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# ***Removing Capital Gains Tax Discount for Foreign Individuals***

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## **Outline of chapter**

1.1 Schedule # to this Bill amends the *Income Tax Assessment Act 1997* (ITAA 1997) to remove the capital gains tax (CGT) discount on discount capital gains accrued after 8 May 2012 for foreign resident and temporary resident individuals.

1.2 All legislative references are to the ITAA 1997 unless otherwise stated.

## **Context of amendments**

1.3 Currently, discount capital gains of individuals may be reduced by a discount percentage before being included in assessable income. A CGT discount of 50 per cent is available to individuals regardless of tax residency status.

1.4 Generally, foreign and temporary residents are only subject to capital gains on taxable Australian property, which includes residential and commercial real estate and mining assets.

1.5 As part of the 2012-13 Budget, the Government announced that the CGT discount would not apply to discount capital gains of a foreign resident. However, the CGT discount will still apply to the portion of the discount capital gain of a foreign resident individual that accrued up until the date of announcement (8 May 2012).

1.6 As temporary residents are subject to CGT on the same basis as foreign residents, they will also be ineligible for the capital gains discount.

1.7 To give effect to the measure, these amendments will apportion the discount percentage applied to reduce discount capital gains, to ensure that the full 50 per cent CGT discount is only available for periods that an asset was held:

- prior to 9 May 2012; and

- after 8 May 2012 during which the individual was an Australian resident.

## **Summary of new law**

1.8 This measure applies where:

- an individual has a discount capital gain, including a discount capital gain as a result of being a beneficiary of a trust, from a CGT event that occurred after 8 May 2012; and
- the individual was a foreign resident or a temporary resident at any time on or after 8 May 2012.

1.9 The effect of the measure is to:

- retain the full CGT discount for discount capital gains of foreign resident individuals to the extent the increase in value of the CGT asset occurred prior to 9 May 2012;
- remove the CGT discount for discount capital gains of foreign and temporary resident individuals accrued after 8 May 2012; and
- apportion the CGT discount for discount capital gains where an individual has been an Australian resident and, a foreign or temporary resident, during the period after 8 May 2012. The discount percentage will be apportioned to ensure the full 50 per cent discount percentage is applied to periods where the individual was an Australian resident.

1.10 Where an Australian resident becomes a foreign resident, the amendments will only apply in circumstances where the assets are taxable Australian property, including where the individual has chosen to disregard the CGT event triggered by their change in residency status (CGT event I1 may be disregarded under section 104-165).

1.11 Capital losses will continue to be offset against capital gains and net capital losses may still be carried forward.

1.12 These amendments are only intended to affect the discount percentage applied to a discount capital gain. These amendments are not intended to affect other rules in the CGT regime, such as the application of the main residence exemption.

## Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>The discount percentage of 50 per cent applicable to a discount capital gain of an individual will be reduced:</p> <ul style="list-style-type: none"><li>• if the CGT event from which the capital gain arises, occurs after 8 May 2012; and</li><li>• the individual was a foreign resident or a temporary resident at any time in the period after 8 May 2012 and the time of the CGT event.</li></ul>	<p>The 50 per cent discount percentage applicable to a discount capital gain of individual taxpayers is available irrespective of the residency of the taxpayer.</p>

### Detailed explanation of new law

1.13 The amendments introduced by this Bill will calculate the discount percentage applicable to a discount capital gain of an individual, where the individual was a foreign resident or temporary resident for some or all of the period that the asset was held after 8 May 2012. *[Schedule #, item 5, subsections 115-105(1) and 115-110(1)].*

1.14 The amendments reduce the discount percentage to take into account circumstances where an individual is a foreign or temporary resident and therefore ineligible for the CGT discount.

1.15 The amendments apply to discount capital gains included in the assessable income of an individual irrespective of whether the gain resulted from a CGT event happening to an asset owned by the individual or was a gain from an asset held by a trust and attributed to the individual.

1.16 The discount percentage for any discount capital gains:

- arising from a CGT event which occurred on or before 8 May 2012; or
- of an individual who at all times on or after 8 May 2012 was an Australian resident,

will be unaffected by the amendments. The discount percentage will remain at 50 per cent.

