Nexia Australia

Taxation Update

Foreign resident capital gains tax update

June 2018

Withholding

FIn a bid to strengthen Australia's non-resident Capital Gains Tax (CGT) regime to assist in the collection of tax liabilities, measures were introduced on 1 July 2016 aimed at the collection of CGT from the sale of direct and indirect interests in taxable Australian property by foreign tax residents.

Because compliance with tax Laws was historically low by non-residents when it came to reporting gains, both on capital and revenue account, the measures were introduced to ensure tax was collected on any disposal of taxable Australian property.

The measures apply to the buyer, so that where a foreign resident sells property in Australia the buyer is responsible for withholding and remitting to the Australian Taxation Office (ATO) a non-final withholding of 12.5% (previously 10%) of the purchase price.

The measures initially applied to sales of taxable Australian property with a market value (essentially the sale price) of A$2 million and above but now apply to sales of A$750,000 and above. The withheld amount will be creditable against the non-residents final CGT liability.

The withholding regime is limited only to taxable Australian property, being:

- Real property in Australia – land, buildings, residential and commercial property
- Lease premiums paid for the grant of a lease over real property in Australia
- Mining, quarrying or prospecting rights
- Interests in Australian entities whose majority assets consist of the above such property or interests
- Options or rights to acquire the real property or interest therein.

With regard to indirect interests the withholding regime will apply if the purchaser knows or reasonably believes the vendor is a foreign resident, the vendor has a foreign address or requests the purchaser to make payment to an account outside of Australia. An indirect interest is a non-portfolio interest, being greater than 10%, in an entity, or holding entity of another entity, where that entity's value is predominantly represented by taxable Australian property.

The withholding regime also provides for a number of exclusions. In the main, if the foreign resident vendor falls within one of these categories then the 12.5% withholding is not applicable:

- Real property transactions with a market value under $750,000;
- Transactions by entities listed on an approved stock exchange;
- The foreign resident vendor is under external administration or in bankruptcy.

The withholding regime uses a clearance certificate model to provide certainty to purchasers regarding their withholding obligations. The clearance certificate confirms that the withholding tax is not to be withheld from the transaction.

Generally a clearance certificate will need to be obtained by an Australian resident vendor to avoid tax being withheld by a purchaser. A non-resident vendor would not ordinarily be able to apply for a clearance certificate but is able to apply for a rate variation if it is believed a withholding of 12.5% is inappropriate and a lesser rate should apply. For example, a variation could be applied for if the non-resident vendor has Australian tax losses available to offset against the gain.

Where a withholding obligation exists, the purchaser must withhold the relevant amount at time of settlement and pay it to the ATO without delay. The penalty for failing to withhold is equal to the amount that was required to be withheld and paid. The ramifications for a purchaser failing to withhold are so severe they invariably will be almost forced to assume withholding applies unless the vendor can prove otherwise.

It is important to remember the new measures impose a non-final withholding tax which means a non-resident vendor is still obligated to lodge an Australian income tax return returning any gain, but they will be entitled to a tax credit (or even a tax refund) for the withheld amount.

CGT discount

The general 50% CGT discount rules do not apply where a foreign resident purchased an asset on or after 8 May 2012. Where an asset was purchased prior to that date the CGT discount may still apply to some of the capital gain. Essentially, this requires a calculation, valuation and apportionment to determine the market value increase prior and subsequent to the 8 May 2012. The portion of the increase prior to the 8 May 2012 will be subject to the 50% discount.

Main residence exemption

Currently, any individual, regardless of their tax residency status, who sells their home, can qualify for the CGT main residence exemption.

In the 2017 Federal Budget it was announced the main residence exemption will no longer apply to a vendor who is a non-resident for tax purposes at the time they sign a contract to sell their home, regardless of how long the home has actually been used as a main residence.

At the time of writing no Legislation has been introduced to reflect the change which will apply from 9 May 2017 and importantly, any homes held before that date are grandfathered until 30 June 2019.

Once (and if) these proposed changes do become law, it will be very important for vendors to determine their tax residency status before they sign a contract to sell a property that would potentially qualify for the full or partial main residence exemption.

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