Foreign Purchaser Surcharge

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In brief

As part of Australia's housing affordability crisis and residents' concerns about being priced out of the market, States were faced with increased pressure to alleviate soaring property prices. Victoria's response to this was to introduce a Foreign Purchaser Surcharge for residential property purchases and land tax on both residential and commercial properties from 1 July 2015.

At the time, this was considered to be a highly controversial move that would deter foreign investment in Victoria. However, one year on, the Victorian government has announced that foreign investment in Victorian real estate has almost doubled in the last 12 months (which has also resulted in additional revenue from the surcharge). In light of this, the Victorian government decided to increase the rates of both the stamp duty and land tax surcharge. New South Wales (NSW) and Queensland have also followed suit, introducing surcharges of their own.

In typical stamp duty fashion, despite the common intention and starting point for the surcharge, each State has introduced its own individual mechanisms to impose differing rates, for different types of property, on different classes of purchasers.

In detail

Comparison of current rates of duty and land tax surcharge

	Victoria	Queensland	NSW
Stamp duty surcharge on residential property	7 per cent from 1 July 2016	3 per cent from 1 October 2016	4 per cent from 21 June 2016
Land tax surcharge for the 2017 land tax year	1.5 per cent for residential and commercial property	None	0.75 per cent for residential property

Who is a "Foreign Person" for the purposes of the duty surcharge?

In all States, the surcharge is imposed on a "foreign person", which generally includes a foreign natural person, corporation or trustee of a foreign trust. However, exactly who is included in this definition varies.

For foreign natural persons all States are consistent, applying to persons other than Australian citizens and holders of certain types of permanent resident visas.[1] For foreign corporations and trusts there is more variation, with NSW referring directly to the definitions in the Foreign Acquisitions and Takeovers Act 1975 (Cth) (FATA) and Victoria and Queensland providing their own tests.

Who is a foreign corporation or trust?

Victoria and Queensland both include any corporations incorporated outside of Australia, as well as any corporations or trusts where a foreign person (whether an individual, company or trust) has a "substantial" or "controlling" interest. For trusts, this generally requires an interest in the trust of 50 per cent or more. For companies, this broadly requires a foreign person to own 50 per cent or more of the shares in the corporation, or be in a position to control 50 per cent of the voting power, or potential voting power, in the corporation.[2] The definition of "voting power" and "potential voting power" in both of these States still links back to the FATA. Accordingly, notwithstanding the difference in legislative approaches, there is still a significant overlap in the concepts between all three States. The key substantive difference is that Victoria and Queensland have raised the interest threshold to 50 per cent instead of the 20 per cent threshold under the FATA adopted by NSW.[3]

What interests are taken into account in determining if the interest threshold has been breached?

In determining whether these interest thresholds are met there are also aggregation rules that need to be considered. Queensland and NSW both aggregate the interests of all foreign persons (whether or not they are associates) and associates of each foreign person (even if the associate is not a foreign person). In Victoria, for the purposes of the duty surcharge,[4] only the interests of associated persons are aggregated, not all unrelated foreign persons.[5] Nevertheless, "associate" is a broad concept in all of the States and can include, for example, trusts where they have a single common beneficiary (regardless of percentage ownership), meaning that seemingly unrelated parties can still be aggregated.

In addition, the Victorian Commissioner has a broad power to treat a corporation or trust as a foreign person if, in the Commissioner's opinion, the person has the ability to influence the outcome of the decisions about the corporation or trust's financial and operating policies.[6] This determination is based on any rights that the person can enforce, the practical influence that the person can exert and any practice or behavior affecting the corporation or trusts financial or operation policies, even if that practice or pattern of behavior involves the breach of an agreement or a breach of trust.[7] Further, this power applies regardless of any interests that any other person may have in the corporation or trust.[8]

How far do the rules trace?

In all States, if a corporation or trust is a foreign person under these tests, that classification then becomes relevant to the classification of other corporations or trusts that they hold interests in. At each step in the chain it is necessary to check whether the relevant "substantial" or "controlling" interest threshold has been breached for that corporation or trust (taking into account the aggregation rule set out above), after applying these tests to its investors. That is, it is possible to trace through a series of "substantial" or "controlling" interests from a foreign person to an Australian incorporated and resident company or trust at the bottom of a chain of Australian incorporated and resident companies and trusts.

