



Law Council  
OF AUSTRALIA

*Business Law Section*

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The Treasury  
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12 August 2015

Dear Sir or Madam,

**Non-final withholding tax on transactions involving taxable Australian property – exposure draft legislation**

The Taxation Committee of the Business Law Section of the Law Council of Australia (the **Committee**) welcomes the opportunity to comment on the exposure draft legislation released on 8 July titled *Tax and Superannuation Laws Amendment (2015 Measures No. 5) Bill 2015: Foreign resident capital gains withholding payments (Exposure Draft)*.

The Committee has also received input from the Australian Property Law Group (**APLG**), part of the Legal Practice Section of the Law Council of Australia.

In December 2014, the Committee provided comments and submissions on the Discussion Paper that was released in October 2014 concerning the design of the proposed regime. Consistent with those submissions, the Committee remains concerned to ensure that the regime, if implemented, is workable, readily available to be complied with and does not unnecessarily disrupt the commercial timetable for acquisitions and disposals involving Australian assets.

Against that background, Annexure A sets out the Committee's key concerns with the proposed regime as reflected in the Exposure Draft. In summary while the Committee has a number of significant concerns in relation to the Exposure Draft, the Committee has identified the following measures which would go a significant way to addressing a number of the concerns:

- 1 The introduction of a *de minimis* threshold, of at least \$2.5 million, whereby small, low value transactions (not just those involving residential properties) are excluded from the cost and complexity of complying with the new regime;

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2. That the introduction of the measure be delayed until 1 July 2017, in order to ensure that there is sufficient time for standard documentation to be updated to take account of the new regime and that all affected parties (including prospective vendors and purchasers, their financiers and advisors) are adequately informed about the scope of the regime and how it will impact on transactions. While withholding will not be required unless one or more of the vendors in a transaction is a foreign resident, every transaction involving any interest in land, or any indirect interest in land, will need to consider, if only as a threshold issue, compliance with the proposed legislation.
3. Further investigation as to the practical impact of the obligation to pay the withheld amount to the ATO on the day of settlement.
4. Inclusion of an express statement in the legislation that a secured creditor's right to deal with the proceeds of sale of a secured asset will not be postponed in favour of obligations of a purchaser to withhold under the measure.

The Committee has also identified some technical drafting points in the Exposure Draft which would benefit from clarification. Given the nature of the concerns raised in relation to the regime more broadly we have not set out those technical concerns here but are happy to engage further on this, if this would be helpful.

The Committee would welcome the opportunity to discuss these comments further, if that would assist Treasury. In the first instance, please contact the Committee Chair, Adrian Varrasso on 03-8608 2483 or via email: [adrian.varrasso@minterellison.com](mailto:adrian.varrasso@minterellison.com) or Katrina Parkyn on 07-3244 8346 or via email: [katrina.parkyn@au.kwm.com](mailto:katrina.parkyn@au.kwm.com). The APLG can be contacted through its Chair, Gary Newton, on 02-8281 4652 or via email: [gnd@cbp.com.au](mailto:gnd@cbp.com.au)

Yours faithfully,

A handwritten signature in black ink, appearing to read 'John Keeves', with a long horizontal flourish extending to the right.

John Keeves, Chairman  
**Business Law Section**

## Annexure A

### 1 Red Tape Introduction

While respecting the obligation of government to protect its revenue base, the Committee is very concerned that the proposed regime will lead to increased compliance costs, market distortions, uncertainty for lenders, increased expense of standard transactional and commercial practice, and the introduction of a new and complex bureaucratic regime.

In particular, by failing to have a general *de minimis* exclusion for small transactions (refer comments below), every transaction involving any interest in land, or any indirect interest in land, will need to consider, if only as a threshold issue, compliance with the proposed legislation.

### 2 Extent of transactions potentially caught by the new obligations

Related to the above, the Committee suggests that all transactions below a certain threshold should be excluded from the regime, not just transactions involving residential property and on-market transactions.

The Exposure Draft attempts to minimise compliance costs by excluding residential properties valued at less than \$2.5 million. However, it is the fact that the regime captures interests in land with relatively modest value that is of most concern. All vacant land, all commercial property, industrial property, leasehold interests (including interests in leases operated by small or medium businesses), and other interests in land will be affected by the regime, regardless of the size of the transaction. There is a concern that the obligations created will significantly increase compliance obligations and, therefore, costs in relation to dealing with any of those sectors, and in particular increase the costs of transactions involving small and medium businesses, disproportionately.