1.17 Where a CGT event does occur after 8 May 2012, the discount percentage applying to a discount capital gain from that event will depend on:

- whether the asset was held on, or was acquired after, 8 May 2012;
- if the asset was held on 8 May 2012, whether or not the individual was a resident on that date;
- whether a choice is made by an individual who was a foreign or temporary resident on 8 May 2012 to use the market value approach to determine the part of the discount capital gain that accrued on and prior to that date; and
- the residency of the individual during so much of the period the asset was held after 8 May 2012.

1.18 For assets acquired after 8 May 2012 by an individual who was a foreign or temporary resident for the entire period the asset was held, the discount percentage will be zero. This is because such individuals are no longer eligible for the CGT discount.

1.19 For assets acquired prior to 9 May 2012, and assets acquired after 8 May 2012 where the residency status of the individual owner changes during the time the asset was held, the discount percentage is reduced to reflect the periods the individual was eligible for the CGT discount. This is achieved through several mechanisms outlined below, generally by pro-rating the discount percentage. *[Schedule #, item 5, section 115-115]*

1.20 Individuals, who were foreign or temporary residents on 8 May 2012, can receive the CGT discount for the gains of an asset that accrued prior to the announcement of the measure. To do so, the individual must undertake a market valuation of the asset as at 8 May 2012 to ascertain the gain attributable to that earlier period. Individuals who do not undertake a market valuation will be ineligible for the CGT discount on pre-announcement gains. *[Schedule #, item 5, subsections 115-115(3)-(6)]*

### **Direct gains from assets owned by the individual**

1.21 Where a discount capital gain arises from a CGT event from an asset owned by an individual, the discount percentage applicable to the discount capital gain will be calculated under the amendments if:

- the CGT event occurs after 8 May 2012; and

- the individual was a foreign resident or temporary resident during some or all of the period of ownership. [Schedule # item 5, subsection 115-105(2)]

### **Gains attributable to beneficiaries from assets held by a trust**

1.22 Where a trust disposes of an asset and the discount capital gain is assessed to a beneficiary of a trust who is an individual (under Subdivision 115-C), the discount percentage will be calculated under these amendments if:

- the CGT event occurs after 8 May 2012; and
- the individual is a foreign resident or temporary resident during some or all of the discount testing period which occurs after 8 May 2012. [Schedule # item 5, section 115-110)]

### **Calculating the discount percentage**

#### *Assets acquired after 8 May 2012*

1.23 Generally, where an asset is acquired after 8 May 2012 and the individual is an Australian resident during the entire time the asset is held, these amendments do not apply and the discount percentage will not be reduced. Therefore, any discount capital gain will continue to be eligible for a discount percentage of 50 per cent.

1.24 Where an asset is acquired after 8 May 2012 and the individual is a foreign resident or temporary resident during some or all of the discount testing period, the amendments will apply to calculate the discount percentage applicable to any discount capital gain from the asset. [Schedule #, item 5, subsection 115-115(2)]

1.25 This calculation effectively apportions the discount percentage to allow individuals to receive the CGT discount for the days they were a resident, and deny the CGT discount for days they were a foreign or temporary resident.

1.26 The discount percentage is calculated under the following formula:

$$\frac{\text{Number of days during discount testing period that you were an Australian resident (but not a temporary resident)}}{2 \times \text{Number of days in discount testing period}}$$

1.27 In calculating the discount percentage, the *discount testing period* is:

- where the asset is held by an individual, the period from the day the CGT asset is acquired by the individual ending on the day the CGT event happens after 8 May 2012; or
- where the asset was held by a trust, the period on the day the trustee acquired the CGT asset *or* the day the individual last became a beneficiary of the trust estate (whichever is the later), and ends on the day the CGT event happens after 8 May 2012.
- In certain circumstances assets subject to this measure are also subject to CGT rollovers. Where this is the case, the special acquisition rules (in section 115-30) apply to determine when those assets were acquired for the purposes of identifying the start of the discount testing period. In such circumstances the individual is treated as having acquired the CGT asset when the earlier owner of the CGT asset acquired it. The individual is also treated as having the same residency status as that of the first entity during the relevant period.  
*[Schedule # item 5 subsection 115-105(3)]*

1.28 If the individual was a foreign resident or temporary resident for the entire discount testing period the discount percentage for any discount capital gain will be zero.

