

Chapter 2

Views on the bill

2.1 The measures in the Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018 [Provisions] (Measures No. 2 bill) and the Foreign Acquisitions and Takeovers Fees Imposition Amendment (Near-new Dwelling Interests) Bill 2018 [Provisions] (Near-new Dwelling Interests bill) seek to improve housing affordability, encourage investment in affordable rental housing and improve the integrity of the tax system by making changes to capital gains tax for foreign investors, streamlining and enhancing the foreign investment framework, and expanding tax incentives for investments in affordable housing.

2.2 This chapter examines the evidence received in relation to the measures contained in the bills:

- Capital gains tax changes for foreign residents
- Reconciliation payment for near-new dwelling exemption certificates
- Capital gains tax incentive for investments in affordable housing

Capital gains tax changes for foreign residents

2.3 The majority of the evidence received by the committee in relation to this inquiry raised concerns about the proposed changes in Schedule 1 of the Measures No. 2 bill, which affect the capital gains tax main residence exemption for foreign residents. In particular, concerns were raised in relation to how the changes would affect Australians living and working overseas and how the bill might impact outcomes for future deceased estates.

Australians living and working overseas

2.4 The committee heard from a number of Australians currently living and working overseas, who are concerned about the way in which the changes to the main residence exemption could affect them, should they need to sell their Australian property whilst living overseas.

2.5 SMATS Group submitted that the Measures No. 2 bill should be amended to ensure Australian citizens and permanent residents remain eligible for the main residence exemption regardless of whether they are living abroad at the time.¹ SMATS Group provided a petition signed by 1357 in support of its submission.²

2.6 One Australian citizen, currently working in New Zealand, submitted that they felt the changes were 'overly punishing' their decision to 'take an opportunity to work overseas whilst also having the Australian dream of owning an investment property in the country I was born and raised in and more so in [being] able to keep

1 SMATS Group, *Submission 7*, p. 6.

2 SMATS Group, *Submission 7*, p. 7.

the property that I have worked very hard to own'.³ They understood that the proposed change to the main residence exemption would not apply if they moved back to Australia resumed tax residency before selling the property. However, they also noted their circumstances might change unexpectedly, making it necessary to sell the property whilst based overseas.⁴

2.7 They noted that the capital gain tax rate of 45 per cent would be:

...bearable—if it applied from the date I rented the property [after moving overseas] (i.e. the period in which it was my main residence is exempt). However, the law proposed indicates that the CGT will actually be calculated based on the gain I made from the date I acquired the property.⁵

2.8 Another submitter, also an Australian citizen working overseas, argued that the changes should not apply to Australian citizens, only non-resident, non-citizens. They argued that:

The existing law—which precludes non-residents from claiming the CGT discount—is already a sufficient penalty. Most non-resident citizens who are away for more than six years and renting out their former residences already have to pay CGT on the full, undiscounted gain from the time they started to rent out the residence. There is no need for a further penalty, and the possible future negative impacts on their superannuation position should not be overlooked.⁶

2.9 Mr Frederick Morgan questioned the 'wisdom of denying non-residents, the entire exemption, rather than pro-rating the exemption, so that it is only available, for the portion of the ownership period, that the individual is resident'. In particular, he maintained that the loss of the exemption for Australians who depart overseas seemed 'massively unfair and intrudes into the flexibility of Australians'.⁷

2.10 The proposed changes to the main residence exemption will also mean that Australian citizens who are foreign residents will no longer be able to access a partial main residence exemption for the time the property was their main residence. CST Tax Advisors opposed this change and were of the view that Australian citizens who become foreign residents should continue to be eligible to claim a partial CGT exemption for the period of ownership during which they lived in the property and were Australian residents.⁸

Impact on housing affordability

2.11 The National Affordable Housing Consortium (NAHC) posited that the removal of the main residence exemption may have the effect of discouraging foreign

3 Name withheld, *Submission 3*, p. 2.

4 Name withheld, *Submission 3*, p. 2.

5 Name withheld, *Submission 3*, p. 2.

6 Name withheld, *Submission 11*, p. 4.

7 Mr Frederick Morgan, *Submission 1*, p. 1.

8 CST Tax Advisors, *Submission 2*, p. 3.

residents from selling their properties, thereby reducing available housing stock. In the event that the amendment does have the desired effect of easing the general property market, NAHC suggested that the benefits may not necessarily be passed on to renters.⁹

2.12 One Australian working overseas also questioned whether the changes would in fact improve housing affordability for low income earners or families, noting:

Whilst we would sell before June 2019 rather than risk-'needing' to sell whilst overseas and having to pay the punitive CGT (technically yes creating one more house on the market) many expats would hold onto their properties.¹⁰

