


LCR 2016/7 - Foreign resident capital gains withholding regime: options

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Foreign resident capital gains withholding regime: options

Relying on this Ruling

This publication is a public ruling for the purposes of the *Taxation Administration Act 1953*.

This Ruling describes how the Commissioner will apply Subdivision 14-D in Schedule 1 of the *Taxation Administration Act 1953* to CGT assets that are options and CGT assets acquired as a result of exercising an option, to entities that rely on this Ruling in good faith.

If you rely on this Ruling in good faith, you will not have to pay any underpaid tax, penalties or interest in respect of matters covered by the Ruling if it does not correctly state how a relevant provision applies to you.

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What this Ruling is about

1. This Ruling explains how to work out the amount to be paid to the Commissioner under the foreign resident capital gains withholding regime in Subdivision 14-D of Schedule 1 to the *Taxation Administration Act 1953*.¹
2. Specifically, it discusses when a purchaser that becomes the owner of:
 - an option to acquire ‘taxable Australian real property’² (TARP) or an ‘indirect Australian real property interest’³, or
 - TARP or an indirect Australian real property interest as a result of exercising an optionis required to pay an amount to the Commissioner under section 14-200.

Date of effect

3. This Ruling applies to acquisitions of:
 - options to acquire TARP or indirect Australian real property interests; or
 - TARP or indirect Australian real property interests as a result of exercising an optionunder transactions entered into on or after 1 July 2016, where the vendor of the asset is a relevant foreign resident.⁴

Background

4. Purchasers of certain types of capital gains tax assets (CGT assets) must withhold an amount where they acquire the asset from a foreign resident. This is not a final withholding tax on the gain from the asset sale, and the amounts withheld can be applied against any of the foreign resident vendor’s income tax liabilities.
5. An option to acquire property is a CGT asset of the option holder.⁵ When a foreign resident grants an option over TARP or an indirect Australian real property interest, they may trigger a withholding obligation for the grantee (purchaser)⁶ in respect of the amount paid for the option (called the option fee or premium).⁷ If the purchaser exercises the option to acquire the asset, a further withholding obligation may arise.
6. If the withholding obligation arises from a transaction entered into on or after 1 July 2017, the purchaser must withhold from the vendor, and pay to the Commissioner, an amount equal to 12.5% of:
 - the first element of the CGT asset’s cost base just after the acquisition, less
 - if the acquisition is the result of the purchaser exercising an option – any payment the purchaser made and the market value of any property that the purchaser gave for the option (or for its renewal or extension).⁸

¹ All legislative references are to Schedule 1 to the *Taxation Administration Act 1953* unless otherwise stated.

² ‘Taxable Australian real property’ is defined in section 855-20 of the *Income Tax Assessment Act 1997* (ITAA 1997).

³ ‘Indirect Australian real property interest’ is defined in section 855-25 of the ITAA 1997.

⁴ Section 14-210 sets out whether the vendor is a foreign resident for the purposes of the withholding obligation.

⁵ Section 108-5 of the ITAA 1997.

⁶ The term ‘purchaser’ in this LCR is also used to mean a party to whom an option is granted.

⁷ The obligation arises under section 14-200.

⁸ Paragraph 14-200(3)(a).

6A. For transactions entered into on or after 1 July 2016 and before 1 July 2017, the withholding rate is 10%.^{8A}

7. The first element of the cost base is the total consideration given to acquire the CGT asset. This is usually the money paid, plus the market value (worked out at the time of the acquisition) of any property given, to acquire the asset.⁹ Where the purchaser and vendor are acting at arm's length, the first element of the cost base is generally equal to the purchase price of the asset.

Withholding upon grant of option or transfer of option

8. Where a purchaser acquires an option or right to acquire TARP or an indirect Australian real property interest from a foreign resident, the purchaser must pay the Commissioner an amount equal to 12.5% of the first element of the option's cost base (generally, 12.5% of the option fee) on or before the day the purchaser becomes the owner of the option.¹⁰

9. A purchaser could acquire an option or right through a grant or creation by the owner of the underlying property. Alternatively, it is possible to acquire an existing option or right from another entity before it is exercised.

10. The purchaser does not have to withhold an amount if the vendor is not a relevant foreign resident at the time the option is granted.