**Example 1.1: Asset acquired after 8 May 2012 and the individual is a foreign resident during part of the discount testing period**

XYZ Trust buys an asset on 1 January 2014 for \$10,000. XYZ trust then sells the asset on 1 January 2016 for \$20,000.

There are two beneficiaries of the trust, each holding a 50 per cent interest in the trust. The first is Lucas, who has been a beneficiary of the trust since 1 January 2013 and has been an Australian resident for the entire period.

The other beneficiary is Lachlan. Lachlan has also been a beneficiary of the trust since 1 January 2013. Lachlan was a foreign resident individual until 1 January 2015, when he became an Australian resident taxpayer.

The capital gains of the XYZ trust is \$10,000 against which it applies the full discount percentage (50 per cent). Lucas and Lachlan are both presently entitled to \$2,500 each.

Applying the rules in Subdivision 115-C, both Lachlan's and Lucas's capital gains are grossed up so that they have a discount capital gain of \$5,000 each.

As Lucas has not been a foreign or temporary resident during any of the discount testing period, he is not subject to the amendments. Therefore, he is entitled to the full discount percentage of 50 per cent.

Lachlan has been a foreign resident during the discount testing period and therefore is subject to sections 115-110 and 115-115. As the trust acquired the asset while Lachlan was a beneficiary, the date the asset was acquired by the trust is the relevant starting date for the discount testing period (subparagraph 115-110(2)(d)(i)).

As the asset was acquired after 8 May 2012, Lachlan must calculate the discount percentage under the formula in subsection 115-115(2). Therefore, Lachlan's discount percentage is,

$$\frac{365}{1460} = 25\%$$

### ***Assets acquired prior to 9 May 2012***

1.29 The Government announcement of the measure removed the CGT discount for gains accrued by foreign resident and temporary resident individuals after 8 May 2012. For individuals that were foreign or temporary residents on 8 May 2012, the gains accrued prior to the announcement of the measure will be eligible for the CGT discount. In order to be eligible, the individual must elect to use the market value of the asset as at 8 May 2012.

1.30 Gains accrued after 8 May 2012 will receive the CGT discount on an apportionment basis with regard to the individual's eligibility for the CGT discount. That is, the discount percentage will reflect the period that the individual was an Australian resident whilst it held the CGT asset.

1.31 If an individual was a resident on 8 May 2012 and for all of the period which occurred after 8 May 2012 (until the CGT event), then the individual is not subject to these amendments. Therefore, the discount percentage will remain at 50 per cent.

### ***Foreign or temporary resident on 8 May 2012 and the individual has chosen market value***

1.32 Where a discount capital gain is from an asset acquired prior to 9 May 2012 and the individual was a foreign or temporary resident on 8 May 2012 and the individual chooses to use the market value approach for determining the gain which accrued prior to 9 May 2012, the discount percentage for the discount capital gain is calculated as follows:

- Step 1 – Calculate the CGT asset’s *excess*.
  - The *excess* is the net increase in value of the asset that has accrued prior to 9 May 2012. It is calculated as the amount that the CGT asset’s market value exceeds its cost base at the end of 8 May 2012. [Schedule # item 5, paragraph 115-115(4)(c)].
  - If the *excess* is equal to or greater than the discount capital gain from the asset, the discount percentage is 50% and no further calculation is needed. This ensures that individuals do not have a reduction in discount percentage where the value of the CGT asset has fallen between 8 May 2012 and the end of the discount testing period. [Schedule #, item 5, subsection 115-115(4)]
- Step 2 - If the *excess* is less than the discount capital gain from the CGT event, the discount percentage is worked out using the following formula:

$$\frac{\text{Excess} + \left( \frac{\text{Shortfall} \times \text{Number of apportionable days that you were an eligible resident}}{\text{Number of apportionable days}} \right)}{2 \times \text{Amount of the *discount capital gain}}$$

[Schedule #, item 5, subsection 115-115(5)]

- The *shortfall* is the net increase in the value of the asset accrued *after* 8 May 2012. This is calculated by subtracting the *excess* (amount of the capital gain accrued prior to 9 May 2012) from the amount of the discount capital gain.
- The number of *apportionable days* means the number of days after 8 May 2012 during the discount testing period.
- *The number of apportionable days that you were an eligible resident* is the number of days after 8 May 2012 during the discount testing period that the individual was an Australian resident (but not a temporary resident).
- It should be noted that in circumstances where the asset was subject to section 115-30 (rules regarding acquisition when the asset has been subject to a rollover), the



apportionable days and residency status of the previous owner of the asset will be relevant.

