11 August 2017

The Manager
Individuals Tax Unit
Individuals and Indirect Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: housingtaxdeductions@Treasury.gov.au

Dear Sir or Madam

Exposure draft: Treasury Laws amendment (Housing Tax Integrity) Bill 2017

Thank you for meeting with Chartered Accountants Australia and New Zealand (**CA ANZ**) to discuss the abovementioned Exposure Draft (**ED**) and Explanatory Material (**EM**) designed to limit deductions for plant and equipment and travel expenditure for residential rental properties.

Our comments on the draft documents are set out below.

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Scope and introductory comments

Our comments are primarily limited to the ED and EM.

Our views on policy aspects of the proposed measures (except to the extent that in our view the proposed changes do not accord with the Budget announcement) have not been sought.

Nonetheless, these measures are seen by CA ANZ as part of a regrettable trend towards piecemeal reform of the income tax base, driven by what is considered to be politically achievable.

Treasury would be well aware of our consistent advocacy for a broad base, low rate tax system built on reforms which encompass both the direct and indirect tax systems. We also urge all stakeholders – including the major political parties – to consider the Generic Tax Policy Process which (in most cases) has been followed in New Zealand since 1995[1].

These measures no doubt also reflect concerns within the ATO over mounting deduction claims from individual taxpayers which the regulator finds difficult to contest and cannot validate using existing data collection powers. If so, we simply make the observation that, if the policy foundations of personal tax deductions are under review, this should be part of a broader policy discussion with Australians which includes trade-offs (i.e. deductions forgone for personal tax rate cuts). To deny deductions bit by bit, year by year without such a dialogue is taxation by stealth.

References below are to sections of the ED unless otherwise indicated.

Schedule 1 - Travel expenditure for residential rental premises

(a) The architecture of s26-31

The ED seeks to deny a deduction for an otherwise deductible loss or outgoing to the extent to which it is attributable to travel if:

(a) it is incurred in producing your assessable income from the use of residential premises as residential accommodation; and
(b) it is not necessarily incurred in carrying on a business for the purpose of producing assessable income.

Section 26-31 is unusual in that, apart from determining the extent to which an outgoing is attributable to travel, it does not contain any words requiring apportionment (i.e. to the extent that…).

As we understand it, the proposed amendments are intended to deny a deduction for travel related expenditure incurred in deriving assessable income from residential premises to overcome existing concerns that, where the travel is also for private purposes, the deductible portion is being overstated in individual income tax returns. They are not intended to deny a deduction for travel related deductions incurred where the income is derived from the carrying on of a business. Nor are they intended to deny a deduction for travel related expenses to the

[1] Refer: http://taxpolicy.ird.govt.nz/how-we-develop-tax-policy

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extent they are incurred for the purpose of deriving assessable income from non-residential premises, from employment or other sources entirely (e.g. travel to inspect an income producing solar panel installation).

If this is the case then in our view s26-31 would be clearer if it effectively denied an entity a deduction for a loss or outgoing *insofar* as it is attributable to travel:

(a) to the extent it is incurred in producing the entity's assessable income from the use of residential premises as residential accommodation; *unless*
(b) it is necessarily incurred in carrying on a business for the purpose of producing assessable income.

The combined effect of s26-31 and Example 1.5 as currently drafted is that the proposed amendments could be interpreted as denying a deduction for travel related costs incurred *to any extent* in deriving assessable income from residential premises used as residential accommodation except to the extent incurred in carrying on a business. If so, s26-31 would deny an employee a deduction for total travel related expenditure incurred for the dual purpose of, for example, undertaking repairs on a residential rental property and attending a work related seminar. It would also deny an investor a deduction for travel costs incurred in relation to both residential and commercial premises (e.g. the building in Example 1.5).

Amending s26-31(1) along the lines suggested would mean that, in Example 1.5, a deduction would be denied for travel expenses to the extent they relate to the apartment but not the workshop which is not residential premises. There is no need to consider paragraph (b) if renting the apartment is not considered to be part of the business carried on in the workshops.

