



Explanatory Statement

PAYG Withholding variation for foreign resident capital gains withholding payments – income tax exempt entities

General Outline of Instrument

1. This instrument is made under subsection 14-235(5) of Schedule 1 to the *Taxation Administration Act 1953*.
2. All legislative references in this explanatory statement are to Schedule 1 to the *Taxation Administration Act 1953* (TAA) and *Income Tax Assessment Act 1997* unless otherwise stated.
3. Subdivision 14-D requires that an amount be paid to the Commissioner of Taxation in relation to the acquisition of certain assets from one or more entities where at least one of those entities is a foreign resident within the meaning of section 14-210 at the time the transaction is entered into.
4. This instrument varies to nil the amount that would otherwise have to be paid to the Commissioner under section 14-200, when certain acquisitions of taxable Australian property from income tax exempt entities¹ occur.
5. This is a legislative instrument for the purposes of the *Legislation Act 2003*.
6. Under subsection 33(3) of the *Acts Interpretation Act 1901*, where an Act confers a power to make, grant or issue any instrument of a legislative or administrative character (including rules, regulations or by-laws), the power shall be construed as including a power exercisable in the like manner and subject to the like conditions (if any) to repeal, rescind, revoke, amend, or vary any such instrument.

Date of effect

7. The instrument commences on the day after its registration on the Federal Register of Legislation.

¹ Exempt entity is defined under subsection 995-1(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) which means an entity all of whose *ordinary income and *statutory income is exempt from income tax because of this Act or because of another *Commonwealth law, no matter what kind of ordinary income or statutory income the entity might have; or an *untaxable Commonwealth entity.

What is this instrument about

8. Subdivision 14-D introduces a new regime, commencing on 1 July 2016, which imposes withholding obligations on the purchasers of certain Australian assets. The purpose of the regime is to assist in the collection of foreign residents' capital gains tax (CGT) liabilities.
9. The amount payable to the Commissioner under the withholding regime is generally 10% of the asset's purchase price, unless the Commissioner exercises the discretion under section 14-235 to vary the amount or classes of amounts.²
10. The entity must provide the purchaser with evidence that they are an income tax exempt entity. This should either be a private binding ruling confirming its income tax exemption valid for the year in which the transaction is occurring, or documentation showing that the entity is endorsed for income tax exemption as a registered charity under item 1.1 of section 50-5 of the *Income Tax Assessment Act 1997* (ITAA 1997).
11. This instrument removes the need for an income tax exempt entity to make an application for a variation under subsection 14-235(2). As a result of this instrument, no withholding is required when an income tax exempt entity disposes of ownership of a relevant asset.

What is the effect of this instrument

12. In the absence of a variation under section 14-235, as is provided under this instrument, subsection 14-200(3) would require an amount to be paid to the Commissioner equal to 10% of the first element of the cost base of the asset being acquired. When an asset is acquired at no cost, the first element of cost base of the asset is the asset's market value at the time of acquisition³.
13. The purpose of this instrument is to provide certainty to purchasers that no amount is required to be paid to the Commissioner in the circumstances specified in paragraph 10.
14. The variation of the withholding amount to nil is consistent with what would be the ultimate tax liability in relation to the relevant asset for the income tax exempt entity in those circumstances.
15. The new instrument is of a minor or machinery nature. An assessment of the compliance cost impact indicates that both implementation and on-going compliance costs will be minor. It reduces the on-going compliance costs of income tax entities that satisfy paragraph 10 of this explanatory statement.

² 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).

³ Section 112-20(1)(a) of the ITAA 1997.