11. The vendor is not a relevant foreign resident if:

- before the purchaser pays an amount to the Commissioner, the vendor gives the purchaser a valid declaration stating that they are an Australian resident, and
- the purchaser does not know the declaration is false.¹¹

12. The withholding obligation does not apply to acquisitions of TARP, or indirect Australian real property interests giving rise to company title interests¹², where the asset has a market value of less than \$750,000.¹³ Options, however, are not subject to this \$750,000 threshold.^{13A} A purchaser that pays an option fee to a vendor that is a relevant foreign resident must withhold, even if the option is over an asset that has a market value of less than \$750,000 (see Example 2 in this Ruling).¹⁴

Withholding upon exercise of option

13. When an asset is acquired as a result of exercising an option, subparagraph 14-200(3)(a)(ii) ensures the withholding obligation does not apply to the option fee twice. Otherwise, the obligation would arise when the option is granted, and

^{8A} As well as an increase to the withholding rate, the withholding threshold was reduced from \$2 million to \$750,000: *Treasury Laws Amendment (Foreign Resident Capital Gains Withholding Payments) Act 2017*.

⁹ Subsection 110-25(2) of the ITAA 1997.

¹⁰ Under subsection 109-5(1) of the ITAA 1997, the time when the purchaser acquires a CGT asset is when they become its owner. Under subsection 109-5(2) of the ITAA 1997, the purchaser acquires the option at the time the option is granted. Applicable rate for transactions entered into on or after 1 July 2017.

¹¹ Subsection 14-210(3) and section 14-225.

¹² 'Company title interest' is defined in subsection 317(1) of the *Income Tax Assessment Act 1936*. Broadly, it is an interest that gives the holder a right to occupy the land by holding shares in the company that owns the land.

¹³ Paragraph 14-215(1)(a). Applicable withholding threshold for transactions entered into on or after 1 July 2017. Applicable withholding threshold for transactions entered into on or after 1 July 2017.

^{13A} Applicable withholding threshold for transactions entered into on or after 1 July 2017.

¹⁴ Note that a purchaser or vendor can apply for a variation of the withholding amount if they can provide evidence supporting the exercise of the Commissioner's variation power under subsection 14-325(2). Applicable rate for transactions entered into on or after 1 July 2017.

again when the option is exercised, as the option fee forms part of the first element of the asset's cost base.¹⁵ Subparagraph 14-200(3)(a)(ii) avoids double counting of the option fee by reducing the amount to which the 12.5% withholding is applied by any payments the purchaser made, and the market value of any property the purchaser gave, for the option (or for its renewal or extension).¹⁶

14. In limited circumstances, subparagraph 14-200(3)(a)(ii) reduces the amount of withholding even where there was no withholding on the granting of the option. This may be the case, for example, if the option was acquired from an entity that was not a relevant foreign resident at the time the option was granted (see Example 3 in this Ruling), or if the option was granted before 1 July 2016.

15. If the asset acquired as a result of exercising the option is either TARP or an indirect Australian real property interest giving rise to a company title interest, and has a market value of less than \$750,000, the purchaser does not have any further withholding obligation.¹⁷ Where the market value of the asset is \$750,000 or greater, the vendor may nonetheless be able to provide a clearance certificate to ensure no withholding occurs.¹⁸

15A. If a purchaser acquires an option before 1 July 2017 the purchaser will be subject to a withholding rate of 10%. However, if the option is acquired on or after 1 July 2017 then a withholding rate of 12.5% will apply to the option's cost base at the time of the acquisition.

15B. If the purchaser subsequently exercises the option before 1 July 2017 then a withholding rate of 10% will apply to the asset – if the asset is TARP, or indirect Australian real property interests giving rise to company title interests, it only applies where the purchase price is \$2 million or more.

15C. If the purchaser subsequently exercises the option on or after 1 July 2017, a withholding rate of 12.5% will apply if the asset is TARP, or indirect Australian real property interests giving rise to company title interests, it only applies where the purchase price of the asset is \$750,000 or more.