(b) Outgoings which are 'attributable to' travel

The EM indicates that the ordinary meaning of travel applies and that *'Travel expenditure would be expected to include motor vehicle expenses, taxi or hire car costs, airfares, public transport costs, and any meals or accommodation related to the travel'.*

It is readily apparent that outgoings 'attributable to travel' will include travel costs themselves. It would presumably also include costs of accommodation and meals incurred in transit.

However, as you are aware, doubt has been expressed as to whether this concept is sufficiently broad to encompass all accommodation and meal costs incurred while a person is away from home attending to, for example, repairs - see article attached as **Appendix A**.

(c) The extent to which outgoings are attributable to travel

The EM indicates that fees paid by a residential property owner to a real estate agent for property management services remain deductible notwithstanding that those services would normally involve some travel by the agent (e.g. a yearly inspection of the property). However, travel costs paid directly or reimbursed for a relative to, for example, inspect a property would not be deductible.

This suggests that s26-31 is only concerned with outgoings directly incurred on travel related expenditure and entities are not required to 'trace through' an outgoing (e.g. property management fees or body corporate fees), to determine the extent to which it relates to travel. This is despite the fact that the phrase 'attributable to' imports the notion of causation or

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connection and, as the ED is drafted, there is no qualification or limitation conveyed by such terms as sole, dominant, direct etc.

If so, this would mean that directly paying the airfare of a real estate agent to, for example, inspect a property would be non-deductible and this is consistent with paragraph 1.23 of the EM (notwithstanding our understanding that this is not the intention of the proposed amendments). It also opens up the possibility that, should fees be charged on an hourly rate plus costs, including motor vehicle expenses, reimbursement of those travel costs would be non-deductible.

In our view, the line of demarcation between what is, and is not, non-deductible expenditure attributable to travel needs to be clearer. At a minimum, it should be clear that arm's length amounts paid to unrelated parties, whether directly or indirectly, remain deductible.

(d) Residential premises used as residential accommodation

The use of GST concepts generally

We appreciate that using GST concepts to determine the sort of residential investment property which falls within the scope of the proposed measures is, on the face of it, attractive as those concepts are the subject of judicial and ATO guidance. However, that does not mean that they are familiar to all tax advisers and tax agents, or necessarily appropriate in an income tax context.

In addition, it should be borne in mind that the practical application of the real property provisions and definitions in the GST Act[2] has proven to be one of the most complex, uncertain, and consequently litigious subject areas of the GST law, with several cases being appealed to the Full Federal Court[3] and the High Court.[4] Many of the cases have also resulted in a suite of legislative amendments being required to resolve unintended or unforeseen outcomes from the judicial decisions, often with significantly retrospective application[5] and this trend may continue in the future.

From a drafting perspective, we note that the use of the GST definition in the context of proposed s26-31 is somewhat cumbersome as it results in a repeating of the "for residential accommodation" concept, as that component is already included as an aspect within the GST definition of "residential premises". This creates interpretational difficulties or anomalies which may give rise to unintended outcomes.

Therefore, it may be preferable to de-couple this measure from the GST law by simply using a customised definition that is appropriately designed for this specific purpose, or it may be worthwhile considering adopting definitions in other relevant legislation such as the respective State or Territory equivalent of the *Residential Tenancies Act 2010* (NSW)[6] which governs the rental of the such property.

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[2] A New Tax System (Goods and Services Tax) Act 1999.
[3] See for example, *South Steyne Hotel Pty Limited v Commissioner of Taxation* [2009] FCAFC 155; *Commissioner of Taxation v Gloxinia Investments (Trustee)* [2010] FCAFC 46; *Marana Holdings Pty Ltd & Another v Commissioner of Taxation* [2004] FCAC 307 925
[4] *Commissioner of Taxation v MBI Properties Pty Ltd* [2014] HCA 49
[5] For example, the '*Marana* amendments' were made in 2006, applying retrospectively from 1 July 2000. The '*Gloxinia'* amendments, were made in 2012, applying retrospectively from January 2011.
[6] Refer s.3(1) in the NSW Act.

