THE TAX INSTITUTE

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Manager
Individuals Tax Unit
Individuals and Indirect Tax Division
The Treasury

By email: housingtaxdeductions@treasury.gov.au

Dear Manager

Housing tax integrity – disallowing travel deductions and limiting depreciation deductions

The Tax Institute refers to the Treasury Laws Amendment (Housing Tax Integrity) Bill 2017 (**Bill**) and the exposure draft explanatory material in relation to the Bill (**Explanatory Memorandum**).

Broadly, the Bill and Explanatory Memorandum introduce amendments to deny deductions for travel expenses relating to residential investment properties and limit depreciation deductions for plant and equipment used in relation to residential investment properties.

Policy issues

In our opinion, the measures in the Bill conflict with one of the basic principles of our tax system. That is, that a taxpayer is entitled to a deduction for expenses incurred in gaining or producing assessable income (refer s8-1 of the *Income Tax Assessment Act 1997*). This is a fundamental principle of the Australian tax system.

The measures in the Bill are being used to address a compliance concern. That is, a concern that some taxpayers are incorrectly claiming deductions for certain travel expenses and depreciation deductions for plant and equipment.

Our view is that taxpayers should be entitled to deductions for travel expenses and the depreciation of plant and equipment provided their claims are within the current law. We obviously do not support any abuse of the system. However, we think this is a compliance issue for the ATO and should not simply be legislated away. Rather than arbitrarily introducing new legislation to deal with what is essentially a compliance issue, compliance measures should be reassessed or changed and additional resources provided to the ATO if considered necessary.

In this regard, during a meeting on 8 August 2017, Treasury made the point that the costs associated with ensuring compliance with the existing laws outweigh the benefit of potential revenue gains with stopping non-compliance. Even if this is the case, this does not justify denying all deductions.

If the Government considers that the abuse is so rampant that these measures are the only option, it should provide empirical evidence. In our opinion, the revenue the Government expects to gain from these measures is not the relevant number. The relevant number is the amount of illegitimate claims that these measures will stop.

If the Government wants support in relation to this measure from the tax profession, it is going to need to prove to the public that the cost to the revenue of the illegitimate claims far outweighs the legitimate claims. Otherwise, the Government's policy basis for this measure simply cannot be supported.

The proposed measures will add additional complexity to the tax system and increase compliance costs. Taxpayers will have to assess whether these provisions apply to them. Often, taxpayers will turn to tax agents to do this analysis and thereby increase compliance costs.

The measures will not advance the equitable treatment of taxpayers. Taxpayers who are investors in residential properties will be treated less favourably than other taxpayers with other investments. Additionally, companies are treated differently to individuals and trusts, further damaging horizontal equity in the tax system.

These measures will penalise taxpayers who are doing the right thing to capture those that are not. The focus should be on identifying those taxpayers who are not complying with the law and deal with them appropriately rather than introducing these measures which have the potential to penalise all taxpayers with investment properties.

The measure is likely to stop self-management of investment properties, as the fees paid to managers to perform management tasks in relation to residential properties would be deductible. However, if the same task is performed by the taxpayer, the expenses incurred would not be deductible. Arguably, this will increase the costs for landlords who will then raise rents and/or decrease the supply of rental properties. Accordingly, in our opinion, these measures are in conflict with the Government's policy to improve housing affordability as they may have the opposite effect.

Technical issues

Plant and Equipment - section 40-27

In our opinion, proposed section 40-27(2)(d), should be reconsidered. It has the potential to produce results that are arbitrary.

The provision denies deductions where "in an earlier income year, you used the asset, or had it installed ready for use, wholly for purposes that were not *taxable purposes."

Our issue with this provision is best illustrated by using a simple example. Assume a taxpayer buys and renovates a residential property in March and installs ready for use new plant and equipment (but does not use the plant and equipment). In July, once the property is renovated, the taxpayer starts to look for tenants. Under the proposed amendments, as the plant and equipment was installed and ready for use in a different income tax year to the year in which the property is used to derive assessable income, the taxpayer will not be entitled to depreciation deductions.

Such a result is arbitrary and has no policy basis. Taxpayers will have to carefully manage when they carry out renovations to avoid an arbitrary tax result. This seems very artificial. In our opinion, section 40-27(2) needs to be redrafted so that the provision does not deny deductions simply because an asset was installed ready for use in a previous income year if it was in fact not used.

Plant and Equipment - Developers

Developers who temporarily rent out their over-supply of stock (being residential premises) will prevent future purchasers from being able to subsequently claim deductions.

Consideration should be given to providing an exemption for temporary (say 6 month) periods of use of plant and equipment when the property is subsequently sold by a developer.

Plant and equipment – mixed use premises

We support Treasury's approach to allow apportionment where a property is used for mixed purposes. That is, where the property is only partly used for residential purposes, deductions may still be allowed on a proportional basis. This will affect premises that are partly used for residential purposes and partly used for other purposes (eg a doctor who lives above his surgery, a newsagent who lives above the agency etc).

Travel deductions – cost base

We do not understand the rationale for denying the inclusion of travel expenses in the cost base of the asset (ie the residential premises). Legitimate expenses should be included in the cost base of an asset. Travel expenses will now effectively fall into black hole expenditure (ie these expenses will be totally unrecognised for tax purposes).

Other approaches

In our opinion, we do not need arbitrary legislation to deal with what is essentially a compliance issue. However, if measures must be taken – why not consider and consult on other approaches.

For example, for plant and equipment other approaches such as the following might be considered:

- Requiring an independent valuation of plant and equipment if claiming depreciation for plant and equipment. A quantity surveyor could be used to provide an independent valuation. Proper regulation of the quantity surveyors to manage those who are thought to be providing unsubstantiated and inflated assessments of plant and equipment would be required. The powers to do this are already available to the Tax Practitioners' Board.
- Requiring an independent valuation when the value of the deductions are greater than a certain amount (eg $1000 p/a per property).
- Requiring vendors to give a statement of the written down value of the plant and equipment when selling a property. Purchasers may only depreciate based on that value. If no statement is provided, then depreciation deductions for plant and equipment are not allowed.

For travel deductions, other approaches such as the following might be considered:

- Limit deductions based on the amount of visits per year or place a dollar cap on the deductions for travel.
- Cap accommodation deductions when travelling to inspect rental properties.
- Deny deductions for interstate travel only.
- Consider a carve out for regional Australia – ie no restrictions on deductions for travel to regional Australia to inspect rental properties.

We are firmly of the opinion that this compliance issue needs to be dealt with using compliance measures rather than introducing yet another ad hoc piece of legislation into our already over complex tax system.

If you would like to discuss, please contact either me or Tax Counsel, Angie Ananda, on 02 8223 0011.

Yours sincerely

Matthew Pawson
President