

11 March 2016

Ms Deborah Robinson
Director, New Measures & Government Relations
Public Groups and International
Australian Taxation Office

By email: Deborah.Robinson@ato.gov.au

Dear Ms Robinson

LIV comments regarding draft Australian Taxation Office “Foreign resident capital gains withholding payments Learner Guide”

We refer to the draft Learner Guide (Guide) which the Australian Taxation Office (ATO) has provided for comment.

The LIV considers that the legal profession, as well as a range of other groups (including consumers and directors of companies) affected by this regime, will need significant education to ensure compliance with all aspects of the regime. While the LIV understands that the Guide is proposed to be used internally by the ATO at this stage, the LIV assumes that its contents will inform other educational material produced by the ATO and has therefore provided comments on the basis that the Guide’s contents will be adapted accordingly.

The LIV therefore welcomes the initiative of the ATO in releasing the Guide for comment, and is pleased to see that the ATO has considered providing examples in the Guide as to how the regime may impact on various types of transactions and consumers. The LIV also notes that the ATO intends to provide targeted education, and looks forward to working with the ATO as this progresses.

It is clear from the content of the Guide that there are many aspects of the regime which require clarification prior the regime coming into effect. Set out below are some specific examples of matters in the Guide which we consider require further clarification, however we note that this is not an exhaustive list. We also note that, while this guide may serve as guidance as to how the legislation operates at a broad level, in the LIV’s view more specific guidance about the practical operation of the regime will be required both internally at the ATO and externally to groups potentially affected by this regime.

1. Section 2.1 (pages 8 – 9)

- The reference to 'CGT regime' used in this section is somewhat confusing and gives the impression that the document relates to capital gains tax generally rather than the foreign resident capital gains withholding tax. We suggest that this term is amended.

2. Section 3 (pages 10 – 11)

- It would assist if definitions of 'taxable Australian real property', 'indirect Australian real property interest' and 'an option or right to acquire interest' were included in this section (and in section 4.2). Practical examples of the application of the regime to these types of property would also be beneficial noting that the breadth of the regime will impact on lay people and professionals (as well as foreign residents), who should be alerted to the Australian legal meaning behind these terms.
- It would also be beneficial, particularly for consumers who do not engage legal representation or professional assistance regarding their transaction, if a flowchart could be included in the Guide to show the steps required to comply with the regime. For example, the flowchart could specify the presumption that every vendor of land is a foreign resident, the processes for vendors to obtain a clearance certificate, variation or declaration and any further steps required if the purchaser knows, or considers it likely, that the declaration is false.

3. Section 4.1 (page 13)

- The third dot point under section 4.1 which states 'any vendor of the asset is a relevant foreign resident' is somewhat misleading as withholding may be required even if the vendor is not, in fact, a foreign resident. We recommend that this is amended to say 'any vendor of the asset is, or is treated for these purposes to be, a foreign resident.'

4. Section 4.2 (pages 13 – 17)

- Please refer to our comments above in respect of Section 3.
- In the example related to taxable Australian real property on page 14, the LIV suggests that this should be revised to make it clear that the portfolio of shares in the ASX 200 listed index fund would also be excluded from withholding, on the basis that they are listed and so will be dealt with on a stock exchange.
- More broadly, this example on page 14 raises questions about how the relevant withholding amounts are to be calculated where an individual purchases a bundle of assets, some of which are exempt and some are not, particularly if there is no apportionment of the purchase price in the contract.

- It would be beneficial to include a definition of 'membership interest' (and potentially some practical examples) which could then be referred to throughout the Guide rather than referring to the definition in the *Income Tax Assessment Act 1997* (Cth) (ITAA).
- The LIV suggests that a further example could be included in relation to the purchaser's acquisition of a business which includes transfer of the leasehold. If the consideration attributed to the leasehold is more than \$2 million, then the regime may apply.

5. Section 4.3 (pages 17 – 22)

- An example is provided on pages 17 to 18 where the regime may still apply even if the sale price for a property is less than \$2 million, because the market value of the property is greater than \$2 million. It is unclear how the ATO will apply this test to transactions where the vendor and purchaser are not dealing at arms-length, such as where there is an ongoing commercial relationship, family business arrangements or involves separating spouses. In family law matters, it is common for parties to agree on a value for a property that is to be transferred from one spouse to the other, from joint names to one spouse or to a third party (e.g. creditor or other anticipated third party to the proceedings, including parties with an equitable claim to the property). Agreed values are often based on a range of appraisals from real estate agents or formal valuation/s if the one or more experts have been appointed. Assuming the vendor is a foreign resident and the only issue in question is the value of the property, it is unclear in that example how the ATO will assess whether the purchaser has an obligation to withhold if the parties agree to a value under \$2 million. Will the ATO require evidence of the value at the time of applying for the clearance certificate or variation, or will this only become relevant at the time the vendor's actual CGT liability is assessed? The LIV submits that more information in the Guide would assist regarding issues that commonly arise in transactions which are not at arms-length, including:
 - what constitutes market value;
 - when the ATO considers it 'necessary for a purchaser to seek a separate expert valuation';
 - what occurs when multiple valuations are obtained; and
 - what occurs when the parties dispute a valuation.
- At page 18, there is a discussion about the 'market value of the interest' of multiple purchasers in an apartment complex (in the context of the requirements in subsection 14-215(2)). It is not clear how these requirements would apply if the transaction is the result of a Court order (or, in family law, a financial agreement made under the *Family Law Act 1975* (Cth)) which alters the interest of the vendor and multiple purchasers in the property. The LIV queries at what stage are the interests to be aggregated to determine whether the \$2 million threshold has

