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Practice Group:
Tax

Foreign Resident Capital Gains Withholding Tax – Draft Legislation Released

Australia Tax Alert

By Betsy-Ann Howe

On 6 November 2013, the Federal Government announced that it would introduce a 10% non-final withholding tax on the disposal of certain taxable Australian property by foreign residents. This measure aims to assist the Australian Taxation Office (ATO) in collecting capital gains tax (CGT) liabilities from foreign residents.

In October 2014, the Government released a discussion paper to consult on the measure and on 8 July 2015 released draft legislation for public comment.

The measure imposes an obligation on purchasers to withhold 10% from the price of certain Australian assets and pay that amount to the ATO, when the vendor is a foreign resident.

The Government is inviting comments on the draft legislation and draft explanatory memorandum until 7 August 2015.

If enacted, these measures will apply to contracts entered into on or after 1 July 2016.

Compliance With the Current Regime

Under current law, a capital gain or capital loss made by a foreign resident is disregarded for Australian tax purposes unless the relevant CGT asset being disposed of is 'taxable Australian property'. Taxable Australian property includes an interest in Australian real property, an asset used to carry on a business at or through a permanent establishment in Australia, and rights and options in respect of these assets.

Foreign residents must lodge tax returns if they have derived Australian sourced assessable income, including a capital gain under the current foreign resident CGT regime. The ATO considers that voluntary compliance with the current legislative requirements is very low, and there are practical difficulties in the ATO's ability to recover this tax from foreign residents.

The New Regime

The draft legislation imposes an obligation on purchasers of certain Australian assets to pay 10% of the purchase price of taxable Australian property to the ATO, when the vendor is a foreign resident. The Explanatory Memorandum accompanying the draft legislation states that this obligation "does not require a withholding as such", but the practical effect will be the same.

The amount to be paid to the ATO is not a final tax on the vendor, but rather is an amount which will be credited against the non resident's Australian tax liability once a tax return has been lodged.

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Foreign Resident

The obligation to pay an amount to the Commissioner under the new regime will only arise if the purchaser has reasonable grounds to believe the vendor is a foreign resident.

As the foreign residency status of a vendor may be difficult to determine for the purchaser, the new regime incorporates knowledge tests which purport to provide certainty for purchasers. If a purchaser has no reason to believe a vendor is a foreign resident, the obligation to pay the Commissioner does not arise. If, however, the purchaser has specific knowledge that a vendor is a foreign resident or if the purchaser reasonably believes a vendor is a foreign resident, the obligation to pay the Commissioner is likely to arise.

Purchasers not comfortable applying the knowledge test may instead seek a vendor declaration that confirms the vendor is not a relevant foreign resident. It is expected that such declarations will become the norm, given that a purchaser that receives such a declaration is entitled to rely on it unless the purchaser knows that it is false.

Which Assets?

The new regime will apply to the acquisition of an asset that is:

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

The following acquisitions will not be subject to the regime.

- Transactions involving residential property valued at less than AUD2.5 million.
- An acquisition that is conducted through an on-market transaction on an approved stock exchange.
- An arrangement that is already subject to an existing withholding obligation.

Variations

The ATO may vary the amount payable in relation to a particular case or a class of cases. The foreign resident, the purchaser or a third party may apply for such a variation. An instance where this may be required is where a creditor of the vendor has a security interest over an asset which is subject to the new regime and the proceeds of sale are insufficient to cover the amount payable to the ATO and the amount required to discharge the security.

The ATO does not have any priority over secured creditors in relation to the recovery of tax and so it would be appropriate for the ATO to vary the amount payable by the purchaser.

How Might the New Regime Affect You?

If you are a purchaser buying taxable Australian real property, an indirect Australian real property interest or an option or right to acquire such property or interest, you may be required to pay 10% of the purchase price to the ATO if you have reason to believe that the vendor of the property is a foreign resident.

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A purchaser paying an amount to the ATO must register as a withholder. The timing of the obligation to make the payment to the ATO is when the purchaser acquires the property.

The standard administrative penalties for failure to withhold, including the general interest charge, apply for failure to comply with the new regime.

Please contact us with any questions, or if you require advice in relation to the foreign resident capital gains withholding tax and how it might affect you.

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