Foreign Resident Capital Gains Withholding

What does the new withholding tax mean for you?

It's important to be across the new "non-final withholding tax regime" came into effect on 1 July 2016, potentially impacting anyone buying or selling property.

The new regime is aimed at foreign residents who sell Australian property, requiring 10 percent of the sale price to be withheld.

It is a significant change in tax law and applies to real estate; interests in Australian entities whose majority assets consist of real estate; and options or rights to acquire such interests.

Perhaps the key aspect of the new tax is that it effectively shifts the tax collection and remittance of the 10 percent withholding tax to purchasers of property.

While it does not apply to the sale of properties with a market value under $2 million or shares listed on an approved stock exchange, it still has a number of implications for both Australian and foreign vendors and purchasers of real estate if not managed appropriately.

Purchasers

Anyone who purchases property from foreign residents will potentially be obliged to act as "tax collector" on behalf of the Australian government.

Accordingly, we expect many purchasers to demand a "clearance certificate" from vendors prior to settlement, to prove the vendor is an Australian resident, or else an approved ATO variation notice if the vendor is a foreign resident but believes the withholding tax is inappropriate in their situation.

If the 10 percent withholding tax is applicable, purchasers will be required to complete an online ‘Purchaser Payment Notification’ form to provide details of the vendor, purchaser and the asset being remitted to the ATO.

Purchasers must pay the withheld amount on or before settlement.

Vendors

Australian residents

Australian residents may need to provide proof to a purchaser that they are not a foreign resident and therefore not liable for the withholding tax.

The ATO can provide a ‘clearance certificate’ which vendors can give to prospective purchasers to confirm their Australian residency status.

Clearance certificates are valid for 12 months and people can apply for one at any time they are considering selling their property, including prior to listing for sale. With sufficient planning, we would recommend this as the preferred approach.

Foreign residents

Foreign residents subject to the new withholding tax requirements can apply for a variation to reduce the amount of the tax if they believe that 10 percent is inappropriate (for example because the property will be sold at a capital loss). This variation can be done via an on-line form from the ATO.

It is important the notice of variation is provided to the purchaser before settlement to ensure the reduced withholding rate applies.

In addition, this new regime operates as a “non–final withholding tax.” This means foreign residents are still required to submit an Australian tax return reflecting the sale of the property and the 10 percent amount withheld will be factored into the final tax payable (or refundable) to vendors.

Background -provided by the Australian Taxation Office

The government announced on 14 May 2013 that it would introduce a 10% non-final withholding tax on payments made to foreign residents that dispose of certain taxable Australian property. The Bill for this measure, introduced by the current Government has been passed and received Royal Assent on 25 February 2016.

The new withholding regime will apply to contracts entered into on or after 1 July 2016.

Broadly, where a **foreign resident** disposes of certain taxable Australian property, the purchaser will be required to withhold 10% of the purchase price*and pay that amount to the Australian Taxation Office (ATO).

* Note: the legislation specifies that the 10% withholding is actually on the "first element of the cost base". However, as purchase price is understood by vendors and purchasers, and in many instances will equate with the "first element of the cost base", we have used the term purchase price for simplicity.

While the withholding regime will protect the integrity of the foreign resident CGT regime, it also applies where the disposal of such taxable Australian property by a foreign resident generates gains on revenue account and, as a result, is taxable as ordinary income, rather than as a capital gain.

How will this be administered?

Legislation was enacted on 25 February 2016 to introduce a 10% non-final withholding on payments made to foreign residents under contracts entered into on or after 1 July 2016 to dispose of certain taxable Australian property.

Three online forms will be made available at ato.gov.au/FRCGW before 30 June 2016. These are:

1. Clearance certificate application for Australian residents

2. Rate Variation application for foreign residents and other parties

3. Purchaser payment notification

Assets affected

This withholding is limited to taxable Australian property, being:

- Real property in Australia – land, buildings, residential and commercial property;
- Lease premiums paid for the grant of a lease over real property in Australia;
- Mining, quarrying or prospecting rights;
- Interests in Australian entities whose majority assets consist of the above such property or interests – this is called an indirect interest;
- Options or rights to acquire the above property or interest.

Exclusions

There are a number of exclusions. If the foreign resident vendor falls within one of these categories then the 10% withholding is not applicable:

- Real property transactions with a market value* under $2 million, ensuring that the vast majority of residential house sales will be unaffected by this measure;

* Note: if a purchase price negotiated between a purchaser and vendor is on an arm's length basis, then the purchase price may be used as a proxy for market value.

- Transactions listed on an approved stock exchange;
- The foreign resident vendor is under external administration or in bankruptcy.

Clearance certificates

The legislation introduces a clearance certificate model to provide certainty to purchasers regarding their withholding obligations. The clearance certificate confirms that the withholding tax is not to be withheld from the transaction.

For real property transactions with a market value of $2 million or above, the purchaser must withhold 10% of the purchase price unless the vendor shows the purchaser a clearance certificate from the ATO. This certificate can be provided to the purchaser on or before the settlement of the transaction. Where a clearance certificate is provided, the purchaser is not required to withhold an amount from the purchase price.

If the vendor fails to provide the certificate by settlement, the purchaser would be required to withhold 10% of the purchase price and pay this to the ATO. This means **Australian resident vendors** of real property with a market value of $2 million or above will need to apply for a clearance certificate and provide this to the purchaser before settlement to ensure no funds are withheld from the sale proceeds.

The vendor may apply for a clearance certificate at any time they are considering the disposal of real property. This can be before the property is listed for sale. The clearance certificate will be valid for 12 months and must be valid at the time the certificate is given to the purchaser prior to settlement.

The ATO is implementing an 'automated' process for issuing a clearance certificate. This would involve:

- the vendor (or their agent) completing an online 'Clearance certificate application for Australian residents' form;
- the information on the application being automatically checked against information held by the ATO to assess if the vendor should be treated as an Australian tax resident for the purposes of the transaction; and
- the automatic issuance of a clearance certificate which removes the need for the purchaser to withhold the 10% from the sale proceeds.

In straightforward cases where the ATO has all the required information, it is expected that clearance certificates will be provided within days of being submitted.

However, where there are data irregularities or exceptions, some manual processing may be required and the clearance certificates will be provided within 14 – 28 days. Higher risk and unusual cases may also require greater manual intervention which could take longer.

Variation application

Where the vendor is not entitled to a clearance certificate, but believes a withholding of 10% is inappropriate, the vendor can apply for a variation. The vendor completes an on-line 'Variation application for foreign residents and other parties' form requesting a lesser withholding rate be determined by the ATO. In the majority of cases (where the ATO has all the required information), the variation will be provided within 28 days.

The notice of variation should be provided to the purchaser before settlement to ensure the reduced withholding rate applies.

Paying and reporting withholding amounts

Where a withholding obligation exists, the purchaser must withhold the relevant amount at settlement and pay it to the ATO without delay (general interest charge may apply to late payments). The penalty for failing to withhold is equal to the amount that was required to be withheld and paid. An administrative penalty may also be imposed.

Purchaser payment notification

Where an amount is withheld, the purchaser is required to complete an online ‘Purchaser Payment Notification’ form to provide details of the vendor, purchaser and the asset being acquired to the ATO.

The purchaser will then automatically receive a payment reference number, and a payment slip which includes a barcode for use if paying in person at Australia Post. The purchaser needs to pay the withholding on or before settlement. The ATO's preference is electronic payment (funds transfer), however the purchaser can choose to pay the withheld amount at a post office with the barcode, or they can mail a cheque to the ATO with the payment reference number.