PROPERTY COUNCIL of Australia THE VOICE OF **LEADERSHIP**

4 December 2014

Manager
International Taxation Unit
Corporate and International Taxation Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: tapwithholding@treasury.gov.au

Att: Michael Atfield

Dear Michael,

Non-final withholding tax on transactions involving taxable Australian property

Thank you for the opportunity to comment on Treasury's discussion paper on the proposed non-resident withholding tax regime for disposals of taxable Australian property (the Discussion Paper).

The Property Council is the peak body representing the interests of owners and investors in Australia's $670 billion property investment industry. The Property Council represents members across all four quadrants of property investment, debt, equity, public and private.

Industry understands Government's concern. The proposal is intended to give Government greater comfort that the right tax is being paid under Australia's tax rules for disposals of taxable Australian property.

However, industry is keen to ensure that implementation of the 10% non-final withholding tax regime does not escalate the level of compliance and administrative costs for all property transactions.

This would be inconsistent with the Government's deregulation agenda, and impose a significant disincentive for international investment in Australia.

Critically, the regime must incorporate pre-clearance processes (similar to the US and Canada regimes), to eliminate the need for unnecessary withholding on transactions that do not give rise to Australian tax receipts, or where the tax payable will be less than 10% of the purchase price.

Without pre-clearance processes, there is considerable risk that tax will be withheld even where no tax is owed.

Specifically, unless amended, the proposals will lead to:

- purchasers withholding on ***all*** property transactions due to uncertainty over identifying whether:
  - a vendor is a foreign resident; or

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  - there has been a disposal of "taxable Australian property", particularly for security (share or unit) transactions as they require purchasers to determine if the vendor holds greater than 10% of a land-rich company. This information is difficult to obtain;

- unnecessary withholding and a loss of significant cashflow for vendors who are not liable for Australian transaction tax (eg due to existing tax losses);

- purchasers being forced to trace through Australian custodians to determine whether the custodian's client is a non-resident, which is inconsistent with existing withholding tax rules that impose the obligation on the custodian;

- retirement village units inadvertently being caught by the regime if the carve out for residential property under $2.5 million is not defined appropriately;

- purchasers being forced to:

  - withhold amounts ahead of settlement (i.e. before all pre-settlement conditions are satisfied); and

  - withhold on post-completion amendments to the purchase price; and

- foreign residents being unnecessarily forced to apply for a tax file number when they acquire Australian property, which will delay commercial transactions and impede Australia's international competitiveness.

These problems can be easily fixed by:

- clearly defining the scope of the withholding obligation by:

  - **providing purchasers with clear and practical guidance and safe harbours** regarding the necessary enquiries to determine when a transaction is caught by the regime; and

  - **excluding all transactions involving listed securities from the regime**, as purchasers will have nil or limited information on who the vendor is, and whether the vendor holds greater than 10% interest in a listed security;

- reducing unnecessary withholding by:

  - **allowing purchasers to rely on a declaration by the vendor** that the transaction is not caught by the withholding rules;

  - **allowing vendors to apply for, and receive a clearance certificate within 21 days**, to exempt the vendor from the withholding tax regime (e.g. for those vendors exempt from Australian tax, or with strong compliance history); and

  - **allowing vendors to apply for a variation of withholding tax rate within 21 days** (e.g. where tax payable is expected to be less than 10% of the purchase price);

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- **adopting the existing withholding tax rules** which provide for the withholding obligation to sit with the Australian custodian, where applicable;

- **relying on the GST definition of "residential premises"** which the ATO has accepted as including retirement village units – i.e.

  "land or a building that:
  (a) is occupied as a residence or for residential accommodation; or
  (b) is intended to be occupied, and is capable of being occupied, as a residence or for residential accommodation;
  (regardless of the term of the occupation or intended occupation) and includes a floating home";

- **clarifying when amounts must be withheld** by confirming that:

  - withholding is not required on deposits, rather withholding only needs to be paid on settlement of the transaction (i.e. all condition precedents have been satisfied); and

  - there is no requirement to withhold on post-settlement amendments, as these will be managed as part of the vendor's tax return process; and

- **eliminating the requirement for non-residents to apply for a tax file number** when they acquire Australian property, as no other country forces foreign investors to apply for a tax file number or equivalent red tape.

