

SEPTEMBER 2017

TAX ALERT:
CAPITAL GAIN WITHHOLDING REGIME IS RELEVANT FOR ANY TAXPAYERS SELLING CERTAIN ASSETS

From 1 July 2017, there is now a very simple rule – if you are a purchaser of property for more than \$750,000 then you must withhold unless the vendor shows you a clearance certificate or a variation certificate.

Introduction

The Foreign Resident Capital Gains Withholding (“FRCGW”) regime commenced on 1 July 2016, and we are now one year on, it is necessary to give an update of these rules.

The terminology “foreign resident” is slightly misleading. We must stress that this obligation arises regardless of whether the vendor is a foreign resident or not.

On 1 July 2017, the following important changes to the FRCGW regime took effect:

1. The withholding rate increased from 10% to 12.5%; and,
2. The market value threshold reduced from the current \$2 million to \$750,000.

Relevant asset

The FRCGW regime applies to the disposal of the following assets by a foreign resident:

- A. Australian Real property – i.e. vacant land, buildings, residential and commercial properties. Also, mining rights and grants of a lease over real property are included in this category.
- B. Indirect Australian real property interest – i.e. a taxpayer acquired more than 10% membership interest in a company where more than half of the asset of the company comprises of Australian real property, otherwise known as “property rich companies”.
- C. Options to acquire Australian real property or indirect Australian real property interest.

From 1 July 2017, the above categories of asset are exempt if their market value is less than \$750,000. The practical impact of this should not be underestimated, as the new threshold will capture most sales of residential properties in most Australian capital cities.

If you are intending to dispose of a property for a purchase price that is close to the threshold, you should be aware of your obligation as a vendor.

Foreign resident vendor

The vendor is deemed to be a “foreign resident” when the purchaser knows for a fact, or reasonably believes, that the vendor is a foreign resident. Apart from factual knowledge, the purchaser might suspect that the vendor is a foreign resident if an address outside of Australia was provided or the vendor directs that funds should be transferred to an overseas account.

In relation to the sale of assets in category (A) and (B) above, a vendor who does not provide a valid clearance certificate is automatically deemed to be a foreign resident vendor.



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Vendor's obligation

The practical advice for **any Australian Vendor** of property is that they should apply online to the Australian Tax Office ("ATO") to get a clearance certificate immediately a sale of relevant property is contemplated. The clearance certificate is specific to one vendor and it lasts 12 months from the date of issue. The vendor should apply with the name that appears on the certificate of title.

Foreign vendors may apply to the ATO for a variation certificate on the grounds that the tax they are expected to pay on the gain (if any) will ultimately amount to less than 12.5% of the purchase price. The effect of the variation by the ATO may reduce the withholding required to nil, or some other amount.

This is a non-final withholding measure. This means that the foreign vendor should file an Australian tax return disclosing any gain, and the amount withheld by the purchaser is offset as a tax credit to the amount otherwise payable by the vendor. Therefore, if a withholding is made where the vendor has no tax liability, the vendor should be entitled to a full refund on filing an Australian income tax return.

If the asset has more than one owner (i.e. a jointly owned investment property between Mum & Dad), then each vendor must individually apply for their own clearance certificate.

Purchaser's Obligation

There is no obligation to withhold for a purchaser who has been provided with a valid clearance certificate or a vendor's declaration from the vendor. If no valid clearance certificate is obtained by settlement, the purchaser must withhold 12.5% of the market value of the property from the vendor and remit this amount to the ATO.

After entering into a contract for sale, the purchaser will need to complete a *Foreign resident capital gains withholding purchaser payment notification form*. The purchaser will need to pay to the ATO the amount withheld before the transfer of ownership of the asset has occurred (i.e. settlement date).

Penalties

The liability to withhold this amount ultimately lies with the purchaser and penalties can be incurred for any failure to do so. It is therefore essential that both parties to a transaction are aware of their obligations in ensuring that a clearance certificate is obtained.

If the purchaser fails to withhold, then the ATO can potentially impose a penalty of the amount of tax which should have been withheld. Given that the rules only apply to properties with a market value in excess of \$750,000, this would be a penalty amount of approx. \$95,000.

Conclusion

The FRCGW regime is now in its second year, and it is clearly here to stay. Vendors and purchasers need to be aware of their respective obligations in the sale of property transaction.

From 1 July 2017, the market value threshold was reduced from the current \$2 million to \$750,000, and the withholding rate increased from 10% to 12.5%; which makes this regime applicable to more properties and the potential penalty amount higher.

The practical impact is that the regime will now capture most sales of residential properties in most Australian capital cities.

Please do not hesitate to contact your Lowe Lippmann Relationship Partner if you wish to discuss any of these matters further.



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