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Ultimately, if GST definitions and other GST terms are adopted in the ED, they will need to be interpreted in the context of the *Income Tax Assessment Act 1997* (**ITAA 1997**). In our view additional ATO guidance will be required because the context in which those terms are used is different.

Residential premises and paragraphs 1.15 and 1.16 of the EM

The GST Act defines 'residential premises' to mean

> *'land or a building that:*
> *(a) is occupied as a residence or for residential accommodation; or*
> *(b) is intended to be occupied, and is capable of being occupied, as a residence or for residential accommodation ……..'*

Paragraphs 1.14 and 1.15 of the EM currently state that:

> *1.14 Broadly, land or a building will be residential premises if it provides, at a minimum, shelter and basic living facilities and is either occupied or designed for occupation [as a residence or for residential accommodation].*
>
> *1.15 This to be ascertained by an objective consideration of the character of the property – the purpose for which an entity may hold the property is not relevant.*

GSTR 2012/5 *Goods and services tax: residential premises* indicates that the actual use of the premises as a residence or for residential accommodation is relevant for the purposes of paragraph (a) of the definition, whereas paragraph (b) is ascertained effectively by an objective consideration of the character of the property (paragraphs 6 and 7). In either case to be residential premises it is necessary that they provide at a minimum, shelter and basic living conditions.

As paragraph 1.15 of the EM is currently drafted, it could be read as saying that both limbs of the definition require 'an objective consideration of character of the property' when actual use – which is not purpose - is relevant to paragraph (a). We think paragraph 1.15 should be amended.

More broadly we think that the commentary should provide a more comprehensive explanation of the difference between paragraphs (a) and (b) of the definition of 'residential premises' and the meaning of the undefined term 'residential accommodation'.

The definition of 'residential premises'

The definition of 'residential premises' could readily be interpreted as requiring the taxpayer to identify land or a building and determine whether, viewed as an entirety, it is occupied as a residence or for residential accommodation etc and hence 'residential premises' as defined.

However, the EM suggests that it is permissible to determine the extent to which a single property is residential premises (e.g. Example 1.5 in which an apartment on the first floor of a two storey brick building with a workshop at ground level is regarded as 'residential premises' but the workshop is not). There is nothing in the Example to suggest the building is strata titled and we assume that the characterisation of the apartment as residential premises does not turn on the fact that, in the Example, it is subject to a separate lease.

Even if a similar approach is adopted for GST purposes this is in the context of the GST Act. We think that it would be clearer and provide more certainty if the term 'residential premises' was defined to mean either:

- land or buildings to the extent to which it is occupied as a residence etc, or
- land or buildings, or any part thereof, which is occupied as a residence etc.

The use of residential premises as residential accommodation

As currently drafted, the only example in the EM which considers the circumstances in which assessable income will be regarded as being from *'the use of residential premises as residential accommodation'* is Example 1.2. In our view the EM needs to provide further guidance.

Premises fit for purpose as retail/office premises being used for residential accommodation

For otherwise deductible travel related expenses to be denied, s26-31 requires that they be incurred in deriving assessable income '*from the use of residential premises as residential accommodation*'.

Generally speaking, premises which provide shelter and basic living facilities will be 'residential premises', as defined, under paragraph (a) of the definition if they are occupied as a residence or for residential occupation, and under paragraph (b) if they are vacant but the physical characteristics of the premises indicate that they are, in our words, 'fit for purpose' as a residence or for residential accommodation (e.g. as in Example 1.2).

As indicated in Example 7 of GSTR 2012/5 (see extract attached as **Appendix B**) the definition of 'residential premises' means that premises fit for purpose as retail premises rather than residential accommodation (and hence not residential premises under paragraph (b) of the definition) may nonetheless be residential premises as a result of paragraph (a) because they are occupied as a residence or for residential accommodation.

Currently, none of the Examples in the EM deal with how s26-31 would apply in these circumstances.

Using the fact pattern in Example 7 of GSTR 1012/5, if regard is had to the actual use of the premises by the tenant, any income derived from the premises would be assessable income from the use of residential premises as residential accommodation. This would mean that travel costs incurred in attending the property to undertake repairs for example would be non-deductible. More generally it would mean that the deductibility of travel related costs will be dependent on the use of premises by the tenant.

