
Australia: Capital gains tax changes for foreign residents

July 28, 2017

In brief

As part of the 2017-18 Federal Budget, the Australian Government announced on May 9, 2017 a range of reforms to reduce pressure on housing affordability and to put “Australians first for Australian housing”.

One of the Federal Budget announcements was that as of 7:30pm (AEST) on May 9, 2017 foreign and temporary tax residents would no longer be exempt from capital gains tax (CGT) when selling their main residence; this rule was made subject to grandfathering for existing properties held on this date and disposed of on or prior to June 30, 2019.

The Government has now released an Exposure Draft of a Bill to implement these measures for consultation. The closing date for submissions on the Exposure Draft is August 15, 2017.

In the Exposure Draft, the Government has made a policy change to ensure all Australian tax residents, including those who are temporary tax residents, can continue to access the main residence exemption. This is a welcome development, as it was initially thought that all temporary tax residents would not be able to access the concession. Temporary tax residents are individuals who hold a temporary visa and who also meet other requirements.

However, the Exposure Draft proposes that the CGT main residence exemption will be denied from 7:30pm (AEST) on May 9, 2017 for foreign residents. In addition, there will be no apportionment of the main residence exemption based on days of ownership over the whole period of ownership. Existing properties held on May 9, 2017 will be grandfathered until June 30, 2019. For the purpose of the Exposure Draft, “foreign resident” means someone who is not a tax resident of Australia.

Foreign residents, including Australian citizens and permanent residents who are foreign residents, should consider how these changes will impact their circumstances.

In detail

Current CGT main residence exemption for foreign residents

The main residence exemption provides an exemption from CGT where a gain is made on the disposal of a dwelling and it is an individual’s main residence

throughout their ownership period.

The main residence exemption rule also provides a partial exemption if the dwelling was the individual’s main residence for only a part of their ownership period or if it was also used partially to produce

assessable income (e.g., rental income) during their ownership period.

Furthermore, in cases where individuals do not treat any other dwelling as their main residence, they can treat their

dwelling as their main residence for CGT purposes for up to six years if their main residence is rented out or for an unlimited period where their main residence is not rented out. This rule is commonly known as the “absence rule”.

Finally, the main residence exemption can also apply to individuals who are beneficiaries of an estate of a deceased person who used the dwelling as their main residence.

CGT main residence exemption removed for foreign residents

The policy change removes access to the CGT main residence exemption for all foreign residents. A foreign resident is an individual who is not a resident of Australia for taxation purposes.

Individuals who sell their Australian main residence and who are foreign resident at the time of disposal (referred to as a “CGT event”) will no longer be entitled to the main residence exemption.

Importance of the Australian tax residency status at the time of disposal

For individuals having an ownership interest in a dwelling, the date of the disposal of their interest in the dwelling will be the time a contract for sale is entered into. This will be the relevant time to determine whether the individual is an Australian resident or a foreign resident.

If, at that time, the individual is a foreign resident, the main residence exemption will not apply. As a result, the capital gain or loss on the disposal will not be exempt for Australian tax purposes.

The Exposure Draft does not contain any apportionment of the main residence exemption, either based on days of ownership over the whole

period of ownership as an Australian resident or as a non-resident for Australian taxation purposes.

Interaction with the “absence rule”

In the Exposure Draft, there is no consideration of the Australian “absence rule” which allows an individual to continue to treat a dwelling as their main residence (subject to the conditions listed above) for CGT purposes.

Accordingly, if an individual is a foreign resident at the time they sell their residence, they would be subject to CGT on the full amount of any capital gain.

In this context, the proposed law can be seen as a partial abolition of the “absence rule” as foreign residents would no longer benefit from this rule. However, individuals who resume Australian tax residency prior to selling their main residence may still be able to benefit from the “absence rule”.

In practice

Australian citizens or permanent residents going overseas and becoming non-residents of Australia who sell their main residence, perhaps due to unforeseen consequences (e.g., financial hardship, divorce, health reasons etc.), will be adversely impacted (but see transitional relief below) by these changes.

