LCR 2016/6 - Foreign resident capital gains withholding regime: amount payable to the Commissioner

Foreign resident capital gains withholding regime: amount payable to the Commissioner

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* in determining the amount to be withheld, 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. This extends to how the purchaser can determine the amount to withhold in circumstances where:

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

- the value of the asset differs from the contract price; or
- the contract price relates to more than one asset.

3. This Ruling does not explain how the vendor can determine the amount of their capital gains tax (CGT) obligation on the disposal of the asset.

Date of effect

4. This Ruling applies to acquisitions of assets that are:

- 'taxable Australian real property' (TARP) [2],
- an 'indirect Australian real property interest'[3], or
- an option or right to acquire such property or interest

under transactions entered into on or after 1 July 2016, where the vendor of the asset is a relevant foreign resident.[4]

Background

5. Purchasers of certain types of CGT assets must withhold an amount where they acquired 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.

6. The withholding obligation applies to acquisitions of CGT assets that are:

- TARP
- indirect Australian real property interests, and
- options or rights to acquire these types of property or interests.[5]

7. The amount to be paid to the Commissioner under the withholding obligation is worked out under subsection 14-200(3). For transactions entered into on or after 1 July 2016 and before 1 July 2017, the amount payable to the Commissioner is 10% of the asset's purchase price, unless the Commissioner exercises the variation power under section 14-235.[5A] For transactions entered into on or after 1 July 2017, the withholding rate increases to 12.5%.[5B]

Withholding on value of relevant CGT asset, not contract price

8. The amount payable to the Commissioner is equal to 12.5% of the first element of the CGT asset's cost base to the purchaser, worked out just after the acquisition (excluding any amounts otherwise included because the purchaser had exercised an option to acquire the CGT asset).[6]

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[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] Paragraph 14-200(1)(c).
[5A] Subsection 14-235(2) allows the Commissioner to vary a particular amount payable by a specific purchaser, while subsection 14-235(5) allows the Commissioner to vary the amount payable by a class of purchasers (a class of amounts).
[5B] The withholding threshold also reduces from $2 million to $750,000 for transactions entered into on or after 1 July 2017. *Treasury Laws Amendment (Foreign Resident Capital Gains Withholding Payments) Act 2017*.
[6] Paragraph 14-200(3)(a). Applicable rate for transactions entered into on or after 1 July 2017.

9. 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.[7]

10. Where the purchaser and vendor are dealing at arm's length, the first element of the cost base is generally equal to the purchase price of the asset, as stated in the contract of sale.

11. However, the first element of the cost base of a CGT asset may differ from the contract or purchase price where:

- the first element of the cost base has been modified under Division 112 of the *Income Tax Assessment Act 1997* (ITAA 1997) (Modifications to cost base and reduced cost base), or
- the purchaser acquires more than one asset under the contract for an undissected lump sum, and not all of the assets are subject to the withholding obligation.

12. In the latter case, the purchaser must pay an amount in relation to the value of the CGT asset(s) that are subject to the withholding obligation, and not an amount based on the value of the entire contract.

Market value substitution rule

13. The first element of the cost base may be modified in certain situations, for instance, where the vendor and purchaser are not dealing with each other at arm's length. In these cases, the first element of the purchaser's cost base for an asset is the asset's market value at the time of acquisition.[8] This is known as the market value substitution rule.

14. The market value substitution rule can also apply in cases of collusion between the parties on the allocation of values in a contract.[9] Under a normal arm's-length dealing – when the values of each asset in the contract are the subject of real bargaining between the parties – the purchaser can rely on the values assigned to work out whether the withholding obligation applies, and how much they must pay.