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[1] Namely, a permanent visa under section 30(1) of the *Migration Act 1958* (Cth) or a New Zealand citizen with a special category of visa under section 32(12) of the *Migration Act 1958* (Cth).
[2] For Victoria, the requirement is more than 50 per cent rather than 50 per cent or more.
[3] Section 17 of the *Foreign Acquisitions and Takeovers Act 1975* (Cth).
[4] This is different to the position for Victorian land tax purposes which is discussed further below.
[5] The definition of "associate" is quite broad and can include two trusts where there is at least one common beneficiary.
[6] Sections 3C and 3D *Duties Act 2000* (Vic).
[7] Sections 3C and 3D *Duties Act 2000* (Vic).
[8] Sections 3C and 3D *Duties Act 2000* (Vic).

Who else can be included as a foreign person?

In NSW, the surcharge will apply if the funds have been provided by a foreign purchaser, regardless of the legally named purchaser.[9] Also, as NSW essentially adopts the definition of foreign person set out in the FATA, it also expressly applies to bodies other than corporations or trusts, such as foreign governments.

One of the most important (and surprising) extensions to the foreign person definition is the Queensland rule which requires the test to continue to be applied for 3 years after the liability arose. If the purchaser becomes a foreign person within this 3 year period, the provisions require the corporation or trustee to give notice to the Commissioner within 28 days of becoming a foreign person and for the Commissioner to issue a reassessment of duty, imposing the surcharge retrospectively.[10] This means that if an Australian owned company that owns residential land is acquired by a foreign person, the surcharge could become payable on both the acquisition itself and retrospectively on acquisitions of residential property made directly or indirectly by that company in the last three years.

What is subject to the duty surcharge?

All three States have limited the duty surcharge to direct and indirect acquisitions of interests in "residential property". However, once again, they have adopted slightly different definitions of exactly what should be included.

Victorian approach

The original definition under the Victorian provisions introduced last year broadly defined "residential property" as land on which there is a building that is designed and constructed solely or primarily for residential purposes and may lawfully be used as a place of residence.[11] It also included an intention test, to ensure that land which will be developed into residential property was also caught.

While clear enough on first reading, it quickly became apparent that determining exactly where the boundaries of this definition were was not as easy as it seemed. However, over the course of the year, the Victorian Revenue Office issued private rulings to various taxpayers confirming that hotels and serviced apartment buildings should not be included as residential property.

In an amending bill brought before Parliament in April this year, the Victorian government briefly proposed expanding the definition of residential property to include "short term accommodation", such as hotels, motels, retirement villages, student accommodation and serviced apartments. This was purportedly to "remedy" an apparent gap in the rules.[12]
However, this bill was changed during its passage through the Legislative Council following a great deal of industry pressure. Citing a need to "ensure that unintended consequences will not occur" the definition of "residential property" was amended to remove the new addition of "short term accommodation". Instead, the definition of residential property was changed to expressly exclude premises used or intended to be used as commercial residential premises (which takes its definition from the GST legislation[13]), a residential care facility, a supported residential service or a retirement village. In the second reading speech, the Government noted that this was to ensure that premises such as "hotels, motels, serviced apartments and student accommodation will not be captured by the duty surcharge."

While on its face, this appears to settle the position on what should or shouldn't be included in the definition of "residential property" in Victoria, it is likely that there will still be some questions around the limits of the definition. This is because the definition of "commercial residential property" under the GST law that has now been adopted in Victoria is still a relatively contentious part of the GST legislation. The

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[9] Section 104T *Duties Act 1997* (NSW).
[10] Section 246A *Duties Act 2001* (Qld).
[11] Section 3 *Duties Act 2000* (Vic).
[12] *State Taxation and Other Acts Amendment Bill 2016* (Vic), as originally introduced to the Legislative Assembly on 27 April 2016.
[13] *A New Tax System (Goods and Services Tax) Act 1999* (Cth).

definition has been subject to a number of court cases (including consideration by the High Court) and there still continues to be uncertainty around areas such as student accommodation (particularly relating to the level of connection to universities required) and hotel rooms not included in hotel letting pools. Accordingly, it will still be important that consideration is given to the particular characteristics of the relevant property before assuming it can be safely excluded.

The amending bill also added provisions to capture situations where existing buildings (or parts of them) are intended to be refurbished into residential premises.[14] However, unlike NSW and Queensland, the Victorian provisions do not appear to include an ability to apply the surcharge to only the residential proportion of the land.

The other key (and at this stage unique) feature of the Victorian definition of residential property is that it also applies where the purchaser changes their intention after acquisition. This means that a foreign purchaser who acquires non-residential property but subsequently forms the intention to convert it into residential property may have to pay the surcharge. There is no clear time limit on how long after a purchase this change of intention test continues to apply. Further, the rate of the surcharge is the rate that applies at the time of the change of intention not the original purchase. This means that a commercial property acquired before 1 July 2016, where the intention to convert it to residential property is formed after 1 July 2016, would be subject to the 7 per cent surcharge not the 3 per cent surcharge that would have applied at the time of acquisition.

