
Foreign resident capital gains tax withholding regime

21 June 2016

In brief

On 25 February 2016, Tax and Superannuation Laws Amendment (2015 Measures No 6) Act 2015 became law, introducing a new 10 per cent non-final withholding tax on the acquisition of certain taxable Australian property from foreign residents.

This new regime applies to contracts entered into on or after 1 July 2016 for the sale of real property in Australia or relevant property interests. Below, we consider some of the practical aspects of the new regime for both vendors and purchasers.

In detail

The new withholding regime is intended to ensure that capital gains of foreign residents do not escape tax in Australia by imposing a new obligation on the purchaser (whether they are an Australian resident or not) in relation to a relevant transaction. The obligation applies to a transaction involving the acquisition of an asset that is taxable Australian real property (TARP), an indirect Australian real property interest (such as a membership interest in a 'land-rich' company or trust) or an option or right to acquire such property or such an interest, unless:

- the transaction is specifically excluded from the new regime (e.g. transactions involving real property valued under \$2 million, on-market transactions, or transactions involving vendors that are subject to formal insolvency or bankruptcy proceedings), or
- in the case of a transaction involving TARP, the vendor provides a clearance certificate issued by the Australian Taxation Office (ATO) that confirms the vendor is not a foreign resident, or
- in the case of a transaction that does not involve TARP, the vendor provides a 'residency' declaration or an 'interests' declaration (declaring that the asset is not an indirect Australian real property interest), or the purchaser has sufficient knowledge that the vendor is an Australian resident.

If an exception above does not apply, the purchaser is required to pay 10 per cent of the first element of the cost base (usually, the purchase price where dealings are at arm's length) to the Commissioner on settlement of the transaction. The amount to be paid to the Commissioner will usually be withheld from the proceeds of the transaction, and the foreign resident vendor will be entitled to a credit for that amount

paid upon lodging an income tax return. Any party to the transaction can apply to the ATO for variation of the rate of tax payable where they believe the 10 per cent rate is excessive (see below for examples of when this might be relevant).

Some practical considerations for purchasers and vendors are outlined below.

For Purchasers

The penalty for failing to withhold lies with the purchaser. What do you need to do to mitigate these penalties?

For transactions involving membership interests, if the vendor has not provided a residency or interests declaration, what information do you have about the vendor and/or the relevant asset to decide whether to withhold?

Does the transaction proceeds comprise at least 10 per cent in cash? If not, you will be required to fund the withholding tax liability, as the market value of any property given in relation to the acquisition is included in determining the amount to be paid to the Commissioner. A similar issue may arise where part of the purchase price is payable after settlement (for example, in a deferred payment or vendor financing arrangement).

When should you notify the ATO of the transaction? The ATO has advised that a purchase payment notification form needs to be completed and lodge “on or before the day of settlement of the purchase of the asset”. However, where withholding is required, this form should be lodged well before the date of settlement to enable the ATO to issue you with a payment reference number that must accompany the payment of the tax.

For Vendors

For an Australian resident vendor, do you need to obtain a clearance certificate from the ATO or can you provide a residency declaration? This depends on the nature of the asset being sold, as a clearance certificate is required for transactions involving TARP.

For an Australian resident vendor selling TARP, when should you apply for a clearance certificate to ensure that no amount is withheld from the proceeds? A clearance certificate can be applied for online at <https://www.ato.gov.au/FRCGW> and is expected to be issued within days for most cases or up to 28 days for irregular cases. A paper copy of the clearance application is also available. An application for a clearance certificate should be considered in the initial phases of any transaction to avoid delays.

For transactions involving membership interests, can you provide an ‘interests’ declaration confirming that the asset is not an indirect Australian real property interest? What information is needed and/or available in relation to the underlying assets of the company or trust?

Can or should you seek a withholding rate variation? Consider whether you will make a capital loss from the transaction, have carried forward capital or tax losses that can be utilised, or can apply a capital gains tax roll-over to the transaction. A withholding rate variation application can take up to 28 days to process where all information required is provided to the ATO, so should be considered early in the planning stages of the transaction. It is unclear at this stage what kind of supporting documentation the ATO may seek in order to approve a variation, although we understand that the ATO will provide some clarity on the documentation requirements via its proposed Law Companion Guidelines (refer below). The timing of the variation is critical - unless the purchaser has received the Commissioner’s approved variation by the time the contract settles, the purchaser will continue to have an obligation to withhold at the full rate.

The ATO is developing a legislative instrument and a number of Law Companion Guidelines to accompany the new rules that should hopefully provide clarity on some other outstanding practical issues. At the date of writing, these Guidelines have not yet been released. We expect that the Guidelines will cover:

- how the withholding rules apply to acquisitions from multiple entities (this will be in the form of a legislative instrument)

-
- amount payable to the Commissioner where the value of the asset is different to the contract price or the contract price relates to more than one asset
 - how the withholding rules will apply to option arrangements (for example, when will the withholding obligation arise if the option price is less than \$2 million but the exercise price is greater than \$2 million, what if the vendor ceases to be an Australian resident after granting an option), and
 - the Commissioner's variation power and supporting documentation that should be lodged with a rate variation application.

The takeaway

The new rules are drafted very widely, in particular in relation to acquisitions involving TARP, where, to avoid withholding, a clearance certificate from the ATO will be required, regardless of the identity of the vendor (even if the vendor is an Australian government authority).

For transactions involving membership interests, purchasers may need to perform additional due diligence to confirm the vendor's residency and the nature of the underlying assets, and may need to seek declarations from the vendor regarding these factors. Contracts should be reviewed to ensure the new withholding obligation is adequately addressed e.g. through withholding tax gross-up clauses (if appropriate). Other practical issues that should be considered include:

- Appropriate clauses should be included in the sale contract so each party is clear about their responsibilities e.g. making declarations about residency and the nature of underlying assets, obtaining clearance certificates/variations, etc.
- How the rules apply to the issue of shares/units in a land rich company/trust or conversion of convertible instruments, and
- In some cases, contracts entered into before 1 July 2016 but becoming unconditional on or after 1 July 2016 may also be caught under these rules.

Let's talk

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

Joshua Cardwell, Sydney
+61 (2) 8266 0532
josh.cardwell@au.pwc.com

Christian Holle, Sydney
+61 (2) 8266 5697
christian.holle@au.pwc.com

Mike Davidson, Sydney
+61 (2) 8266 8803
m.davidson@au.pwc.com

Kirsten Arblaster, Melbourne
+61 (3) 8603 6120
kirsten.arblaster@au.pwc.com

Nick Rogaris, Sydney
+61 (2) 8266 1155
nick.rogaris@au.pwc.com

© 2016 PricewaterhouseCoopers. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers a partnership formed in Australia, which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity. This publication is a general summary. It is not legal or tax advice. Readers should not act on the basis of this publication before obtaining professional advice. PricewaterhouseCoopers is not licensed to provide financial product advice under the Corporations Act 2001 (Cth). Taxation is only one of the matters that you need to consider when making a decision on a financial product. You should consider taking advice from the holder of an Australian Financial Services License before making a decision on a financial product.

Liability limited by a scheme approved under Professional Standards Legislation.