Paragraph 1.18 suggests that it is actual use of residential premises as residential accommodation which is relevant. It says:

> *1.18 These amendments do not prevent an entity from deducting travel expenditure where they are not using residential premises as residential accommodation.*

Even if the fact pattern in Example 7 of GSTR 2012/5 is not common, including an example in the EM dealing with the outcome will help illustrate when income is from the use of residential premises as residential accommodation. Such an example would also be relevant in the reverse

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situation (i.e. where premises fit for purpose as residential accommodation are used for business purposes).

Example 1.2 – Travel expenditure related to residential premises may be deducted, where use is not for residential accommodation

Example 1.2 considers whether income from the sale of stored solar energy from panels installed on the roof of a residential investment property at a time when it is vacant is income from the use of residential premises (as a result of paragraph (b) of the definition) as residential accommodation.

The Example concludes that although the income is from the use of residential premises it is not from their use as residential accommodation so the cost of David's travel to repair the panels is fully deductible. The implication, supported by paragraph 1.18, is that this is because the premises are vacant and not used as residential accommodation.

If the 'vacant' rationale is the appropriate explanation, does it also mean that had David also repaired the windows on the house, the travel costs would be fully deductible because, although the income is from the use of the residential premises, it is *not* from their use as residential accommodation?

To achieve the desired outcome would require a conclusion that the income from the sale of stored solar energy is simply not from the use (if the premises were occupied), or availability for use (if vacant), of residential premises as residential accommodation. As we understand it, this is the intended rationale and would be consistent with paragraph 2.24 of the commentary on Schedule 2. We recommend that the wording in Example 1.2 be amended to clarify the principle underlying the outcome of deductibility of the expense.

Additional examples

As noted above, we think the EM should include an example equivalent to Example 7 in GSTR 2012/5. It would also benefit from examples dealing with the following situations likely to arise in practice:

- The lease of a property which contains both residential accommodation and, for example, a doctor's surgery; and
- The lease of a farmhouse on a large area of land and how much of the land is part of the residential premises (picking up on paragraph 46 of GSTR 2012/5). The lessee may maintain the area in close proximity to the farmhouse, but the landlord the remaining land.

(e) Carrying on a business

The ED opens the vexed question of the circumstances in which an entity which derives rent from one or more residential premises will be regarded as carrying on a business.

Given existing guidance we appreciate that this issue is not addressed in any detail in the EM. However, we expect that there will be many taxpayers potentially impacted by these changes for whom the answer is not clear cut.

In our view the ATO will need to revisit the consistency and clarity of existing guidance. The examples in the ATO publication *Rental Properties 2017* may provide a useful starting point but there is a large grey area between the fact patterns in:

- Example 3 – Co-owners who are not carrying on rental property business (involving three properties managed by the co-owners), and
- Example 4 – Is it a rental property business (involving 26 properties managed by the co-owners where the answer is yes).

As the proposed amendments are likely to result in a number of private ruling requests, consideration should be given to providing some form of safe-harbour to provide certainty and minimize compliance costs for both taxpayers and the ATO.

CA ANZ would be happy to work with the ATO officials tasked to develop the new guidance and safe harbour. Given the 1 July 2017 start date, we hope this work is already underway.

(f) Large unit trust exception must be expanded to cover wholesale funds

A strict 300 unit holder exception rule may exclude a large population of 'institutional investors' in residential premises which are intended to be excepted from the rules.

Examples include unit trusts with less than 300 direct unit holders owned by one or more 'institutional investors' or by superannuation fund unit holders, that would themselves qualify for the exception if each had held the residential property investment directly.

Other genuine widely held wholesale property funds may also have less than 300 direct unit holders and not be entitled to the exception, even though they are not private arrangements and clearly would not be established "solely to benefit from this exclusion", which is the rationale for the drafting of the exception given in the EM.