16. Where the vendor and purchaser deal with each other at arm's length, the purchase price of the asset may be used as a proxy for the market value of the asset at the time the option is exercised. If the parties are not dealing at arm's length, the purchaser will have to determine the market value of the asset to work out whether they have a withholding obligation. The purchaser may seek an independent valuation to determine the market value of the asset.¹⁹

17. In the following examples, assume that the parties to the transaction are dealing at arm's length.

Example 1 – Withholding on option and property subject to option

18. *On 1 November 2016, Emu Co, an Australian resident company acquires an option from Forco, a foreign resident entity, giving it the right but not the obligation to purchase a commercial property in Australia for \$30 million within 12 months of acquiring the option. Emu Co pays Forco \$1 million upon grant of the option.*

¹⁵ Section 134-1 of the ITAA 1997.

¹⁶ Refer to paragraphs 2.104 to 2.106 of the Explanatory Memorandum to the Tax and Superannuation Laws Amendment (2015 Measures No. 6) Bill 2015. Although it specifies the existing 10% withholding rate, the intent is still applicable.

¹⁷ Paragraph 14-215(1)(a). Applicable withholding threshold for transactions entered into on or after 1 July 2017.

¹⁸ Subsection 14-210(2). Applicable withholding threshold for transactions entered into on or after 1 July 2017.

¹⁹ Refer to LCR 2016/6 *Foreign resident capital gains withholding regime: amount payable to the Commissioner*. Further guidance on market valuation can be found on our website. Go to ato.gov.au and search for 'market valuation'.

19. All the conditions under subsection 14-200(1) are met, so the withholding obligation applies.

20. The first element of the option's cost base is \$1 million, and Emu Co pays \$100,000 (being 10% of \$1 million) to the Commissioner on the day it becomes the owner of the option (that is, on the day the option is granted).

21. In October 2018 Emu Co exercises the option and acquires the property for \$30-million. At this time, all the conditions are met for a further withholding obligation under subsection 14-200(1) to apply. The first element of the cost base of the property when the option is exercised is \$31 million (being the \$30 million paid on exercise plus the \$1 million option fee).

22. Emu Co withholds from \$30 million (being \$31 million less the \$1 million that was paid for the option) and remits \$3.75 million (being 12.5% of \$30 million) to the Commissioner on the day of settlement.

Example 2 – Property with market value less than the withholding threshold

23. On 1 August 2017, Wombat Co, an Australian resident company acquires an option from Forco, a foreign resident entity, giving it the right but not the obligation to purchase a residential property in Australia for \$600,000 within 12 months of acquiring the option. Wombat Co pays Forco \$500 for the option.

24. All the conditions under subsection 14-200(1) are met, so the withholding obligation applies.

25. The first element of the option's cost base is \$500, and Wombat Co pays \$62.50 (being 12.5% of \$500) to the Commissioner on the day it becomes the owner of the option (that is, on the day the option is granted).

26. In March 2018 Wombat Co exercises the option and acquires the residential property for \$600,000. Wombat Co is not subject to any further withholding obligation as the property is TARP but its market value is less than \$750,000.

Example 3 – Option not subject to withholding

27. On 1 January 2018 Numbat Co acquires an option from Vendor Co, enabling Numbat Co to purchase a commercial property in Australia for \$65 million within 18 months of acquiring the option. Both Numbat Co and Vendor Co are Australian residents.

28. Numbat Co pays Vendor Co an option fee of \$5 million for the option.

29. Numbat Co considers subsection 14-210(1), and, thinking that Vendor Co is a foreign resident, intends to withhold from the option fee. However, Vendor Co provides Numbat Co with a written declaration of its Australian residency and, consequently, Numbat Co does not need to withhold under section 14-200. The declaration is stated to be valid for 6 months from the date it is made.

30. In October 2018 Vendor Co becomes a foreign resident.

31. In February 2019, Numbat Co exercises the option and acquires the property for \$65 million. At this time, all the conditions are met for the withholding obligation under subsection 14-200(1) to apply. The first element of the cost base of the property when the option is exercised is \$70 million (being the \$65 million paid on exercise plus the \$5 million option fee).

32. The amount to which the 12.5% withholding applies is reduced by the \$5 million option fee, despite the fact that there was no withholding at the time the option was granted. Accordingly, Numbat Co is only required to withhold from \$65 million (being

\$70 million less the \$5 million that was paid for the option) and remits \$8.125 million (being 12.5% of \$65 million) to the Commissioner on the day of settlement.