We have set out further details in the attached technical submission.

Please contact Belinda Ngo (on 0400 356 140) or me (on 0406 45 45 49) if you have any queries.

We look forward to your reply.

Yours sincerely,

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PROPERTY COUNCIL OF AUSTRALIA

NON-FINAL WITHHOLDING TAX ON TRANSACTIONS INVOLVING TAXABLE AUSTRALIAN PROPERTY

SUBMISSION TO TREASURY
4 December 2014

SUBMISSION

On 31 October 2014, Treasury released a discussion paper canvassing design options for implementing the non-final withholding tax regime for disposals of taxable Australian property.

In particular, the paper stresses the importance of reducing the compliance burden and red-tape associated with the withholding obligation.

Industry supports Government's aim to ensure the proposal does not escalate the level of compliance and administrative costs for all property transactions.

Set out below are industry's recommendations for a practical and workable withholding tax regime.

1. PRE-CLEARANCE MECHANISMS TO ELIMINATE UNNECCESARY WITHHOLDING

Australia's international competitiveness will be adversely affected if the proposed regime does not incorporate pre-clearance mechanisms to eliminate the need for unnecessary withholding.

There will be many instances where vendors are not liable for Australian tax on the transaction (eg due to existing tax losses), or where vendors have a strong compliance history in Australia.

The rules could also result in unnecessary withholding on disposals by Australian resident vendors, due to difficulties purchasers face in determining residency status.

Without pre-clearance mechanisms, the proposed withholding rules will result in a loss of significant cash flow for these vendors, which will increase the cost of doing business in Australia.

This will adversely impact our competitiveness when compared to other jurisdictions like Canada and US who have sensible pre-clearance processes.

Recommendation 1: ***Allow purchasers to rely on a declaration by the vendor that the transaction is not subject to the withholding regime***

Industry supports the "Payee declaration option" set out at 4.2.1 of the Discussion Paper.

Under this option, purchasers would not be required to withhold where the vendor provides a declaration that:

- the vendor is a resident of Australia for income tax purposes; or
- the disposed asset is not 'taxable Australian property.'

This will ensure disposals by Australian resident vendors are not inadvertently subject to withholding, and also safeguard foreign resident disposals which do not involve taxable Australian property.

The declaration will reduce the compliance burden on both the purchaser and the ATO, as it will eliminate the need to process unnecessary withholding payments and refunds.

Industry agrees with the Discussion Paper's suggestion that the declaration could be included as a term of the contract exchanged between the parties.

Recommendation 2:	***Introduce a "clearance certificate" that exempts certain vendors from the withholding tax regime***

Industry supports the "Clearance Certificate" proposal set out at 4.2.3 of the Discussion Paper.

Under this approach, the vendor has the opportunity to engage with the Commissioner to eliminate unnecessary compliance cost where there is no need for withholding.

This will be most relevant for vendors who may be exempt from Australian tax, or have a strong compliance history in Australia. Removing the need to withhold will represent a significant cash flow saving for these vendors.

The regime should establish a clear set of parameters where such a certificate will be issued, to ensure applications can be completed by the vendor, and processed by the ATO, in a timely manner.

The clearance certificate must be issued to approved vendors within 21 days of the original application being lodged.

This is essential to ensure the withholding regime does not hold up ordinary commercial settlement timeframes.

Where the certificate is not received by the settlement date, the purchaser should be entitled to deposit the withheld amount in an escrow account, pending finalisation of the approval process.

If withholding is required, the funds will be remitted to the ATO, if withholding is not required, the funds will be released from the escrow account to the vendor.

The clearance certificate should also be valid for a reasonable period (provided the vendor's facts and circumstances remain unchanged), as exchange or settlement processes can be delayed.

Recommendation 3:	***Introduce a "rate variation" regime that allows vendors to reduce the withholding rate***

Industry supports the "Variation of withholding amount" proposal set out at 4.2.4 of the Discussion Paper.

