being listed for sale. The Commissioner may set a time period for which the clearance certificate is valid.

Where multiple vendors dispose of the one asset, the purchaser still has an obligation to remit 10 per cent of the total proceeds, unless each vendor provides a clearance certificate by settlement day.

All vendors disposing of Withholding TARP will be taken to be foreign residents. This puts the obligation to address the residency issue on the vendor.

Flow chart

The following flow chart can be used to determine whether or not a purchaser has a withholding obligation in respect of an interest in Withholding TARP:



In practice, purchasers are likely to have a strong preference for obtaining a declaration from the vendor to mitigate any risk of a withholding obligation arising, rather than seeking to determine whether the vendor is a foreign resident and, if so, the vendor's ownership percentage and the relative value of the underlying assets during the relevant period.

Determining the vendor's residency

The clearance certificate process does not apply to indirect Australian real property interests. For indirect interests, the purchaser may have to determine whether or not the vendor is a foreign resident using a set of rules known as the knowledge condition.

The knowledge condition is satisfied where:

1. the purchaser has specific knowledge that a vendor is a foreign resident (for example the vendor discloses that they are a foreign resident for income tax purposes)
2. the purchaser reasonably believes that the vendor is a foreign resident
3. the purchaser has no reasonable grounds to believe the vendor is an Australian resident and either the vendor has an address in a foreign jurisdiction, or the purchaser is authorised to provide a financial benefit, such as a payment, to a place outside Australia.

The effect of the third condition is that where the purchaser objectively has reasonable grounds to believe the vendor is an Australian resident, there is no obligation to withhold even if the purchaser pays an amount to an overseas place or the vendor has an address in a foreign jurisdiction.

Going forward, the Regulations may prescribe additional circumstances in which the knowledge condition will be satisfied.

Residency declaration

The vendor can provide a residency declaration that confirms that the vendor is not a relevant foreign resident. The purchaser is entitled to rely on that declaration, unless it knows it to be false. Knowing that a declaration is false in this context means the purchaser must have specific knowledge of that fact.

It is envisaged that residency declarations could be inserted into sale agreements as a standard clause contractual warranty.

Indirect Australian real property interests

Different rules apply to indirect Australian real property interests. Broadly, a vendor will be disposing of an indirect Australian real property interest where:

- the vendor is a foreign resident who holds a 10 per cent or more membership interest in an entity (at the time of disposal or throughout a 12 month period within the period commencing 24 months before the time of the disposal and ending at the time of the disposal); and
- more than 50 per cent of the market value of the entity's assets is attributable to Australian real property.

Is the asset an indirect Australian real property interest?

If the vendor is a foreign resident for tax purposes, there is then the question of whether the vendor is disposing of an indirect Australian real property interest. Typically, the vendor will be in the best position to determine whether or not this is the case. As such, a foreign vendor may provide the purchaser with an interest declaration that the membership interest is not an indirect Australian real property interest (an interest declaration). The purchaser is entitled to rely on the vendor's interest declaration, unless it knows it to be false.

"Residency" and "interest" declarations may cover a period but can be valid for a maximum period of six months only.

