

GMS Flash Alert

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Australia - Legislation Denying Foreign Residents Main Residence CGT Exemption Re-Introduced

On 23 October 2019, Australia's *Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures) Bill 2019* was introduced to Parliament. This new bill contains provisions that will remove the Capital Gains Tax (CGT) exemption relating to a main residence for foreign residents, unless the foreign resident satisfies certain transitional provisions, or the foreign resident has been a foreign resident for six years or less **and** a particular 'life event' occurs during that period of foreign residency.

This bill replaces the previous *Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018* which lapsed at the end of Parliament in July 2019. (For prior coverage, see [GMS Flash Alert 2019-115](#), 12 July 2019.)

WHY THIS MATTERS

- i. The bill re-introduces the controversial May 2017 Australian Federal Budget measure to remove access to the CGT main residence exemption for individuals who are not resident for Australian tax purposes at the time of entering into the contract for sale of the property.
- ii. Despite intense lobbying by expat groups, the revamped legislation would still apply to Australian citizens or permanent residents who dispose of their Australian main residence while a foreign resident, e.g., while working overseas on secondment.
- iii. Revised transitional provisions will allow foreign residents to still access the CGT main residence exemption provided the CGT event occurs on or before 30 June 2020, and the ownership interest in the residence was held

throughout the period starting just before 7:30pm (by legal time in the Australian Capital Territory) on 9 May 2017 and ending just before the CGT event occurs.

- iv. While the new bill does contain 'exception' provisions not included in the 2018 bill, which remove some of the perceived harshness of the original bill, an exception to the general rule will only apply where an individual has been a foreign resident for a period of six continuous years or less, and only in very limited and unfortunate, extenuating circumstances. These circumstances are described as 'life events' and include a terminal medical condition (of the foreign resident, his or her spouse, or his or her child under 18 years of age) or death (of a spouse or child under 18 years of age). They also include a situation where the CGT event in relation to the property occurs in connection with a family law matter (such as in the event of divorce or separation or similar maintenance agreements). The life event needs to have occurred during the period of foreign residency.
- v. For those individuals who do not qualify for the transitional provisions or life event exception, the removal of the entitlement to the CGT main residence exemption for foreign residents should mean heavier tax costs tied to ownership of main residences and sales thereof, as well as a change in how they would declare the CGT event in their Australian tax returns.
- vi. Employers should communicate these changes to their employees so that the necessary planning is undertaken to help ensure employees undertaking an overseas secondment are not caught out unnecessarily paying Australian CGT on their main residence. Planning might entail, depending on the individual's situation, deferring commencement of his or her secondment. Employers should also consider the impacts this legislation will have on their population of Australian outbound employees that have already localised overseas, or may localise overseas at some point in the future, as they may not have the flexibility to resume Australian tax residency prior to selling their Australian main residence.

Background

As it currently stands, both resident and nonresident individual taxpayers have access to the CGT main residence exemption, which generally allows for an exemption from Australian CGT in relation to a property considered to be a taxpayer's main residence. The exemption continues to be available for a period of up to six years where a taxpayer vacates their main residence and uses it to produce rental income.

This option is popular for expatriate employees who undertake an overseas secondment and become a nonresident of Australia for tax purposes (hereafter referred to as a 'foreign resident'). Such taxpayers that rent out their main residence in Australia while on their overseas secondment are currently still able to access the CGT main residence exemption provided they cease using their main residence to produce income before the six-year period expires.

Following the 2017-18 Australian Federal Budget announcements in May 2017, proposed legislation was introduced in 2018 to remove the CGT main residence exemption for foreign residents. This proposed legislation included transitional provisions in which individuals could still access the exemption if they entered into a contract to sell their main residence before 30 June 2019. This bill did not pass the Senate and lapsed at the end of Parliament in July 2019.

Removal of CGT Main Residence Exemption

The new legislation¹ introduced into Parliament this week amends section 118 of the Income Tax Assessment Act 1997 by adding wording after the CGT main residence exemption provisions to note that they do not apply to foreign residents.

Foreign residents are, by definition, those taxpayers that are not 'resident' for Australian tax purposes. Therefore, the new rules will also apply to Australian citizens or permanent residents who dispose of their Australian main residence while a foreign resident, e.g., while working overseas on secondment.

