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10 August 2017

Dear Sir / Madam

Re: Submission re Housing Tax Integrity Exposure Draft

We appreciate the opportunity to respond to your request for submissions on the proposed Exposure Draft (ED) legislation addressing the housing tax integrity issues announced in the Federal Budget 2017-18.

We enclose in the attached annexure our short comments on what we consider to be the pertinent issues raised by the form and content of the ED legislation, and hope that these comments prove useful in your consideration of the form of the final legislation.

Should you wish to discuss our submission in greater detail, please do not hesitate to contact either Michael Ward on (02) 9322 7319 or Max Persson on (02) 9322 7538.

Yours sincerely

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Annexure

1. Tax policy issues

At the outset, although we understand the behaviours that the Government is seeking to prevent, we consider that the blanket denial of specific deductions in particular investment scenarios represents poor tax policy. This type of measure does not seek to target the quantum of inappropriate claims which have given rise to the concerns ultimately driving the measures. Rather, these policy responses are a blunt instrument that alter the fundamental taxation principle of being able to deduct expenses incurred against the relevant revenues derived.

We also believe that the measures result in an inequitable tax policy outcome given that travel expenses and capital allowances are still deductible if the investment is in commercial real estate rather than residential real estate.

This specific approach to discrete tax deductions is also likely to set an unwelcome precedent for other deductions that are believed to be the subject of excessive or unreasonable claims. For example future deductions in the firing line are likely to be the House of Representatives inquiry into inappropriate work related expenses, and travel costs claimed as part of self-education courses, which were the subject to discussion in recent years.

2. Proposed unit trust exclusion

Given the intent of the proposed legislation, we welcome the exclusions of corporate tax entities, certain unit trusts and superannuation plans that are not SMSFs.

However we would note that if the unit trust exclusion will require 300 direct unit holders, this will not exclude the vast majority of institutional investors on the basis that real estate investments would nearly always be undertaken through funds and generally through sub-trusts. We would therefore suggest that the rules also carve out residential premises that are indirectly widely held.

In addition in this regard, a 300 unitholder requirement is overly restrictive and misaligned with existing "widely held" tests, for example the managed investment trust 25 or 50 member "widely held" requirement (subsection 275-20(1) and paragraph 275-20(2)(b)) or the "public unit trust" 50 member requirement (section 102P).

As such we would recommend that the following simple drafting changes are adopted in order to effectively exclude widely held trusts:

Exception—kind of entity

(3) Subsection (2) does not apply to you if, at any time during the income year, you are:

(a) a *corporate tax entity; or

(b) a *superannuation plan that is not a *self managed superannuation fund; or

(c) a unit trust that has, directly or indirectly (through one or more interposed entities) at least 50 unit holders and is not a trust that is covered by section 116-35 (about trusts that are not widely held).

3. Commercial residential premises and retirement villages

We would propose that the scope of the measures exclude "commercial residential premises" (such as hotels) and "retirement villages" as those terms are defined in *A New Tax System (Goods and Services Tax) Act 1999*, on the basis that such assets are typically used in the carrying on of a business (as highlighted by the examples in the Explanatory Memorandum identifying hotels, retirement villages, student accommodation and aged care facilities). This could be achieved with minimal drafting changes, for example in subsection 40-27(2):

(2) Reduce your deduction by any part of the asset's decline in value that is attributable to your use of it, or your having it *installed ready for use, for the *purpose of producing assessable income:

(a) from the use of *residential premises (other than *commercial residential premises or a *retirement village) to provide residential accommodation;

A specific exclusion is preferable due to the uncertainties associated with a factually dependent test and justifiable based on the low integrity risks posed by these categories of assets.

Alternative travel integrity measures

We consider that the blanket denial of all travel expenses is unnecessarily harsh in that there will be a significant quantum of genuine travel expenses where the burden will now fall entirely on the investor, with no tax relief at all. Where costs relate solely to the investment property (for example, to visit a property after a serious weather event such a cyclone or flood, or after a bushfire), we believe the cost should be deductible in full.

We believe that a ceiling or cap – be it a flat dollar rate or a percentage of gross rental income – would be a more appropriate integrity measure and would achieve a fairer outcome whilst still targeting the alleged concerns.

Practical application of revised CGT event K7

We understand the denial of tax depreciation claims for second hand items in residential investment properties. However we believe that the resulting situation which now implicitly splits the sale of a residential investment property into two CGT events, being CGT A1 for the property and CGT event K7 for the depreciating assets results in an impractical and complicated process. It is likely that in practice, taxpayers will merely include all of the assets in CGT event A1, which would in any case achieve the right tax outcome.

Given this reality, is there a need to include or cater for an alternative compliance solution where for example, a taxpayer could elect on acquisition to include all acquired depreciating assets as part of the cost base for CGT purposes?