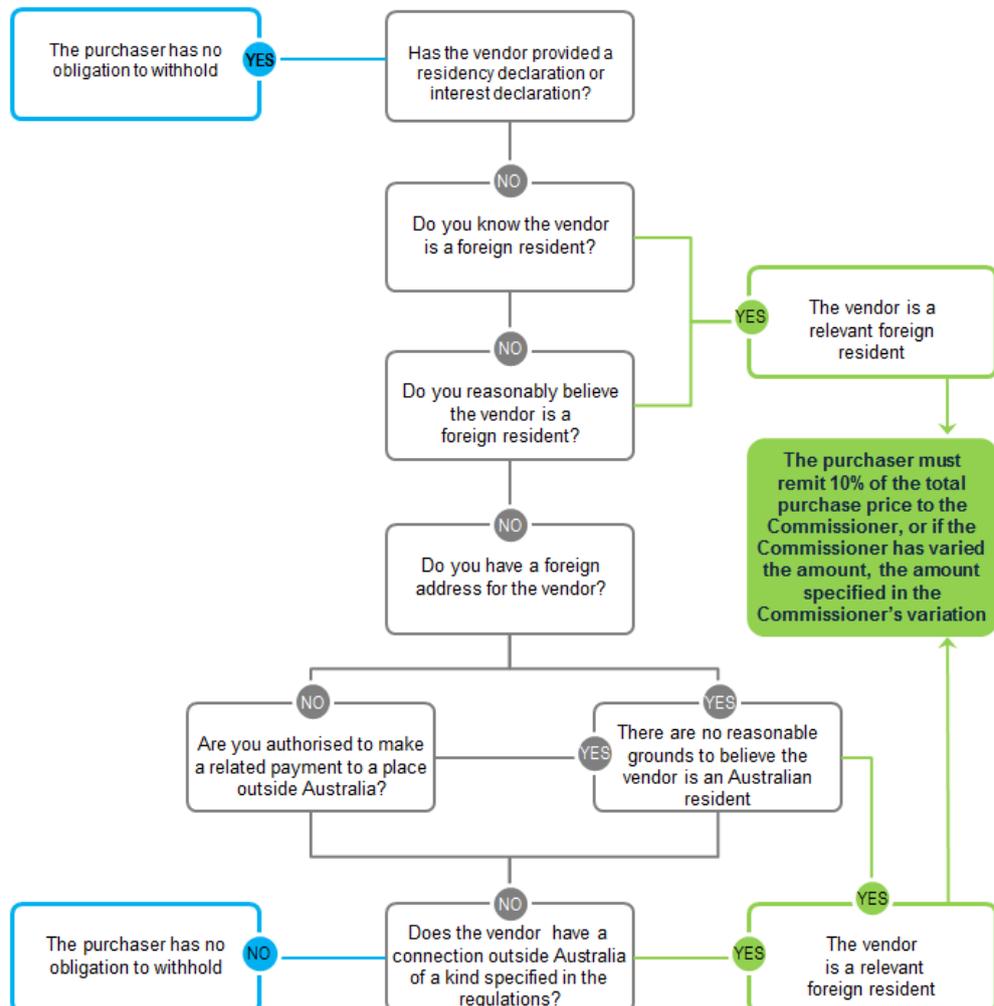
Flow chart

The following flow chart can be used to determine whether the vendor is a foreign resident in respect of an indirect Australian real property interest:

Purchaser's obligations

For transactions caught by the measure, the purchaser is obliged to pay to the Commissioner an amount equal to 10 per cent of the first element of the acquired asset's cost base for CGT purposes. The first element of the cost base will generally be equivalent to the total purchase price of the asset.

Payment must be made on or before the day the transaction settles and through an approved electronic payment method. This means the Commissioner is to receive payment no later than settlement day. With the move towards electronic conveyancing, it is envisaged that the withholding process for cash transactions involving real property will ultimately be straightforward. At this point, however, there is a concern that the conveyancing electronic systems may not be in readiness by the 1 July 2016 start date. In consultation, the Commissioner indicated that initial implementation problems could be



overcome by granting a period of grace for cheques issued at settlement to be received by the Commissioner.

Non-cash transactions

Non-cash transactions, such as scrip for scrip arrangements will need to be dealt with through the variation process, otherwise the purchaser will be left with an unfunded liability. Where no roll-over applies to the vendor the Commissioner would, however, be unlikely to provide a variation.

Variations

A vendor or a purchaser can apply to the Commissioner for a variation of the amount to be withheld, including to nil. Examples of where a vendor may apply for a variation include:

- CGT or income tax rollover applies to the transaction;
- the vendor will make a loss in respect of the disposal or has other current year or carried forward losses;
- the capital gains tax payable is less than the full amount of the withholding;
- the income or gain arising from the transaction is exempt.

Where the vendor has borrowings, secured or unsecured creditors can apply for a variation of the amount to be withheld if there are insufficient proceeds to repay the loan and meet the 10 per cent withholding obligation. The Commissioner does not have any priority over secured creditors and when exercising his power to vary an amount, the Commissioner must have regard to the policy of protecting a creditor's right to recover a debt.

Earnout arrangements

The Bill also introduces provisions dealing with the CGT treatment of certain earnout rights. The proposed rules only apply to arrangements that qualify as “look-through earnout rights”.

There are specific rules under the foreign resident CGT withholding regime for “look-through earnout rights”. Broadly, a purchaser may be required to withhold from multiple payments as follows:

- the purchaser is required to remit 10 per cent of the value of the proceeds paid to the vendor at or before settlement. The value of the earnout right(s) is excluded from the total purchase price for the purposes of this initial withholding payment;
- as and when any payment is made to the vendor in respect of an earnout right, the purchaser must then remit 10 per cent of the amount payable. However, payments in respect of earnout rights are only caught by this measure if the vendor is still a foreign resident at the time an earnout payment is made.

For earnout arrangements that do not qualify for the proposed look-through treatment, the value of the earnout right will form part of the total purchase price at the time the contract is settled. Therefore, a purchaser will need to know the value of each earnout right at that point in time so that it can remit 10 per cent of the total purchase price at or before settlement.

A vendor or a purchaser can apply to the Commissioner for a variation of the amount to be withheld, including to nil.

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