The determining factor is the Australian tax residency status of the taxpayer at the time of the CGT event (i.e., when the contract for sale is signed). Therefore, for any Australian citizen and permanent resident who may be a foreign resident for a period of time and rents out his or her Australian main residence while working overseas, the CGT main residence exemption should still be available (provided all other requirements are satisfied) provided the individual repatriates to Australia and disposes of his or her main residence after firstly re-establishing Australian tax residency.

Transitional provisions will still allow foreign residents to access the exemption on sales occurring on or before 30 June 2020, if the ownership interest in the residence was held throughout the period starting just before 7:30pm (by legal time in the Australian Capital Territory) on 9 May 2017 and ending just before the CGT event occurs.

Furthermore, under the new legislation, the CGT main residence exemption can still apply to taxpayers if they are foreign residents at the time of the sale, have been foreign residents for a continuous period of six years or less and a life event has occurred during that period of foreign residency. Life events are defined as:

- Terminal medical condition for the taxpayer, or his/her spouse, that existed at any time during the taxpayer's period of foreign residency;
- Terminal medical condition of the taxpayer's child, that existed at any time during the taxpayer's period of foreign residency, and that child was under 18 years of age, at least one such time;
- Death of the taxpayer's spouse, or child who was under 18 years of age at death, during the taxpayer's period of foreign residency;
- The CGT event in relation to the property occurs in connection with a family law matter involving the taxpayer and his or her spouse (or former spouse), such as in the event of divorce or separation or similar maintenance agreements.

Unlike the removal of the 50-percent CGT discount for foreign residents announced in the May 2012 Federal Budget, the new changes will not allow for any pro-ration or apportionment of capital gain arising in respect of that part of the ownership period in which the individual was a tax resident prior to the Budget announcements, but rather the entire capital gain accrued over the full ownership period would be subject to Australian CGT and the period that the property was held as an Australian tax resident is irrelevant. Furthermore, there is no consideration of the six-year 'absence rule' in determining the taxable capital gain where the contract is entered into as a foreign resident. The new provisions will effectively override any other provisions that may have allowed a partial exemption.

KPMG NOTE: Considerations and Action Steps

While it is not common for an expatriate employee on a fixed-term secondment to dispose of his or her main residence in Australia when on secondment, it can and does happen.

Any expatriate employees who are currently foreign resident and considering selling their main residence should obtain specific taxation advice based on their personal facts and circumstances. If the new legislation is passed by Parliament, it may be beneficial to enter into a contract to sell their property on or before 30 June 2020 (provided they held an ownership interest in the property at 7:30PM by legal time in the Australian Capital Territory on 9 May 2017). This would allow them to access the CGT main residence exemption via the transitional provisions.

KPMG NOTE: Considerations and Action Steps (cont'd)

Taxpayers who did not hold their ownership interest at 7:30PM on 9 May 2017, or are looking to sell their main residence after 30 June 2020, should consider waiting until they resume Australian tax residency before selling their main residence, as this should allow them to still access the CGT main residence exemption (provided they meet the other requirements).

Any taxpayers who are currently Australian tax resident and considering selling their main residence, if the legislation is passed by Parliament, should consider entering into the contract for sale of their property while still Australian tax resident, and before commencing an overseas secondment if the secondment will result in their becoming a foreign resident for Australian tax purposes. They may need to consider deferring the commencement date of their secondment in this scenario.

Any foreign residents who are not able to access the CGT main residence exemption under the new legislation will need to include any associated capital gain from the sale of their main residence in their Australian tax returns, with consideration given to any CGT discount that may be available. Note that there is no opportunity for pro-ration or apportionment of the capital gain to only declare as taxable the capital gain accrued over the foreign residency period and, accordingly, the full capital gain accrued over the entire ownership period will be taxable.

The above provisions may be a key consideration to expatriate employees before choosing to localise in their host country. As employees may not have an opportunity to re-establish Australian tax residency before localising, they could be exposed to significant CGT when selling their main residence. Employers should consider, accordingly, the impact that the new legislation will have on their employees and the extent to which they may provide support to the employee in this regard.

Any employers who have a tax equalisation policy in place that covers personal income will also need to consider whether they will tax equalise any CGT imposed on an individual for the sale of their main residence.

FOOTNOTE:

1 For the *Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures) Bill 2019*, see: https://parlinfo.aph.gov.au/parlInfo/download/legislation/bills/r6439_first-reps/toc_pdf/19209b01.pdf;fileType=application%2Fpdf.

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