THE NEW 'FOREIGN RESIDENT' CAPITAL GAINS WITHHOLDING REGIME – A NEW TAX ON BECOMING AN OWNER

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From 1 July 2016, a 10% non-final withholding tax applies to persons who 'become the owner' of interests in Australian real property and real property-related membership interests such as shares, with a value above $2,000,000.

It is important to note that:

- although described as a tax in respect of payments to 'foreign residents' the tax can in fact apply regardless of the vendor's residency status. A vendor will be deemed a foreign resident where the asset to be disposed of is an interest in real property or company title property in Australia.

- although described as a 'withholding tax', the provisions can apply where there is no sale and where no money changes hand at all – all that is required is a change in ownership.

The amendments impose a significant compliance burden on purchasers, lessees, transferees and others who become the owner of affected property or interests. There is considerable complexity and this bulletin is a brief summary only. Unfortunately it is easy to predict that the wide reach of the new tax will catch many unawares.

The new provisions

The *Tax and Superannuation Laws Amendment (2015 Measures No. 6) Act 2016* (**Amending Act**) inserted a new Division 14-D into Schedule 1 of the *Taxation Administration Act 1953* (Cth), and provides that you must pay the Commissioner 10% of the first element of the cost base (generally, the aggregate purchase price) for an asset if:

1. you become the owner of a **relevant Australian asset**; and

2. at least one of the vendors of the relevant CGT asset was a **relevant foreign resident** at the time the transaction was entered into; and

3. the acquisition is **not** an **excluded transaction**.

The amount may be withheld from the payment that the purchaser makes to the vendor, and must then be remitted to the ATO.

What is a relevant Australian asset for the purposes of the new tax?

The obligation will only apply to the acquisition of an asset that is one of the following:

1. taxable Australian real property (**TARP**) – which is essentially an interest in real property in Australia and includes residential premises, commercial property, vacant land, and leasehold and strata property, as well as mining/prospecting rights; or

2. an indirect Australian real property interest – which is essentially a membership interest of greater than 10% in an entity whose TARP assets constitute 50% or more of that entity's value; or

3. an option or right to acquire such property or such an interest.

Who is a 'relevant foreign resident'?

Under the new provisions, an entity is a relevant foreign resident if, at the time the transaction was entered into:

1. the purchaser:

(a) is aware or reasonably believes that the entity is a foreign resident;

(b) does not reasonably believe that the entity is an Australian resident and either:

(i) the entity has an address outside Australia; or

(ii) is authorised to make payments outside Australia; or

2. the entity has a connection outside Australia, as specified in the regulations; or

3. the relevant Australian asset to which the transaction relates is a TARP or a company title interest (under company title, entities own shares in a company that owns real property rather than any direct real property interest).

The final definition relating to asset type means that **all vendors of TARP or company title interests are effectively deemed to be 'foreign residents' for the purposes of the new tax**. However, the new legislation has provided for a number of excluded transactions as well as an ability for the vendor to provide the purchaser in some cases with a certificate or a declaration that the vendor is an Australian resident for tax purposes, which can be relied on by the purchaser in not withholding or paying the10% tax as would otherwise be required. These elements are discussed further below.

Which transactions are excluded?

In an effort to minimise compliance cost with the new legislation, there is no obligation to pay the 10% tax in the following circumstances:

1. transactions involving TARP and company title interests, with a market value of less than $2 million;

2. a transaction that is conducted 'on market' (i.e. through a stock exchange) or particular off-market broker-operated trades (i.e. through a crossing system);

3. an arrangement that is already subject to an existing tax withholding obligation;

4. certain securities lending arrangements; or

5. transactions involving transferors who are subject to formal insolvency or bankruptcy proceedings.

There is also no obligation in the following situations:

1. in the case of TARP and company title interests, where the vendor obtains a clearance certificate from the Commissioner of Taxation; or

2. in the case of other types of property covered by the amendments:

(a) where the vendor has made a declaration that they are an Australian resident for tax purposes; or

