

Article

TAX

Foreign Resident CGT Withholding – Not Just for Foreign Residents!

Foreign Resident Capital Gains Tax Withholding Regime

By Briony Hutchens

The foreign resident CGT withholding tax regime inserted into the *Taxation Administration Act 1953* has been in effect since 1 July 2016.

While the name of the legislation suggests that it only applies to foreign residents, this isn't the case. In practice, all Australian resident vendors will need to comply with the prescribed regime prior to settlement to ensure that the purchaser is not obliged to withhold any amount and the vendor receives the full proceeds of sale at settlement.

The starting position for parties is to determine whether the transaction relates to an asset to which this regime applies.

What is a Relevant Asset?

The rules apply to transactions relating to:

- a. a direct interest in Australian real property;

- b. a company title interest in Australian real property (being an arrangement whereby the right to occupy a particular piece of land or unit in a building is conferred by ownership of a share in the company that owns the land or building);
- c. an indirect interest in Australian real property, which includes the sale of shares in a company which holds Australian real property where the market value of the Australian real property assets of the company is more than the non-Australian real property assets; and
- d. the grant of an option or right to acquire a direct or indirect interest in Australian real property.

For the purpose of the legislation, Australian real property includes mining, quarrying or prospecting rights and leases over Australian real property.

Different rules apply to the interests in categories (a) and (b) above (direct interests and company title interests) than to the interests in categories (c) and (d) (indirect interests and options or rights to acquire). Each of these will be explained below.

Direct Interests & Company Title Interests

Value Threshold

Subject to certain exclusions which are discussed in more detail later in this article, where the asset the subject of the transaction comprises a direct interest in Australian real property or a company title interest, the rules will apply if the value of the asset being acquired is \$2M or more.

Where the asset being acquired is only a proportionate interest in the relevant land, it is the value of the whole of the land, not just

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the interest being acquired, that is relevant. For example, if you are selling or acquiring a 50% interest in a piece of land with a market value of \$3M, the rules will apply because the value of the whole of the land is more than \$2M, even though the value of the interest being acquired or disposed of is only \$1.5M.

In a transaction involving unrelated parties, the purchase price will usually be accepted by the Commissioner as the market value of the asset, however this may not always be the case.

Withholding Obligation

Where the value threshold is met, the purchaser of the interest must withhold 10% of the purchase price and pay it to the ATO on or before settlement unless the vendor provides the purchaser on or before settlement with a clearance certificate verifying that the vendor was an Australian resident at the time that the transaction was entered into. For this purpose, the relevant date is the date that the contract is entered into, not the settlement date, or if no contract has been entered into, the date of transfer.

The ATO has, however, taken an administrative position that, provided the clearance certificate covers the date of settlement, it will still be valid and can be relied upon by the purchaser even if it does not cover the date of the contract.

Where there are multiple vendors, a clearance certificate must be obtained from all vendors to avoid a withholding obligation.

If any of the vendors do not provide a valid clearance certificate, this will trigger a withholding obligation on the purchaser for 10% of the whole purchase price, not just that portion of the purchase price payable to the vendor which has not provided the certificate.

In this situation the parties can apply to have the amount withheld varied so that, in effect, the purchaser is only withholding on that part of the purchase price payable to the vendor who has not provided a certificate. The variation process is explained in more detail later in this article.

Obtaining a Clearance Certificate

The vendor must apply to the ATO for a clearance certificate. The application can be made via the ATO website. Certificates are valid for 12 months and can be made at any time before a transaction is entered into.

Indirect Interests, Options & Rights to Acquire

Indirect Interest

You hold an indirect Australian real property interest if you and your associates hold 10% or more of the ownership interests in a company or trust which holds Australian real property and the value of the Australian real property assets held by the company or trust exceeds the value of its other assets. For example, if you sold 15% of the shares in a company which holds land in Australia worth \$3M and has other assets of \$2M, the shares

will be an indirect Australian real property interest and subject to the withholding rules.

