THE TAX INSTITUTE

THE MARK OF EXPERTISE

10 August 2015

Ms Luise McCulloch
General Manager
Corporate and International Tax Division
The Treasury, Langton Crescent
PARKES ACT 2600

**By email:** taxlawdesign@treasury.gov.au

Dear Ms McCulloch,

**Foreign resident capital gains withholding tax**

The Tax Institute welcomes the opportunity to make a submission to Treasury in relation to the *Tax and Superannuation Laws Amendment (2015 Measures No.5) Bill 2015: Foreign resident capital gains withholding payments* exposure draft legislation (**Exposure Draft**).

We appreciate that a number of points in our submission dated 27 November 2014 to the Discussion Paper dated October 2014 have been taken into account in this Exposure Draft. For example, we welcome the proposal to limit the application of withholding to real property and related items and exclude assets of a permanent establishment.

The Exposure Draft could be further improved in relation to the areas outlined below. Some of these points were raised in our earlier submission, and others arise from the wording of the Exposure Draft.

**Issues requiring clarification**

*Timing of obligation to withhold*

Proposed section 14-200(2) requires the withheld amount to be paid on or before the day on which the purchaser becomes the asset's owner. This will generally be the time of settlement. Hence, this suggests that the obligation to pay an amount could be interpreted as not arising until settlement date: see also Explanatory Memorandum (**EM**) paragraphs 1.98 and 1.99. However proposed section 14-200(1) refers to the term acquisition, which is defined in section 109-5(2) Item 1 as the time that a contract for the disposal of a CGT asset is entered into. There should be clarity and consistency in proposed section 14-200 that the due date for payment is a reasonable time after settlement.

Level 10, 175 Pitt Street
Sydney NSW 2000
Tel: 02 8223 0000
Fax: 02 8223 0077
info@taxinstitute.com.au
taxinstitute.com.au
ABN 45 008 392 372

It is entirely possible that settlement of transactions under these provisions will occur in foreign jurisdictions that are in different time zones. As such, it may not physically be possible for the payment to be made on the date of settlement. Whilst one would expect that the Commissioner would waive penalties and interest in such cases of impossibility, it seems inappropriate to create a law that cannot be complied with in certain, reasonably common, circumstances. As noted above, circumstances such as these should be dealt with by the legislation clearly allowing a reasonable time after settlement for performance of the obligations. If that cannot be done, these issues could be dealt with by including a specific provision providing the Commissioner with discretion to extend the date for payment in such circumstances. Alternatively, this could be dealt with under the Commissioner's existing general discretion to extend the date for making the payment to the Commissioner in section 255-10 of Schedule 1 of the *Taxation Administration Act 1953*. The Commissioner could therefore issue a Practice Statement specifying how the general discretion would be exercised in this context and the EM could refer to that Practice Statement.

The legislation should state that a declaration by a vendor under section 14-220 made as at the acquisition time as defined for CGT purposes is valid for all consequent payments, so that the parties are aware of any withholding obligations as at the contract date.

*Statutory indemnity for purchaser*

If a purchaser inadvertently pays the purchase price in full to the vendor and is then pursued by the Commissioner, a statutory indemnity should be provided as against the vendor, similar to current section 16-195. Section 16-20 (which does apply to Division 14) would not achieve the same result in a situation where the payment has already been made to the vendor.

*Absolute entitlement*

Example 1.11 in the EM indicates that the obligation to withhold falls on the purchaser where the purchase is from an Australian custodian with an absolutely entitled beneficiary. It is unclear how the situation Example 1.9 differs from Example 1.11. The example refers to section 106-50, which applies only in the context of capital gains. A provision should be included to extend the treatment in section 106-50 to revenue gains for the purpose of this draft legislation.