Similar to the managed investment trust (**MIT**) eligibility rules, a unit trust should also qualify for the exception where the trust is a managed investment scheme (**MIS**) as defined in section 9 of the *Corporations Act 2001*. This must include a trust that is not required to be registered under the Corporations Act because they provide financial services to wholesale clients (i.e. an unregistered wholesale fund). However, none of the additional licencing and ownership conditions imposed on MITs should apply for a wholesale MIS to qualify for this exception.

Schedule 2 – Limiting deductions for plant and equipment in residential premises

The proposed amendments seek to deny a deduction for plant used in gaining or producing assessable income from the use of residential premises to provide residential accommodation where:

- the plant has been previously used or installed ready for use (other than as trading stock), or
- the plant has been previously used or installed ready for use by you for non-taxable purposes.

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There is an exception for plant acquired in 'new residential premises' (within the meaning of the GST Act) providing no entity has resided in those premises and no entity has previously been entitled to claim a deduction for the decline in value of the plant.

(a) Use of GST concepts

This measure also uses GST concepts, including the term 'residential premises' and residential accommodation, which are used in the proposed amendments in relation to travel expenditure in Schedule 1. Accordingly, the above comments are also relevant here.

Additional GST concepts introduced include the concept of 'new residential premises' and 'substantial renovations', both of which are subject to lengthy GST rulings, and complex judicial decisions.[7]

We note that whereas the measure in relation to travel expenditure is concerned with 'the use of residential premises as residential accommodation', this measure is concerned with 'the use of *residential premises to provide residential accommodation'. We do not know whether this is intended to convey a different meaning.

(b) Partner in a partnership which carries on a property investment business

In relation to the application of Schedule 1 to rental properties owned by a partnership, we note that the question whether travel expenditure is deductible is determined at the partnership level.

However, where rental properties are owned by a partnership, entitlement to depreciation arises at the partner level. So, a partner in a partnership which is carrying on a business will only be excluded from the measures in Schedule 2 if the partner is carrying on a business.

We do not know whether the fact that an entity is a partner in a partnership carrying on a business is sufficient to ensure that the partner is also regarded as carrying on a business. If there is any doubt as to whether this is the case we recommend that the ED make clear that, for the purposes of these measures, a partner in a partnership which carries on a business will also be regarded as carrying on a business.

(c) Proposed changes versus the Budget announcement

In our view the proposed amendments go further than was intended by the Budget announcement which said:

> *'From 1 July 2017, the Government will limit plant and equipment depreciation deductions to outlays actually incurred by investors in residential real estate properties.* ***Plant and equipment items are usually mechanical fixtures or those which can be 'easily' removed from a property such as dishwashers and ceiling fans.***
>
> ***This is an integrity measure to address concerns that some plant and equipment items are being depreciated by successive investors in excess of their actual value.*** *Acquisitions of existing plant and equipment items will be reflected in the cost base for capital gains tax purposes for subsequent investors.*

[7] See *Marana Holdings*, and *Gloxinia*, notes 1 and 3 above.

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> *These changes will apply on a prospective basis, with existing investments grandfathered.* ***Plant and equipment forming part of residential investment properties*** *as of 9 May 2017 (including contracts already entered into at 7:30PM (AEST) on 9 May 2017) will continue to give rise to deductions for depreciation until either the investor no longer owns the asset, or the asset reaches the end of its effective life.*
>
> ***Investors who purchase plant and equipment for their residential investment property after 9 May 2017 will be able to claim a deduction over the effective life of the asset. However, subsequent owners of a property will be unable to claim deductions for plant and equipment purchased by a previous owner of that property.'*** *(Our emphasis)*

It seems relatively clear to us that the announcement is directed at plant and equipment which is integral to, and acquired as part of, a property such as fans, dishwashers and carpets. These are, in terms of the announcement:

- Affixed but easily removed and forming part of residential investment properties
- Their cost is determined by allocating a portion of the overall purchase price of the property which may be in excess of their actual value thereby raising integrity concerns.

The last paragraph of the announcement clearly states that, should investors purchase plant or equipment for their residential property after 9 May 2017, they will be able to claim depreciation. This will be the case, regardless of whether the plant is new or second hand, because if the newly acquired plant is affixed to the property, depreciation will not be available to a subsequent purchaser of the property which includes those items.

