Taxing issues for departing taxpayers

Simon Dorevitch explains the potential tax issues that taxpayers encounter when relocating overseas.

It is estimated that approximately 5% of Australian citizens live outside of Australia, with Europe and Asia the most popular destinations. If your client has made the decision to relocate to another country (whether permanently or for an extended period), they should be aware of two potential tax issues:

1. When a taxpayer becomes a non-resident of Australia, they are deemed to have sold their non-Australian assets for market value (CGT event I1). However, such taxpayers may make an election to disregard any capital gain and thereby defer any tax payable.
2. Thanks to recent changes, Australians living abroad must now report their income and make repayments towards their HELP (university) and TSL (apprenticeship) debts if their income exceeds a certain threshold. These changes have effectively brought the repayment obligations of Australians living overseas in line with those living in Australia.

A SILENT TAXING POINT: CGT EVENT I1

Generally, the assessable income of taxpayers who are tax residents of Australia includes income from all sources, whether in or out of

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Australia. In contrast, the assessable income of foreign residents generally only includes income with an Australian source.

In the context of CGT, this means that foreign residents disregard capital gains or losses that happen in relation to a CGT asset that is not taxable Australian property (TAP)[1].

Broadly, TAP includes:

- taxable Australian real property (TARP) – eg land or buildings situated in Australia (including a lease of land if the land is situated in Australia). It can also include mining rights.
- indirect Australian real property Interests – ie a membership interest in another entity, where the interest is a non-portfolio interest (10% or more) and the entity passes the principal asset test (market value of TARP assets exceeds market value of non-TARP assets)
- A CGT asset used in carrying on a business through an Australian permanent establishment, and
- An option or right to acquire one of the above assets.

Where a taxpayer ceases to be an Australian resident those assets that are not TAP are taken outside the remit of the Australian tax system. As you might imagine, the government does not like this, so CGT Events I1 and I2[2] were included in the legislation[3] to tax these assets before they fell out of Treasury's grip.

WHEN DOES CGT EVENT I1 HAPPEN?

CGT event I1 happens when an individual or company stops being an Australian resident. For an individual taxpayer, this will occur when they no longer satisfy any of the four tests of residency – the resides test, the domicile test, the 183-day test and the superannuation test.

1: Note that taxable Australian property replaced the concept of "necessary connection" with Australia with effect from 12 December 2006

2: Note CGT Event I1 happens in the case of an individual or company and CGT event I2 deals with trusts. The focus on this article is individual taxpayers.

3: CGT Events I1 and I2 are found in Subdiv 104-I ITAA97

In certain situations, it may be difficult to pinpoint precisely when a taxpayer ceases to be a resident (or even if they ceased being a resident at all). Where such timing could have a significant impact on the taxpayer's liability it may be prudent to seek a private ruling from the ATO.

WHAT ARE THE CONSEQUENCES OF CGT EVENT I1 HAPPENING?

The taxpayer is deemed to have disposed of their non-TAP assets, and also their indirect Australian real property interests, for their market value at the time. Therefore, they make a capital gain if the market value is more than their cost base and a capital loss if the market value is less than the reduced cost base.

There are, however, exceptions:

- A capital gain or loss is disregarded if the asset was acquired before 20 September 1985 (ie before the introduction of CGT).
- If the taxpayer is an individual, they may choose to disregard the capital gain or loss. This choice is evidenced by how the taxpayer prepares their tax return (ie whether the gain is included or excluded). Note that the choice is all in or all out – it cannot be made per CGT asset.

The ATO has published a fact sheet that contains a rough "rule of thumb" to assist emigrating taxpayers.
Below is an extract from this fact sheet:

If you go overseas temporarily and do not set up a permanent home in another country…then you may continue to be treated as an Australian resident for tax purposes.

If you leave Australia permanently… then you will generally not be considered an Australian resident for tax purposes, from the date of departure.

WHAT ARE THE CONSEQUENCES OF MAKING THIS CHOICE?

If a taxpayer makes a choice to disregard the capital gain, the assets are taken to be TAP until the taxpayer disposes of the asset or becomes an Australian resident once more. Effectively, the assets are kept within the Australian tax system. Note, however, that this may be overridden by a Double Taxation Agreement (DTA)[4].

How the ATO will become aware of a foreign resident disposing of non-TAP assets is unclear, though it is noted that data-sharing between tax authorities has increased in recent years.

WHEN SHOULD THE CHOICE TO DISREGARD CGT EVENT I1 BE MADE?

In some cases the taxpayer will simply not have the cash to fund the CGT liability (since, being a deemed disposal, they have not actually received any capital proceeds). In those situations the choice to disregard any capital gain is clear.

In other cases, knowing whether it is in a taxpayer's interests to make the choice requires a consideration of numerous factors and, ideally, a well-functioning crystal ball! The time between the CGT event and the lodging of the return is an important consideration (see table).

Keep in mind also that non-residents are subject to non-resident rates of tax and no longer have access to the CGT discount. This makes it more likely that the taxpayer will face higher taxation on the future capital gain if a choice is made to disregard the deemed gain.

WHAT IF THE TAXPAYER BECOMES A RESIDENT AGAIN?