NSW approach

NSW introduced its own concept of "residential land" which includes:

- land on which there are dwelling(s) or building(s) under construction that, when completed, will constitute one or more dwellings;
- strata lots, utility lots, or land use entitlements that relate to a separate dwelling; or
- substantially vacant land that is zoned or otherwise designated for residential or principally residential purposes.

There is a carve-out for land used for primary production,[15] but mixed use developments will be subject to duty on a proportionate basis. [16]

The clear limits of the intended definition of "residential land" and how it might apply to commercial residential property are not expressly dealt with in the NSW legislation itself. However, NSW Revenue Office has released detailed guidance about the foreign surcharge provisions, including their interpretation of the definition of "residential land". This guidance indicates that commercial residential premises such as hotels, motels, caravan parks, camping grounds and premises used to provide accommodation in connection with a school should not be subject to the surcharge. While retirement villages and other student accommodation would arguably also fit into the description of commercial residential premises, both are notably absent from the list of examples of types of property excluded from the surcharge.

Interestingly, at this stage, the NSW definition does not include commercial properties that are intended to be demolished or refurbished for residential purposes (which would be captured under the Victorian definition) but will include any vacant land zoned for residential purposes regardless of how the land is actually proposed to be used.

A unique feature of the NSW provisions is that they already had a premium rate of duty for residential land having a value over $3 million (with the top rate increasing from 5.5 per cent to 7 per cent). While

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[14] Section 3G *Duties Act 2000* (Vic).
[15] Section 104I *Duties Act 1997* (NSW).
[16] Section 104ZB *Duties Act 1997* (NSW).

there is significant overlap between the definition of residential land for the purposes of the premium property surcharge and the foreign purchaser surcharge, they are not identical,[17] adding an extra layer of complexity for investors. If both the premium property surcharge and foreign purchaser surcharge apply, the top rate of duty is 11 per cent (i.e. double the top rate of 5.5 per cent that applies to standard commercial transactions).

Queensland approach

Residential land is land in Queensland that is, or will be, solely or primarily used for residential purposes and, on which there is, or will be, a building designed or approved for 'human habitation for a single family unit' (i.e. a test based on current and intended use for the land).[18] It also includes buildings that are intended to be refurbished to meet this definition and mixed use developments (i.e. only part of the building needs to used as residential).[19] Like NSW, Queensland only applies the duty surcharge to the residential proportion of the mixed use development.

The language of 'human habitation by a single family unit' appears to have been adopted from the definition of 'residential' under Queensland's electronic conveyancing network (PEXA). In the initial roll-out of PEXA, the system was designed to cater specifically to the family home. This would suggest that the legislative intent is to exclude commercial residential premises such as hotels and motels. This is broadly consistent with the guidance published by the Queensland Revenue Office which indicates that it considers that hotels and motels should not be residential land. However, retirement villages and student accommodation have been specifically identified as requiring consideration on a case-by-case basis.

Is apportionment available for joint Australian and foreign investment?

Where residential land or interests in landholders that hold any residential land[20] are purchased by multiple parties, of which some are foreign persons, the surcharge is generally applied on a proportionate basis, such that Australians are shielded from its application. However, there does not seem to be any ability to apportion if the acquiring entity is partly foreign owned. For instance, an Australian company, owned 55 per cent by foreigners and 45 per cent by Australians, may be subject to the surcharge on the entire amount for a purchase of residential land or acquisition of a residential landholder. This would unintentionally subject Australians to the surcharge. The situation is even worse in NSW where a mere 20 per cent interest is enough to deem a company to be foreign.

When does the surcharge start to apply?

As noted above each State has a different commencement date for the surcharge – NSW's surcharge commenced on 21 June, Victoria's rate increased from 1 July and Queensland will commence on 1 October. In a bid to create certainty, transitional arrangements exist to prevent the surcharge from applying retrospectively. In all three States, the date of entry into the contract (even if those agreements settle after the commencement of the surcharge) is generally intended to be the relevant point for determining whether the surcharge applies (even if this is not the duty trigger). However, in Victoria, there is some uncertainty about whether the transitional provisions properly achieve this outcome for direct purchases of land.[21]

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[17] For example, the premium property surcharge refers to "vacant land" zoned for residential purposes, while the foreign purchaser surcharges include "vacant land" and land that the Commissioner is satisfied is "substantially vacant".
[18] Section 232 *Duties Act 2001* (Qld).
[19] Section 232 *Duties Act 2001* (Qld).
[20] That is, a company or trust that holds landholdings with a value above $2 million in NSW and Queensland or $1 million in Victoria, that includes any residential land.
[21] The transitional provisions deal in detail with imposition of landholder duty but for transfer duty are focused on when the liability arises, which is generally on completion rather than signing of the agreement.

