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# *Australia: Removal of capital gains tax exemption for foreign residents on sale of main residence*

*February 8, 2018*

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## ***In brief***

On February 8, 2018 the Australian Government introduced a Bill to remove the capital gains tax (CGT) exemption for the sale of a main residence by a foreign resident. A foreign resident for tax purposes includes Australian citizens, permanent residents and New Zealand citizens who are not a tax resident of Australia.

As part of the 2017-18 Federal Budget, the Australian Government announced on May 9, 2017 a range of reforms to reduce pressure on housing affordability. The main reform that will affect internationally mobile employees is the removal of the main residence exemption for Australian CGT purposes for foreign residents.

This proposed reform was the subject of a consultation process during July/August 2017 with the release of an Exposure Draft. On February 8, 2018, a Bill, which does not differ from the Exposure Draft, has been introduced into the House of Representatives.

For properties acquired on or before May 9, 2017, the new rules will not apply to disposals of the property until after June 30, 2019.

Most of the other reforms related to properties have now been legislated such as:

- New law denying landlords deductions for travel expenses relating to rental properties;
  - New law limiting depreciation deductions for assets in rental properties;
  - Increase of the withholding tax rate from 10% to 12.5% and reduction of the CGT withholding threshold for Australian real properties from A\$2 million to A\$750,000 for foreign resident vendors; and
  - New property vacancy fee and annual reporting by foreign owners who have an Australian residential property which is not occupied for at least 183 days in a 12-month period.
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## **In detail**

### **Current CGT exemption - sale of main residence**

The Australian main residence exemption provides an exemption from CGT where a gain is made on the disposal of a dwelling and it is an individual's main residence throughout their ownership period.

The main residence exemption rule also provides a partial exemption if the dwelling was the individual's main residence for only a part of their ownership period or if it was also used partially to produce assessable income (e.g. rental income) during their ownership period.

Furthermore, in cases where individuals do not treat any other dwelling as their main residence, they can treat their dwelling as their main residence for CGT purposes for up to six years if their main residence is rented out or for an unlimited period where their main residence is not rented out. This rule is commonly known as the 'absence rule'.

### **Changes for foreign residents**

The Bill introduced into the House of Representatives proposes that the CGT main residence exemption will be denied from 7:30pm (AEST) on May 9, 2017 for all foreign residents.

### **Foreign resident**

For the purpose of the Bill, 'foreign resident' means someone who is not a tax resident of Australia. Foreign residents, including Australian citizens, permanent residents and New Zealand citizens who are foreign residents, should consider how these changes will impact their circumstances.

If the Bill is legislated in its current form, individuals who sell their main residence and who are foreign resident at the time of disposal

(referred to as a 'CGT event') will no longer be entitled to the main residence exemption. This will include Australian citizens or permanent residents going overseas and becoming non-residents.

### **Importance of the Australian tax residency status at the time of disposal**

For individuals having an ownership interest in a dwelling, the date of the disposal of their interest in the dwelling generally will be the time a contract for sale is entered into. This will be the relevant time to determine whether the individual is an Australian resident or a foreign resident.

If, at that time, the individual is a foreign resident, the main residence exemption will not apply. As a result, the capital gain or loss on the disposal will not be exempt for Australian tax purposes.

The Bill does not contain any apportionment of the main residence exemption. This means that the days the dwelling has been owned as an Australian resident for Australian taxation purposes is irrelevant.

### **Interaction with the 'absence rule'**

In the Bill, there is no consideration of the Australian "absence rule" which allows an individual to continue to treat a dwelling as their main residence (subject to the conditions listed above) for CGT purposes.

Accordingly, if an individual is a foreign resident at the time they sell their residence, they would be subject to CGT on the full amount of any capital gain.

If the Bill is enacted as proposed, this would be a partial abolition of the 'absence rule' as foreign residents would no longer benefit from this rule. However, individuals who resume

Australian tax residency prior to selling their main residence may still be able to benefit from the 'absence rule'.

### **Example**

The Bill provides the following example:

*Vicki acquired a dwelling on September 10, 2010, moved into it, and established it as her main residence. On July 1, 2018 Vicki vacated the dwelling and moved to New York. On October 15, 2019 Vicki signs a contract to sell the dwelling. As Vicki is a foreign resident on October 15, 2019, she is not entitled to the main residence exemption. This outcome is not affected by Vicki previously using the dwelling as her main residence.*

However, where an individual returns to Australia and resumes Australian tax residency before entering into a contract of sale, they may still be able to claim the main residence exemption.

### **Application and transitional provisions**

The amendments to the main residence exemption rules for foreign residents apply to CGT events happening on or after 7:30pm (AEST) on May 9, 2017.

However for properties acquired on or before May 9, 2017 the new rules will not apply to disposals of the property until after June 30, 2019.

Therefore, individuals who owned an Australian dwelling before May 9, 2017 that they use as their main residence - or where the absence rule provision applies to treat this dwelling as their main residence - will still be able to benefit from the main residence exemption for disposals on or prior to June 30, 2019.

In this context, foreign residents who owned a main residence before May 9, 2017 may consider selling their main residence before June 30, 2019, should they wish to benefit from the exemption.

### *Foreign resident at the date of death*

Where an individual is a foreign resident at the date of death then the portion of the main residence exemption accrued by the deceased individual in respect of the dwelling is not available to the beneficiary.

### *The takeaway*

If the Bill is legislated in its current form, the main residence exemption removal for foreign residents will have impacts for both companies and individuals.

### *Employers of expatriates*

Employees may be more reluctant to accept an assignment outside Australia if they will be negatively impacted by these rules.

In order to benefit from the main residence exemption, employees will need to either sell their home before

going overseas, wait until they return to Australia before selling their main residence, or perhaps delay or not take up the assignment at all.

Employees may seek to remain Australian tax residents or defer their assignment until their main residence is sold. This may have associated cost implications for the employer. For example, there could be additional tax costs for the employer on benefits if the employee were to remain an Australian tax resident.

Employees may alternatively seek reimbursement from their employer of any additional tax should they sell their main residence while on assignment (where transitional relief is not available).

Employers who have tax equalisation arrangements and who tax equalise personal income, should consider whether they will tax equalise any CGT imposed on the sale of an employee's main residence where they are a foreign resident and no longer qualify for the main residence exemption.

Finally, employers should ensure that employees who are either foreign residents or who will become foreign residents are made aware of the changes, and seek appropriate tax advice.

### *Individuals*

Individuals who are either foreign residents or who will become foreign residents will need to be aware of the potential tax implications should they sell their main residence while they are foreign residents.

Advice on tax residency, the potential impact of the proposed rules, as well as the calculation of any potential CGT should be considered.

If a main residence was acquired on or before May 9, 2017, current and future foreign residents may want to consider selling their main residence before June 30, 2019 in order to benefit from the transitional rules.

In any case, globally mobile employees should seek specific personal taxation advice in order to evaluate the impact of these measures and take action where appropriate.

## **Let's talk**

For a deeper discussion of how this issue might affect your business, please contact your PwC Global Mobility Services engagement team or one of the following individuals:

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