The 10% withholding tax rate is intended to be a proxy for the expected tax payable on the transaction.

However, as tax is only paid on the profit from the transaction (not the purchase price), there will be many instances where the 10% withholding tax is significantly greater than the expected tax payable.

Under the rate variation proposal, the vendor has the opportunity to engage with the Commissioner to reduce the withholding rate, where the tax payable from the transaction is expected to be less than 10% of the purchase price.

The ability to vary the rate will represent a significant cash flow saving for vendors who are not expecting to make a significant profit on the transaction. It will also be relevant for vendors who have borrowings that need to be repaid from the sale proceeds, particularly where the 10% withholding would otherwise result in the vendor having insufficient funds to discharge a security over the asset.

The regime should establish a clear set of parameters where such a rate variation will be issued, to ensure applications can be completed by the vendor, and processed by the ATO, in a timely manner.

The rate variation must be issued to approved vendors within 21 days of the original application being lodged.

This is essential to ensure the withholding regime does not bog down or stall ordinary commercial settlement timeframes.

Where the rate variation is not received by the settlement date, the purchaser should be entitled to deposit the withheld amount in an escrow account, pending finalisation of the approval process.

If withholding is required, the funds will be remitted to the ATO, if withholding is not required (or the varied rate is less than 10%), the funds will be released from the escrow account to the vendor.

2. SCOPE OF THE WITHHOLDING REGIME

As touched upon briefly above, the proposed withholding regime could force ***all*** purchasers to withhold on ***all*** direct and indirect property transactions due to uncertainty on whether the vendor is a foreign resident, or there has been a disposal of taxable Australian property.

The pre-clearance options discussed above will significantly reduce the level of unnecessary withholding.

However, for those transactions that are not part of a pre-clearance process, purchasers could still be left with significant uncertainty on whether they have a withholding obligation.

Recommendation 4:	***Provide purchasers with clear and practical guidance on what enquiries need to be made to determine when a transaction is caught by the regime.***

The proposed regime requires purchasers to identify:

- whether the vendor is a foreign resident; and
- whether the property in "taxable Australian property" – which includes direct and indirect property transactions.

The definitions of these concepts is not straightforward and if the purchaser is unsure, it is likely they will simply withhold regardless of the vendor or property status. The vendor then is unnecessarily denied part of their payment, and put to considerable time and expense to recover the money from the ATO. No doubt the ATO will be inundated with erroneous withholding tax information and requests for refunds.

a) Identifying residency

Industry recommends that the withholding tax provisions provide safe harbours that purchasers can rely on for identifying foreign residency.

Potential safe harbours include:

- Withholding is triggered if the vendor has an address outside of Australia, or the payment is directed to a place outside Australia. This is consistent with the Managed Investment Trust withholding tax rules.
- Withholding is <u>not</u> required if the vendor has an Australian Business Number, as this indicates they have an Australian business (and therefore tax) presence.

There should also be clear and practical guidance provided on what enquiries purchasers need to make to satisfy themselves as to whether the vendor is a foreign resident.

b) Identifying taxable Australian property

The Discussion Paper recognises the potential difficulties purchasers face in determining if a security (share or unit) sale constitutes the disposal of "taxable Australian property", and therefore, triggers a withholding obligation.

A security sale will only trigger a withholding obligation if:

- the vendor (and its associates) hold 10% or more of the entity (the non-portfolio interest test); and
- the value of the entity is principally derived from assets that are taxable Australian real property (the principal asset test).

Purchasers will not have access to the share registry to determine if the vendor and its associates hold 10% or more of the entity.

The regime should incorporate safe harbours to allow the purchasers to rely on the information provided by the vendor.

There should also be clear and practical guidance provided regarding which enquiries purchasers need to make to satisfy themselves as to whether the purchase involves taxable Australian property.

Recommendation 5: Exclude all transactions involving listed securities from the regime

As discussed in the Treasury Paper, it is infinitely more difficult for a purchaser of listed securities to determine whether the transaction should be subject to the withholding regime.