Background

16. The PAYG system, introduced in *A New Tax System (Pay As You Go) Act 1999*, is a simple and convenient way for individual taxpayers to meet their annual income tax liabilities either through instalments or through withholding as their income is earned. This system aims to prevent large end-of-year tax bills for relevant entities. It also ensures that Government has the revenue it needs during the year to provide services and benefits to the community.
17. Subdivision 14-D forms part of the Pay As You Go Withholding system and its purpose is to assist in the collection of capital gains tax from foreign entities.
18. Paragraph 14-200(1)(a) provides that an amount is payable to the Commissioner if “you become the owner of a CGT asset as a result of acquiring it from one or more entities under one or more transactions;”. Under subsection 14-200(2), the amount must be paid to the Commissioner “on or before the day you became the CGT asset’s owner”.
19. Subsection 109-5(2) of the ITAA 1997 sets out circumstances in which an acquisition of a CGT asset is taken to occur by a purchaser. When an income tax exempt entity is selling or otherwise disposing of its ownership of a relevant asset to another entity, this will come within events specified within this subsection as being an acquisition by a purchaser.
20. Under subsection 109-5(2) of the ITAA 1997, the purchaser is taken to have acquired the relevant asset from the income tax exempt entity and might, but for this instrument, have a payment obligation to the Commissioner.

Property

21. Where the relevant asset is taxable Australian real property, or an indirect Australian real property interest giving rise to a company title interest, and has a market value of less than \$2 million, then no withholding applies as these assets are specifically excluded from being subject to the withholding regime.
22. Where the property is of a type referred to in the preceding paragraph and has a market value of \$2 million or more, and the income tax exempt entity was an Australian tax resident, that entity would need to apply for a clearance certificate to ensure the purchaser does not have to pay the Commissioner an amount in accordance with section 14-200.
23. For the clearance certificate to be valid, it must be obtained by the income tax exempt entity by the time the purchaser acquires ownership of the property in accordance with subsection 14-210(2).

Other assets

24. Where the relevant asset is not of a type referred to in paragraph 21 of this explanatory statement, the income tax exempt entity would need to complete a vendor declaration to authorise the purchaser not to pay the Commissioner an amount under section 14-200.

25. However, for the vendor declaration to be valid it must be made by the income tax exempt entity by the time the purchaser obtains ownership of the asset.
26. As a vendor declaration completed after the purchaser has obtained ownership of the asset cannot be valid, the purchaser would be required to pay the Commissioner an amount equal to 10% of the first element of the asset's cost base.

Variation application

27. In circumstances where a clearance certificate has not been (or cannot be) obtained, or a vendor declaration has not been (or cannot be) provided, the income tax exempt entity still has the option of applying to the Commissioner for a variation to the 10% withholding rate.
28. However, for the variation to be valid, the income tax exempt entity must supply the approved variation to the purchaser by settlement date. If a variation cannot be obtained, the purchaser would be required to pay the Commissioner an amount equal to 10% of the first element of the asset's cost base.

Intent of this instrument

29. The purpose of this instrument is to avoid the unnecessary withholding in circumstances where no income tax will be payable by the seller of the relevant property.
30. Income tax exempt entities include the range of entities listed within subdivision 50-A of the ITAA 1997. However, to be accepted as an income tax exempt entity for the purposes of this instrument the entity needs to provide the purchaser with a private binding ruling confirming its income tax exemption and is valid for the year in which the transaction is occurring, or documentation showing that the entity is endorsed for income tax exemption as a registered charity under item 1.1 of section 50-5 of the ITAA 1997.
31. It is consistent and fair under the Commissioner's power provided in 14-235 to reduce the withholding to nil which means that no withholding is payable.

Consultation

32. The ATO has consulted extensively with legal bodies and persons engaged with income tax exempt entities about the impact of subdivision 14-D on the transactions discussed in this explanatory statement.
33. The necessity for this instrument was identified through that consultation process and there has been general agreement that there is need to put this instrument in place.

Legislative references:

Acts Interpretation Act 1901

Taxation Administration Act 1953

Legislation Act 2003

A New Tax System (Pay As You Go) Act 1999

Income Tax Assessment Act 1997

Statement of Compatibility with Human Rights

This Statement is prepared in accordance with Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

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This Legislative Instrument is compatible with the human rights and freedoms recognised or declared in the international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

Overview

This Legislative Instrument avoids the imposition of an unnecessary withholding on the acquisition of certain Australian assets from income tax exempt entities.

Human rights implications

This legislative instrument does not engage any of the applicable rights or freedoms because the new instrument is of a minor or machinery nature. The instrument avoids unnecessary withholding in circumstances where no tax will be payable.

Conclusion

This legislative instrument is compatible with human rights as it does not raise any human rights issues.