2.13 SMATS Group observed:

This proposed legislation is submitted as being a measure tackling 'foreign investors' and purported to assist in 'reducing pressure on housing affordability', however the legislation as submitted is far more likely to affect ordinary Australians that may have chosen, willingly or on forced assignment, to take up a position overseas for a period of time.¹¹

Deceased estates

2.14 The proposed changes to the main residence exemption will have implications in relation to deceased estates if the deceased person was a foreign resident at the time of their death, or if the beneficiary was a foreign resident at the time of death.¹²

2.15 BNR Partners oppose the proposed changes to the main resident exemption in relation to deceased estates, stating:

The removal of the CGT exemptions of a non-resident at date of death, is a form of death duty, that is purely imposed on a taxpayer due to their tax residency status at a single point in time, and does not consider either their personal circumstances, or prior contributions to Australia society.¹³

2.16 It argued the proposed legislation should be amended so that 'a person that dies abroad, also be permitted to continue to access these absentee rules, for the reason stated above. Their premature death should not be penalised by the Australian Tax System'.¹⁴

2.17 CPA Australia supported BNR Partners' submission and informed the committee that its members were concerned over the impacts the proposed changes would have on deceased estates. It outlined these concerns:

9 National Affordable Housing Consortium (NARC), *Submission 12*, p. 4.

10 Name withheld, *Submission 3*, p. 3.

11 SMATS Group, *Submission 7*, p. 1.

12 Explanatory Memorandum, pp. 21–24.

13 BNR Partners, *Submission 9*, p. 4.

14 BNR Partners, *Submission 9*, p. 4.

For example, the proposed changes in relation to CGT concessions that apply to a principal place of residence may have significant impacts on deceased estates where the deceased is considered a non-resident as at date of death.

These proposed changes may significantly impact the CGT treatment and classification of their residence during a deceased's entire ownership period should they die whilst outside of Australia. Examples 1.6 and 1.7 in the explanatory memorandum relating to deceased estates show how the already complex area of property in deceased estates is about to become even more so.¹⁵

Transitional arrangements

2.18 Some submitters expressed concern that the changes to the main residence exemption for foreign residents would impose retrospective changes. CST Tax Advisors considered that 'it is highly inequitable for taxpayers with existing arrangements to have concessions removed which are likely to have a material financial impact given recent gains in the property prices'.¹⁶ As such, it proposed amending the Schedule 1 to the Measures No. 2 bill to include grandfathering provisions to ensure that:

Australian citizens who were foreign residents (not Australian resident for tax purposes) when the changes were announced on 9 May 2017, should continue to be able to access the 'CGT absence concession' under current rules, regardless of where they presently reside, on eligible properties they owned on 9 May 2017.¹⁷

2.19 Some submitters raised concerns that it may be difficult for those affected by the changes, who will no longer be eligible for the main residence exemption, to substantiate changes to the cost base of their home as they would not have maintained the necessary documentation to allow for offset of expenses as it would not have been necessary or required at the time.¹⁸

2.20 CST Tax Advisors did not believe the timeframe for transitional arrangements would allow enough time to foreign residents to sell their properties before the end of the transition period on 30 June 2019. It also questioned whether it was 'sound tax policy to subject thousands of Australians living overseas to material tax changes that they are unlikely to become aware of'.¹⁹

Principal assets test

2.21 The amendments in Part 2 of Schedule 1 to the Measures No. 2 bill seek to modify the foreign resident CGT regime to clarify that, for the purpose of determining

15 CPA Australia, *Submission 10*, p. 2.

16 CST Tax Advisors, *Submission 2*, p. 1.

17 CST Tax Advisors, *Submission 2*, p. 1.

18 CPA Australia, *Submission 10*, p. 2; Name withheld, *Submission 3*, p. 3.

19 CST Tax Advisors, *Submission 2*, p. 3.

whether an entity's underlying value is principally derived from TARP, the principal asset test is applied on an associate inclusive basis. The NAHC queried the effectiveness of this measure, as a group of foreign residents could potentially swap the membership interests in associates with direct interests in TARP assets.²⁰

Reconciliation payment for near-new dwelling exemption certificates

2.22 The Housing Industry Association (HIA) supported the proposed amendments in relation to near-new dwelling certificates for property developers selling to foreign investors 'as they represent a logical extension of the current rules for the purchase of properties by foreign investors and remove the unintended consequence that could arise where a first property sale fails to proceed'.²¹

Capital gains tax incentive for investments in affordable housing

2.23 The submissions received in relation to the capital gains tax incentive for investments in affordable housing were broadly supportive of the measure. The NAHC observed that increasing the capital gains discount from 50 to 60 per cent, if a CGT event occurs to an ownership interest in residential premises that has been used to provide affordable housing, would send a positive signal. However, the NAHC was uncertain that the increased benefit to investors would be sufficient to make any significant impact for the tenant.²²

