ALERT

RECENT CHANGES AFFECTING FOREIGNERS AND POTENTIALLY AUSTRALIAN RESIDENTS

Recently, both the Federal and Victorian Governments have announced many legislative changes affecting foreigners. Many of the legislative changes have a wide ambit and potentially affect Australian resident taxpayers. This Alert summarizes the changes.

1 FOREIGN RESIDENT CAPITAL GAINS WITHHOLDING

Changes to the foreign resident capital gains withholding (**FRCGW**) rate and threshold apply to contracts entered into on or after 1 July 2017. The FRCGW applies to *all* Australian real property transactions where the contract price is $750,000 or more (previously $2 million), unless an appropriate exception is available (e.g. an Australian Taxation Office (**ATO**) Clearance Certificate if the vendor is a resident for Australian tax purposes). The FRCGW withholding tax rate will be 12.5% (previously 10%).

The FRCGW applies to the sale price and not to the capital gain. Application of the FRCGW may, therefore, materially impact the cash received by the vendor at the date of settlement. The FRCGW has the potential to affect Australian property transactions even if:

- both the vendor and purchaser are Australian tax residents. For example, it can operate in circumstances where the transaction is between family members or related parties and no consideration is paid;
- an Australian income tax concession or exemption is available, for example, the main residence exemption or a roll-over applies.

On 4 August 2017 a determination was registered pursuant to Schedule 1 to the *Taxation Administration Act 1953* to allow an entity a tax credit for an amount withheld under the FRCGW provisions. The determination is effective from 1 July 2016.

Indirect Australian real property interests are considered in paragraph 2 below.

2 INDIRECT REAL PROPERTY INTERESTS – PRINCIPAL ASSET TEST

The FRCGW applies to the acquisition of an asset that is an indirect Australian real property interest or an option or right to acquire Australian real property or interest in such property.

Unlike transactions involving direct interests in Australian real property, **there is no threshold or minimum transaction amount applicable to indirect Australian real property interests**. However, a foreigner (i.e. a non-resident for Australian tax purposes) holding an indirect Australian real property interest is required to pass the *non-portfolio interest test* at the disposal time or throughout a 12 month period that began no earlier than two years before that time *and* the *principal asset test* at the disposal time.

An interest held by an entity ("holding entity") in another entity (i.e. "test entity'') passes the *non-portfolio interest test* at a time if the sum of the "direct participation interests'' held by the holding entity and its associates is 10 per cent or more. The legislation sets out various rules for determining the "direct participation interests" held in various types of entities.

The principal asset test sets out when an entity's underlying value is principally derived from Australian real property, i.e. where a sufficient connection between a membership interest in an entity and underlying Australian real property exists.

The 2017 Federal Budget announced an intention to amend the *principal asset test* to deal with concerns over indirect interests.

Draft legislation was released on 21 July 2017 amending the *principal asset test* (in Division 855 of the *Income Tax Assessment Act 1997*). The new provisions are proposed to operate from the date of the Budget announcement, being 9 May 2017.

The new rules apply on an *associate inclusive basis* for non-residents (for Australian tax purposes) with indirect interests in Australian real property and it is expect that they will have far reaching consequences of capturing indirect Australian real property interests not previously subject to the FRCGW.

3 MAIN RESIDENCE EXEMPTION

On 28 July 2017 the Federal Treasury released draft legislation removing the entitlement to the capital gains tax (**CGT**) main residence exemption for foreign residents that have dwellings that qualify as their main residence, *effective 9 May 2017*. Therefore any such capital gain or loss arising upon disposal of a foreign resident's main residence will be subject to Australian taxation.

Properties owned before 9 May 2017, however, will be grandfathered until *30 June 2019*, which means that foreign and temporary tax residents who own a main residence as at 9 May 2017 can claim the main residence CGT exemption in respect of a sale of that property made before 30 June 2019.

The test of residence applies at the date of disposal and does not take into account any earlier periods of Australian tax residence i.e. it is a "drop dead" test at disposal: are you an Australian non-resident at that date.

4 VACANT RESIDENTIAL LAND TAX

Part 4 of the *State Taxation Acts Amendment Act 28 of 2017*, amends the *Land Tax Act 2005* to introduce vacant residential land tax (commonly referred to as the vacant residential property tax or vacancy tax) (**VRLT**).The amendment imposes tax on residential property in the inner and middle suburbs of Melbourne that is unoccupied for a period of 6 months or more in a year, at a rate of 1% of the capital improved value of the land. The VRLT will apply from *1 January 2018.*

A property will be considered vacant if it was unoccupied for more than six months in the preceding calendar year by:

- the owner, or the owner's permitted occupier, as their principal place of residence, or
- a person under a lease or short-term letting arrangement

The six months does not need to be continuous.

Therefore, for example, tax liabilities for the 2018 tax year will based on vacancy in *2017*.