On becoming a resident, a taxpayer is deemed to have acquired their non-TAP assets for market value if a choice was not made earlier to disregard the capital gain.

Therefore, a former resident, having not made the choice to disregard a capital gain from CGT event I1, who returns to Australia (and becomes a resident once more) may receive an uplift in the cost base of their non-TAP assets. For CGT discount purposes, the date of regaining residency (and not the original date of actual acquisition) is used to determine whether the asset has been held for at least 12 months.

WHEN SHOULD THE CHOICE TO DISREGARD CGT EVENT I1 BE MADE?

✔ It may be more favourable to make the choice where:	✖ It may be less favourable to make the choice where:
• The taxpayer's taxable income is higher than it is expected to be in the year of disposal (since CGT is applied at marginal tax rates) • The asset is expected to fall in value (and therefore the capital gain in the future will be lower) • Being able to defer payment to a later date is important • The subsequent disposal will not be taxable in Australia (eg because of a DTA)	• The taxpayer's taxable income is lower than it is expected to be in the year of disposal (since CGT is applied at marginal tax rates) • The asset is expected to rise in value (and therefore the capital gain in the future will be greater) • The taxpayer intends to return to Australia (and the market value is expected to rise whilst they are away) • There is no income tax regime or CGT regime in the juridiction to which the taxpayer is relocating (eg New Zealand does not have CGT)

4: Refer, for example, to Clause 5, Article 13 of the Australia-UK DTA.

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EXAMPLE

In June 2016 James decides he has had enough of Australia and emigrates to France, vowing never to return. He is considered to have terminated his Australian residency at this time. Upon departure James owns the following assets:

- a home in Toorak
- an investment property in the US, and
- 50% of the shares in Gemba Pty Ltd, a company whose sole asset is a farm in NSW.

When James's Australian residency ends, CGT Event I1 happens. He is deemed to have disposed of his US investment property for its market value, triggering a capital gain. CGT event I1 does not happen with respect to his home in Toorak and his shares in Gemba Pty Ltd because they are TAP.

James decides not to make the choice to disregard the gain on his US investment property. However, having been out of work since August 2015, his taxable income in the 2016 financial year is very low and therefore low marginal tax rates apply to the capital gain.

Five years later, with his favourite Australian sporting team competing for their fourth-straight premiership, James decides he misses Australia too much and returns permanently. He is deemed to have reacquired his US investment property for its market value when he becomes an Australian resident once more. Any increases in value that occurred whilst he was in France will not be subject to Australian tax.

HELP DEBTS

In November 2015, the government passed legislation closing a loophole which enabled university graduates living overseas to avoid making student loan repayments. From 1 July 2017, the HELP (Higher Education Loan Program) and TSL (Trade Support Loan) repayment obligations for overseas residents will be brought in line with those who remain in Australia.

FROM 1 JANUARY 2016

Taxpayers with an existing HELP or TSL debt who leave Australia and intend to be overseas for more than six months in any 12-month period will need to need to notify the ATO within seven days of leaving Australia. Those who already live overseas will need to update their details no later than 1 July 2017.

It does not matter whether the taxpayer is overseas for work, study or travel.

Taxpayers should notify the ATO by updating their contact details, including international residential and email addresses, using the ATO's online services via the myGov website. This means that, if they haven't already, such taxpayers will need to register for a myGov account. The ATO should also be informed if there are any further changes to a taxpayer's contact details whilst they reside overseas.

FROM 1 JULY 2017

Taxpayers living overseas and not Australian residents for tax purposes will need to self-assess the world-wide income they have received in the 2016-17 financial year and submit details to the ATO via myGov. Foreign income will be translated to Australian dollars using the average exchange rate for the financial year.

They should do this, even if their income is below the threshold (or if they have not worked at all). Income details should be submitted by 31 October each year.

The ATO have indicated that, at this stage, their first priority is to educate taxpayers and encourage self-compliance. However, they have also confirmed that individuals who do not comply with their obligations will potentially be subject to the same range of penalties that apply under broader taxation law.

Taxpayers who remain Australian residents despite being overseas will continue to file tax returns and will therefore not need to report income via myGov.

If the taxpayer's income for repayment purposes exceeds the minimum repayment threshold, they will be required to make compulsory repayments towards their debt. Non-resident taxpayers will make repayments via myGov.

The repayment income[5] rates for the 2016-17 financial year are identical to those that apply to taxpayers who remain in Australia. As with resident taxpayers, non-resident taxpayers may also make voluntary repayments. Note that new HELP repayment amounts have been legislated by Parliament and apply from 2018-19. ■

5: Repayment income is taxable income plus total investment loss, reportable fringe benefit amounts, reportable super contributions and exempt foreign employment income.

HELP repayment income rates for the 2016-17 financial year

Repayment income	Repayment rate
Below $54,869	Nil
$54,869 – $61,119	4.0%
$61,120 – $67,368	4.5%
$67,369 – $70,909	5.0%
$70,910 – $76,222	5.5%
$76,223 – $82,550	6.0%
$82,551 – $86,894	6.5%
$86,895 – $95,626	7.0%
$95,627 – $101,899	7.5%
$101,900 and above	8.0%

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