

CGT and the family home: expats and foreigners excluded from tax exemption

Late last year, legislative changes were made that exclude non-residents from accessing the main residence exemption. The retrospective changes directly impact foreigners and expats whose main residence is in Australia or overseas. We explore the impact.

Key points

- Non-residents for tax purposes excluded from the main residence exemption from 9 May 2017
- Transitional rules allow non-residents to sell their property and access the main residence exemption under the previous rules (if they held the property continuously from 9 May 2017).
- An exclusion applies where the taxpayer has been a non-resident for 6 years or less and a 'life event' occurs, such as death.

CGT and the main residence exemption

Capital gains tax (CGT) applies to gains you have made on the sale of capital assets. Unless an exemption or exclusion applies, or you can offset the tax against a capital loss, any gain you made on an asset is taxed at your marginal tax rate. The tax triggers when a 'CGT event' occurs. For residential property, the 'CGT event' is generally the date the contract is signed.

The main residence exemption prevents CGT applying to your family home (the home you treat as your main residence). If the home was your main residence for only part of the time you owned it, or if you use your home to produce income (for

example, you use part of the home as business premises or rent out part of the property), then a partial exemption may be available. In addition, if you move out of your home and you don't claim any other residence as your main residence, then you can continue to treat the home as your main residence for up to six years if you rent it out, or indefinitely if you don't rent it out (the 'absence rule').

Previously, the main residence exemption was available to individuals who were residents, non-residents, and temporary residents for tax purposes.

The new rules

The new rules exclude foreign residents from accessing the main residence exemption and apply to CGT events that occur from 9 May 2017 onwards.

Under the new rules, if you are a non-resident for tax purposes at the time you sell your main residence, you will no longer be able to access the main residence exemption and you will need to pay CGT on any gain you make (subject to transitional rules and an exclusion). These new rules apply regardless of whether you were an Australian resident for part of the time you owned the property and no apportionment applies – the exemption simply does or does not apply depending on your residency status for tax purposes at the time the CGT event is triggered.

However, if you are a resident of Australia at the time of the CGT event, then you may be able to access the main residence exemption, even if you have been a non-resident for some or most of the ownership period. For example, an expat who maintains their main residence in Australia could return to Australia, become a resident for tax purposes again, then sell the property and if applicable, access the main residence exemption (the new rules contain provisions that will deny the exemption where someone attempts to avoid the new rules by

deliberately structuring their affairs to access the exemption – for example, transferring the property to a related party).

The new rules do not impact on Australian tax residents.

The transitional rules until 30 June 2020

Transitional rules are in place for non-resident taxpayers who would have been able to access the main residence exemption prior to the changes. The transitional rules enable someone who held property continuously from 9 May 2017 to apply the existing rules if the CGT event occurs on or before 30 June 2020. This gives non-residents a limited period of time to sell their property and obtain some tax relief under the main residence rules.

Exclusions to the new rules

If you would have been able to access the main residence exemption under the prior rules, and have been a foreign resident for six years or less, there is a limited exclusion to the new rules where certain ‘life events’ occur.

A ‘life event’ is generally:

- Your death or the death of your spouse or child (under 18 years)
- Terminal illness of you, your spouse or your child
- Marriage breakdown and divorce

Under these circumstances, the taxpayer is able to access the main residence exemption. For example, if you or your spouse dies while living overseas, it has been six years or less since you became a non-resident, and the property is treated as your main residence.

After six years however, the main residence exemption will not

apply. That is, if you have been a foreign resident for tax purposes for more than six years, you or your beneficiaries cannot access the main residence exemption once the transitional period has ended unless you move back to Australia and become a resident again before the CGT event occurs.

Who is an Australian resident for tax purposes?

Working out whether or not you are a resident of Australia for tax purposes can be difficult as it requires the exercise of judgement rather than applying a single 'black and white' test. Many people believe it is just a matter of how much time you spend out of the country but this is not always the case. There are four tests that are used to work out your residency status:

- **Resides test** – The first test looks at whether you reside in Australia. For example, are you moving out of the country permanently and migrating, or just moving away for a while? The actions you take help determine this test. For example, do you appear to have cut your ties with Australia (sold your furniture as opposed to being in storage, closed memberships, etc.,)
- **Domicile test** – The second test looks at your where you are living and where you have your permanent home. Someone who was born or migrated to Australia will generally retain their Australian domicile unless they leave Australia permanently. Someone with an Australian domicile will be treated as a resident for tax purposes unless they can show that their permanent home is overseas. There are a range of factors to consider in order to determine whether someone's permanent home is overseas. For example, is your home overseas permanent or temporary (like a hotel)?

- **183 day test** – Assuming you are not already considered to be an Australian resident by the other tests, the 183 day test looks at how long you are physically present in Australia during a particular income year.
- **Superannuation test** – If you are a current member of certain superannuation funds covering Commonwealth Government employees then you will generally be considered a resident for tax purposes regardless of how long you intend to live overseas.

The residency tests can be confusing. If you are uncertain, you should seek advice to clarify your position.

Common questions

I have been living overseas for the last 5 years for work. I am a non-resident for tax purposes but my main residence is in Australia. My house, which I bought in 2005, is being rented out while I am overseas. Now what?

If you own a property in Australia that used to be your main residence, you can use the absence rule to maintain the exempt status of your property just in case you decide to return to Australia. When you return permanently to Australia and decide to sell, you may be able to access the main residence exemption (or a partial exemption). If you rent out your property while you are away, the absence rule allows you to treat the property as your main residence for up to six years.

If you sell the property while you are a non-resident, you will no longer be entitled to the main residence exemption or a partial exemption unless you enter into a contract and sell the property prior to 30 June 2020. Similarly, if you die while overseas, and your home is sold within two years of the

date of your death, it's unlikely that your beneficiaries will be able to claim all or part of the main residence exemption.

If you intend to return to Australia and become a resident again at some point, there is no change to your position as a result of the new rules. If you remain overseas but enter into a contract to sell prior to 30 June 2020, your position is also unchanged under the transitional rules.

If you remain a foreign resident and sell the property after 30 June 2020, you will not be able to access the main residence exemption in part or in full.

My mother lives overseas after retiring four years ago and is a non-resident for tax purposes. The family home in Australia is her main residence. My sister is living in the home rent free. What happens if my mother dies? Can my mother gift the home to her children now and still access the main residence exemption?

After 30 June 2020, if your mother is a foreign resident for six years or less at the time she passes away, the main residence exemption she accrued continues to be available to the trustee or beneficiaries of the deceased estate that inherit the property.

If the trustee or beneficiaries sell the property within two years of your mother's death, then the main residence exemption accrued by the deceased applies. If the property is sold more than two years after the date of death then the position is more complex.

If your mother passes away and was a non-resident for tax

purposes for more than six years, then the main residence exemption she accrued does not pass to the estate or beneficiaries. However, if your sister inherits all or part of the property and continues to be her main residence then a partial exemption may apply on future sale if she is a resident of Australia at the time of the CGT event.

If your mother gifts the property to her children prior to 30 June 2020 then it may be possible to apply a full exemption under the main residence rules depending on the situation. If the property is transferred to the children after 30 June 2020 then the exemption won't be available at all.

If you have any questions about how the changes affect you, please contact our office.