1.33 This formula ensures that, if an individual chooses to use the market valuation method, the full CGT discount (50 per cent) applies to the increase in value of the CGT asset attributed to prior to the announcement of the measure. Any increase in the value of the CGT asset attributed to after 8 May 2012 will be subject to a discount percentage that is apportioned with regard to the individual's eligibility for the CGT discount: the days the entity was a resident.

1.34 Where the 'market value' approach is chosen by an individual, the general CGT record keeping requirements must be met (section 121-20). This means that a market valuation must be undertaken and the record of that valuation must be kept, in order to satisfy the record keeping requirements.

**Example 1.2: Asset acquired before 9 May 2012 and market value is chosen. However, the gain at 8 May 2012 exceeds the discount capital gain**

Dominic is a resident of France. On 1 January 2011 he purchased a property in Sydney for \$1,000,000. On 8 May 2012 the property was valued at \$1,100,000. On 1 July 2012 Dominic sold the property for \$1,050,000.

Dominic has a discount capital gain from the disposal of the property of \$50,000.

As Dominic is a foreign resident, the discount percentage applicable to the gain will be determined by reference to the amendments introduced by the bill.

For the purposes of determining the discount percentage, Dominic chooses to use the market value approach. The discount percentage is worked out as follows:

- Calculate the CGT asset's *excess*.

$$\$1,100,000 - \$1,000,000 = \$100,000$$

As the amount of the *excess* is greater than the discount capital gain of \$50,000 from the disposal of property the discount percentage is 50%.  
[Schedule #, item 5, subsection 115-115(4)]

### **Example 1.3 Asset acquired before 9 May 2012 and market value is chosen**

Samantha is an Australian resident. On 1 July 2012, Samantha's grandmother died and Samantha inherited land in Victoria's Yarra Valley that was purchased on 1 January 2011 for \$10,000,000. Samantha's grandmother was a tax resident of the United Kingdom.

On 8 May 2012, Samantha's land was valued at \$11,000,000. On 1 January 2013 Samantha sold her land for \$12,000,000.

Samantha has an overall discount capital gain from the disposal of the land of \$2,000,000.

As Samantha is a resident for part of the discount testing period, the discount percentage will be determined by reference to the amendments introduced in this bill.

Furthermore, because item 6 of section 115-30 applies to the asset (as Samantha received the asset as the beneficiary of a deceased estate), Samantha's grandmother's residency status and previous holding are relevant for determining the discount percentage. As Samantha's grandmother held the asset on 8 May 2012, her residency status determines that Samantha must calculate the discount percentage under subsection 115-115(4) or (6).

For the purposes of determining the discount percentage, Samantha chooses to use the market value approach. The discount percentage is worked out as follows:

Step 1 Calculate the CGT asset's *excess*.

$$\$11,000,000 - \$10,000,000 = \$1,000,000$$

Step 2 As the *excess* is less than the discount capital gain (\$2,000,000) from the CGT event, the discount percentage is worked out using the following figures:

- The *shortfall* amount is \$1,000,000 (\$2,000,000 less the *excess*);
- The *number of apportionable days* Samantha was an *eligible resident* is 184 days (that is, days Samantha and her grandmother were an eligible resident);
- The *number of apportionable days* is 237 days (that is, the number of apportionable days taking into account Samantha and her grandmother's holding of the asset); and
- Twice the *amount of discount capital gain* is \$4,000,000.

Therefore, Samantha's discount percentage is:

$$\frac{\$1,000,000 + \left( \frac{\$1,000,000 \times 184 \text{ days}}{237 \text{ days}} \right)}{\$4,000,000} = 44.4\%$$

*Individual is a foreign or temporary resident on 8 May 2012 and has not chosen market value*

1.35 Where the asset is acquired before 9 May 2012 and the individual does not choose the market value approach, the discount percentage applicable to the discount capital gain is determined by the following formula:

$$\frac{\text{Number of apportionable days that you were an Australian resident (but not a temporary resident)}}{2 \times \text{Number of days in discount testing period}}$$

*[Schedule #, item 5, subsection 115-115(6)]*

1.36 The effect of the individual not choosing to use the market value approach is that no CGT discount is available for any of the gain which accrues prior to 8 May 2012. Consequentially the discount percentage is apportioned by reference to the days the entity was an Australian resident after 8 May 2012 as a proportion of the total time that the asset was held.

