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Ref: AMK

10 August 2017

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

Email: housingtaxdeductions@treasury.gov.au

Dear Sir/Madam,

**EXPOSURE DRAFT LEGISLATION – TREASURY LAWS AMENDMENT (HOUSING TAX INTEGRITY) BILL 2017: LIMITING DEDUCTIONS FOR PLANT AND EQUIPMENT IN RESIDENTIAL PREMISES AND TRAVEL EXPENDITURE FOR RESIDENTIAL RENTAL PROPERTY**

Thank you for the opportunity to provide comments on the Exposure Draft Legislation ("**ED**") and Explanatory Memorandum ("**EM**") concerning the Treasury Laws Amendment (Housing Tax Integrity) Bill 2017, which contains proposed measures to limit deductions for plant and equipment in residential premises and travel expenditure for residential rental property.

We highlight that we have significant reservations on the policy of the provisions contained in the ED. The new legislation is very complex and contains significant ambiguity around a number of aspects.

Furthermore, the ED goes well beyond the scope of the Budget announcement. The Budget stated that the provisions would only be intended to capture second hand items and was intended to address concerns that some plant and equipment items were being depreciated by successive investors in excess of their actual value. However, the draft legislation captures newly acquired items which are not second hand and also captures items that are not subject to a quantity surveyor report (i.e. where their depreciable value is not in excess of their actual value)[1]. Depreciation of these items does not fit into the integrity issue / Budget policy identified by the Government. If the Government was looking to extend the scope of the provisions, we believe that Treasury need to obtain a Government statement that is consistent with that additional scope. However, we do not understand why the Government would be seeking to target the acquisition of such depreciating assets.

[1] This is because the depreciation provisions write down assets even if they are not used for the purpose of generating assessable income.

We have provided our comments on a number of these issues that we have identified with the ED and EM in Appendix A to this letter. We would be happy to discuss these matters further with you in detail.

Please contact me on (03) 8610 5170 at any time if you would like to discuss this further.

Yours sincerely

A M KOKKINOS
Executive Director

## APPENDIX A – SPECIFIC COMMENTS RELATING TO THE ED AND EM

| Issue # | Issue | Comments | Recommendation | Importance |
|---|---|---|---|---|
| 1. | Proposed section 26-31(2)(c) and section 40-27(3)(c): Widely held unit trust | The ED introduces (yet another) definition of a widely held trust that is not commonly used in the legislation. The Managed Investment Trust ("**MIT**") rules contained in Division 275 already provide for a widely held and not-closely held test. We do not understand why the MIT definition would not be used. Furthermore, the Government has also made an announcement that allows MITs concessions for investing in affordable housing. It would therefore be counter-intuitive to apply this to MITs. Furthermore, the definition of residential premises is so broad, that it is likely to inadvertently apply to common MIT arrangements, such as hotels. We do not believe that this is the intended target area of the provisions. | We recommend that section 26-31(2)(c) and section 40-27(3)(c) be amended to provide an exclusion for an MIT rather than a widely held trust as proposed. | High |
| 2. | Proposed section 26-31(1): "attributable to travel" | It is unclear what is intended by the words "insofar as it is attributable to travel". We believe that it was the intention of government to deny deductions for investors in residential property from travelling to inspect the property themselves and effectively claiming a deduction that is largely for private purposes. The scope of "attributable to travel" would suggest that travel undertaken by third party would not be deductible. Further, section 1.23 of the EM states that "regardless of who undertakes the travel, these amendments deny deductions for travel expenditure incurred by the taxpayer."<br><br>The Budget announcement clearly stated that "this measure will not prevent investors from engaging third parties such as real estate agents for property management services". | "Attributable to travel" should be clearly defined under section 26-31 to ensure that the legislation complements Government's policy intention. Costs associated with travel undertaken by an unrelated third party should remain deductible to be consistent with the Budget announcement. This should also be articulated in the ED and EM. | High |

| Issue # | Issue | Comments | Recommendation | Importance |
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| 3. | Proposed section 26-31(1): enforceability of expenditure "attributable to travel" | In considering our comments in Issue 2, we would query how a taxpayer would know the proportion of property management costs that were attributable to travel.<br><br>Unless the third party expenditure is itemised, this would be near impossible for the taxpayer to correctly apportion the expenditure as they would not have access to such information. | Expenditure undertaken by third parties that is attributable to travel should remain deductible. Denying deductions related to travel should be limited to expenditure incurred directly by the taxpayer and their related entities. | High |
| 4. | Proposed section 40-27: "second-hand assets" | The header of the section 40-27 states that the application of the provision is to be a "further reduction for second-hand assets in residential property". We read the ordinary meaning of "second-hand assets" to be assets that have previously had a different owner. We highlight that under subsection 960-50(1), headings form part of the Act.<br><br>Section 40-27(2)(d) states that the provision also applies to assets that have been previously held by the entity "wholly for purposes that were not taxable purposes". Consequently, we believe that the provision has a broader application than "second-hand" assets which we believe is not consistent with the original policy intent. | If the intention of the provisions is to apply more broadly than second hand assets, the heading is misleading. The subheading of the provision should be altered to "previously held assets" to reflect the true scope of the provision.<br><br>However, the Budget announcement stated that the provision would be limited to items "purchased by a previous owner" of the property. We question whether section 40-27(2)(d) is consistent with this scope announced in the Budget. We highlight that an asset that has been previously used by the same owner (and is not subject to a quantity surveyor report) is not an asset that gives rise to the issues raised in the Budget and is not one within the scope of the original Budget announcement. | High |

