20 August 2024

Director
International Tax Unit
Corporate and International Tax Division
The Treasury
Langton Crescent
Parkes ACT 2600

By email: MNETaxIntegrity@treasury.gov.au

Dear Director,

**Strengthening the foreign resident capital gains tax regime**

The Tax Institute welcomes the opportunity to make a submission to the Treasury regarding the Federal Budget 2024-25 measure to strengthen Australia's foreign resident capital gains tax (**CGT**) regime consultation paper (**Consultation Paper**).

In developing this submission, we have closely consulted with our National Large Business and International Technical Committee to prepare a considered response that represents the views of the Tax Institute's broader membership.

As a preliminary comment, given that both this consultation and the Tax Practitioners Board registration review involve critical systemic changes, it is of concern that these consultations were released concurrently. Stakeholders within the tax profession need adequate time to comprehend the practical implications of the various proposals before finalising their positions and making recommendations regarding the issues presented in the Consultation Paper. Rushed consultation reduces effectiveness and increases the risk of poor policy outcomes and unintended consequences, potentially compromising the integrity of the tax system and adversely affecting the tax profession and the broader community.

As a result, our comments in this submission focus on broader proposals and do not address every question posed in the Consultation Paper.

Our detailed response and recommendations are contained in **Appendix A**.

Our submission is intended to be a starting point for further discussion and consultation. If you would like to discuss any of the above, please contact The Tax Institute's Senior Counsel – Tax & Legal, Julie Abdalla, on (02) 8223 0058.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for

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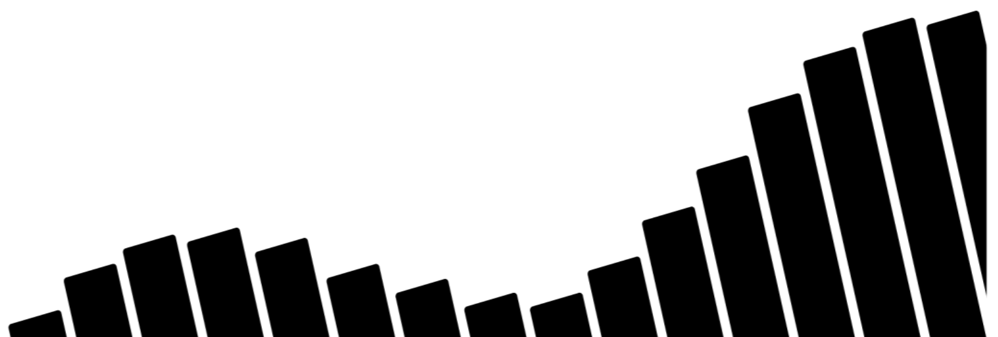

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the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all.

Yours faithfully,

**Scott Treatt**
Chief Executive Officer

**Todd Want**
President

## APPENDIX A

We have set out below our detailed comments and observations for your consideration.

# Clarifying and broadening the foreign CGT base

The Consultation Paper seeks to clarify and broaden the CGT base for foreign residents, ensuring that assets with a close economic connection to Australian land, and/or natural resources are effectively included in the tax framework. This change aims to better align the CGT outcomes for foreign residents with international tax standards and the current tax treatment for Australian residents, especially in relation to Australia's unique land and natural resources.

In order to fully consider the proposed framework, the Consultation Paper needs to be both clear and definitive in not only its stated aims but also the means by which the proposed changes are to be effected. A major concern with the proposals as currently configured is that the Consultation Paper does not provide sufficient clarity on the criteria for establishing a close economic connection to Australian land. We also have a number of other concerns regarding this proposal.

### Grandfathering or transitional rule

Assets not currently classified as taxable Australian property (**TAP**) may become TAP once the proposal becomes law, and disposals of those assets may be subject to taxation where a CGT event happens on or after 1 July 2025 (**new TAP assets**). The Tax Institute considers this may result in an unjust outcome as CGT consequences may flow from the divestment of assets previously considered non-TAP by taxpayers who could not have reasonably anticipated that assets acquired prior to the announcement in the Federal Budget 2024-25 would be treated as TAP if disposed of on or after 1 July 2025. The Tax Institute considers it essential to duly consider enacting grandfathering rules or transitional arrangements in respect of these circumstances.

Broadening the CGT base for non-residents without providing for grandfathering or suitable transitional rules may also harm Australia's reputation as a favourable investment environment for foreign investors. These changes are being considered at a time when foreign residents are already navigating recent unexpected and significant changes to both the thin capitalisation and stapled structure rules. This has the potential to further disincentivise foreign investment.