been met? For example, in family law matters, a court order made under s79 of the Family Law Act 1975 (Cth) (or equivalent de facto provisions) alters the interests of the parties to the marriage in the property. The orders usually require the parties to take steps, including for one party to transfer their interest in real property or an indirect real property interest, to the other party to give effect to the orders. In this scenario, assuming the party transferring the real property interest is a foreign resident at what stage is the market value of the aggregate interest in the property considered to assess whether there is a requirement for the transferee party to withhold?

- Further clarification and examples about what is meant by 'indirect Australian real property interest' would be useful on page 19 in the context of company title interests valued at under \$2 million. For example, if a person in their capacity as trustee of a discretionary trust is on the title, do the beneficiaries of that trust have an indirect Australian real property interest? If the company on the title is a trustee company for a trust or self-managed superannuation fund, do the shareholders have an indirect Australian real property interest even though the company is on title only in its capacity as trustee?
- At page 21, it states that the regime will not apply where another withholding obligation applies to the transaction. It would assist to include at that part of the Guide examples of other withholding obligations so consumers can consider whether they need to obtain independent legal advice from a taxation expert about this. Further, the example provided raises two issues. Firstly, one of time, as a section 98 withholding will not be known until the time the trust allocates the income to the beneficiary under the legal disability (which is likely to be months after the end of the financial year in which the sale occurs). Secondly, clarification is required as to how a purchaser can satisfy themselves that another withholding does apply.
- At page 21, the Guide refers to security lending arrangements not triggering an obligation for the purchaser to withhold as those arrangements attract roll-over relief under the ITAA. The LIV is of the firm view that all arrangements/transactions which attract roll over relief should be explicitly excluded from the withholding regime and that parties to such arrangements should not be required to go to the delay and expense of applying for a variation. To be required to seek a variation if the transaction does not trigger a CGT event serves only to increase costs and red-tape for both ATO and consumers. We note that under sub-section 14-235(5) the Commissioner may issue a legislative instrument varying the amount payable by the purchaser in a particular class of cases. The LIV calls on the Commissioner to issue a legislative instrument to vary the amount for the following class of cases to nil:
 - transactions attracting roll-over relief;
 - transactions in which it is anticipated there will be no capital gain (e.g. carried-forward losses); and

- o transactions where a secured creditor has an interest in the subject property and where all of the proceeds of sale are required to extinguish the vendor's liability to that secured creditor.
- We note that the Guide states on page 41 that it is not the intention of the law to undermine the security of creditors. It would assist if a specific instrument was passed to that effect.
- The example in respect of external administration on page 22 would benefit from the inclusion of a reference to real life examples, e.g. a US Chapter 11 bankruptcy process.

6. Section 4.4 (pages 23 – 30)

- With reference to the 'declarations about residency', it would assist if the ATO could provide sample wording of a declaration as to residency which it considers will satisfy the Commissioner for the purpose of this withholding regime. This wording could then be incorporated into existing precedents and transactional documents to ensure consistency.
- In relation to reliance on clearance certificates, it would be helpful to clarify if this requires an 'original certificate' or if an electronic copy is sufficient and what happens if a purchaser relied on a fraudulent certificate.
- In relation to clearance certificates, the LIV understands that in 'straightforward' cases (e.g. where the person applying for the certificate has submitted tax returns for the previous two years) the provision of the clearance certificate will be automated and will occur quickly. It would be beneficial to explain this process in the Guide and also explain the steps that will be taken by ATO staff to assess an application for a clearance certificate in more complex cases.
- It is not clear in the Guide what a purchaser should do if, during the period a clearance certificate is valid (12 months), the purchaser becomes aware that the vendor has become a foreign resident for the purpose of the regime. This situation is likely to occur where there is an ongoing relationship between the vendor and purchaser (commercial or private) and the purchaser is in possession of documents or information unrelated to the transaction which may cause them to 'know' that the residency status of the vendor has changed. In such a case, the LIV queries whether the purchaser is still able to rely on the clearance certificate. Does it make a difference if the legal representative of the purchaser or vendor is the one who becomes aware of this change?
- Similarly, further guidance and clarity is required on pages 25 and 26 when discussing the factors affecting the purchaser's decision about whether or not the vendor is a foreign resident. Without further guidance on this, the legal obligations this regime imposes on consumers and legal practitioners are unclear.