### 3 Requirement for change of standard documents

Given the wide reaching impact of the regime, there is a wide range of standard transactional and commercial documentation (e.g. land sale contracts and banking documents) that will need to be varied to take account of the possibility of the new regime applying.

In particular, standard Contracts for Sale of Land and standard Contracts for Sale of Business produced by the various Law Societies and Real Estate Institutes will all need to be reviewed and updated. In addition, every lending institution will need to update their letter of offer, residential security documentation (recognising that in many markets the \$2.5 million threshold will be exceeded by a number of customers) and all commercial security documentation, as well as the underlying systems and processes that currently exist.

This is an enormous exercise, particularly since the interaction of the proposal with existing state or territory regimes and individual lending practices of different financiers, will differ. There will be no “one size fits all” answer which can be easily applied.

Additionally, every legal practitioner involved in the transfer of indirect property interests, such as sales of shares in companies or sales of units in trusts, will need to review and update their template documentation, to ensure it is consistent with the requirements of the new regime.

#### **4 Training and Education**

Following on from the previous comment, there will be an enormous need to educate not only the community, but also practitioners, particularly lawyers and accountants, as to the obligations of purchasers under the regime and as to what matters need to be considered in what are often “bread and butter” transactions.

Given the need to: (i) redesign existing documentation and the supporting systems; and (ii) implement a training and awareness campaign, it would appear that a 1 July 2016 commencement date, if the measure is to be implemented as proposed, will be very difficult to achieve.

The Committee urges that consideration be given to postponing the commencement date of the regime to 1 July 2017.

#### **5 Mechanics of “how it works” – electronic payment in real time not yet feasible**

It is unclear, even in the context of a very simple transaction, exactly how the measure is going to be implemented. Any method which involves a purchaser passing the amount of the withholding to the ATO after settlement involves risk to the vendor. If the withholding is to be made, a mechanism needs to be implemented that allows payment to be made simultaneously with completion of the transaction. While appreciating that in years to come electronic conveyancing platforms may assist in facilitating this, the reality is that:

- (a) very few transactions currently occur on that basis, nor are they expected to occur on that basis by 1 July 2016, relying instead on the traditional paper method; and
- (b) transactions involving indirect interests in taxable Australian property (ie, shares) will not involve an electronic conveyancing method, but will rely on a traditional paper settlement.

Ultimately, implementation of the measure needs to be able to integrate seamlessly with eConveyancing, as it rolls out, and not restrict this initiative.

#### **6. Risk Profile Alteration**

The Committee has concerns about how transacting parties will be able to manage the risks of the regime. If, for example, a purchaser is required to pay a withheld amount to the Commissioner but then fails to do so, whether through fraud, force majeure, insolvency or inadvertence, the vendor is left in a position of having disposed of its asset, and does not have the benefit of the a tax credit for the withheld amount. The vendor will have lost 10% of the asset’s value, and must embark on litigation to try and recover it, which, in the case of insolvency for example, may be unrecoverable. Such risks have the potential to create significant market distortions.

#### **7. Payment Method Unclear**

There is also the mechanics of physically arranging for payment. For example, if a physical cheque is produced by an incoming mortgagee and given to a purchaser, how is that to be electronically forwarded to the ATO? If it is intended that it be placed into the purchaser’s solicitors trust account, then the funds will not be available for immediate clearance, and there will be a delay in forwarding

the same. Is it intended that the general interest charge would then apply for the delay in doing so (as the exposure draft currently contemplates)? In short, the actual mechanics, even for a very standard transaction, and risk apportionment if payments are not made as expected, are unclear.

If the regime is to be workable, it must be able to be readily complied with, within the framework of existing settlement and completion mechanics.

The mechanical requirements, which will see private individuals drawn into registration as withholders (EM 1.106), seem inconsistent with a desire, overall, to reduce red tape. This also seems to suppose that private citizens will be entrusted with another person's tax file number (for example, in the case of a dwelling): EM 1.105. The integrity of the tax file number system needs to be considered.

