

Buying or Selling Property? The 1 July Tax Problem you Didn't Know you Had

New rules to prevent foreign residents avoiding tax when they sell Australian property will affect everyone buying or selling property with a market value of \$2 million or more from 1 July 2016. Many transactions involving shares in a company or units in a trust will also be caught.

From 1 July, a 10% withholding tax will apply when foreign residents sell certain types of Australian property. However, if you are selling Australian property, the new rules assume you are a non-resident unless you have a clearance certificate from the Australian Taxation Office (ATO). Without this clearance certificate, the purchaser can withhold 10% of the purchase price and pay this to the ATO. For purchasers, if you do not withhold the tax and do not have a clearance certificate, you are liable for the tax (on a \$2 million property, that's \$200,000).

You can probably already see the problem here. Until everyone gets used to this new system there are likely to be quite a few issues where property contracts do not mention the withholding tax, no clearance certificate is provided, and no tax is withheld on settlement.

The good news is that the withholding tax does not apply to real property that has a market value of less than \$2 million. This exclusion can apply to residential dwellings, commercial premises, vacant land, strata title units, easements and leasehold interests as long as they are below the \$2 million market value threshold.

Where there is more than one purchaser, the market values of all of the interests to be acquired need to be aggregated to determine whether the \$2 million threshold applies. For example, if mum and dad are buying a property as joint tenants with a total market value of \$3 million, the rules could be triggered even though

their individual interest in the property is only worth \$1.5 million.

The \$2 million exclusion does not apply to indirect interests in Australian real property such as shares in a company or units in a trust that hold real property in Australia. However, the exclusion can apply to company title arrangements, where someone holds shares in a company which provides them with a right to occupy part or all of the property that is owned by the company. This ensures that company title arrangements are treated in the same way as properties held under strata title.

The other main exception is when the foreign resident vendor is under external administration (for a company) or is bankrupt (for an individual). This is to ensure that the withholding tax rules do not disturb the priority of other creditors.

What "property" is affected by the new rules?

The new withholding rules capture:

- Taxable Australian real property – such as residential property, commercial property, land, etc. situated in Australia as well as certain mining, quarrying or prospecting rights;
- Indirect Australian real property interests (i.e. shares in a company or units in a trust where certain conditions are met). This is generally where most of the value of the company or trust relates to real property holdings in Australia; and
- Options or rights relating to the points above.

I'm selling a property: what do I need to do?

If you are selling real property affected by the new rules after 1 July and that property is likely to have a market value of \$2 million or more, you need to apply for a clearance certificate from the ATO. Without this certificate, the purchaser of your property must assume you are a foreign resident and will be permitted to withhold 10% of the purchase price and remit it to the ATO.

When a certificate is issued by the ATO it remains valid for 12 months. The ATO has been developing an automated process for issuing a clearance certificate. The vendor (or an agent) will be able to complete an online application form. In straightforward cases the ATO expects that certificates will be issued within a matter of days.

I'm buying a property: what do I need to do?

If you are buying real property affected by the new rules after 1 July and that property has a market value of \$2 million or more, you need to ensure that you receive the clearance certificate from the vendor before settlement occurs. While the tax rules allow you to withhold 10% of the purchase price if the clearance certificate is not provided, it might also be a good idea to have this built into the sale contract to avoid any uncertainty.

If the sale proceeds and you do not have a clearance certificate and have not withheld the tax, the tax liability rests with you, the purchaser.

Buying or selling indirect property interests – shares in a company or unit trust

If you are buying or selling shares in a company or units in a trust then a withholding obligation can also be triggered, even if the company or trust does not hold any real property interests in Australia. In this case the process of validating whether or not a withholding obligation exists is slightly different.

Withholding will be required if either:

- The purchaser knows or has reasonable grounds to believe that the vendor is a foreign resident; or
- The purchaser does not have reasonable grounds to believe that the vendor is an Australian resident and either the purchaser has a foreign address for the vendor or they are authorised to make payment to a place outside Australia.

In these circumstances the vendor can make a declaration to the purchaser confirming that they are an Australian resident to ensure that the withholding tax does not apply. In general, you would expect to see these declarations in the sale agreements as warranties.

A vendor can also make a declaration confirming that shares in a company or units in a trust are not classified as an indirect Australian real property interest. Shares or units that are not classified as an indirect Australian real property interest and do not relate to company title arrangements are outside the scope of the withholding rules.

Can we vary the withholding tax?

The Commissioner has the power to vary the amount that is payable under these rules. Either a vendor or purchaser may apply to vary the amount to be paid to the ATO. This might be appropriate in cases where:

- The foreign resident vendor will not make a capital gain as a result of the transaction (e.g. they will make a capital loss on the sale of the asset);
- The foreign resident will not have a tax liability for that income year (e.g. where they have carried forward capital losses or tax losses etc.); or

- Where there are multiple vendors, but they are not all foreign residents.

If the Commissioner agrees to vary the amount, it is only effective if it is provided to the purchaser before settlement occurs.

Warning on Super Contributions

The 2016-17 Federal Budget announcements on superannuation have caused a lot of concern.

These include:

- A \$500,000 lifetime non-concessional contributions cap from Budget night;
- A reduction in the concessional contribution cap from 1 July 2017;
- The removal of the tax exemption on earnings supporting transition to retirement income streams from 1 July 2017;
- The extension of the 30% super contributions tax on high income earners; and
- Tax-free super balances capped at \$1.6m from 1 July 2017.

Many clients have asked what they should be doing. The main area to be mindful of is the \$500,000 lifetime cap on non-concessional contributions as what you do now may have a lasting and potentially detrimental impact.

Under the current rules, you can use the “bring forward rule” and contribute up to \$540,000 across a three year period to your super fund. Anyone utilising these rules in the current year may find that the proposed rules, if they come into effect, will radically change their position.

It is really important that anyone contemplating making large contributions to super or utilising the bring forward rule should get advice first.

SuperStream Deadline

A reminder for small business clients:

You have just 28 days before the new SuperStream provisions take effect for your employee SGC obligations. From 1 July 2016 all SGC payments must be made via a SuperStream Clearing House. Please contact us if you have any concerns.

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