



GES NewsFlash

Australia — Removal of CGT Discount for Foreign Resident Individuals

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On Friday 8 March 2013, the Assistant Treasurer released the exposure draft legislation and draft explanatory materials in relation to the removal of the Capital Gains Tax (CGT) discount for individuals who are considered foreign residents or temporary residents for Australian tax purposes.

Background

Current CGT legislation allows a 50% discount to be applied to any taxable gain an individual derives on an asset that has been held for more than 12 months. The 50% discount is available to all individuals regardless of their Australian tax residency status. The result is that only half of the capital gain is included in the individual's assessable income and subject to tax at their marginal tax rate.

As part of the 2012-13 Federal Budget announcements, the government proposed the removal of the CGT 50% discount in respect of capital gains that foreign resident individuals accrued after 7:30 p.m. (AEST) on 8 May 2012.

Individuals who are foreign residents for tax purposes are only subject to CGT in Australia in relation to assets that are considered Taxable Australian Property (TAP) — e.g., Australian real estate or assets that the individual has elected to treat as TAP on ceasing Australian tax residency.

Upon cessation of Australian tax residency, an individual is deemed to have disposed of all assets (which are not TAP) at their market value on that date and is therefore required to report the resulting net taxable (unrealized) gain or loss in their income tax return in the year they ceased residency. This is commonly referred to as the "deemed disposal" rule.

Individuals can make an election for the deemed disposal rule not to apply. In this case, the assets will be deemed to be TAP and therefore would be subject to CGT in Australia upon actual disposal, necessitating the reporting of any gain on an Australian income tax return in the year of sale (subject to any relevant income tax treaty relief available under a Double Tax Agreement).

In addition to foreign resident individuals, the proposed changes would also affect individuals who qualify as temporary residents for Australian tax purposes. Broadly, a temporary resident is generally only subject to tax in Australia on Australian-sourced income and capital gains that relate to TAP.

Draft legislation

A new section of legislation is being proposed to deny any discount to the extent that a capital gain accrued after 8 May 2012, and the individual is a foreign resident or temporary resident for Australian tax purposes for some or all of the ownership period after 8 May 2012.

Individuals would still be able to utilize the 50% discount to reduce the taxable capital gain for assets:

- In which the increase in value of the asset accrued prior to 9 May 2012, or
- Where the individual remained an Australian tax resident from 8 May 2012, until the date of sale (i.e., at no stage after 8 May 2012, were they a temporary or foreign tax resident of Australia).

The proposed changes would not have any impact on the ability to use capital losses to reduce a capital gain. Additionally, individuals would retain the right to carry forward capital losses to offset against future capital gains and would still have access to other CGT exemptions (e.g., the main residence exemption and the absence rule).

Assets that were acquired after 8 May 2012, by an individual who is a foreign resident or temporary resident from purchase until sale would not be eligible for any discount.

The proposed measures would also apply to individuals who are beneficiaries of a trust estate and received a distributed capital gain after 8 May 2012. Finally, individuals who inherit assets as a result of a deceased estate would need to take into account the residency status of the individual who originally held the asset.

Draft legislation example of how the proposed changes could apply

The calculations below show the difference between the current legislation and the proposed changes. The assumptions used in the calculations are as follows:

- An Australian resident individual purchased shares in company XYZ for \$100,000 on 1 July 2009
- The individual ceased Australian tax residency on 20 August 2011, and the market value of the same shareholding on that day was \$120,000
- The shares were subsequently sold for \$135,000 on 4 January 2013, at which time the individual was a foreign resident for Australian tax purposes
- No capital losses are available to offset any capital gain
- The tax rate applicable in all scenarios is 32.5%

Current legislation – elected out of deemed disposal

Under current legislation, if an individual were to elect out of deemed disposal, the capital gain associated with the above shares would be \$35,000. This would then be eligible for a 50% discount to determine the amount to be included in the individual's assessable income (\$17,500 included in the 2012/13 Australian tax year). The tax payable in relation to the discounted gain would be \$5,688.

Current legislation – deemed disposal applied

If the individual chose to have deemed disposal apply on ceasing Australian tax residency, the gain on the shares would be \$20,000. This would then be eligible for a 50% discount to determine the amount to be included in the individual's assessable income (\$10,000 included in the 2011/12 Australian tax year). The tax payable in relation to the gain would be \$3,250 and no tax would be payable in Australia on the actual sale of the shares.

Proposed changes

Market valuation (scenario 1)

The taxpayer received a market valuation, which shows that the value of the shares on 8 May 2012, was \$130,000. Under the proposed changes, this would result in a discount percentage of 42.86%, a taxable gain of \$19,999 and tax payable of \$6,500 (for the 2012/13 Australian tax year).

Market valuation (scenario 2)

The taxpayer received a market valuation that shows that the value of the shares on 8 May 2012, was \$136,000. Under the proposed changes, the discount percentage that can be applied to the taxable gain would remain as 50%. The proposed changes protect an individual where the value of the asset falls between 8 May 2012, and the date of sale.

No market valuation

The taxpayer does not choose a market valuation. Under the proposed changes, this would result in a discount percentage of 30.40%, a taxable gain of \$24,361 and tax payable of \$7,917 (for the 2012/13 Australian tax year).

The above examples are provided for illustrative purposes only. CGT can be a complex area of tax legislation and specific facts and circumstances would affect how the taxable gain is calculated. It is therefore recommended that you seek specific advice surrounding your exact circumstances before you make any decisions regarding your asset holdings.

Deloitte's view

- Temporary residents are currently only subject to CGT on assets that are considered TAP. Therefore, if temporary residents only have Australian real estate, which they reside in as their main residence, and any sale of the property meets the main residence exemption requirements, the proposed changes would have minimal impact.
- The changes would only affect temporary residents who own investment properties in Australia (the purchase of which requires Foreign Investment Review Board approval). Shares and other assets (which are not considered TAP) only enter the Australian CGT regime if the individual remains a tax resident but is no longer eligible to be treated as a temporary resident. Therefore, if they sell assets (which are not TAP) after ceasing to be a temporary resident but while remaining a tax resident, the changes should have no impact on these individuals.
- The biggest impact of these proposed changes is likely to be felt by Australian residents who cease Australian tax residency and either:
 - Sell an investment property while a foreign resident for tax purposes or
 - Elect out of the deemed disposal rules on ceasing tax residency, such that tax is payable on the actual sale of the asset (subject to any treaty relief).
- If these changes become law, individuals ceasing Australian tax residency may want to consider whether they should have the deemed disposal rules apply and pay tax on ceasing residency, rather than electing out of the deemed disposal rules. This may result in a lower overall tax exposure in Australia because of the availability of the discount while

resident.

- Individuals who were temporary residents or foreign residents as of 8 May 2012, and held assets at this date that are subject to CGT in Australia, may wish to consider whether it is worth obtaining a market valuation for these assets. A record of the market valuation should be maintained with tax records to be able to use the market valuation choice when determining any taxable gain to be reported.
- The draft legislation has been provided for public consultation. Any feedback on the proposed changes should be addressed to Treasury prior to 5 April 2013. Alternatively, if you would like to discuss the proposed changes please feel free to reach out to one of the Deloitte contacts detailed below.
- The final legislation would need to be reviewed to determine if the proposals contained within the draft have remained unchanged. Deloitte will provide further guidance following the enactment of any legislation changes

People to contact

If you have any questions concerning the issues in this GES NewsFlash, please contact one of the GES professionals at our Deloitte offices as follows:

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