

Variation 51 - Explanatory statement -



Explanatory Statement

PAYG Withholding variation for foreign resident capital gains withholding payments – marriage or relationship breakdowns

General Outline of Instrument

1. This instrument is made under subsection 14-235(5) of Schedule 1 to the *Taxation Administration Act 1953* (TAA).
2. All legislative references in this explanatory statement are to Schedule 1 to the *Taxation Administration Act 1953* 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. The instrument varies to nil the amount that a spouse¹ or former spouse (the ‘transferee’) would otherwise have to pay to the Commissioner under section 14-200, when a relevant asset is transferred to them by an individual, company or trustee (the ‘transferor’) as a result of a court order, agreement or award under the *Family Law Act 1975* or under a State law, Territory law or foreign law relating to breakdowns of relationships between spouses, and there is a rollover under Subdivision 126-A of the *Income Tax Assessment Act 1997* (ITAA 1997).
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. This instrument commences on the day after its registration on the Federal Register of Legislative Instruments.

¹ Spouse is defined within subsection 995-1(1) of the *Income Tax Assessment Act 1997*.

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. This instrument requires the transferee to obtain a copy of the relevant documentation specified in subsection 126-5(1) of the ITAA 1997 by the time of the finalisation of the transfer, showing that the relevant asset was acquired by the transferee under the *Family Law Act 1975* or under a State law, Territory law or foreign law relating to breakdowns of relationships between spouses. Only upon possession of this documentation can the transferee rely upon paragraph 11 of this legislative instrument.
11. This instrument removes the need for the transferee to make an application for a variation under subsection 14-235(2). As a result of this instrument, no withholding is required when under the *Family Law Act 1975* or under a State law, Territory law or foreign law relating to breakdowns of relationships between spouses, a transferee acquires ownership of a relevant asset and there is a rollover under Subdivision 126-A of the ITAA 1997

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 the entities specified in paragraph 4 of this explanatory statement by stating the need for the transferee to have the appropriate documentation as specified in paragraph 10, and that no amount is required to be paid to the Commissioner in the circumstances specified in paragraph 11.
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 transferor 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 the entities listed at 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 *Income Tax Assessment Act 1997* (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 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. Under a court order, maintenance agreement, financial agreement, award made in arbitration, or other written agreement that is binding under the *Family Law Act 1975* or under a State law, Territory law or foreign law relating to breakdowns of relationships between spouses, an asset to which Subdivision 14-D applies may be transferred to the transferee.
20. Subsection 109-5(2) of the *Income Tax Assessment Act 1997* (ITAA 1997) sets out circumstances in which an acquisition of a CGT asset is taken to occur. The transfer of a relevant asset under a court order, maintenance agreement, financial agreement, award made in an arbitration, or other written agreement that is binding under the *Family Law Act 1975* or under a State law, Territory law or foreign law relating to breakdowns of relationships between spouses is a CGT event A1.
21. Under subsection 109-5(2) of the ITAA 1997, the transferee is taken to have acquired the relevant asset from the transferor and might, but for this instrument, have a payment obligation to the Commissioner.

Property

22. 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.
23. 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 transferor was an Australian tax resident, the transferor would need to apply for a clearance certificate to ensure the transferee does not have to pay the Commissioner an amount in accordance with section 14-200.
24. For the clearance certificate to be valid, it must be obtained by the transferor by the time the transferee acquires ownership of the property. Depending on the terms of the court order, award or agreement, this could potentially be when the court order, award or agreement is made. The transferor may not have sufficient notice of the orders, award or agreement being made to apply for and obtain a clearance certificate before the transferee acquires ownership of the property.

25. Accordingly, the transferor may be unable to give the transferee a clearance certificate that would be valid in accordance with subsection 14-210(2).
26. As a clearance certificate obtained after the transferee has ownership of the property will not be valid, the transferee would be required to pay the Commissioner an amount equal to 10% of the first element of the property's cost base.

Other assets

27. Where the relevant asset is not of a type referred to in paragraph 22 of this explanatory statement, the transferor would need to complete a vendor declaration to authorise the transferee not to pay the Commissioner an amount under section 14-200.
28. However, for the vendor declaration to be valid, it must be made by the transferor by the time the transferee obtains ownership of the asset. Depending on the terms of the court order, award or agreement, there may not be any time between the making of the orders, award or agreement, and the time when the transferee is taken to have received ownership of the asset. Accordingly, the transferor may be unable to complete a vendor declaration that would be valid in accordance with subsection 14-210(3).
29. As a vendor declaration completed after the transferee has obtained ownership of the asset cannot be valid, the transferee would be required to pay the Commissioner an amount equal to 10% of the first element of the asset's cost base.