In addition to the existing land tax exemptions, there will be specific exemptions, including for:

- holiday homes (owned by those with a principal place of residence in Australia and where it is used and occupied as a holiday home for at least 4 weeks in the year preceding the tax year);
- a city apartment, unit or home used for work purposes;
- certain property transfers during the tax year (For example, if a property is sold and transferred during 2018, it will be exempt from the tax for the 2019 tax year.); and
- Land that becomes "residential land" during the year will not be subject to the vacant residential land tax in the following calendar year. For example, if a warehouse is converted into residential apartments during 2018, it will be exempt from the vacant residential land tax for the 2019 calendar year.

5 VACANT FOREIGN RESIDENT TAX – FEDERAL LEVEL

On 28 July 2017 the Federal Treasury released draft legislation imposing an annual charge on foreign owners of Australian residential property. The charge will apply to foreign persons required to make a foreign investment application with the Foreign Investment Review Board (**FIRB**). The FIRB definition of a foreign person is substantially wider than that of Australian tax residence and consequently, this annual charge may apply to Australian tax residents who are deemed to be "foreign persons" for FIRB purposes.

The draft legislation provides that from 9 May 2017, foreign owners of residential properties left unoccupied or unavailable to rent for *6 months in a year* or more will pay an annual charge *equivalent to the foreign investment application fee* paid by the foreign investor when they purchased the property. The minimum fee payable is $5,500.

6 ADDITIONAL DUTY FOR FOREIGN PURCHASERS OF PROPERTY (VICTORIA)

Foreign purchasers (for Victorian duty purposes) acquiring residential property in Victoria must pay foreign purchaser additional duty (**FPAD**) (sometimes referred to as the foreign purchaser "surcharge") in addition to land transfer duty. The FPAD is based on the dutiable value of the property.

FPAD applies to any arrangement or transaction that involves the transfer of an interest in residential property to a foreign purchaser. These include:

- buying a residential property at, for example, auction or by private sale;

- buying a non-residential property with the intention to convert it to residential property;
- being given a residential property as a gift; and
- certain leasing arrangements in respect of residential property.

The FPAD applies even if only a part interest in the property is acquires. It also applies to relevant acquisitions in a landholder that holds residential property.

FPAD applies to contracts, transactions, agreements and arrangements entered into on or after *1 July 2015*. For contracts, transactions, agreements and arrangements entered into on or after *1 July 2016*, the additional duty rate is *7 per cent*.

Similar provisions apply in NSW and Queensland. We can assist you with considering your circumstances and the relevant provisions in respect of property held in other States.

7 ADDITIONAL DUTY ON THE PURCHASE OF RENTAL PROPERTIES IN DISCRETIONARY TRUSTS IN VICTORIA

From 1 July 2016 stamp duty rules in Victoria may result in Victorian families paying an additional 7% stamp duty on the purchase of rental properties in a discretionary trust structure with the ability to distribute to a non-resident beneficiary, (i.e. Typically, a distant relative who lives overseas).

8 FOREIGN INVESTMENT REVIEW BOARD 50% FOREIGNER CAP

As part of an effort to make sure that dwellings are kept available for Australians, effective from *9 May 2017* the Federal Government introduced a 50% cap on foreign ownership in new developments. The FIRB definition of a foreign person applies, and accordingly it may apply treat Australian tax residents as foreign persons for the purposes of the cap.

The changes are applied through conditions imposed on New Dwelling Exemption Certificates and a Near-New Dwelling Exemption Certificates (**Exemption Certificate**), which are granted by the FIRB to property developers and act as a pre-approval allowing the sale of new dwellings in a specific development (consisting of 50 or more dwellings (other than townhouses)) to foreign persons. A near-new dwelling means a dwelling that has never been lived in, was sold but failed to settle.

Where the developer holds an Exemption Certificate, the foreign investor will not be required to seek their own FIRB approval to purchase a new dwelling or near-new dwelling in that development.

Applications for Exemption Certificates made *from 9 May 2017* will be subject to a condition that the developer may only sell a maximum of 50% of the total dwellings in the development to foreign persons. This condition will not apply to existing approvals, or applications.

9 CHANGES TO INVESTMENT MANAGER REGIME AND MANAGED INVESTMENT TRUSTS REGIMES

On 21 July 2017 the government announced changes to the investment manager regime (**IMR**) and the new tax system for managed investment trusts (**MITs**).

9.1 *IMR*

Foreign funds satisfying certain requirements and invest through an Australian fund manager are eligible to access certain Australian income tax and CGT concessions.

It is intended that the changes will clarify that when a foreign investor (i.e. a non-resident for Australian tax purposes) invests in Australia through a foreign fund or an independent Australian fund manager it will be in the same tax position as if it had invested directly.

It has been anticipated that any amendment would apply retrospectively from the start of the IMR regime in 2015.