#### **9. Variations - ATO Resourcing/Timeliness of Response**

The proposed regime relies heavily upon the ability to apply for a variation of the amount that is required to be withheld. The Committee reiterates the concerns raised in its response to the Discussion Paper about the imperative for ensuring that the variation process is workable and that applications are able to be processed quickly and efficiently. Although the Committee understands that the standard turnaround time for a variation application is expected to be 28 days, the mechanics of the variation process are still unclear. It would be helpful for the ATO, prior to the commencement of the new regime, to publish guidance setting out the process for obtaining a variation, the relevant ATO contacts and examples of when a variation will be granted.

The Committee is particularly concerned about the level of resourcing to be made available to deal with variation requests, and also the timeliness by which the variation process can be considered. In many real property transactions, either time will be "of the essence" or alternatively under "notice to complete provisions", time can easily be made of the essence, usually within the giving of a 7 or 14 day period. If in the context of a commercial transaction, if a variation cannot be dealt with within the commercial parameters dictated by current market conditions, then there can be very serious consequences. These include liquidated damages, but more seriously, possible termination of contracts due to party default.

There is a real concern that unless adequate resourcing is available to deal with matters, and in particular with a capacity to do so on an expedited basis where necessary, transactions may fail, leading to dispute, litigation in the State courts between vendors and purchasers, and lack of confidence in the settlement process. The Committee would be interested to understand what modelling has been undertaken to determine the number of expected variations, particularly given our previous comments as to the nature and breadth of the number of transactions potentially affected by the measure.

#### **10. Effect on Secured Interests**

There is particular concern that the measure interferes unreasonably with the rights of secured creditors, and in particular with the rights of mortgagees. It is clear from the Exposure Draft that while consideration must be given to the interest of secured creditors, that is a discretionary matter for the Commissioner.

The equity which is otherwise available to a mortgagee is now potentially "at risk" depending on the circumstances of the matter. The Committee considers that the Exposure Draft legislation should be amended to provide certainty that in the case of a contest of priorities between the purchaser's obligation to withhold or to pay an amount to a secured creditor, the obligation to pay the secured creditor is the first priority. It should be as simple as that. If it is not, lending institutions, or private

lenders for that matter, will have no choice but to adapt their lending model so as to assume the worst case scenario i.e. that potentially 10% of the sale proceeds may not be able to be recovered by them. This is something that will have an enormous change to lending practices. While withholding is only required where the vendor is a foreign resident, residency is by nature something that can change over time. Further, where there are multiple vendors, the Exposure Draft contemplates that withholding will be required on account of the total purchase price (even that amount referable to any resident vendors). Thus, the impact on lending practices is not limited to cases where the borrower is a foreign resident at the time the borrowing is made. The impact is far broader reaching than that.

Refer additional comments at part 12 below.

#### **11. Relevant Foreign Resident Vendors – Definition**

The Committee notes the advice and explanatory memorandum that “tax residency can be a complex legal and a factual question. The purchaser will often have limited information about the Vendors to be able to determine this question.” The concern of the Committee however is that the additional tests that have been proposed, still allow a degree of subjectivity as to whether or not there are “reasonable grounds” to believe that a vendor is or is not an Australian resident. The advice in the explanatory memorandum at paragraph 1.61 that “the question is whether a reasonable person in the position of the purchaser would have thought that there were reasonable grounds to support the relevant belief” concerns the Committee, in that it is unclear in what circumstances it would be regarded as “reasonable”.

To use an example, if a company is selling a property and on the ASIC company search for that company, it shows that two of the three shareholders have a foreign address, does that amount to some form of constructive notice that would put a reasonable purchaser under an obligation to withhold? What about if sales instructions from a real estate agent refer to an address of one party overseas, but when the contract arrives the address for the vendor is care of the vendor’s solicitor? The examples are illustrative only, and in the Committees’ view need to be looked at more carefully, particularly as the consequences of non-compliance are so significant.

While the ability to rely on a declaration is welcome, it also raises some concerns. While the expectation is that declarations will be inserted into sale agreements as a so called “standard clause” or as a “contractual warranty”, the danger is that practitioners or advisors acting for sellers who are not experienced in the area, or dealing with low value transactions, may not appreciate the significance of obtaining detailed instructions in relating to the matters to which the declaration relates. This further reinforces the need for the education and training associated with the introduction of the measure detailed above.

#### **12. Change to enforcement techniques**

Paragraph 1.86 of the Exposure Draft contains the statement that “the Commissioner does not have any priority over secured creditors in relation to the recovery of tax-related liabilities.” It is the view of the Committee that this statement should be expressly reflected in the legislation, because the legislation as drafted does not give effect to that outcome.