*Approved form*

Item 2 of Part 2 of the Exposure Draft amends section 202 of *the Income Tax Assessment Act 1936* to include facilitating the administration of the proposed Subdivision. Section 202 refers to the establishment of a system of tax file numbers (TFNs). The EM at paragraph 1.105 suggests that purchasers only have to provide the vendor's TFN where they have one. As noted in our submission dated 27 November 2014, introducing a requirement to provide a TFN will impose an administrative burden on foreign residents and add an unnecessary impediment to commercial transactions. The Exposure Draft should confirm that the purchaser is not required provide a TFN for the vendor in the approved form.

*Foreign purchasers*

Proposed section 14-200 suggests that foreign purchasers are covered by these provisions, which would be a departure from other withholding provisions in Division 12 of the *Taxation Administration Act 1953*. If the intention is to include foreign purchasers, this should be clarified in the EM. We note that there will be practical difficulties in enforcing the withholding obligation in relation to foreign purchasers with indirect interests in real property where there is more than one tier of interposed entity involved. While the current owner of Australian assets (or indirect interests in Australian assets) may be reasonably expected to have familiarised themselves with their Australian tax obligations, it is less reasonable to assume that a foreign purchaser of non-Australian shares from a non-Australian vendor would (or should) be aware of an Australian law imposing an obligation to withhold for Australian tax.

*Earn out rights*

Proposed section 14-205(3)(a) requires the withheld amount to be 10% of the market value of the financial benefit provided under the look through earn out right. The provision should clarify that this is the market value on the day that the financial benefit is provided.

*Excluded transactions*

Proposed section 14-215 is not intended to apply to vacant land: paragraph 1.45 of the EM. We suggest that there be a de minimis exclusion for interests in land such as easements and rights to pass over land in relation to non-residential property which may be granted for nominal consideration. This would be consistent with the Government's red tape reduction objective.

We welcome the exclusion of transactions involving on-market transfers from the Exposure Draft. We submit that IPOs should also be excluded from the rules as the on-market exclusion may only apply to transactions on the secondary market. We also note that off-market buy-backs of listed shares from existing shareholders are not excepted, and question whether that is intended.

*Operation of secrecy provisions*

Proposed section 14-225(3)(c) allows secured creditors to apply to the Commissioner for a variation of the withholding amount. The EM should note the relevant exclusion to the secrecy provisions in Division 355 under which the Commissioner is entitled to disclose relevant information to the secured creditor for these purposes.

*Adjustments to purchase price*

Example 1.6 of the EM provides an example of a look through earn out right on real property. While not necessarily incorrect, the example does not on its face include all of the facts necessary to engage proposed section 118-565 of the Look Through Earnouts Exposure Draft. Adjustments to the purchase price outside the scope of the Look Through Earnouts Exposure Draft are not specifically dealt with in this Exposure Draft.

The EM at paragraph 1.32 states that the withholding obligation applies to the total purchase price, avoiding multiple obligations in relation to a single transaction completed through instalments. It is unclear how this result would follow for transactions which do not meet the definition of a look-through earnout right under the Look Through Earnouts Exposure Draft. For example, earnouts in relation to potential mineral resources may be excluded from the Look Through Earnouts Exposure Draft. It is submitted that this is undesirable. The final consideration for an acquisition may be settled by negotiation only very close to contract and settlement, and it is imposing unnecessary burdens on the purchaser to require valuations of the net present value of a deferred consideration arrangement to be finished by settlement. Confining section 14-205 to the artificially narrow definition of “look through earnouts” is undesirably restrictive.

As noted in our submission dated 27 November 2014, to ease compliance, post-completion adjustments should not be subject to additional withholding. The adjustments can move either way (i.e., increasing or decreasing the purchase price) and are generally not material as compared to the total purchase price.

*Knowledge test*

The interaction between proposed section 14-210(1)(b) and (c) is unclear. On one reading there may be no distinction between “*you reasonably believe that the entity is a foreign resident*” and “*you do not reasonably believe that the entity is an Australian resident*”. In this case, proposed section 14-210(1)(c) would be redundant as only one of the paragraphs of section 14-210(1) need to be satisfied in order for the obligation to arise.