15. The purchaser may seek an independent valuation to determine the market value of the asset.[10] While we do not prescribe who may undertake a market valuation, the valuation must be reliable and use an appropriate valuation methodology. Generally, we would expect a valuation undertaken by a qualified valuer with expert knowledge about the asset type to be more reliable than one provided by a person without formal valuation qualifications.[11]

Dissection of contract price to determine value of CGT assets

16. Where the contract deals with the disposal of a number of CGT assets for an undissected lump sum, and only some of the assets are subject to the withholding obligation, the purchaser needs to work out the correct amount to withhold.

[7] Subsection 110-25(2) of the ITAA 1997.
[8] Paragraph 112-20(1)(c) of the ITAA 1997.
[9] See for example, *Collis v FCT* 96 ATC 4831.
[10] The purchaser may be able to deduct the cost of obtaining the valuation. Refer to section 25-5 of the ITAA 1997 and Taxation Ruling TR 2004/2 *Income tax: whether expenses incurred obtaining valuations for consolidation are deductible under section 8-1 of the Income Tax Assessment Act 1997.*
[11] Further guidance on market valuation can be found on our website. Go to ato.gov.au and search for 'market valuation'.

17. Where the parties to the contract are dealing at arm's length, they may dissect the purchase price by using the proportionate market value of each asset. The parties need to identify all the assets transferred under the contract. The parties can take any appropriate steps to determine the value of the assets, and apportion the contract price on a reasonable basis. They may seek an independent valuation of each asset. Alternatively, the parties may choose to value the assets and apportion the contract price themselves, if they are able to justify the values they have assigned to each asset.[12]

18. Normally, the vendor is required to undergo a similar valuation process. To lodge their tax return, they need to know the value of each asset to determine whether they have made a capital gain that is not disregarded under Division 855 of the ITAA 1997. The purchaser also needs this information to determine the cost base of each asset they acquire. In order to satisfy the withholding obligation, the purchaser can use any method that results in a reasonable apportionment of the contract price.

19. Once the purchaser has determined the first element of the cost base of each relevant CGT asset, they can determine the correct amount to withhold and pay to the Commissioner.[13]

20. Purchasers have until the day they receive legal title to the property[14] (usually the day the contract is settled) to determine the appropriate amount to withhold and pay to the Commissioner.

Example 1 – Contract price substituted for market value

21. *Peta purchases a residential property from an associate who she knows is a foreign resident. The purchase price is $3 million under a contract executed on 1 July 2017, with a settlement date of 2 August 2017. Peta and her associate did not deal at arm's length. Shortly before the purchase, Peta obtained an independent market valuation report that valued the property at $4 million.*

22. *As the parties did not deal at arm's length, the market value substitution rule applies. Therefore, the $4 million market value becomes the first element of Peta's cost base of the property.*[15]

23. *All the conditions for the application of subsection 14-200(1) are met, so Peta remits $500,000 to the Commissioner on 2 August 2017.*

Example 2 – Dissection of contract price

24. *On 10 July 2017, Afonso, a foreign resident, enters a contract to sell assets used in his Australian business to Relic Co. The transaction is at arm's length.*

25. *The contract sets out total consideration of $4 million with a settlement date of 30 September 2017. Relic Co obtains an independent valuation of the assets at the time of sale which sets out the following values:*

(a) *Land $1.9 million*

(b) *Commercial building $1.8 million*

(c) *Plant and equipment $0.3 million.*

[12] Refer to paragraph 3 of CGT Determination TD 9 *Capital Gains: How do you apportion consideration received on the disposal of a composite asset?*

[13] A purchaser complying with their withholding obligation is protected by subsection 16-20(2), which discharges the purchaser from any liability to pay the vendor to the extent that an amount is paid to the Commissioner under this withholding obligation.

[14] Subsection 14-200(2).

[15] The capital proceeds received by the foreign resident vendor are also replaced with the market value of the property under paragraph 116-30(2)(b) of the ITAA 1997.