Options & Rights to Acquire

A withholding obligation also arises on the grant of an option or right to acquire either a direct or indirect interest in land or a company title interest. In this situation, the withholding amount is calculated on the consideration paid for the option or right and, in the event that the option or right is subsequently exercised, the consideration paid for the option or right is taken off the purchase price for the underlying asset to ensure that the withholding obligation does not arise in respect of the same amount twice.

No Value Threshold

One of the most significant differences between the rules as they apply to indirect interests and options and rights to acquire interests is that there is no value threshold. That is, the \$2M value threshold that applies to direct interests does not apply, even where the option or right is to acquire a direct interest in land.

Accordingly, an indirect interest, option or right to acquire a direct or indirect interest is subject to the withholding regime regardless of:

1. the value of the interest, option or right itself;
2. the value of the underlying property over which the option or right is granted; and

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- where the indirect interest is an interest in a company or trust – the value of the land held by the company or trust.

purchaser requests the purchase price be paid to an overseas bank account; and/or

- Transactions that arise from the administration of the estate of a bankrupt, a composition or scheme of arrangement under the *Bankruptcy Act 1996*, a debt agreement under Part IX of the *Bankruptcy Act 1996* or a personal insolvency agreement under part X of the *Bankruptcy Act 1996*.

Withholding Obligation

Another difference between the rules as they apply to indirect interests and options and rights to acquire interests is that the vendor is not required to give a clearance certificate.

Instead, the purchaser can rely on either a declaration from the vendor or the purchaser's own reasonable belief and knowledge as to whether the vendor is an Australian resident.

In particular, a withholding obligation arises if:

- The purchaser knows or reasonably believes that the vendor is a foreign resident;
- The purchaser does not have a reasonable belief that the vendor is an Australian resident and either:
 - the vendor has an address outside Australia (according to any record that is in the purchaser's possession, or is kept or maintained on the purchaser's behalf about the transaction, e.g. the contract or any documents obtained during due diligence);
 - the vendor authorises the purchaser to provide a related financial benefit to a place outside Australia (whether to the entity or to anyone else), e.g. the

- the entity has a connection outside Australia of a kind specified in the regulations (no regulations have been made to date); or

- The vendor gives a declaration that they are an Australian resident at the time of entry into the transaction and the purchaser knows it to be false.

In practice, parties should ensure that the sale agreement contains a declaration from the vendor that they are an Australian resident at the time of entry into the agreement. Provided the purchaser doesn't know this to be false, then the purchaser can rely on the declaration and is not required to withhold.

Exclusions

There are a number of exclusions to the rules. Most relevantly, these include:

- Acquisitions of direct interests in Australian real property where the value of the real property is less than \$2M.
- Transactions on an approved stock exchange.
- Transactions where, at the time of the transaction, Section 161A of the *Corporations Act 2001* applies to the vendor (e.g. where the vendor is insolvent or under external administration at the time of the transaction).

If any of the above circumstances apply, the rules do not apply and no withholding obligation arises.

Variation

As mentioned above, where an amount is required to be withheld, any party to the transaction can apply for the amount to be varied if the tax liability arising from the transaction would be less than the 10% otherwise withheld. In these instances, the ATO may make a determination to reduce the amount to be withheld, potentially reducing it to nil. A variation is only effective upon the purchaser being given a copy of the Commissioner's determination to vary.

Examples of where this might be used include where there are multiple vendors, only some of which have given a clearance certificate, or if the asset being sold was a pre-CGT asset (and therefore any capital gain on sale will be disregarded), or if the vendor has capital losses that can be applied against any resulting capital gain.

Importantly, a variation application can be made by a creditor of the vendor.

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For example, a bank may make an application for variation where the debt secured by the asset is more than 90% of the sale price of the asset.

Payment

Where an amount is required to be withheld, the purchaser is required to register with the ATO as a withholder via the ATO website and complete an online "Purchaser Payment Notification" form which requires disclosure of the details of the vendor, purchaser and the asset the subject of the transaction. Once the amount to be withheld has been determined, the purchaser must pay the amount to the ATO at or before settlement via EFT, at Australia Post or via cheque.

Penalties will apply if a purchaser fails to withhold or does not pay the amount withheld by the date required.