The alternative construction of proposed section 14-210(b) and (c) is that (b) applies where you have formed a positive belief that the entity is foreign, and it is reasonable for you to do so. On this interpretation, section 14-210(b) will not apply if you have not formed a positive belief, even if your failure to form a positive belief is unreasonable. It also won't apply if your positive belief is unreasonably formed. Under this construction, proposed section 14-210(c) will apply if you have failed to form a belief either way and one of (i) or (ii) are satisfied. Proposed section 14-210(c) may also apply if you have formed the belief that the entity is Australian, but your belief is not reasonable.

The Explanatory Memorandum should clarify if one of the above interpretations is the desired result, or if there is an alternative interpretation that is favoured. The clarification should be supported with relevant examples.

*Drafting issues*

In proposed section 14-210 ‘acquisition, or financial benefit’ is defined as ‘transaction’ but this is not used consistently. 'Transaction' is used in proposed sections 14-215 and 14-225 (presumably with its defined meaning), while 'acquisition or financial benefit' is used in proposed section 14-220.

Proposed section 14-215 as currently drafted states “*A transaction that acquires a CGT asset . . .”* Entities acquire CGT assets, transactions do not. The provision should be redrafted to read *“A transaction under which a CGT asset is acquired . .* .”

As an overall comment, the title of the Expose Draft and EM is misleading. There is no need for the asset sold to be held on capital account by the seller (or indeed the buyer) for the withholding provisions to be activated.

*Valuation issues*

For barter transactions additional time for withholding ought to be allowed in order to allow the parties to obtain an appropriate valuation to determine the amount to be withheld. This applies also to deferred variable consideration transactions that are not “look through earnouts” such as where the variability relates to the mineral content of a mining tenement. While the vendor may need to obtain such a valuation for purposes of determining their tax liability, it may not be obtained until later. It would add administrative costs to require the purchaser to obtain its own valuation to determine the amount to be withheld. Alternatively, this may be dealt with by allowing the purchaser to withhold on the basis of the purchaser's own estimate, without requiring a valuation.

*Variations*

Given that the proposed measure operates on acquisitions, there may be a significant number of variations applied for under proposed section 14-225. This is because an acquisition may not necessarily be a taxing event for the vendor, particularly where rollovers in relation to scrip-for-scrip transactions or marriage breakdowns apply.

It may also occur where the withholding obligation depends on a valuation, where a purchaser may well wish for a variation to prescribe a particular dollar amount based on their valuation rather than risk later penalties on a challenge to the valuation. Another example will be cases where there are multiple vendors not all of whom are non-residents (since the withholding obligation seems not to operate only on amounts paid to non-residents).

We are not proposing any particular policy change to the legislation to address this, but we merely note that the legislation in its current form may well turn out to create a substantial administrative burden.

*Nation of acquisition*

In the event of a share buyback, where the company buys back its own shares from a non-resident shareholder, the company briefly becomes the owner of those shares prior to their cancellation. By contrast, if there is simply a cancellation of shares on a reduction of capital, the shares aren't acquired. It is unclear with the inconsistency between these two outcomes is the desired result.

A lease is taxable Australian real property, but the EM should confirm if a grant of lease would be an acquisition "from" the grantor covered by the Exposure Draft. If covered, there it should be clarified that the withholding obligation is intended to apply only to a lease premium.

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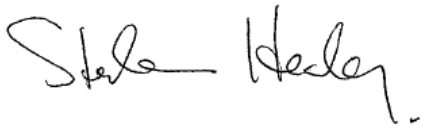
If you would like to discuss any of the above, please contact either me or Tax Counsel, Thilini Wickramasuriya, on 02 8223 0044.

Yours faithfully,



**Stephen Healey**
President