2.24 HIA supported this measure and considered that the amendment would support the establishment of the National Housing Finance and Investment Corporation (NHFIC). HIA considered the NHFIC would generate a significant shift in the environment for the funding, construction and operation of long term managed affordable housing developments in Australia. HIA submitted that:

This change, and the creation of the NHFIC, will provide some additional incentive for future investors and providers of affordable housing. However, it is important to recognise that other incentives and appropriate tax settings such as the current tax treatment of charities and not-for profits, will still need to be in place if this emerging sector of the housing market in Australia is to become a viable and effective part of the response to housing affordability nationally.²³

2.25 The Property Council of Australia also supported this measure. However, it also expressed some concerns:

...we believe that this incentive—in isolation—will be ineffective in encouraging institutional scale investment in the supply of affordable housing for members of the community earning low to moderate incomes.²⁴

20 National Affordable Housing Consortium (NARC), *Submission 12*, p. 4.

21 Housing Industry Association (HIA), *Submission 14*, p. 1.

22 National Affordable Housing Consortium (NAHC), *Submission 12*, p. 19.

23 Housing Industry Association, *Submission 14*, p. 1.

24 Property Council of Australia, *Submission 4*, p. 1.

2.26 PowerHousing Australia noted that the changes to the capital gains discount combined with a new affordable housing Managed Investment Trust (MIT) could direct more foreign investment in the provision of affordable housing. However, it queried the exclusion of superannuation funds and public unit trusts from the capital gains discount. It observed:

This seems like a flaw; the main users of the MIT are meant to be institutional investors like superfunds (even with their concessional tax rate it is some benefit).²⁵

2.27 PowerHousing Australia considered that the government had laid out the framework for a potential long-term solution to the challenges posed by housing in Australia's rapidly changing market, stating:

A CGT discount that incentivises longer-term holdings, as well as other policies pursued by the Federal Government in conjunction with initiatives currently being undertaken at the State level, has the potential to vastly improve the lives of many Australians struggling to secure affordable housing from those working to save for a first home, to those struggling to meet market rent expectations, to those seeking stable housing options.²⁶

2.28 Treasury advised the committee in responses to questions on notice that:

This measure aims to create the right incentives to encourage private investment in affordable rental housing. The value of this incentive and subsequent take up of this measure will depend on individual circumstances, including the nominal capital gain on an individual's investment and marginal tax rate.

The additional capital gains tax discount is one element of the Government's broader housing affordability plan which, overall, is intended to reduce pressure on housing affordability for Australians.²⁷

Committee view

2.29 The committee believes that housing is fundamental to the wellbeing of all Australians, and a driver of social and economic participation that promotes better employment, education and health outcomes. The committee considers that the measures contained in these bills will form an essential part of the government's comprehensive and targeted plan to improve outcomes for Australians across the housing spectrum.

2.30 The committee notes that the bills will assist the government's commitments to implement stronger rules for foreign residents owning Australian housing to reduce pressure on housing affordability; streamline the foreign investment framework; and introduce tax incentives to boost investment in affordable housing, to create the right incentives and improve outcomes for those in need.

25 PowerHousing Australia, *Submission 8*, p. 4.

26 PowerHousing Australia, *Submission 8*, p. 4.

27 Treasury, Answers to written questions on notice, received on 19 March 2018, p. 2.

2.31 The committee notes that the integrity measures contained in Schedule 1 to the Measures No. 2 bill, along with the foreign resident capital gains withholding payments which was enacted separately in the *Treasury Laws Amendment (Foreign Resident Capital Gains Withholding Payments) Act 2017*, are expected to have a gain to revenue of \$570 million over the forward estimates period.

2.32 The committee acknowledges the concerns expressed regarding the changes to the CGT main residence exemption for foreign residents including Australian citizens and permanent residents living and working overseas that may be affected by the changes. The committee acknowledges those people who may be affected by these changes and notes that it is the government's responsibility to ensure that they are made aware of the changes and the transitional arrangements, so they can plan accordingly.

2.33 With respect to the capital gains tax incentive for investments in affordable housing, the committee notes that this measure is part of a broader package of measures to address housing affordability. As such, the committee supports the government's broader housing affordability plan, in particular, the establishment of the National Housing Finance and Investment Corporation.

Recommendation 1

2.34 The committee recommends that the Australian Government ensures that Australians living and working overseas are aware of the changes to the CGT main residence exemption for foreign residents, and the transitional arrangements, so they are able to plan accordingly.

Recommendation 2

2.35 The committee recommends that the bills be passed.

