

# Australia Raises Capital Gains Withholding Rate for Foreign Residents in Real Estate Transactions

## IN SHORT

**The Situation:** From 1 July 2017, the withholding rate that a buyer must pay to the Australian Tax Office on purchase of real estate assets from a foreign resident seller increased from 10 percent to 12.5 percent. The threshold values at which the laws apply have also reduced from \$2 million to \$750,000.

**The Result:** Sellers of real property or shares in companies holding real property will need to apply for a clearance, variation or make a declaration ahead of completing a transaction if they do not wish the buyer to withhold the payment.

**Looking Ahead:** The law is expected to improve compliance by foreign residents with Australian tax obligations and to reduce pressure on housing affordability.

The Australian Commonwealth Government first introduced foreign resident capital gains withholding payments in July 2016 at a rate of 10 percent, in response to issues in collecting tax from foreign resident sellers and political pressures concerning foreign investors and housing affordability in Australia. The issue was highlighted in 2011 in a high-profile case involving the Australian Tax Office's ("ATO") claim for tax on profits made by a foreign private equity fund following an initial public offering of shares in department store Myer.

The laws require a buyer of real property from a foreign resident seller to pay an amount to the ATO equivalent to 12.5 percent of the "first element of the cost base of the CGT [capital gains tax] asset's cost base just after the acquisition", minus, in the case of the exercise of an option, any amount/property paid or given for the option. The first element of the CGT asset's cost base is usually equivalent to the consideration paid for the asset (but not always).

The buyer's payment of the withholding to the ATO is a discharge of its obligation to the seller to pay that amount to the seller.

### When Do the Laws Apply?

The laws apply to transactions involving real property, such as a direct transaction for the sale and purchase of real property with a market value in excess of \$750,000 or an indirect transaction for sale and purchase of real property. An indirect sale includes: (i) a "company title" transaction of real property with a market value in excess of \$750,000 (i.e., transfer of ownership of shares in a company that owns real property and that confers rights to occupy a specified area of the real property; or (ii) a "membership interest", generally a transfer of more than 10 percent interest in shares or units in a company, trust or fund that has more than 50 percent of its asset value in real property (regardless of the market value of that property).

The laws also apply to any option or right to acquire any of the above.

Real property includes vacant land, buildings, residential or commercial property, mining, quarrying or prospecting rights and both freehold and leasehold interests.



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### Exceptions

The laws do not apply to:

- Direct real property transactions or company title transactions with a market value of less than \$750,000;
- Transactions through an approved stock exchange or crossing system;
- Transactions subject to another withholding obligation;
- Securities lending arrangements (as there is no CGT liability triggered);
- Transactions in which the foreign seller is in external administration (or similar under foreign law);
- Transactions arising from administration, bankruptcy or similar; and
- Portfolio interests in a company, trust or fund.

### What to Do—Clearance Certificate, Declaration or Variation?

The options depend on whether the seller is foreign or Australian and the nature of the interest being transferred.

**Obtain a Clearance Certificate.** Available to Australian sellers of a direct interest in real property. The Australian seller needs to obtain a "clearance certificate" from the ATO, stating that it is an Australian resident. The clearance certificate can be obtained online, is not property specific and lasts 12 months. Companies that regularly deal in property will probably wish to have one at hand permanently.

**Obtain a Variation.** Available to foreign sellers when the ultimate tax payable will be less than the 12.5 percent rate or nil (e.g., because there has been no gain or because there are carry-forward tax losses). An application can be made to the ATO to vary the amount the buyer must withhold (including a reduction to nil). Variations are also available in other situations—for example, if there is a mortgage over the property and there will not be enough funds after payment of the mortgage to withhold the payment, or if a creditor acquires title as a result of a foreclosure and its security would be further diminished. There is no prescribed timeframe for issuance of a variation, but at least 10 days should be allowed, possibly more if the situation is complex. Forms for a variation application are available on the [ATO website](#).

**Seller Makes a Declaration.** Available to Australian and foreign resident sellers on indirect transfer of real property (shares, units, fund interest). The seller can declare either that it is an Australian resident or that the interests are "not an indirect real property interest".

The declaration is valid for six months, and the buyer is entitled to rely on it unless it knows it to be false. There is no specific form for the declarations required, but templates for the declarations are available on the [ATO website](#).

**Buyer Pays the Tax at the Full Rate.** Applies to foreign resident sellers that do not obtain a variation and are not eligible to make a declaration.

### What is the Penalty for Not Complying?

The penalty for a buyer not complying with these obligations is an amount equal to the payment that should have been withheld. There are also penalties for the seller giving false or misleading declarations (the severity depends on whether the conduct was knowing, reckless or a failing to take reasonable care).

### POINTS TO CONSIDER

There are a number of points that might arise in a transaction that will require careful consideration.



**Conditions Precedent for Clearance, Variation or Declaration** If applicable, the contract should provide for the obtaining of the variation, clearance or giving of the declaration in the conditions precedent and in the completion mechanics.

**Purchase Price Adjustment** The contract should provide for adjustment of the purchase price on completion for any amount the buyer is obliged to pay to the ATO.

**Warranties / Indemnity** If you are a buyer with a seller giving a declaration, consider including a warranty and indemnity as to the accuracy of the seller's declaration so there is a contractual remedy if the declaration is incorrect.

**Timing** Clearance certificates and variations may take some time to receive from the ATO so build that timing into the transaction timetable.

**Multiple Sellers** If there are multiple sellers, some of whom are Australian resident and some of whom are foreign resident, consider the different treatments that might apply to the purchase price.

**Multiple Purchasers** If there are multiple purchasers, the obligation to withhold will apply pro rata to the entitlement to the purchase price.

**Difference in Cost Base and Cash Consideration** If there is a difference between the cash consideration that will be received and the value of the cost base, consider the cash flow impact for the buyer.

**Seller Tax Return** The buyer's payment to the ATO is a non-final amount paid on account of the tax the seller is obliged to pay; the seller will need to submit a tax return for a final assessment.

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### THREE KEY TAKEAWAYS

1. Changes to Australia's withholding rates on real estate purchases from a foreign resident seller apply to both direct and indirect transactions for the sale and purchase of real property. "Real property" is broadly defined and includes both freehold and leasehold interests and residential, commercial and mining interests.
2. There are exceptions, including for transactions via an approved stock exchange, for portfolio interests, in situations when the seller is bankrupt or similar and, in some cases, when the market value of the real estate exceeds \$750,000.
3. "Clearance certificates" are available to Australian sellers of real property, as are "variations" for foreign sellers, if the tax ultimately owed will be less than 12.5 percent. Otherwise, sellers can also make a "declaration" if the transaction does not involve a real property interest.

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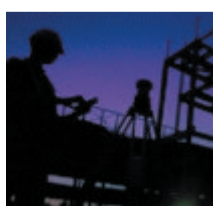


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