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26 February 2018

Senate Standing Committees on Economics
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Parliament House
Canberra ACT 2600
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Dear Sir/Madam

Submission regarding the Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018

We refer to the abovementioned Bill and the proposed changes to be made to the main residence capital gains tax (CGT) exemption for foreign residents.

CST Tax Advisors represents a significant number of Australians living overseas in relation to their income tax affairs. We believe that the Government's objective in introducing this Bill could still be achieved with the modifications that we recommend to the Committee below.

Our Submissions

We strongly urge the Committee to recommend that the Bill be modified as follows;

Submission 1 – **Grandfather existing arrangements**

The Bill should 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.

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In addition, Australian citizens living abroad should also be able to access time apportionment so that they would continue to have access to the main residence exemption for ***that part of the ownership period during which they lived in the home and were resident of Australia.***

If the government is concerned about foreign resident *non-Australian citizens* obtaining CGT free outcomes (in our opinion the minority) then laws could be introduced separately to deal with that class of taxpayers.

Submission 2 – retain partial CGT concessions for actual main residence use

If the Government wishes to remove the 'absence concession' **prospectively** for those who depart Australia, then it should only be done so for main residences acquired after 9 May 2017 but provided that Australian citizens continue to be permitted to claim a partial CGT exemption for **at least** *that part* of the ownership period during which they lived in the property and were resident of Australia.

Reasons

In relation to our first submission we believe 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.[1]

The proposed manner used by the Bill to 'transition' to the new rules, is that taxpayers have until *30 June 2019* to sell their former main residence and still access the CGT concessions. Not only is that an impractically short a period for foreign residents, but a 'drop dead' date has the potential to cause panic in the market. We have already seen reports in the press of

[1] If a person had departed Australia on 1 January 2013, and had rented out their former home, then under current law they would not be subject to CGT if they were to sell their home any time up to 1 January 2019. If they were to hold the property past 1 January 2019 they would still be entitled to a partial CGT exemption. Given recent property price gains removing that concession retrospectively is extremely unfair.

expat property fire sales. [2]

It is not sound tax policy to subject thousands of Australians living overseas to material tax changes that they are unlikely to become aware of.

Even if they do become aware, these Australians are not abusing the tax system, they are simply claiming concessions granted to them by existing law. Australian expatriates are an asset to Australia. They are not creating mischief and should not be penalised.

Grandfathering is the only equitable path. Fundamental CGT changes should only be introduced by ensuring that taxpayers with existing arrangements are grandfathered - particularly where such arrangements are based on the straight forward application of existing income tax laws and where no abuse is occurring.

In relation to our second submission we are greatly concerned that the Bill seeks to deny even a *partial* CGT concession to Australian citizens who become foreign residents.

In this regard we would refer the Committee to Example 1.2 from the Explanatory Memorandum to the Bill which we have copied below.

Example 1.2 — Main residence exemption denied

Vicki acquired a dwelling in Australia on 10 September 2010, moving into it and establishing it as her main residence as soon as it was first practicable to do so. On 1 July 2018 Vicki vacated the dwelling and moved to New York. Vicki rented the dwelling out while she tried to sell it. On 15 October 2019 Vicki finally signs a contract to sell the dwelling with settlement occurring on 13 November 2019. Vicki was a foreign resident for taxation purposes on 15 October 2019. The time of CGT event A1 for the sale of the dwelling is the time the contract for sale was signed, that is 15 October 2019. As Vicki was a foreign resident at that time she is not entitled to the main residence exemption in respect of her ownership interest in the dwelling. Note:

This outcome is not affected by:

[2] We refer to the Australian Financial Review article published on 23 February 2018 entitled "Capital Gains Tax exemption changes expected to ignite expat property fire sale."

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• Vicki previously using the dwelling as her main residence; and

• the absence rule in section 118-145 that could otherwise have applied to treat the dwelling as Vicki's main residence from 1 July 2018 to 15 October 2019 (assuming all of the requirements were satisfied).

Comments in relation to Example 1.2

There are many problems with the outcome illustrated in example 1.2.

Firstly, it is not clear what policy objective is being served by denying Vicki the absence concession on the facts given. Since the *Bill* is apparently part of measures to combat housing affordability, the question arises as to whether the Government believes that the removal of the concession would force Vicki to sell resulting (economy wide) in an increase in the stock of houses for sale?

What if Vicki simply elected to hold the property and never sell it - subsequently returning to Australia live in the property – as considered in Example in 1.3 of the Explanatory Memorandum. How does the Government believe that housing affordability concerns would have been addressed if Vickie took that approach? Arguably, a lock-in effect is being created as Vicki maybe compelled to keep the property.

In addition, if Vicki rents out the property (as many departing Australians do) then does the action of renting the property not in contribute to the *supply* of rental stock in any event?

Secondly, we note that the effect of Example 1.2 is that **Vicki will be denied even a partial main residence CGT exemption**. That outcome is being made crystal clear.

Surely after having lived in the property for the period 10 September 2010 to 1 July 2018, Vicky should be entitled to an exemption for that period (consistent with the current CGT law). Why should she be penalised for moving to overseas? Why should she be forced to sell for fear of losing the CGT exemption completely?

We do not feel that is sufficient that Vicki be allowed CGT relief only if she moves back into the property after returning to Australia as a resident (as described in Example 1.3).

We believe that this approach would create significant problems for the thousands of Australians each year who depart for take up opportunities overseas.

It would effectively mean that to retain the CGT exemption for their home - an Australian who departs Australia (and becomes non-resident) would ***either*** need to sell their family home before they depart Australia or retain their family home for a potentially unknown period until they return to Australia to live in it again. Both options create significant practical difficulties.

Horizontal equity issues are also created. Why should an Australian moving to New York be treated any differently from an Australian moving from say Brisbane to Perth? In both situations the person is likely to rent out their former main residence. Why should the Australian moving to Perth continue to benefit from a CGT concession over their former Brisbane main residence while the person who moved New York cannot? Is there an economic policy difference?

While the Australian in New York may not be paying Australian income tax on their salary income (if they have become non-resident), they will nonetheless pay tax on their rental income in addition to the State land taxes they are likely to both pay.

If there is a concern that negative gearing is being used to create tax losses on certain properties for foreign residents while tax-free capital gains accrue then it would be quite simple to address that issue separately.

We think it is self-evident that the Committee should strongly recommend modifications to the Bill to ensure fairness and equity.

Partial CGT exemptions should always available to Australian citizens for that part of the ownership period during which they have resided in their main residence.

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If the absence concession is to be removed *prospectively* then we request that Australian citizens living abroad be treated fairly in respect of their current arrangements, which grandfathering would ensure.

Should you have any questions about this submission please contact the writer.

Yours sincerely

Matthew Marcarian
Principal