We see nothing in the announcement to suggest that a second hand item of plant acquired after and separately from the acquisition of the property itself will not qualify for depreciation (e.g. the washing machine in Example 2.1 of the EM or indeed the fridge). Ordinarily, the notional depreciated value of the fridge would be depreciated from the time it commences to be used for income producing purposes and not some overstated value.

We understand that denying depreciation on second hand plant regardless of when it was acquired is to ensure that that plant included in a property is not sold separately from the property. There may be other ways of achieving this outcome while remaining true to the Government's announcement.

(d) Exception for certain assets in new residential premises

Example 2.2

This example proceeds on the basis that Hannah acquires a new apartment from a developer which is fitted out with the usual fixtures and fittings as well as furniture. As those assets have been installed by the developer, they are previously used and a deduction denied as a result of s40-27(1).

However, the 'saving' provision in s40-27(4) applies to allow Hannah a depreciation deduction in respect of the assets as the premises are 'new residential premises', as defined, the developer has not claimed depreciation, and no entity previously resided in the premises.

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In our view, the fact that the apartment (and possibly also the assets included in it) would have been trading stock in the hands of the developer warrants some discussion in the Example.

Premises previously leased by developer

Whether 'residential premises' are 'new residential premises' is to be determined having regard to the meaning of that term in the GST Act (contained in s40-75 – see s40-27(4)(a)(ii)).

Paragraph 2.36 of the EM indicates that premises will be 'new residential premises' as defined for GST purposes if they have not previously been sold or 'leased' as residential premises, or have been subject to a substantial renovation or built to replace existing premises.

However, s40-75(1) of the GST Act precludes premises from being new residential premises only where they have previously been sold or subject to a 'long term lease' (50 years). Any other lease(s) will preclude residential premises from being new residential premises only where, in broad terms, the premises are leased for five or more years (s40-75(2)). Paragraph 2.36 of the EM should be amended accordingly.

Despite the fact that, for GST purposes, a developer may sell premises, say an apartment, as new residential premises within that five year window, an investor who acquires the previously leased apartment from the developer will be precluded from claiming depreciation in respect of any depreciating assets.

We understand that this outcome is intended by the Government notwithstanding that it is not unusual for developers to lease apartments when they are unable to sell them, or to defer selling until market conditions improve. From what we read in the press, a number of developers are currently confronted with this scenario.

(e) Other comments

- The exception for new residential premises in paragraph (a) of s40-27(4) requires that:

  *'when you first *hold the asset:*
  *(i) the asset is used, or *installed ready for use, in the *residential premises; and*
  *(ii) the residential premises are new residential premises (within the meaning of the *GST Act); and'*

  We query whether brand new premises which are sold by a developer as new residential premises to an investor will be new residential premises in the hands of the investor, as it has been 'previously sold'. If not, this subsection will need amending to achieve its intended outcome. We suggest that it may need to say "the residential premises are *acquired by you as* new residential premises".

- We recommend that Treasury confirm with the ATO that, where a new apartment in a building with common areas is sold to an investor, the fact an earlier purchaser of another apartment is residing in the building will not preclude the investor from claiming a deduction for depreciation in respect of the common property. We appreciate that the intention is that the investor be able to claim depreciation but would be concerned if it became an issue at some future date.

- Example 2.3 which shows how the balancing charge and CGT provisions interact when plant to which the proposed amendments apply is sold is welcome. To the extent that the detailed commentary could be simplified that would be welcome.

***

If you wish to discuss our comments please contact Michael Croker on 02 9290 5609 or by email at michael.croker@charteredaccountantsanz.com or Susan Cantamessa on 02 9436 1176 or by email at susan.cantamessa@charteredaccountantsanz.com.

Yours sincerely

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Appendix A

[1071] Denial of residential rental property travel deductions creates uncertainty

Product Title: Income Tax

Publication Date: 21/07/2017

ARTICLE

by Graeme Prowse, Director, Webb Martin Consulting

Treasury recently released draft law (see 2017 WTB 30 [1034]) for the 2 measures announced in the 2017-18 Federal Budget in May this year in relation to denying tax deductions for travel relating to residential rental properties and also in relation to the removal of access to depreciation deductions for pre-existing depreciable assets.