Example 4 – Asset held on revenue account

33. On 1 February 2018, Bilby Co, an Australian resident, acquires an option from Forco, a foreign resident, giving it the right but not the obligation to purchase a commercial property in Australia for \$3 million within 12 months of acquiring the option.

34. Forco holds the commercial property on revenue account. Bilby Co will hold the property on capital account if it exercises the option to acquire the property.

35. Bilby Co must pay Forco \$10,000 for the option.

36. At this time, all the conditions for the withholding obligation under subsection 14-200(1) to apply are satisfied.

37. The first element of the option's cost base is \$10,000, and Bilby Co pays \$1,250 (being 12.5% of \$10,000) to the Commissioner on the day it becomes the owner of the option (that is, on the day the option is granted).

38. In October 2017 Bilby Co exercises the option and acquires the property for \$3 million.

39. At this time, all the conditions are met for a further withholding obligation under subsection 14-200(1) to apply. The fact that the property is held by the vendor on revenue account does not exclude the purchaser from having to comply with the withholding obligation.

40. The first element of the cost base of the property when the option is exercised is \$3.01 million (being the \$3 million paid on exercise plus the \$10,000 option fee).

41. Bilby Co withholds from \$3 million (being \$3.01 million less the \$10,000 that was paid for the option) and remits \$375,000 (being 12.5% of \$3 million) to the Commissioner on the day of settlement.

Example 5 – Put & call option – purchaser's option fee credited towards purchase price

42. On 1 January 2018, Goanna Co, an Australian resident company, enters into a put and call option. Under the terms of the call option, Forco, a foreign resident entity, grants to Goanna Co the option to purchase a property in Australia for \$750,000 within 12 months (option period).

43. If Goanna Co does not exercise the option within the option period, Forco can require Goanna Co to purchase the property for \$750,000 under the put option. When either the call option or put option is exercised, a contract for the sale of the property is entered into immediately.

44. The option deed provides that Goanna Co must pay Forco \$10,000 for the call option on the date of the deed. This option fee is credited towards the deposit payable under the contract to purchase the property that arises from the exercise of the call or put option.

45. When the option is granted, all the conditions for the withholding obligation under subsection 14-200(1) to apply are satisfied. The first element of the option's cost base is \$10,000, and Goanna Co pays \$1,250 (being 12.5% of \$10,000) to the Commissioner on the day the option is granted.

46. In July 2018 Goanna Co exercises the call option and acquires the property for \$750,000 less the \$10,000 option fee already paid to Forco.

47. All the conditions are met for a further withholding obligation under subsection 14-200(1) to apply. The first element of the cost base of the property when the option is exercised is \$750,000 (being the \$740,000 paid on exercise plus the \$10,000 option fee).

48. Goanna Co withholds from \$740,000 (being \$750,000 less the \$10,000 that was paid for the option) and remits \$92,500 (being 12.5% of \$740,000) to the Commissioner on the day of settlement.

49. Note: If the terms of the deed provided for the option fee to be forfeited to Forco in the event of Goanna Co not exercising the call option, Goanna Co would not be subject to any further withholding obligation.

Example 6 – Option fee deferred

50. On 1 January 2018, Dingo Co, an Australian resident, enters an agreement with Forco, a foreign resident, under which Dingo Co will acquire the right but not the obligation to purchase a commercial property in Australia for \$750,000 within 10 months of acquiring the option.

51. Dingo Co must pay Forco an option fee of \$10,000, but the payment is not due until one month after the option agreement is entered into. Under the terms of the agreement, the option will be granted once the option fee is paid.

52. For CGT purposes, Dingo Co acquires the option when the option is granted.²⁰ It is at this time that Dingo Co will become the owner of the option²¹ and will be subject to the withholding obligation in section 14-200.

53. Dingo Co withholds \$1,250 (being 12.5% of \$10,000) from the option fee and pays the amount to the Commissioner on the day the option is granted.

54. Note 1: If Dingo Co exercises the option, it would be subject to a further withholding obligation on the purchase of the commercial property as the market value of the property is taken to be \$750,000 at this time.

55. Note 2: If, under the terms of the agreement, the option is granted before the option fee is paid, Dingo Co must still pay the amount to the Commissioner on or before the day the option is granted. Dingo Co should withhold the amount payable to the Commissioner from the option fee payable to Forco at a later date.

