THE TAX INSTITUTE

8 April 2013

Manager
International Tax Base Unit
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Attn: Mr William Potts

By email: cgtdiscountremoval@treasury.gov.au

Dear Mr Potts,

Removal of capital gains discount for non-resident individuals – Exposure Draft

The Tax Institute is pleased to have the opportunity to make a submission to the Treasury in relation to the *Removal of capital gains discount for non-resident individuals – Exposure Draft* (**Exposure Draft**).

Summary

The Exposure Draft has been released following an announcement made by the Government in the 2012-13 Federal Budget to remove the availability of the capital gains tax discount for non-residents.

Our submission below addresses our main concerns with the amendments contained in the Exposure Draft. In particular:

- A clear statement of policy should be made to justify the need for the changes being made in the Exposure Draft;
- Given the potential practical and administrative complexities arising as a result of these new provisions, the timing of the application of these changes should be deferred to 1 July 2012; and
- There are interaction issues with the trust provisions in the tax law which need to be further considered.

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Discussion

1. Policy concerns

There does not appear to be a clear policy statement supporting these provisions. We refer to the announcement made in the 2012-13 Federal Budget on 8 May 2012 which stated:

> The Government will remove the 50 per cent capital gains tax (CGT) discount for non-residents on capital gains accrued after 7.30 pm (AEST) on 8 May 2012. The CGT discount will remain available for capital gains accrued prior to this time where non-residents choose to obtain a market valuation of assets as at 8 May 2012. This measure is estimated to have a $55.0 million gain to revenue over the forward estimates period.

There is no further clear annunciation of the policy intent in the Explanatory Memorandum (**EM**). We request that Treasury include in the EM a clear policy statement outlining the reasons why the CGT discount is to be denied.

In addition, the following aspects of the Exposure Draft are inconsistent with the Budget announcement:

(a) the Exposure Draft extends the scope of the changes to include temporary residents in addition to the announced changes to non-residents; and
(b) the Exposure Draft also apportions values based on number of days of residency. However, the announcement only refers to obtaining a market valuation if a taxpayer seeks to apply the CGT discount for the portion of the gain which accrued prior to 8 May 2012.

2. Time of application

The measure is intended to apply from the date of announcement of the measure, being 8 May 2012. Since the date of announcement, the 2012 financial year has ended and there are likely to be many non-resident individuals who will be impacted by these rules where they have already lodged tax returns including gains based on the current rules.

On the basis the rules are intended to preserve the CGT discount for the portion of the gain arising up to 8 May 2012 and deny it thereafter, there may be taxpayers who have recognised disposals applying the full value of the CGT discount based on the current rules. There may be others who have recognised disposals attempting to take account of this measure, but they are unlikely to have determined the amount of the CGT discount in accordance with the proposed rules contained in the Exposure Draft or have obtained a market valuation as at 8 May 2012.

If these rules are to apply from 8 May 2012, these taxpayers will be required to amend their 2012 income tax returns to reflect these rules, causing additional administrative burden on them and the ATO to do so.

In this regard, we request the Government considers applying this measure prospectively from 1 July 2012. This will allow individual taxpayers to properly account for all capital gains where the CGT event occurs on or after 1 July 2012 in accordance with these rules knowing the full details of how they are intended to apply.

This will also assist the ATO in not having to issue amended assessments in all cases where the denial of the CGT discount was not taken into account in 2012 returns that have been lodged. We also see very little risk to the revenue for the discounts which have already been claimed.

In addition to the above, as the inclusion of temporary residents in this measure has only become apparent since the issue of the Exposure Draft, we suggest the Government only consider applying the rules from the date of release of the Exposure Draft (8 March 2013).

3. Complexity of the provisions to recalculate the CGT discount percentage

The rules proposed include a complex set of calculations required to be undertaken by an individual who wishes to apply the CGT discount for the portion of gain accreted up to 8 May 2012. This will prove particularly difficult for individuals who will be required to recognise gains for multiple assets disposed of in an income year, particularly through a trust. Adding such complexity to the CGT discount provisions does not assist in trying to achieve simplification in our tax system.