26. *The land and commercial building are TARP, and are therefore subject to the withholding obligation in section 14-200. The plant and equipment, which is not a fixture, is outside the scope of the withholding obligation.*

27. *The total market value of the assets in the independent valuation report is equal to the contract price ($4 million). Relic Co apportions the contract price between the assets according to the market value of each asset. The first element of Relic Co's cost base of the land and commercial building is $3.7 million. All the conditions for the application of subsection 14-200(1) are met, so Relic Co withholds and remits $462,500 to the Commissioner on 30 September 2017.*

Example 3 – Dissection of contract price – apportionment – contract price less than market value

28. *On 10 July 2017, Cake Company, a foreign resident, enters a contract to sell assets used in its Australian business to Slice Co. The transaction is at arm's length.*

29. *The contract sets out total consideration of $9.5 million with a settlement date of 30 September 2017. Slice Co and Cake Company agree to jointly obtain an independent valuation of the assets shortly after entering the contract of sale. The valuation report sets out the following values:*

- *(a) Land $5 million*
- *(b) Commercial building $3 million*
- *(c) Plant and equipment $2 million.*

30. *The land and commercial building are TARP and therefore subject to the withholding obligation in section 14-200. The plant and equipment, which is not a fixture, is outside the scope of the withholding obligation.*

31. *As the contract price is an undissected lump sum, the purchaser must apportion the contract price between the assets to determine the amount to withhold for the land and commercial building. The first element of Slice Co's cost base of each asset is determined in proportion to the asset's share of the total independent valuation. This is in accordance with subsection 112-30(1) of the ITAA 1997.*

32. *The values of the land and commercial building are 50% and 30% of the total valuation respectively. The relevant amounts are therefore:*

- *(a) Land $4.75 million (50% of $9.5 million)*
- *(b) Commercial building $2.85 million (30% of $9.5 million).*

33. *The first element of the cost base of the land and commercial building is therefore $7.6 million.*

34. *All the conditions for the application of subsection 14-200(1) are satisfied, so Slice Co withholds and remits $950,000 to the Commissioner on 30 September 2017.*

Example 4 – Dissection of contract price – apportionment – contract price greater than market value

35. *On 10 July 2017, Sarabi, a foreign resident, enters a contract to sell assets used in her Australian business to Components Ltd. The transaction is conducted at arm's length.*

36. *The contract sets out total consideration of $11 million with a settlement date of 30 September 2017. Components Ltd obtains an independent valuation of the assets shortly after entering the contract. The valuation report sets out the following values:*

- *(a) Land $5 million*

(b) Commercial building $3 million

(c) Plant and equipment $2 million.

37. *The land and commercial building are TARP and therefore subject to the withholding obligation in section 14-200. The plant and equipment, which is not a fixture, is outside the scope of the withholding obligation.*

38. *The purchaser must apportion the contract price between the assets to determine the amount to withhold for the land and commercial building. The first element of each asset's cost base is determined in proportion to the asset's share of the total independent valuation. This is in accordance with subsection 112-30(1) of the ITAA 1997.*

39. *The values of the land and commercial building are 50% and 30% of the total valuation respectively. The relevant amounts are therefore:*

(a) Land $5.5 million (50% of $11 million)

(b) Commercial building $3.3 million (30% of $11 million).

40. *The first element of the cost base of the land and commercial building is therefore $8.8 million.*

41. *All the conditions for the application of subsection 14-200(1) are satisfied, so Components Ltd withholds and remits $1.1 million to the Commissioner on 30 September 2017.*

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(1)(c) TAA 1953 14-200(2) TAA 1953 14-200(3) TAA 1953 14-200(3)(a) TAA 1953 14-210 TAA 1953 16-20(2) ITAA 1997 ITAA 1997 25-5 ITAA 1997 Div 112 ITAA 1997 112-20(1)(c) ITAA 1997 112-30(1) ITAA 1997 116-30(2)(b) ITAA 1997 Div 855 ITAA 1997 855-20 ITAA 1997 855-25
Related Rulings/Determinations	TD 9 TR 2004/2
Case references	Collis v FCT 96 ATC 4831; (1996) 33 ATR 438