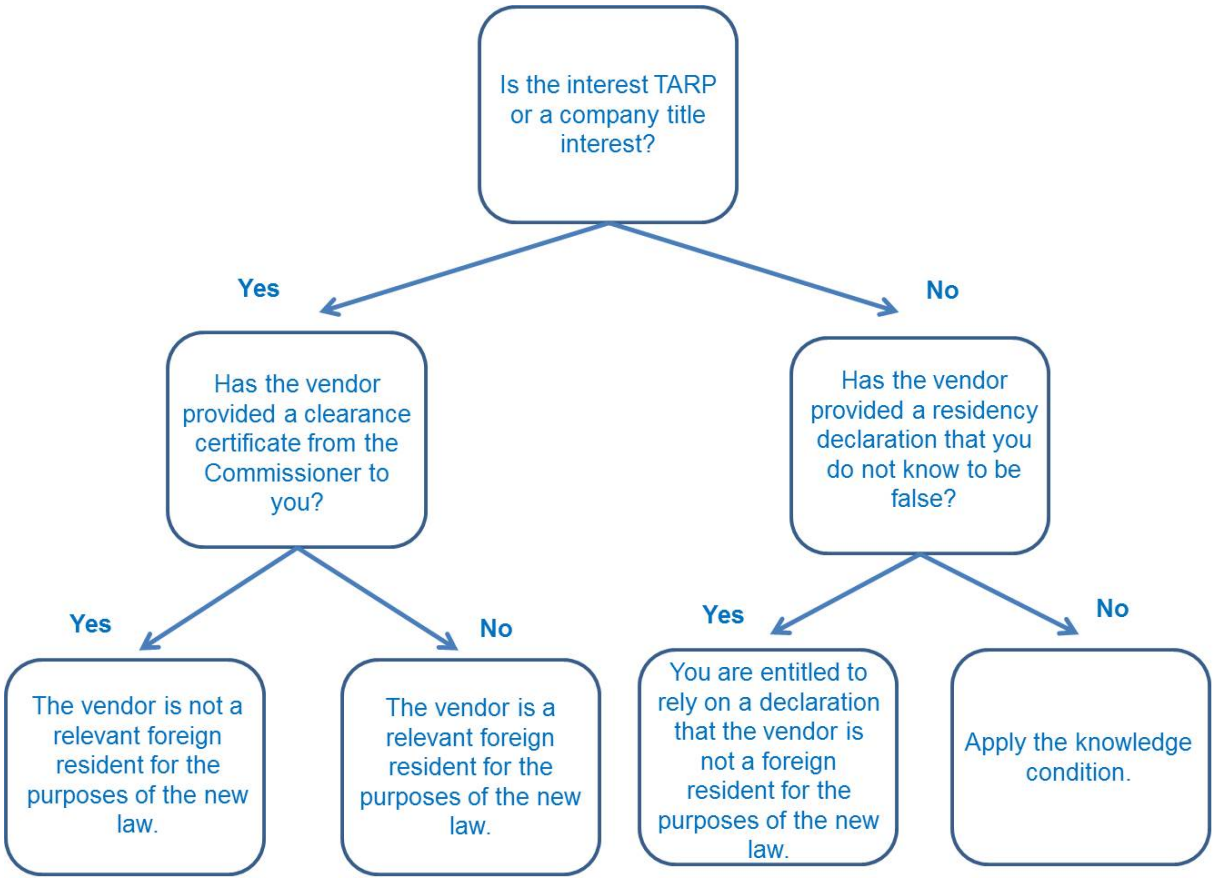
(b) where, if the relevant Australian asset acquired is a membership interest (other than company title), the vendor has made a declaration that the interest is not an indirect Australian real property interest.

This means that for membership interests (other than company title) and options in relevant Australian assets, whether the purchaser is dealing with a foreign resident depends on

whether the purchaser has knowledge that the vendor is a foreign resident or the vendor has made a declaration that they are an Australian resident for tax purposes.

In the case where the CGT asset to which the transaction relates is TARP, or an indirect Australian real property company title interest, the entity will be treated as a relevant foreign resident unless a clearance certificate is obtained from the Commissioner certifying that the entity is not a relevant foreign resident for the purposes of these amendments. In practice this means that for interests in Australian property with a value of more than $2million there is an obligation to pay the tax unless there is an ATO clearance certificate. Those certificates are already becoming a routine part of the conveyancing process.

The following flowchart from the Explanatory Memorandum to the amending legislation summarises the application of the new tax and when a clearance certificate or declaration may be relied on:



Wide scope – beyond purchases and sales

The new tax goes way beyond sales and purchases. Because the tax is attracted by a *change in ownership* it can apply not just to purchasers but also to transferees in many other situations, including *in specie* trust distributions, transfers pursuant to wills, matrimonial settlements and gifts. The Government has already issued a number of instruments effectively exempting some of those kinds of transactions from the operation of the new rules.

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