The draft legislation simply notes that the Commissioner must consider the intention when deciding whether to vary a withholding amount. The reality is however that the Commissioner is only going to be asked to undertake a variation if a secured creditor is applying to the Commissioner for a variation where they are exercising a power in relation to the security to recover the debt. In most cases those are not the circumstances. Most secured creditors usually negotiate with their asset holder to have a negotiated sale, rather than exercising formal powers to institute recovery. This is

better for all parties, and is good commercial practice. To restrict a secured creditor's ability to apply for a variation to situations where they are exercising their enforcement powers will artificially change the enforcement policies of lenders, and lead to a more adversarial, expensive, and time consuming process to be adopted. Furthermore, even if a secured creditor does go through the process of formally exercising their rights under the security, the legislation does no more than require the Commissioner to consider the security holder's interest in relation to making a determination of variation.

The examples given make it very clear that the Commissioner is not going to do so even if the bank is entitled as a matter of law, and as part of their security to require full repayment. Example 1.5 in the Exposure Draft makes it clear for example that notwithstanding the legal right of the bank to require the whole of the proceeds of sale under its registered mortgage, the asset holder "will need to make other commercial arrangements acceptable to the bank." Paragraph 1.89 of the Exposure Draft does attempt to deal with the distinction between "ordinary sales" and a "sale by mortgagee" but it creates a whole range of other uncertainties. For example how is it intended to deal with the question of receivers or administrators or other forms of external administration? What factors will be considered in relation to the exercise of the Commissioner's discretion? Any uncertainty in relation to the enforceability of secured creditors' interests is of real significance, and expected to significantly distort existing lending, security and market practices.

### 13. Unintended applications of the regime

The Exposure Draft is based on an acquisition model, where the withholding obligation is enlivened by the acquisition of a CGT asset, rather than a disposal model. This means that a purchaser will have a withholding obligation even where a tax liability may not ordinarily arise for a foreign resident vendor and, therefore, where it would be inappropriate for a withholding obligation to be imposed on the purchaser. Having to apply for a variation in these circumstances is unduly onerous and creates an unnecessary administrative burden for both taxpayers and the ATO. Transactions that fall into this category include:

- (a) Transactions under which no gain or no CGT event arises by virtue of the nature of the transaction (e.g. capital raisings/share issues). For example, a purchaser may acquire an indirect Australian real property interest for the purposes of the proposed regime by virtue of a capital raising conducted by a foreign resident. In those circumstances, under section 14-200 of the Exposure Draft, a liability would arise for the purchaser to remit 10% of the purchase price. This is despite the fact that the issue of shares should not result in a gain to the issuing company.
- (b) Transactions where no tax is payable (e.g. roll over relief and exemptions). It is counterintuitive that a purchaser should be required to remit 10% of the purchase price (or apply for a variation) where the vendor will not have a tax liability because of a rollover or other exemption. This issue and a possible way to address it were discussed in some detail in the Committee's previous submission.<sup>1</sup>
- (c) Non-cash transactions. Imposing an obligation on a purchaser to remit 10% of the value of the purchase price to the ATO in circumstances where payment is by means other than cash (e.g. shares or other non-cash assets) will artificially distort transactions by requiring the purchase consideration to include a cash component equal to 10% of the purchase price (which may not be possible depending on the purchaser's circumstances) or for the purchaser to convert 10% of the non-cash consideration into cash (which may not be possible if the consideration is not divisible). This issue, which was raised in the

<sup>1</sup> See Annexure A paragraph 6(b).

Committee's previous submission, does not appear to have been addressed in the Exposure Draft.

- (d) The purchaser is required to remit 10% of the entire purchase price, even where there are foreign and Australian resident vendors. Under the Exposure Draft, in the case of multiple vendors where at least one vendor is a foreign resident (and the other criteria in section 14-200 are satisfied), the purchaser is required to remit 10% of the total purchase price. Although a variation could be sought in this instance, the Committee considers that it would be more appropriate that the liability to remit be, at first instance, only in respect of the amount payable to the foreign resident.
- (e) Minor interests, of doubtful value. The grant of an easement, by a foreign resident, often for nominal consideration, has not been excluded from the net. The grantee may be subject to transaction costs, of valuation, registration, payment to the ATO of a nominal amount, and record keeping in such a case.