Given the complexity of these provisions, taxpayers will require sufficient guidance to assist them to properly comply with these provisions. Additional examples should be included in the EM stepping out the calculation required, particularly for the circumstances where the gain is derived through an interest in a trust. Subject to our comment above regarding the proposed application date for the new measures, the ATO should also be ready to provide guidance to taxpayers as soon as these provisions are enacted.

4. Practical implications for individuals obtaining market valuations

Non-resident and temporary resident individuals have the option of obtaining a market valuation as at 8 May 2012 for the purpose of applying these rules where they either hold the asset directly or hold their interest indirectly through a trust (new section 115-115(4)(c) of the *Income Tax Assessment Act 1997* (Cth) (**1997 Act**)). In practical terms, particularly for beneficiaries of more sophisticated trust structures like widely held unit trusts who hold many CGT assets, we query how a beneficiary would practically obtain

a market valuation for all the assets in the trust to work out what portion of the CGT discount is to be denied to them when the relevant capital gains are flowed through the trust to the beneficiaries.

Trustees will be required to provide beneficiaries with information such as acquisition dates and other information required to be provided to a valuer for the purpose of valuing the disposed assets. This brings into question the role trustees are to play in assisting beneficiaries to properly comply with these rules and whether this impacts on the trustee's duty to beneficiaries to provide best outcomes for beneficiaries in properly administering the trust. The practical reality is that a trustee is in a better position to obtain a market valuation for assets held in the trust such that the likely burden of these rules may be passed to trustees from the non-resident beneficiaries. Indeed, simply on the basis that the trustee will usually be located in Australia and a non-resident beneficiary (obviously) won't be, the trustee will have better and easier access to Australian-based valuers to value the Australian assets than the beneficiary.

Also, there is no guidance available as to whether a market valuation is required to be obtained from a registered valuer or whether another source of valuation will suffice (for example, in the case of real property, whether a valuation from a real estate agent would be appropriate).

Given the rules are directed to apply to individuals and not trusts, The Tax Institute queries whether this is the correct outcome as to where the burden of these new rules will ultimately lie in practice.

5. Interaction with ordinary trust provisions

Non-resident trustee beneficiaries

These rules apply only to individual non-resident beneficiaries of Australian trusts. We query how these rules are intended to deal with capital gains that pass through trusts to non-resident individuals who indirectly benefit from the Australian trust where they are themselves beneficiaries of a foreign trust receiving a distribution from the Australian trust. Such a trustee of the recipient foreign trust may be a company or individual.

Chain of trusts

Where a chain of trusts may be involved, it is not clear which trust new section 115-110(2) is intended to apply to. That is, what is the “relevant trust gain” that a non-resident should be concerned with for the purpose of applying this provision. Is it a gain from the trust in which they have a direct interest only or does it also apply to gains made by trusts in which the non-resident beneficiary has an indirect interest? There is no indication on the face of the provision or in the EM that the latter enquiry is to be

made. Inclusion of an example in the EM dealing with how these provisions are to apply to a chain of trusts would be useful.

Interaction with Division 6

An Australian trustee has an obligation under Division 6 of the *Income Tax Assessment Act 1936* (Cth) to work out how much tax to remit on income and gains ultimately passing through to a non-resident beneficiary to satisfy the Australian tax liability which arises. Therefore the Australian trustee will be obliged to work out the correct CGT discount percentage that will apply to the ultimate non-resident beneficiary. We query how a trustee is intended to be able to do this; if a trustee is unable to do this, they are unlikely to be able to properly satisfy their obligations arising under Australian tax law.

For widely held unit trusts, this is especially likely to create a significant compliance burden. For example, the trustee will not necessarily know the residency status of each investor on 8 May 2012, and will not (without further enquiry) know whether each investor wishes to apply the market value methodology.

We suggest Treasury give consideration to addressing this issue.

6. Interaction with Division 855

We query how these new rules are intended to interact with Division 855 of the 1997 Act. Division 855 exempts from tax capital gains made by non-residents unless the assets are taxable Australian property[1].

It should be made clear that the new rules only apply to capital gains made by non-residents that are in relation to assets that are either taxable Australian property or deemed to be taxable Australian property by the operation of CGT Event I1.

It would be useful if there was a note included into the law or a clear statement was included in the EM clarifying how the CGT discount rules and Division 855 will interact.