As with many changes to tax law, there is some increased certainty, and there is some increased uncertainty. This article looks at the issues arising from the draft law for the travel expenses denial.

Travel expenses

The denial of deductions for travel expenses applies to individuals, discretionary trusts, smaller unit trusts, and SMSFs only. Companies, large super funds and widely held trusts are specifically excluded from the new rules. Partnerships are not specifically excluded, and so ***the first uncertainty is how the law will apply to a partnership which has one of the excluded entity types as a partner***.

The denial of the deductions applies to residential premises. This phrase is defined in the tax law and links into the same definition used elsewhere in the income tax law and in the GST Act and so there is some certainty here.

Expenses "attributable to travel"

However proposed s 26-31 of the ITAA 1997 denies a deduction "… insofar as it is attributable to travel …" This phrase is not defined and thus ***the second uncertainty arises.*** The draft EM lists several examples; however, these are not in the actual law and so the ATO might (say in a ruling or determination on the subject) come up with a different list and the courts may themselves come up with yet another list. Travel could reasonably be expected to include car expenses when visiting a real estate agent across town or a few suburbs away as easily as it could include an airfare to a different town or city. It may well also include any meals or accommodation costs incurred whilst travelling. So, ***a landlord driving to their rental property to mow the lawns once a fortnight will be non-deductible travel***.

The draft law and EM are silent on whether costs while staying at the rental property (or nearby) will be deductible while not travelling but while undertaking other tasks.

Example: Take the example of a landlord who owns a residential rental property in an area subject to cyclones and has to travel there to undertake urgent repairs in order to mitigate the

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storm damage and put the property back towards being able to be let (a rental property in fire-prone areas would also be a typical example). Just after the cyclone, the likelihood of the landlord finding a tradesperson with the spare time to do the work for them is clearly going to be low, as there will be many home owners similarly affected. So the home owner is faced with the choice of leaving their property to suffer further damage while they wait for a hired tradesperson to have capacity to help or the owner themselves can go there and do what they can. The travel to get there is clearly not deductible; the draft law doesn't really answer the question of whether the costs of the owner being there while they repair the property are deductible. Materials would presumably be deductible (as they clearly aren't travel costs), but what about the meals and accommodation for the owner - they may well be travelling because they are away from home. They are certainly not on holiday!

Not carrying on a rental business

A further uncertainty is that the travel deductions are only non-deductible if the taxpayer is not carrying on a rental business. This may well lead to an increase in private binding ruling applications about how many properties are required, or how much involvement is needed for the activity to be a business, so perhaps Treasury is making sure that the ATO's PBR staff have plenty of work to do!

CGT cost base

The last point to note is that all the non-deductible expenses are specifically not able to be included in the CGT cost base of the relevant rental property, so the new rules completely remove any tax benefit (and there is no mere deferral until the property is sold).

Conclusion

So we now have some idea of how the new travel rules will work; we also can see where the new areas of friction between the ATO and taxpayers will be.

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Appendix B - Extract from GSTR 2012/5

Example 7 – shop

36. Julian leases a building from its owner. It consists of a display area, a storage area, an office, a kitchenette and a toilet. The premises were designed as a shop which is evidenced by the architectural plans held by the lessor. Julian furnishes the premises in order to use it as his residence, but makes no structural changes to it.

37. The building provides shelter and basic living facilities. Although the physical characteristics of the building may be considered similar to characteristics found in a house or apartment, the physical characteristics of the building together with the design plans objectively show that the premises are not residential premises to be used predominantly for residential accommodation. Rather, the characteristics and design plans show that the building is a shop designed to facilitate a retail business.

38. Although Julian's occupation of the shop as a residence means the shop satisfies paragraph (a) of the definition of residential premises in section 195-1, the shop is not residential premises to be used predominantly for residential accommodation. The supply is not an input taxed supply under Division 40 and is a taxable supply under section 9-5.

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