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Draft Treasury Laws Amendment Bill 2017: Official submission from the Property Investment Professionals of Australia (PIPA) – 10th August 2017

This submission has been prepared by The Property Investment Professionals of Australia (PIPA) – the peak, not for profit association for property investment professionals. PIPA represents thousands of Australians who work in the property industry.

The purpose of this submission is to provide an official response to the Draft Treasury Laws Amendment (Housing Tax Integrity) Bill 2017.

This Government's Draft Bill outlines proposed legislation in relation to changes to Depreciation and travel deductions. For the record some industry consultation would have been welcomed prior to the 'surprise' budget announcement. We can't change the past, but given this submission PIPA does have an opportunity to present our subject matter expertise to help find a suitable and workable compromise.

In reference to Depreciation changes:

Why is it that private investors seeking to add to the rental accommodation options for Australians singled out in a 'market' economy? Plant and equipment depreciation is a fundamental element of our tax system and will remain in all other sectors except in residential property.

These proposed changes go too far in trying to address so called 'integrity issues' in the current system. These changes will result in residential property investors (mum and dads made up of services workers like police, nurses, teachers i.e. everyday folks) trying to add to their retirement nest eggs being treated differently to all other investors in all other asset classes by proposing that the transaction of a property between two parties extinguishes the ability to claim a deduction for depreciation on plant and equipment assets within the property. Yet it's one hundred percent clear these properties will experience wear and tear and deterioration by the use of the tenant.

Under the proposed changes, any investor who purchases a business premise, office or retail outlet such as a café or shop, will have different and adequate means to claim depreciation benefits applicable, compared to a mum and dad investor who purchase a residential property.

Suppose it's a mixed use building with both residential and commercial space – one party gets fair benefit of depreciating their asset over its working life and the other is penalised and discriminated against for buying a rental property within the complex.

As highlighted by one of our members – BMT Tax Depreciation, in the 2015-2016 financial year they prepared 63,285 residential depreciation schedules. Of those the vast majority purchased second hand buildings. The average depreciation deduction

claimed for plant and equipment assets on a typical three year old residential property, purchased for $600,000, is $21,178 for the first five years. The proposed changes would result in an average loss of $4,236 (deduction) per year in this scenario. Based on a marginal tax rate of 37 percent, an increase of $47 per week in rental income would be required to counter balance this reduction. A cost landlords must seriously consider recovering through higher rents if this Bill was to pass.

Concern with 'previously used' terminology:
Assets acquired before the 9th of May 2017 will still be affected by the proposed changes as the draft legislation is written. This is not a true grandfathered approach.

Paragraph 2.28 of the draft Treasury Laws Amendment Bill outlines the following –
An entity will have 'previously used' an asset if either:

- The entity is not the first entity that used the asset or installed the asset ready for use (within the meaning of Division 40) other than as trading stock; or
- The entity had used the asset wholly for purposes that were not taxable purposes (within the meaning of Division 40) for an income year.

A regular result of households or individuals climbing up the property ladder is to buy their next property, but retain their existing property and renting it out. The second point targets (presumably unintentionally) those who acquired a property for the purpose of living in the property for a period of time and then renting the property out later.

Yet paragraph 2.72 of the Draft legislation (referring to assets that were previously used prior to the announcement for non-taxable purposes) is to avoid creating unintended incentives for individuals to move personal assets into rental properties.

Our members don't see any evidence of asset movement occurring. Assets depreciate from the date of ownership whether they are used for taxable purposes or not. The difference is whether the owner is eligible to claim the decline in value as a deduction. Depreciation starts from the date ownership commences, there is no opportunity for an individual to claim in excess of the value of the asset simply because it was not previously used for taxable purposes.

Based on feedback from our members, this section gives rise to the legislation going beyond its intended purpose. Assets acquired before the 9th of May 2017 should be allowed to continue to deduct an amount for the decline in value when they are located within an income producing property. The written down value can be easily calculated from when the asset was acquired.

The way in which the draft legislation is written it will create confusion around when assets within a variety of scenarios qualify for the amendment. Some buy new and second hand properties, live in them and then rent the property out. Some move in and out of a rental property over time. Others are first home buyers forced to rent out their property due to changing circumstances often out of their control.

A real nightmare to inforce and administer, if the legislation remains as drafted.

PIPA's alternative Depreciation Recommendation:

In consulting with our members who are specialists in this area, PIPA is putting forward the following recommendations which still address any integrity issues, but also bring workable and common sense outcomes to any changes to the existing legislation.

These alternative options will address the Government's integrity wishes without removing a legitimate deduction available to property investors.

At present there is no set costing methodology preventing an updated value being allocated to an asset each time it is sold/purchased.

PIPA believe that this can be <u>easily solved by establishing a single historical value (costs) method for depreciable plant and equipment assets that is carried forward and written down as it is claimed by the first and subsequent owners.</u>

Put simply, when an asset is sold the written down value will become the opening value and maximum amount claimable by the subsequent owner, until there is no remaining un-deducted value left to claim. This will allocate each plant and equipment asset one value over an effective life regardless of how many owners the asset has had.

Simpler Alternative Option 1 - Establishing a historical total installed cost
A historical total installed cost can be established, this can be either the actual installed cost or the estimated historical cost of the asset at the time the asset was originally purchased and installed. This value can be easily established and runs in line with current legislated methodology used to establish a value for the structural element of a building when calculating a capital works deduction (division 43).