This is because the transaction will most likely occur via brokers and other intermediaries, and there will be little or no contact between the vendor and purchaser. The listed property fund will also have minimal involvement in the transaction (typically, the fund updates its register following completion of the transaction).

The settlement period for listed securities is also usually very short (usually within 1-3 days), which will severely limit the purchaser's ability to conduct any due diligence process.

These difficulties apply to both on market and off market purchases.

The Canada regime has recognised the difficulties associated with listed securities, and carved out listed securities completely from their withholding regime.

A similar exemption from Australia's withholding regime will ensure our rules remain internationally competitive and do not skew investment from Australian listed securities.

Recommendation 6: Rely on the GST definition of "residential premises" for the purposes of the carve out for residential property with a value less than $2.5 million

Industry supports Government's proposal to reduce the compliance burden on the residential property market by excluding residential property with a value of less than $2.5 million from the withholding regime.

The residential property exclusion should also incorporate retirement living units, which are an increasingly common form of residential accommodation for older Australians.

While most retirement living units are not expected to be held by foreign residents, it is possible for the owner of a retirement living unit to pass away, and for the trustee of their deceased estate to be a foreign resident.

As noted in the Discussion Paper, “residential property” is not currently a defined term in the income tax provisions.

The term “residential premises” is used for GST purposes, and is defined as:

> *“land or a building that:*
> *(a) is occupied as a residence or for residential accommodation; or*
> *(b) is intended to be occupied, and is capable of being occupied, as a residence or for residential accommodation;*
> *(regardless of the term of the occupation or intended occupation) and includes a floating home”*;
>
> (source: Section 195.1 of A New Tax System (Goods and Services Tax) Act 1999).

The GST definition of “residential premises” is further considered by the ATO in GST Ruling GSTR 2012/5, and includes retirement village units.

Recommendation 7: ***Adopt the existing withholding tax rules which provide for the withholding obligation to sit with the Australian custodian***

Industry supports the Discussion Paper’s proposal to impose the withholding obligation on the Australian custodian, as they will have the relevant information to determine if their client is an Australian or foreign resident.

This mirrors the requirements under the existing withholding tax regimes, and is well understood by market participants. It will substantially cut down compliance costs, erroneous withholding of tax and refund requests.

3. TIMING OF WITHHOLDING OBLIGATION

Recommendation 8: ***Withholding should only be payable on settlement of the transaction***

The Discussion Paper proposes that purchasers will be required to withhold 10% of the proceeds at the time the relevant payments are made, and pay this amount to the Commissioner at a later time.

Industry supports this approach, however, the regime should clearly set out that:

- withholding is not required on deposit payments, rather, withholding only needs to occur on settlement of the transaction, as this ensures all condition precedents have been satisfied; and

- there is no requirement to withhold on post-settlement amendments, as any amendment to the purchase price that affects the vendor’s tax liability will be resolved as part of the vendor’s tax return process.

4. ADDITIONAL COMPLIANCE SAVING PROPOSALS

Recommendation 9:	***Allow vendors to apply for the pre-clearance mechanisms or lodge an income tax return, and seek a refund, immediately following a transaction subject to withholding***

Certain vendors may not have the time or resources to apply for any of the pre-clearance mechanisms discussed at section 1 above. There may also be circumstances where the actual purchase price (and therefore, expected gain on the transaction) is not finalised until settlement of the transaction.

However, the current tax return lodgement process may mean that these vendors have to wait up to 12 months to file a tax return, and seek a refund of any excess withholding (for example, if a transaction occurs on 1 July, vendors could have to wait until after 30 June to lodge the return for that year).

Vendors should have the ability to seek a refund of any excess withholding, immediately following the completion of a transaction, by either:

- applying for an exemption or rate variation within 3 months of settlement of the transaction; or
- lodging an income tax return.

Recommendation 10:	***Eliminate the requirement for non-residents to apply for a tax file number when they acquire Australian property***

The Discussion Paper asks whether foreign residents should be required to apply for a tax file number when they acquire Australian property.

Industry would not support such a proposal, as it will bog down or stall commercial transactions and impede Australia's international competitiveness. No other country forces foreign investors to apply for a tax file number or equivalent red tape.

CONTACT US

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