Enacting transitional arrangements when extending Division 855 is not new; a precedent exists in the context of Division 855, as can be seen in subsection 855-25(3) of the *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**) where cost base was reset to the market value on the date of the Treasurer's press release. This facilitated a seamless transition for taxpayers, ensuring that no adverse consequences arose when Division 855 was extended to include non-TAP membership interests as a form of TAP. A similar approach was taken in relation to the introduction of Division 880 of the ITAA 1997 – refer section 880-25 of the *Income Tax (Transitional Provisions) Act 1997* (Cth).

## Tax policy consideration regarding renewable energy projects

The Consultation Paper on page 10 indicates that the proposal will not be extended to tax foreign residents on capital gains arising from the sale of livestock and agriculture or forestry equipment except when these assets are affixed to land or utilised in a business operating through a permanent establishment in Australia. This is intended to strike a balance between safeguarding Australia's taxation rights over immovable property and fostering foreign investment. However, the examples provided in the Consultation Paper suggest that the proposal would extend to renewable assets. Feedback received from our members indicates that foreign investors constitute a major part of this sector.

We are of the view that this policy proposal needs to be carefully considered in the context of Australia's continued need to attract foreign investment in the renewable energy sector, as well as the overarching non-tax policy frameworks governing renewable development. Established precedents exist for tax policy incentivising investment in renewable energy projects, such as the Clean Building Managed Investment Trust rules and specific state tax provisions, notably the Victorian Fire Services Levy, which introduced a reduced rate for renewable initiatives when expanding the notion of 'fixture' to include items that are 'fixed to land'. These measures highlight the role that tax policy can play in ensuring enhanced levels of investment in the renewable energy sector.

## Low-value assets

The proposed changes to the taxable Australian real property (**TARP**) framework seem to allow for the inclusion of low value assets, such as licenses for restricted land access. This effect is exacerbated by the proposed removal of the $750,000 foreign resident capital gains withholding (**FRCGW**) regime threshold, resulting in significantly increased compliance costs for low-value transactions. We recommend introducing a *de minimis* threshold to reduce both compliance costs for taxpayers and ATO administration costs in respect of low-value assets. While we were unable to meaningfully contribute to the Treasury consultation on the proposed FRCGW changes due to the short consultation period of less than two weeks, we consider it optimal to consider the submissions on both sets of proposals (those in the Consultation Paper and those related to the FRCGW) alongside each other.

## Further consideration of the tax treaty implications

The Consultation Paper does not clearly state whether the policy implications of these proposals for Australia's existing tax treaties have been considered. The proposed extensions to the TARP regime may capture assets not presently falling under the relevant provisions of Australia's tax treaties – in particular, it is possible that new TAP assets may not fall within 'immovable property' for treaty purposes, and a number of the items expressly listed in the Consultation Paper (such as licences) may not fall within 'property accessory to immovable property'.

Further, it would be useful to clarify whether notification and withholding requirements apply in a situation where the new TAP assets may not fall within the category of 'real property' for tax treaty purposes but are considered TARP under Australia's domestic tax law. It is unclear whether the proposed notification and withholding obligations would apply in such circumstances.

An additional point for consideration is that the proposal to include an option or right to acquire these new TAP assets may be excessive, potentially leading to further uncertainty. While the Consultation Paper appears to state that the 365-day testing period is consistent with Australia's current tax treaty policy, we note that not all of Australia's tax treaty partners have adopted Article 9(1)(a) of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (2016). For example, China has a reservation on Article 9(1)(a), i.e. it has chosen not to adopt the 365-day period in its covered tax agreements. We recommend that a more detailed consideration of the tax treaty ramifications associated with these proposals is undertaken.

## Extending the testing period for the principal asset test

Notably, the Consultation Paper does not raise any specific questions concerning the proposed 365-day testing period under the principal asset test (**PAT**). The proposed PAT requires valuations for all TARP and non-TARP assets for the 365 days leading up to disposal for notification purposes, regardless of any changes in the company's assets during that period. This requirement could lead to compliance costs that may exceed the associated risks, complicating matters particularly for foreign residents that lack a controlling interest in the relevant company and therefore may not be able to access the required information. We consider that a more appropriate approach would be to value only those assets acquired or disposed of within the 365-day testing period, rather than requiring continuous valuations for assets held throughout the entire 365-day period. Concerns that asset values may be manipulated during the relevant 365-day period fall away when one considers assets that are held throughout the testing period.