- It would also be beneficial to include a further example based on the facts set out in the example on page 30, but where the consumers were legally represented and the lawyers were in possession of documents which indicated (or indeed proved) that the vendor was a foreign resident.

7. Section 4.5 (p 30 – 31)

- At page 31, it notes that the 'Commissioner will administratively allow a short period after settlement to receive payment before imposing general interest charges and initiating recovery action'. This is an important feature of the regime as there will continue to be a range of administrative issues that arise in relation to the requirement that payment must be made to the Commissioner on or before the day the purchaser becomes owner of the property (for example, the time frame for a bank cheque to be processed and the funds to clear). The LIV considers that the 'short period' (or at least a minimum) should be specified. This may assist in giving comfort to vendors that they will receive a credit if the ATO commits to taking recovery action within a certain time frame (although the LIV notes that it still leaves risk where the purchaser becomes insolvent before payment). Further, the ATO should explain the processes it has put in place to circumvent such administrative issues which will likely delay a party's ability to make payment to the Commissioner within the required timeframe.
- It would also be beneficial to clarify in the Guide:
 - the process through which the ATO will advise the parties that payment has been received by the Commissioner and the timeframe for doing so; and
 - who the ATO officers should communicate with to confirm payment (and any other matters) given that legal practitioners and conveyancers will generally not be the parties' usual tax agents.

8. Section 5.3 (page 35)

- The LIV suggests that it would be helpful to include an example to clarify that the withholding regime applies to the consideration for the grant of the option, and not the consideration (if any) specified for exercise of the option.

9. Section 6.1 (pages 36 – 39)

- The LIV considers that clarification is required regarding the meaning of 'first element of the cost base' and how this may differ from the market value of the property as represented by an arms-length purchase price.
- The LIV considers that further examples ought to be provided to deal with situations including GST, non-monetary consideration and mixed exempt/non-exempt supplies.

10. Section 6.2 (pages 39 – 42)

- As mentioned above, the LIV considers there to be a number of circumstances where the Commissioner ought to issue legislative instruments. In this regard, it should be specified in paragraph 6.2 whether the Commissioner intends to issue any legislative instruments.
- Further, the LIV considers that the Guide ought to explain the factors and principles that will be applied by the ATO in assessing whether a variation ought to be issued and some practical examples of this process.
- The need for prompt resolution of the exercise of discretions (including in determining whether a variation ought to be issued) and the potentially dire financial consequences for parties if such discretions are not exercised expeditiously ought to be emphasised.
- In relation to the first example in this section, it is not in fact clear in the legislation that a 'conditional' variation may be issued. The LIV would appreciate clarification on this point.

11. Section 7.2 (page 44)

- It is not clear from this section whether there is an obligation for a purchaser to refund an amount where it was originally withheld in error. The LIV seeks clarification regarding this.
- The LIV considers that clarification ought to be provided as to the consequences of errors or required changes in the transaction consideration after the remittance advice has initially been generated and how the ATO will manage this process.

12. Section 9.1 (page 47)

- It would be beneficial for the ATO to clarify whether legal practitioners and conveyancers will need to register as withholding tax remitters in order to remit payments on behalf of their clients.
- The LIV understands that there are proposals for Australia Post to receive and remit withholding tax payments to the ATO. This payment option is only likely to be used by the very small number of legal practitioners and conveyancers' practices that do not maintain a trust account. If adopted, the arrangement with Australia Post needs to be clarified. For example:
 - will it operate similarly to the current arrangements where Australia Post receives and forwards payments for rates and utility payments?
 - will the ATO remittance form or the reference number need to be provided?
 - will the settlement bank cheques provided to the post office designate the payee as Australia Post or the Commissioner?

- The LIV trusts that this Australia Post Post Billpay payment (or similar) option for paper settlement bank cheques will not detract from electronic payment direct from legal practitioners' and conveyancers' trust accounts to the ATO (similar to the manner most tax payments are made by EFT direct to the ATO). Further to the discussion of section 4.5 of the Guide above, please confirm that penalties and interest will not be charged if direct payment from a trust account results in delay in payment of five business days (or more) after settlement. The ATO will be aware that legal practitioners and conveyancers are not legally able to draw against bank cheques deposited into their trust accounts until those bank cheques are cleared. It is expected that the vast majority of legal practitioners and conveyancers in Australia will continue to use this method of payment for the foreseeable future.

Again, we welcome the opportunity to be consulted in relation to this Guide. The impacts that this regime will have on practitioners and consumers in Australia are significant. The LIV is keen to ensure that sufficient time is provided to enable all relevant stakeholders to properly execute education programs to raise awareness of the significant impacts these changes are likely to have. The LIV looks forward to working with the ATO in the coming months regarding its education program.

Please contact Ms Mollie Tregillis at mtregillis@liv.asn.au (or Sarah Bright, sbright@liv.asn.au) if you have any queries or would like further information.

We look forward to hearing from you.

Sincerely yours,


Steven Sapountsis
President, Law Institute of Victoria