What powers do the States have to collect the surcharge?

Given the considerable difficulties governments face in collecting tax from foreigners, it makes sense that a surcharge targeted specifically at foreigners would require additional enforcement mechanisms. In a bid to add teeth to the surcharge, the Victorian and Queensland Commissioners are empowered to impose a first charge on the land for any unpaid duty. Beyond operating as an impediment to sale, a charge also has significant implications in ensuring compliance with financing covenants for the investment, with the registration of a charge potentially triggering a review or default event. Currently, NSW does not empower the Commissioner to register a charge.

In Queensland, the Commissioner may also pursue either the purchaser or vendor for unpaid duties, as both are jointly and severally liable. While it has historically not commonly pursued vendors to recover duty, the Act now provides a mechanism for jointly liable parties to recover surcharge amounts from others.[22] While the guidance published by the Queensland Revenue Office suggests that this is intended to apply for aggregated purchasers, it may also suggest an increased intention to exercise its previously dormant powers, leaving the burden to the surcharge amount with the onshore vendor.

Land Tax Surcharge

Victoria has the broadest land tax surcharge, extending beyond the residential land subject to the duty surcharge, to both residential and commercial land. It instead uses a concept of “absentee persons” which is a broader concept than the Victorian “foreign person” test set out above for corporations and trusts. For working out whether a corporation is an absentee person, there is still a 50 per cent interest threshold but it uses a test that more closely resembles the “subsidiary” test in the *Corporations Act 2001* (Cth) and it aggregates the interests of all absentee persons (regardless of whether they are associated). For trusts, the provisions are much broader, with a single absentee beneficiary enough to make the trust an absentee trust, regardless of the interest held.

NSW’s approach to land tax has been more consistent with its approach to the duty surcharge, limiting the application of the land tax surcharge to residential land and adopting the same definitions of residential land and foreign person as for the duty surcharge.

As of yet, Queensland has not indicated any intention to introduce a land tax surcharge.[23] However, given that land tax applies based on land held as at 31 December of any given year, it is not too late for it to be introduced for the next land tax year if it were to decide to do so.

Are there any special exemptions?

It’s not all bad news for foreign purchasers, who may be comforted by the possibility of an exemption in Victoria and Queensland. In Victoria, this relief is included in the legislation, supported by Treasurer’s Guidelines which set out the factors that will be taken into account in determining the availability of relief. In Queensland, there is no specific legislative power but guidance published by the Queensland Revenue Office has indicated that it may be willing to provide ex gratia relief in certain circumstances. In both cases the relief is highly discretionary and is generally intended to apply to foreign purchasers whose commercial activities benefit the relevant State (e.g. through contributions to the economy, community, infrastructure or housing supply). At the moment, NSW has not indicated an intention to offer any form of special relief.

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[22] There is no statutory right to recover all or part of the base rate of transfer duty or landholder duty that the parties also share joint and several liability for, only the foreign surcharge component. Parties will continue to need to rely on contractual arrangements to allow them to recover any share of duty from another party to the transaction (e.g. for the vendor to recover from the purchaser).

[23] Noting that Queensland already imposes a higher rate on land owned by non-Australian resident individuals that on Australian resident individuals (bring them into line with companies and trusts).

The takeaway

Despite the raft of criticisms the surcharge has been met with, a look at the international landscape shows that this tax is not unique or quite as outlandish as it may first appear. Similar residential duties have been adopted in England, Wales and Northern Ireland, while China subjects foreigners to vigorous requirements on any purchase of land. In light of this international precedent, and following the apparent lack of deterrence to foreign investment in Victoria, NSW and Queensland have been emboldened to follow suit. With State economies continually searching for new sources of income, the surcharge is likely to become a new commercial reality for foreign investors. If past form is anything to go by, we may see an expansion of the application of the surcharge and the introduction of the surcharge in other States and Territories over the coming years - continuing a long standing tradition of following the leader with expansions to the duty/land tax base.

This surcharge highlights the inconsistency between State and Federal messaging to foreign investors, with the Federal Government, not that long ago, talking about Australia "being open for business" and making changes to the AMIT rules to help encourage foreign investment. It also demonstrates the difficulties for businesses, including foreign investors, of operating in a system with so many different sets of rules, with each State introducing a different set of complex rules for what is effectively the same tax. While difficult in the current political climate, it further demonstrates the need for continued discussions on tax reform involving both the State and Federal governments.

Let's talk

For a deeper discussion of how these issues might affect your business, please contact:

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