We note that the reference to the purpose of Article 13(4) OECD Model Tax Convention (**MTC**) 2017 in the Consultation Paper refers to the need to address situations where assets that are not immovable property are *contributed to* the underlying entity shortly before the disposal of the shares or comparable interests in the underlying entity. However, it appears that an application of the 365-day test period may result in a tax liability arising from the disposal of shares or comparable interests by a foreign resident in addition to the tax liability that may arise for the underlying entity when it disposes of TARP assets within the 365-day test period. Such a situation may arise where, for example, the value of the TARP assets disposed of by the underlying entity is included in the value of TARP assets for the purposes of the PAT when the foreign resident disposes of its membership interests in that underlying entity within the 365-day period. We recommend that due consideration should be given to ensure that the risk of such double taxation is addressed. This could be achieved by, for example, including a rule akin to the principal purpose style test contained within subsection 855-30(5) of the ITAA 1997, or by ignoring the value of the immovable property that was disposed of by the underlying entity for the purposes of the PAT where certain conditions are satisfied. The latter option is considered in the Commentary on Article 13(4) OECD MTC 2017, paragraph 28.9.

Accordingly, we consider that underlying entity's assets should be valued only at the time of disposal or at the start and end of the testing period. We are also of the view that it would be helpful to clarify whether the testing period is triggered by the signing of an agreement to dispose of the relevant asset or upon settlement.

## Notification to ATO on disposal of indirect Australian real property interest

The proposed notification framework on the disposal of indirect Australian real property interest (**IARPI**) requires further detail and practical consideration. The approved notification form should be straightforward and not require detailed information about cost bases, potential capital gains, or individual asset values.

### Notification Threshold

The Consultation Paper specifies a $20 million threshold. However, further information pertaining to its scope is needed. This includes, specifically, whether this amount encompasses all assets, including transactions unrelated to Australia; is limited to TARP assets, or pertains solely to Australian assets. Also, in our view, the proposed threshold appears to be relatively low, and it may be worth considering a higher threshold to better balance taxpayer's compliance and the ATO's administrative burden against the associated risks, such as in the case of a $20 million share sale where the Australian land value is only a small part of the total asset value.

### Other considerations

Consideration should be given to circumstances where an ATO notification may not be required. For example, cases where the interest is clearly non-IARPI (e.g. where a foreign-resident sells either (i) portfolio interests or shares in companies without TARP assets, such as a technology company, or (ii) a foreign resident that has interests outside Australia and its global asset values far exceed the value of any Australian assets held) may not merit an ATO notification. Providing examples of where there could be no notification requirement would be useful.

Further guidance is necessary on when a purchaser receives a declaration from a foreign resident vendor in circumstances where the ATO disagrees with the declaration as this may leave the purchaser in an untenable position. There is also the risk that such uncertainty may further disincentivise foreign investment into Australia and this should be taken into consideration in addressing this issue.

The operation of the notification requirement in cases where a CGT event coincides with the signing of a contract is unclear (i.e. where a sale contract signs and completes simultaneously), as in such circumstances, it would often not be possible to give notice 28 days in advance of the signing/completion date since the deal is not agreed by that stage. This issue is particularly relevant for off-market transactions involving publicly listed companies, such as takeovers and schemes of arrangement, where a sale contract may be absent. However, the notification requirement may be unworkable more generally in the context of off-market schemes and takeovers of listed companies.

Further, while a notification period of 28 days may be sufficiently long in many cases, it is essential to allow for flexibility in exceptional cases, such as when a purchaser has to incorporate a special purpose vehicle in order to acquire the relevant asset(s), as it is likely that the relevant transactions details (such as names of parties) may not be sufficiently clear 28 days prior to signing.

Feedback from our members highlights that foreign residents, particularly those engaging with the ATO for the first time, face significant challenges due to the extensive identity verification required by the ATO, which can lead to delays. Streamlining the identity verification process for foreign residents may help to reduce the compliance burden and, in turn, improve compliance with the notification requirement though it is important to ensure the integrity of the process is safeguarded. If streamlining is not possible, it would be worthwhile considering whether an Australian resident purchaser may be allowed to submit the notice on behalf of the foreign resident vendor as such a purchaser would be expected to be known to the ATO and to have satisfied the identity verification process. This could facilitate a more efficient identity verification process.