Example 1.6 in the EM could be reworked to illustrate these issues as it is not clear whether the "asset" referred to is taxable Australian property. If it is not taxable Australian property, by application of Division 855, there should be no taxable gain. If the underlying "asset" is taxable Australian property, there will be a recognisable gain in respect of which these rules will deny the CGT discount.

[1] As defined in the 1997 Act.

Discretionary Trusts

It appears that the CGT discount will be denied with certainty only in the case where an individual has made the gain directly or through a fixed trust. Gains made through discretionary trusts may not be captured by these rules.

There is continuing uncertainty as to how Division 855 applies to discretionary trusts. There are conflicting views held by both the ATO (that Division 855 does not apply to discretionary trusts) and the profession (that Division 855 can apply to a capital gain which passes through a discretionary trust to a beneficiary and has to be calculated in accordance with Sub-Division 115C).

We query how these provisions will apply to capital gains after the trust streaming provisions are reconsidered as part of Treasury's trust tax reform project that is underway and whether the rules will operate to deny the concession provided under Division 855 for gains passing through discretionary trusts to non-resident individual beneficiaries.

7. Interaction with the Managed Investment Trust provisions

If a trustee of a managed investment trust (**MIT**) makes an election under Division 275 of the 1997 Act for capital treatment to apply to gains made from taxable Australian property, the gains will be grossed up and subject to final withholding in accordance with Subdivision 12-H of Schedule 1 of the *Taxation Administration Act 1953* (Cth) (**TAA**)[2].

We query how these new rules are intended to interact with the withholding tax provisions and whether the withholding tax provisions take priority or whether capital gains made by an MIT should be excluded from the operation of the new rules. This would be on the basis that the gain is already grossed up[3] prior to being subject to withholding tax, thus usurping any discount which may otherwise be attributable.

8. Interaction with election to defer capital gain

Section 104-165 operates to allow a taxpayer to disregard the operation of CGT Event I1 and defer the recognition of the CGT gain (or loss) which arises on an Australian resident individual becoming a non-resident for income tax purposes.

It would be useful if Treasury could include an example stepping through the interaction of these new provisions with CGT Event I1 and section 104-165.

[2] These capital gains will form part of the "fund payment" – see section 12-405 of the TAA.
[3] According to the method statement contained in the Method Statement in section 12-405 of the TAA.

9. Examples in the EM

Below are some brief comments on two of the examples included in the EM.

Example 1.3

Firstly, we note that the reference to "item 6" of section 115-30 should actually be to item 4 of section 115-30 as item 6 refers to pre-CGT assets. The property referred to in the example was acquired on 1 January 2011 and is therefore not pre-CGT.

Secondly, the implication behind this example is that not only does Samantha inherit the cost base[4] of the asset that she has inherited from her grandmother, she also inherits the effect these rules would have on her grandmother if her grandmother were the one to dispose of the asset. It would be useful if a note could be included in Division 128 pointing to these provisions to ensure that they are taken into account where Australian CGT assets are inherited from non-residents.

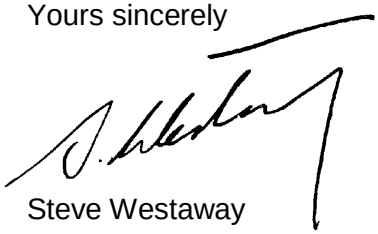
Also, there are practical implications for Samantha in working out how long her grandmother held the assets. We query what information a taxpayer would be allowed to rely on. For example, in the case of real property, will the ATO accept that the taxpayer could rely on the land titles information, which would show a date of registration of ownership, though this would not accurately reflect the date of "acquisition" (which is the contract date). It may be impractical to require a taxpayer to trace back to find a copy of the contract for sale for the real property concerned that they are inheriting.

Example 1.6

We note that inclusion of the statement "This is regardless of the fact he was not a beneficiary of the trust at that time" seems to conflict with the rest of the example as set out. We query whether this statement has been included in error.

If you would like to discuss any of the above, please contact either me or Tax Counsel, Stephanie Caredes, on 02 8223 0011.

Yours sincerely



Steve Westaway
President

[4] Section 128-15 of the 1997 Act