9.2 *MIT*

Changes to the MIT and the attribution managed investment trust (**AMIT**) regimes announced are intended to:

- bring greater alignment in the tax outcomes of MITs and AMITs and provide certainty for MITs that opt into the AMIT regime. For example, with respect to CGT event E4 gains. This change is proposed to apply for distributions made in relation to the 2017/18 and later income years;
- Allow a MIT satisfying eligibility criteria and with an income year starting on a date other than 1 July to opt into the AMIT regime from its first full income year starting on or after 1 July 2015;

- Amend the meaning of fund payment to clarify that the fund payment for both MITs and AMITs should be calculated on taxable Australian property net capital gains only and clarifying that a deemed payment can arise in circumstances where no fund payment is made for the income year;
- Amend the MIT withholding provisions to clarify that they apply to the amount of the fund payment that is attributed to the taxpayer by an AMIT ensuring that the non-assessable non-exempt amount is calculated correctly for ultimate beneficiaries.
- Amend the definitions of dividends, interest and royalty payments to refer to AMITs;
- Amending the meaning of an AMIT so that single unitholder widely-held entities can access the AMIT regime. (this amendment is not expected to extend to platforms, wraps or master trusts);
- the 2016 AMIT reforms will be clarified to allow certain distributions from trusts that ceased to be public trading trusts or corporate unit trusts to be treated as franked distributions; and
- amending the trustee shortfall tax provisions to ensure that discount capital gains are properly taken into account under the AMIT "unders and overs" regime and clarifying the application of CGT event E10 where the cost base of the asset is nil.

10 FOREIGN INVESTORS TO REGISTER WATER INTERESTS

On 1 July 2017, the Federal Government introduced a new water entitlements register to increase transparency around foreign investment in Australia. This is known as the Water Register.

Foreign investors have until 30 November 2017 or 30 days after they begin to hold an interest, whichever is the later, to register their interests in Australian registrable water entitlements or contractual water rights with the ATO.

A foreign investor must notify the ATO every year of certain events regarding their interests in registrable water entitlements or contractual water rights. A foreign person may register at any time during the year but no later than 30 days after the end of the financial year in which the event occurred.

11 GST ON LOW VALUE IMPORTED GOODS

The Federal Government has passed law that will extend Goods and Services Tax (**GST**) to low value imports of physical goods imported by Australian consumers from *1 July 2018*.

The new regime is aimed at foreign suppliers who make supplies remotely to Australian consumers and do not make the supplies through an enterprise in Australia. Foreign (i.e. non-resident for Australian tax purposes) suppliers making supplies to Australian consumers will be caught within the regime and are required to register for GST if their turnover exceeds $75,000.

In summary, the reforms:

- make supplies of goods valued at A$1,000 or less at the time of supply connected with Australia if the goods are purchased by Australian consumers and are brought into Australia with the assistance of the foreign supplier;
- treat the operator of an electronic distribution platform (**EDP**) as the supplier of low value goods if the goods are purchased through the platform by consumers and brought into Australia with the assistance of either the foreign supplier or the EDP operator;
- treat re-deliverers as the foreign suppliers of low value goods if the goods are delivered outside of Australia as part of the supply, and the re-deliverer assists with their delivery into Australia as part of a shopping or "mailbox" service that it provides under an arrangement with the Australian consumer;
- allow foreign suppliers of low value goods that are connected with Australia to elect to access the simplified registration and reporting system; and
- prevent double taxation.

12 GST ON SERVICES AND DIGITAL PRODUCTS

From 1 July 2017, GST will apply to cross-border supplies of imported services and digital products sold to Australian consumers.

The new law applies very broadly to sales of anything except goods or real property imported by Australian consumers. This includes:

- digital products such as streaming or downloading of movies, music, apps, games and e-books; and
- services such as architectural or legal services.

GST will not apply to the services or digital products imported for use in an Australian business register for GST. It will apply if the Australian purchaser is not registered for GST. Suppliers will therefore be required to charge GST unless the purchaser provides the supplier with:

- pan Australian business number (**ABN**); and
- a statement that the purchaser is registered for GST.

Penalties apply for providing a supplier with false information.

Foreign suppliers selling imported services or digital products to Australian consumers that meet the GST registration turnover threshold will need to register for Australian GST. The GST registration turnover threshold is satisfied if sales to Australian consumers in a 12 month period are $75,000 or more.

A simplified system is available for non-residents (for Australian tax purposes) to electronically register, lodge and pay GST.

Electronic distribution platform (**EDP**) operators are responsible for registering, reporting and paying the GST on sales on the EDP. An EDP is a service that allows entities to make supplies available to end-users delivered by electronic communication. Examples of services that may be an EDP are a website, internet portal, gateway, store or marketplace.

Broadly, the operator of an EDP is treated, for GST purposes, as having made supplies of digital products and services that are made through the EDP.

13 CONCLUSION

There have been a number of changes affecting the Australian taxation of foreigners. A number of the changes have a wide scope and potentially impact Australian taxpayers as well as non-residents of Australia for tax purposes. Complexities arise from different definitions of “foreigner” being used for tax and FIRB and State legislation purposes.

We strongly recommend that foreign investors and Australian taxpayers review their personal facts and circumstances to clarify any potential exposure to the changes and we would be happy to assist you with further understanding the changes and how they might affect you.

Disclaimer