| Issue # | Issue | Comments | Recommendation | Importance |
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| 5. | Proposed section 40-27(1): "depreciating assets" | Section 40-27(1) states that a taxpayer may have to further reduce their deduction for a "depreciating asset". The term "plant and equipment" is used in the title of the provision and in the title of Schedule 2.<br><br>We also note that section 2.1 of the EM states that the provision applies to "depreciating assets (plant and equipment)". Section 2.8 of the EM states that "depreciating assets include most items of plant and equipment".<br><br>We believe that there is an inconsistency in terms used in the ED and EM. We recognise that in the ATO's guide for rental property owners the terms "plant and equipment" and "depreciating assets" are used interchangeably. However, we believe that the terms have different technical meanings. We stress that the legislation should not use ambiguous undefined terms and should (in all instances) use the correct terms. | The term "plant and equipment" should be altered to "depreciating assets" to accurately reflect the intended scope of the provision and to align with the defined provisions. | Technical |
| 6. | Proposed section 40-27(2)(b): "not in the course of carrying on a business" | The application of the provision is limited to taxpayers not carrying on a business. Section 2.46 and 2.47 of the EM explains that whether a business is carried on is a question of facts and circumstances.<br><br>Significant uncertainty will occur as to whether a taxpayer is carrying on a business if they are holding multiple rental properties. | We strongly recommend that greater guidance should be provided in the EM to explain whether a business may be carried on in the context of holding residential properties. If greater guidance cannot be provided in the EM, it is critical that the ATO release a contemporaneous LCG or PCG to provide guidance on this issue. This would help to avoid a similar situation now faced by corporate groups who are uncertain in trying to determine whether they are "carrying on a business" for the lower tax rate of 27.5%. | Medium |

| Issue # | Issue | Comments | Recommendation | Importance |
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| 7. | Proposed section 40-27(2)(c): "you did not hold the assets when it was first used" | Section 40-27(2)(c) effectively denies a deduction for depreciation for assets purchased second-hand, however, if the asset is purchased brand new, the taxpayer will be able to claim a deduction for depreciation.<br><br>We believe that this creates an incentive for taxpayers to purchase more expensive, brand new, assets which will give rise to an ability to claim the deduction for depreciation. The after tax cost of buying a new asset may outweigh the savings in buying a second hand asset. We query whether the intention was really to stop a second hand asset from being purchased from a third party (or alternatively to stop depreciation being claimed when buying a house together with second hand assets).<br><br>For example, a taxpayer who is in the market for a new fridge could purchase a brand new fridge for (say) $1,000 or the same fridge (second hand) for $800. If the taxpayer purchases a second-hand fridge for $800 they will not be able to claim a deduction for depreciation under the proposed provision as the taxpayer did not hold the asset when it was first used. However, if the taxpayer purchases the new fridge for $1,000 then they would be able to claim a deduction for depreciation over the life of the fridge. In essence, the after-tax benefit of purchasing the new fridge would outweigh the saving of buying a second hand fridge. We query if this was the intention of the provisions. | The proposed provision should not reduce amounts that can be depreciated for second hand depreciating assets purchased by the taxpayer which are not associated with the purchase of the property (i.e. from an un-associated purchaser not related to the contract of purchase of the home). | High |

| Issue # | Issue | Comments | Recommendation | Importance |
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| 8. | Proposed section 40-27(4)(b): no entity has resided in the premises | Section 40-27(4)(b) states that the provision applies where no entity was residing in the premises at all earlier times. We believe that this applies even if the taxpayer themselves resided in the premises for a short period of time before using the premises to generate rental income. We believe that this is broader than the policy intent.<br><br>Section 40-25(2) already requires deductible amounts to be reduced by an amount attributable to uses that are not for a taxable purpose. Accordingly, there is no mischief in respect of depreciable assets that have only been bought and used by the current owner of the property. | Section 40-27(4) should not apply where it is the taxpayer themselves residing in the premises.<br><br>As such, we recommend that the wording of section 40-27(4)(b) be amended to "no other entity" to ensure the section does not apply if it is the taxpayer themselves residing in the premises, where they have acquired the depreciating asset themselves. | High |
| 9. | Proposed section 40-291: Reduction | We are unclear why section 40-291 is required and why the word could not be performed by section 40-290 (i.e. by including the reference to section 40-27 after all references to section 40-25). We believe that this is an unnecessary complication to the provisions. | We recommend considering removing section 40-291 and replacing this with amendments to section 40-290. | Technical |

| Issue # | Issue | Comments | Recommendation | Importance |
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| 10. | ED - Item 12: Application of amendments | Subsection 2 of Item 12 applies the section 40-27 to assets that have been held and depreciated but the asset was not depreciated in the 2017 financial year.<br><br>For example, if a residential premises that was purchased 5 years ago with depreciation claimed in respect of depreciating assets for 4 of those years, but not in the 2017 financial year as the taxpayer had moved back in to the premises. When the taxpayer subsequently moves out of the property and begins to generate rental income, they will not be able to claim a deduction for depreciation under the new provision. This is not consistent with the Budget announcement which clearly stated that the measure was aimed at addressing "concerns that some plant and equipment items are being depreciated by successive investors in excess of their actual value." | The transitional arrangements under Item 12 should be limited to only depreciating assets installed in residential premises, where the residential premises were acquired after 7.30pm on 9 May 2017. The policy should not have application to assets previously acquired in residential properties prior to 7.30pm on 9 May 2017. | High |