Variation application

30. In circumstances where a clearance certificate has not been (or cannot be) obtained, or a vendor declaration has not been (or cannot be) made, the transferor or transferee still has the option of applying to the Commissioner for a variation to the 10% withholding rate.
31. They could also consider applying for a variation where the transferor is a foreign resident for Australian tax purposes, as neither a clearance certificate nor a vendor declaration concerning the tax residency status of the transferor is applicable in these circumstances.
32. However, for the variation to be valid it must be obtained by the transferor or transferee by the time the transferee obtains ownership of the asset. Depending on the terms of the court order, award or agreement, there may not be any time between the making of the orders, award or agreement, and the time when the transferee is taken to have received ownership of the asset. Accordingly, the transferor or transferee may be unable to apply for a variation that would be valid in accordance with paragraph 14-200(3)(b) and subsection 14-235(2).

33. If a variation cannot be obtained in this circumstance, the transferee 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

34. The purpose of this instrument is to provide certainty to transferees that subject to them possessing the relevant documentation under subsection 126-5(1) of the ITAA 1997 by the time of the finalisation of the transfer that shows that the relevant asset was acquired by the transferee under the *Family Law Act 1975* or under a State law, Territory law or foreign law relating to breakdowns of relationships between spouses, then no amount is payable to the Commissioner in the circumstances covered by this instrument.
35. The above discussion shows that an obligation to pay an amount to the Commissioner arises under subsection 14-200(1) when the transferee acquires an asset from transferor. However, as discussed in paragraphs 2.9 – 2.12 of the Explanatory Memorandum to the Tax and Superannuation Laws Amendment (2015 Measures No. 6) Bill 2015, the aim of the withholding regime is to assist with the collection of foreign residents' Australian tax liabilities upon the disposal of certain CGT assets.
36. Subdivision 126-A of the ITAA 1997 sets out the income tax consequences that arise when an asset is transferred between parties because of certain court orders, awards or agreements under the *Family Law Act 1975* or under a State law, Territory law or foreign law relating to breakdowns of relationships between spouses.
37. At the time of the CGT event happening to the asset⁴, sections 126-5 and 126-15 of the ITAA 1997 provide that any capital gain or capital loss the transferor makes from the CGT event is disregarded because of a rollover.
38. This means that any obligation on the transferee to pay an amount to the Commissioner in accordance with Subdivision 14-D would be counter to the policy intent of Subdivision 14-D, given that no CGT liability arises for the transferor.
39. It is also recognised that the breakdown of the relationship may have created animosity between the parties. The transferor may be unwilling to provide the transferee with a clearance certificate, vendor declaration or variation (as relevant) and thus force the transferee to use their own funds to pay the amount to the Commissioner. It would be counter to the policy intent of Subdivision 14-D for this to occur when no CGT liability arises for the transferor because of the rollover.

⁴ Subsection 126-5(3) of the ITAA 1997 does not provide the rollover where the asset is trading stock of the transferor or that the title in the asset does not transfer before the end of the arrangement.

Consultation

40. The ATO has consulted extensively with legal bodies and persons engaged in dealings involving court orders or arrangements under the *Family Law Act 1975* or under a State law, Territory law or foreign law relating to breakdowns of relationships between spouses, about the impact of subdivision 14-D on the transactions discussed in this explanatory statement.
41. The necessity for this instrument was identified through that consultation process and there has been general agreement that there is an urgent need to put this instrument in place.

Matthew Bambrick
Acting Deputy Commissioner of Taxation
5 October 2016

Legislative references:

Taxation Administration Act 1953

Acts Interpretation Act 1901

Legislation Act 2003

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

Income Tax Assessment Act 1997

Human Rights (Parliamentary Scrutiny) Act 2011

Statement of Compatibility with Human Rights

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

PAYG Withholding variation for foreign resident capital gains withholding payments – marriage or relationship breakdowns

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 varies to nil the amount that a spouse or former spouse would otherwise have to pay the Commissioner under section 14-200 of Schedule 1 to the *Tax Administration Act 1953*. It avoids the imposition of an unnecessary withholding obligation on spouses and former spouses following the acquisition of certain Australian assets.

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.

Conclusion

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