A rate of depreciation can be calculated using current prime cost methodology, with the annual depreciation amount calculated for the original and subsequent owners. The un-deducted or written down value can then be claimed over the remaining effective life of the asset which is set using effective lives currently outlined by the Commissioner in Tax Ruling 2017/1 (TR 2017/1).

Simpler Alternative Option 2 - Total install cost provided with every contract of sale.
Legislation could define a method for passing on an un-deducted value to subsequent owners within the contract of sale. A vendor will be required to provide an un-deducted or written down value in every contract of sale regardless of the previous or future use of the building and its assets.

One option could be that in order for a subsequent owner to be eligible to claim depreciation deductions there must be an un-deducted or written down value provided in the contract of sale.

An asset will carry a single value with it from its first use through to the point where the total depreciable value has been claimed. If the asset is older than its effective life it would be allocated a zero value in the contract of sale and there would be no deduction available for subsequent owners. The same depreciation method and asset valuation methodology can be adopted as outlined in Option 1.

Our member experts in this area are also putting forward the need for some adjustments to the general depreciation legislation should be considered, these are as follows:

• Low value pooling and immediate write-off legislation for residential property investors may need to be reviewed. For an individual property investor, an asset can be claimed at an accelerated depreciation rate of 18.75% in the year of acquisition and 37.5% each year after for assets that qualify for a low value pool. These assets are qualified for the pool by costing or being valued at less than $1,000. Investors can choose not to use a low value pool. When an asset is allocated to the low value pool its identity is removed and an accelerated rate of depreciation is used. An investor can also utilise immediate write-off legislation, claiming 100% of an assets value in the first year of ownership for assets that are valued at less than $300.

Importantly whenever there is an alternative mechanisms which allow one owner to accelerate the rate of depreciation or completely write-off an asset, it will be difficult to administer a method which ensures the value used is in fact the true un-deducted written down value. This is because the history of claims can be difficult to substantiate on a case by case basis.

• Currently, a property investor can choose either a diminishing value method which accelerates the rate of depreciation and maximises the claim in the first five years or a flat line prime cost method which simply allows for the same yearly claim based upon the rate of depreciation. The prime cost method spreads out the deductions evenly over an assets effective life. Allowing a prime cost method only when establishing a rate of depreciation will avoid confusion by subsequent owners when an assets un-deducted written down value needs to be determined.

• A list of appropriately qualified individuals should be established to estimate an un-deducted value for plant and equipment if the actual cost is unavailable. An example of this could be the current scenario as per paragraph 28 of Tax Ruling 97/25 http://law.ato.gov.au/atolaw/view.htm?docid=TXR/TR9725/NAT/ATO/0000 which is used to identify appropriately qualified people who may be able to estimate construction costs should actual costs be unavailable.

In reference to Travel Expense changes:

Whilst PIPA acknowledges that something did need to be done to ensure the current arrangements didn't further expose the government to potential excessive claims for travel deductions, a blanket ban altogether is an extreme measure which puts borderless investors facing increased costs to operate their investment properties.

Furthermore why is it that only residential investors are the ones singled out by this proposed legislative change? If someone owns a business asset interstate, no problem, travel costs to inspect it - fully tax deductable. Investment Property – sorry NO!

Investing in residential property comes at significant cost – hundreds of thousands, in not millions of dollars are invested by individuals and households into these assets. Property investors are only being prudent in protecting their investments by seeking to travel to inspect their property periodically. Name a business anywhere in the world that the owners wouldn't regularly inspect their plant and equipment wherever it's located. It's risk mitigation and minimisation in its basic form and not being able to claim the costs of this travel will once again see mum and dad investors needing to decide if and how much of this cost they will choose to pass onto their tenants.

PIPA's alternative travel expense recommendation:

PIPA believes in the interest of fairness, that investors who hold residential property should be able to claim an amount to recover the direct travel cost involved to inspect their property/ies. Yet to stop any potential of rorting the system, PIPA proposes a maximum dollar cap for travel each year along the following:

- Investors owning property within their own state of Residence – Max. $250 travel costs per property per year

- Investors owning property outside their own state of Residence – Max. $500 travel costs per property per year

Such a fixed cap like this will ensure no excessive travel costs expenses, such as investors claiming 5 days of travel costs to inspect one property.

In summation, PIPA is all about a sustainable residential property investment industry, whereby mum and dad investors have the option to invest fairly in an asset class that provides thousands of jobs and suitable accommodation for the 30% of properties currently being rented.

Our recommendations are fair, sensible and easily administered and as such should be given appropriate consideration. If you would like to discuss our recommendations further you can contact our Chairman – Mr Ben Kingsley on 0403 795 252.

Attachment A

About the Property Investment Professional of Australia:

Property Investment Professionals of Australia (PIPA) is a not-for-profit association established by industry practitioners with the objective of representing and raising the professional standards of all operators involved within property investment.

Since its inception, PIPA has developed codes of ethics and conduct and professional standards of accreditation and education for the property investment industry, including a Property Investment Adviser Accreditation Course.

PIPA is actively lobbying the federal government to bring property investment advice into a regulatory framework. Until such regulation is introduced, PIPA will continue to provide the public with warnings about working with ethical and professional industry practitioners.
For more information visit www.pipa.asn.au