Withholding Tax Credits

A vendor in respect of a transaction where amounts have been withheld is entitled to a credit for the withholding amount paid to the Commissioner. The credit does not arise until the amount has actually been paid to the ATO by the purchaser.

The entitlement to the credit arises at the time of the Commissioner making an assessment to income tax for the vendor in respect of the relevant year. The vendor must lodge an income tax return to claim the credit.

Practical Considerations

From a practical point of view, anyone who is entering into a contract for the sale and purchase of land after 1 July 2016 should ensure that the terms of the contract oblige the vendor to provide a clearance certificate and authorise the purchaser to withhold an amount from the purchase price at settlement if required to do so pursuant to the legislation.

Similarly, anyone entering into a contract or agreement for sale of an indirect interest or an option or right to acquire a direct or indirect interest should ensure that the terms of the contract or agreement contain a declaration from the vendor as to their residency and authorise the purchaser to withhold an amount from the purchase price at settlement if required to do so pursuant to the legislation.

Examples

Set out below are a number of examples to demonstrate how the provisions work.

Example 1 – Direct Interest

John and Sue have owned and operated a vineyard in the Barossa for 20 years. John and Sue decide to sell the vineyard and enter into a contract on 1 November 2016 to sell the vineyard to Barry for a price of \$3M.

Even though John and Sue are each selling a 50% interest in the vineyard, valued at \$1.5M, the withholding regime applies as the aggregate value of all interests in the land is over \$2M.

To prevent Barry withholding 10% of the purchase price on settlement, John and Sue need to provide a clearance certificate to Barry confirming that they were Australian residents at the time that the contract was entered into.

Example 2 - Variation

Assume the same facts as in Example 1, except that the land is being sold by John and Sue's bank as a result of them defaulting on their loan repayments. The amount owing to the bank is \$2.9M and John and Sue refuse to assist the bank in relation to the sale and have not obtained clearance certificates.

As no clearance certificates have been provided, Barry will be required to withhold 10% of the purchase price at settlement. However, as this would not leave enough money to fully discharge the debt owed to the bank, the bank can apply to the ATO for the amount withheld to be varied down to \$100,000 (from \$300,000). Provided the bank provides a copy of the ATO's determination as to the variation to the purchaser, the purchaser is only obliged to withhold the varied amount (\$100,000).

John and Sue will get a credit for the withholding tax paid when they lodge their income tax return for the 2016/2017 income year.

Example 3 – Indirect Interest

Assume that instead of John and Sue holding the vineyard in their own names, the vineyard was held by Wine Co Pty Ltd, a company in

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which John and Sue held all of the shares. In addition to the land, Wine Co Pty Ltd has other assets (plant and equipment, debtors, stock) with a value of \$1.2M. Barry purchases the shares in Wine Co Pty Ltd for \$1.8M. Under the contract for sale and purchase of the shares, John and Sue declare that they are Australian residents at the time of entry into the contract.

As the value of the land is more than the value of the other assets held by the company and the shares represent more than a 10% interest in the company, the shares are an indirect interest in Australian real property. As John and Sue have given a declaration as to their residency, Barry does not have to withhold any amount at settlement unless he knows the declaration to be false.

Example 4 – Option

Assume the same facts as in Example 1, except that instead of selling the land, John and Sue grant Barry an option to purchase the land exercisable in 12 months time. Barry pays \$100,000 for the option and in the event that it is exercised, this amount will be credited against the purchase price of the land such that Barry only has to pay \$2.9M at settlement.

To prevent Barry from withholding an amount from the \$100,000 option fee, John and Sue should provide to Barry a declaration that they are Australian residents at the time of granting the option.

If the option is exercised, the contract for sale and purchase of the land subsequently formed on exercise is a separate transaction. John and Sue will therefore have to obtain clearance certificates confirming that they are Australian residents at the time of exercise of the option and entry into the contract for sale and purchase of the land to prevent Barry from withholding any amount from the purchase price at settlement.

If Barry was required to withhold an amount at settlement of the land, he would only be required to withhold 10% of \$2.9M, being the difference between the purchase price for the land (\$3M) and the option fee (\$100,000).



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