Example 7 – Option fee paid in instalments

56. On 1 January 2018, Possum Co, an Australian resident, enters an agreement with Forco, a foreign resident, under which Possum Co will acquire the right but not the obligation to purchase a commercial property in Australia for \$750,000 within 10 months of acquiring the option.

57. Possum Co must pay Forco an option fee of \$10,000, which is payable in 5 equal instalments of \$2,000. Under the terms of the agreement, the option will be granted upon payment of the final instalment.

58. For CGT purposes, Possum Co acquires the option when the option is granted.²² It is only when Possum Co acquires the option that it will be subject to the withholding obligation in section 14-200.

²⁰ Subsection 109-5(2) of the ITAA 1997.

²¹ Subsection 109-5(1) of the ITAA 1997.

²² Subsection 109-5(2) of the ITAA 1997.

59. *The withholding amount is calculated based on the first element of the option's cost base, which is \$10,000. Possum Co withholds \$1,250 (being 12.5% of \$10,000) from the final instalment and pays the amount to the Commissioner on the day the option is granted.*

60. *Note 1: If Possum Co exercises the option, it would be subject to a further withholding obligation on the purchase of the commercial property as the market value of the property is taken to be \$750,000 at this time.*

61. *Note 2: If, under the terms of the agreement, the option is granted before the final instalment is paid, Possum Co must still pay the amount to the Commissioner on or before the day the option is granted. Possum Co should withhold the amount payable to the Commissioner from the first or subsequent instalments that are to be paid to Forco.*

Example 8 – Payment of security deposit

62. *On 1 January 2018, Koala Co, an Australian resident, acquires an option from Forco, a foreign resident, giving it the right to purchase a commercial property in Australia for \$3 million within 12 months of acquiring the option (option period).*

63. *Koala Co must pay Forco \$100 for the option, and provide a security deposit of \$50,000 to Forco's solicitor. The security deposit is refundable if Koala Co does not exercise the option within the option period. If Koala Co exercises the option, the security deposit will form part of the deposit for the commercial property, and will be held by Forco's solicitor until settlement. Koala Co will be required to pay the remaining \$2,950,000 at settlement.*

64. *When the option is granted, all the conditions for the withholding obligation under subsection 14-200(1) to apply are satisfied. The first element of the option's cost base is \$100 and Koala Co pays \$12.50 (being 12.5% of \$100) to the Commissioner on the day the option is granted.*

65. *As at 1 January 2019, Koala Co has not exercised the option and the security deposit is refunded. Koala Co is not subject to any further withholding on this transaction.*

66. *Note 1: If Koala Co had exercised the option, it would be subject to a further withholding obligation on the purchase of the commercial property. The security deposit would form part of the first element of the cost base of the property, which is \$3,000,100 (being the total of the \$50,000 deposit, the remaining \$2,950,000 of the \$3 million exercise price and the \$100 option fee). Koala Co would withhold from \$3 million (being \$3,000,100 less the \$100 option fee).*

67. *Note 2: If the option agreement provided for the security deposit to be forfeited rather than refunded to Koala Co in the event of Koala Co not exercising the option, Koala Co would not be subject to any further withholding obligation. We would treat the forfeit of the security deposit in the same way as the forfeit of a holding deposit paid pre-contract.*

Commissioner of Taxation

27 June 2016

References

| ATOlaw topic(s) | International issues ~ Non-resident Australian income ~ Other |
|------------------------|--|
| Legislative references | TAA 1953 TAA 1953 Subdiv 14-D TAA 1953 14-200 TAA 1953 14-200(1) TAA 1953 14-200(3)(a) TAA 1953 14-200(3)(a)(ii) TAA 1953 14-210 TAA 1953 14-210(1) TAA 1953 14-210(2) TAA 1953 14-210(3) TAA 1953 14-215(1)(a) TAA 1953 14-225 TAA 1953 14-325(2) ITAA 1997 ITAA 1997 108-5 ITAA 1997 109-5(1) ITAA 1997 109-5(2) ITAA 1997 110-25(2) ITAA 1997 134-1 ITAA 1997 855-20 ITAA 1997 855-25 Income Tax Assessment Act 1936 |
| Related public rulings | LCR 2016/6 |
| Other references | Explanatory Memorandum to the Tax and Superannuation Laws Amendment (2015 Measures No. 6) Bill 2015 |
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