Example

The Exposure Draft provides the following example:

Vicki acquired a dwelling on September 10, 2010 moving into it and establishing it as her main residence. On July 1, 2018 Vicki vacated the dwelling and moved to New York. On October 15, 2019 Vicki signs a contract to sell the dwelling. As Vicki is a foreign resident on

October 15, 2019, she is not entitled to the main residence exemption. This outcome is not affected by Vicki previously using the dwelling as her main residence.

However, where an individual returns to Australia and resumes Australian tax residency before entering into a contract of sale, they may still be able to claim the main residence exemption.

Application and transitional provisions

The amendments to the main residence exemption rules for foreign residents apply to CGT events happening on or after 7:30pm (AEST) on May 9, 2017.

For properties acquired on or before May 9, 2017 the new rules will not apply to disposals of the property until after June 30, 2019.

Therefore, individuals who owned an Australian dwelling before May 9, 2017 that they use as their main residence - or where the absence rule provision will apply to treat this dwelling as their main residence - will still be able to benefit from the main residence exemption for disposals on or prior to June 30, 2019.

In this context, foreign residents may wish to consider selling their Australian main residence before June 30, 2019, should they wish to benefit from the exemption.

CGT main residence exemption maintained for temporary residents

The Government initially announced the removal of the CGT main residence exemption for all foreign and temporary tax residents. This has been changed in the Exposure Draft so that the CGT changes will not apply to temporary residents for taxation purposes (including some New

Zealand citizens and individuals who hold a subclass 457 visa) unless they are a foreign resident at the time of disposal.

Example

The Exposure Draft provides the following example:

James, a New Zealand citizen on a special category visa, purchases a dwelling in Australia and establishes it as his main residence. He is a temporary resident of Australia for taxation purposes. James continues to reside in the dwelling for several years. He signs a contract to sell the dwelling, departing Australia several months later. As James is an Australian resident for taxation purposes at the time CGT event occurs (i.e., when he signs the contract), he is entitled to the full main residence exemption.

The takeaway

If the Exposure Draft is legislated in its current form, the main residence exemption removal for foreign

residents will have impacts for both companies and individuals.

Employers of expatriates

Employers of expatriates should be aware that employees may be more reluctant to accept an assignment outside Australia if they will be negatively impacted by these rules.

Employees who are offered an overseas assignment will have to consider the tax consequences of potentially losing their main residence exemption should they wish to sell their home while on assignment.

In order to benefit from the main residence exemption they will need to either sell their home before going overseas, wait until they return to Australia before selling their main residence, or perhaps not take up the assignment at all.

Finally, employers who have tax equalisation arrangements and who tax equalise personal income, should consider whether they will tax equalise any CGT imposed on the sale

of an employee's Australian home while they are a foreign resident.

Individuals

Individuals who are either foreign residents or who will become foreign residents, will need to be aware of the potential tax implications should they sell their house while they are foreign residents.

Comparative calculations and tax residency analysis may be required before accepting any assignment overseas.

If their main residence was acquired on or before May 9, 2017, current and future foreign residents may want to consider selling their main residence before June 30, 2019 in order to benefit from the CGT main residence exemption transitional rules.

In any case, impacted individuals should seek specific taxation advice in order to evaluate the impact of this measure on their personal tax situation and to take relevant actions where appropriate.

Let's talk

For a deeper discussion of how this might affect your business, please contact your PwC Global Mobility Services engagement team or one of the following individuals:

Global Mobility Services – Australia

Norah Seddon
+61 (2) 8266 5864
norah.seddon@pwc.com

Kevin Lung
+61 (2) 8266 7318
kevin.lung@au.pwc.com

Maria Ravese
+61 (8) 8218 7494
maria.a.ravese@pwc.com

Shane Smailes
+61 (3) 8603 6097
shane.smailes@pwc.com

Lisa Hando
+61 (8) 9238 5116
lisa.hando@pwc.com

Anna Law
+61 (7) 3257 8081
anna.law@pwc.com

Louise Sutton
+ 61 (2) 8266 8641
louise.sutton@pwc.com

Global Mobility Services – United States

Peter Clarke, *Global Leader*
+1 (203) 539-3826
peter.clarke@pwc.com

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