HERBERT SMITH FREEHILLS

NEW CGT WITHHOLDING MEASURES FROM 1 JULY 2016

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Legal Briefings

SNAPSHOT

- The new Capital Gains Tax (CGT) withholding regime commences on 1 July 2016. It is aimed at requiring purchasers of interests in Australian property worth $2m or more to withhold 10% of the purchase price at settlement and pay it to the ATO if there are grounds for believing that the vendor is a foreign resident.
- There are specific carve outs for insolvency practitioners. The new regime does not apply if the vendor is in a recognised form of insolvent administration.
- However, mortgagees should beware, particularly where distressed borrowers with links overseas are undertaking a voluntary sell down. The mortgagee should ensure that appropriate steps are taken to avoid a purchaser seeking to withhold 10% of the price at settlement.

THE NEW REGIME AT A HIGH LEVEL

The new regime applies to contracts entered into on and after 1 July 206 if the following are satisfied:

- the purchaser either:
- pays a premium for a lease of Australian land, or
- obtains a mining, quarrying or prospecting right, or

- acquires 10% or more of an entity whose value is principally derived from Australian real property (eg, shares in a land owning company), or
- obtains a right or option to acquire any of the above, AND
- at the time of the transaction, either:
- at least one of the vendors, is a foreign resident, or the purchaser has reasonable grounds to believe is a foreign resident, or
- the purchaser does not reasonably believe that all vendors are Australian residents, and has information indicating that the vendor has an address outside Australia or has directed payment of settlement funds outside of Australia.

There are some exceptions though. Most notably, the regime does not apply if:

- the market value of the relevant interest is < $2m, or
- the vendor gives the purchaser a clearance from the ATO, or
- the vendor gives the purchaser a declaration stating that they are an Australian resident, and the purchaser does not know it to be false, or
- the transaction arises from a personal or corporate insolvency (see below).

THE CARVE OUT FOR INSOLVENCY PRACTITIONERS

Perhaps unusually, the new regime clearly and unequivocally acknowledges that it is not intended to unsettle the established order of priority in insolvent administrations. In a refreshing statement of clarity, Parliament has recorded in the Explanatory Memorandum that:

“Where the foreign resident is a company under external administration at the time of the transaction, the amendments will not apply. This will ensure that the withholding obligation does not disturb the priority of other creditors.”

A similar statement is made in relation to personal insolvency, and the provisions reflect this position. The new regime does not apply if the foreign resident vendor is a company and is in liquidation, administration, under a deed of company arrangement or has a Receiver or Managing Controller appointed to its property. Similarly, the regime does not apply if the foreign resident vendor is an individual and is bankrupt, subject to a scheme or composition, or under a Part IX or X agreement.

There is also a carve out if the foreign resident vendor is subject to “circumstances that are, under a foreign law” the same or similar to those events described above. Would this apply to a US vendor in a Chapter 11 reorganisation? What about Schemes of Arrangement initiated in the UK? This, and the possibility of the “insolvency” exception also applying to voluntary liquidations might provide some interesting restructuring opportunities.

THE HIDDEN TRAPS FOR MORTGAGEES

The new regime seems unlikely to affect the traditional forms of insolvent administrations. However, there is scope for some potentially uncomfortable situations involving outgoing mortgagees and sales by mortgagors for less than the full payout amount.

Specifically, a mortgagee may be expecting a certain amount at settlement of a contract, but be confronted with a purchaser who feels compelled to withhold 10% of the price and does not regard itself as being in breach of the contract by doing so. This could put the mortgagee in the awkward position of having to decide to either release its securities for less money, or refuse to release and expose its mortgagor-customer to a potential breach of contract claim.

To avoid this situation there should be no surprises at settlement. A mortgagee should consider one or more of the following:

- ensuring that the new CGT regime is clearly and unequivocally addressed in the terms of the contract itself. This could take the form of an appropriately drafted clause which expressly acknowledges that the purchaser is not required or entitled to withhold any funds pursuant to the regime, and records the reasons why, and/or

- including appropriate conditions on the mortgagee’s agreement with its customer to release its securities at settlement. Those conditions might include a requirement that there be no withholding under the new regime at settlement, and a ‘sunset date’ for settlement so that the matter does not become protracted while the vendor seeks ATO clearance / disputes the issue with the purchaser, and/or

- ensuring that the vendor takes appropriate steps well before settlement to avoid any last minute disputes with the purchaser about the application of the regime. Those steps could include the vendor seeking clearance from the ATO well in advance, or giving a declaration to the purchaser stating that they are an Australian resident.

These types of situations seem most likely to arise when the vendor is an individual with links overseas. Those circumstances might enliven the more subjective 'purchaser’s belief' provisions in the regime, which seem most likely to lead to disputes and surprises.

MORE INFORMATION

Please contact the team if you would like to discuss the new regime or any other aspect of personal and corporate restructuring, turnaround and insolvency further.

LEGAL NOTICE