**Example 1.4 Asset acquired before 9 May 2012 and market value is not chosen**

Following on from example 1.2, if Dominic did not choose to apply the market value, then his discount percentage applicable to the discount capital gain of \$50,000 would be:

$$\frac{0}{547} = 0\%$$

**Example 1.5**

Following on from example 1.3, if Samantha does not choose to apply the market value, then her discount percentage applicable to the discount capital gain of \$2,000,000 would be:

$$\frac{184}{1462} = 12.58\%$$

*Resident individual on 8 May 2012*

1.37 If an individual makes a discount capital gain from a CGT event occurring after 8 May 2012 and was:

- an Australian resident (but not a temporary resident) on 8 May 2012; and
- a foreign or temporary resident at any time during the period after 8 May 2012,

then the discount percentage is directly apportioned to reflect all days in the period of ownership before 9 May 2012 and only those days after 8 May 2012 that the individual was an Australian resident.

1.38 This is achieved by the following formula:

$$\frac{\text{Number of days in discount testing period} - \text{Number of apportionable days that you were a foreign resident or *temporary resident}}{2 \times \text{Number of days in discount testing period}}$$

*[Schedule #, item 5, subsection 115 115(3)]*

1.39 This effectively determines the discount percentage as if the individual was eligible for the CGT discount for the entire period it owned the asset prior to 9 May 2012, and reduces the discount percentage to reflect any period the individual was not eligible for the CGT discount after 8 May 2012 (any period in which the individual was a foreign or temporary resident).

**Example 1.6 Resident individual on 8 May 2012**

XYZ Trust buys an asset on 1 January 2011 for \$10,000. XYZ trust then sells the asset on 1 January 2016 for \$50,000.

There are two beneficiaries of the trust, each holding a 50 per cent interest in the trust. One of the beneficiaries is Lucas, who has been a beneficiary of the trust since 1 January 2010 and was an Australian resident individual until 1 January 2015.

The discount capital gain of the XYZ trust is \$40,000, against which it applies the full discount percentage (50 per cent). Lucas and Lachlan are both presently entitled to \$10,000 each.

Applying the rules in Subdivision 115-C, both Lachlan's and Lucas's capital gains are grossed up so that they have a discount capital gain of \$20,000 each.

Lucas is subject to section 115-110 and subsection 115-115 (3) as he is an individual, was a resident at 8 May 2012, has been a foreign

resident individual during the discount testing period and received a discount capital gain as a beneficiary of a trust.

Lucas is subject to subsection 115-115(3) because he was an Australian resident on 8 May 2012. This is regardless of the fact he was not a beneficiary of the trust at that time.

The relevant dates for the discount testing period are 1 January 2011 (as this is the latter of the date Lucas became a beneficiary and the date the trustee acquired the asset) and 1 January 2016. Therefore, the following numbers are relevant:

- *the number of days in the discount testing period* is 1826 days;
- *the number of apportionable days Lucas was foreign or temporary resident* is 365 days; and
- *two times the number of days in the discount testing period* is 3652 days.

Therefore, applying subsection 115-115(3), Lucas' discount percentage is:

$$\frac{1826 - 365}{3652} = 40\%$$

## Application and transitional provisions

1.40 The amendments apply to CGT events that occur after 8 May 2012.

1.41 However, the portion of gains accrued prior to 9 May will still be eligible for the full CGT discount if the taxpayer undertakes a market valuation of the asset as at 8 May 2012.

## Consequential amendments

1.42 Amendments are required to make references to sections 115-105 and 115-110. [*Schedule #, items 1, 2 and 3, subsection 115-30(1) and section 115-100*]

1.43 An amendment is also required to add the discount percentage resulting from section 115-115 if section 115-105 or 115-110 applies to the gain. [*Schedule #, item 4, subsection 115-100*]