THE TAX INSTITUTE

22 August 2019

Senate Economics Legislation Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Email: economics.sen@aph.gov.au

Dear Mr Fitt,

SELC: Treasury Laws Amendment (2019 Tax Integrity and Other Measures No. 1) Bill 2019

The Tax Institute has prepared the following submission to the Senate Economics Legislation Committee in relation the inquiry into *Treasury Laws Amendment (2019 Tax Integrity and Other Measures No. 1) Bill 2019* (**Bill**).

The Bill has several schedules. Our submission covers:

- Schedule 1 – no comments.
- Schedule 2 – no comments.
- Schedule 3 - will deny deductions for some taxpayers for expenses associated with holding vacant land.
- Schedule 4 - will extend to family trusts a specific anti-avoidance rule that applies to other closely held trusts that engage in circular trust distributions.
- Schedule 5 - amends the *Taxation Administration Act 1953* to allow the ATO to disclose to credit reporting bureaus the tax debt information of businesses that have owed the ATO at least $100,000 for more than 90 days and have not effectively engaged with the ATO to manage their debt.
- Schedule 6 – no comments.
- Schedule 7 – No comments.

GPO box 1694
Sydney NSW 2001
Tel: 02 8223 0000
Fax: 02 8223 0077
info@taxinstitute.com.au
taxinstitute.com.au
ABN 45 008 392 372

Schedule 3 – Vacant Land

We refer to our submission prepared in relation to this issue (refer Annexure A).

We do not consider that the legislation in its current form adequately deals with the issues raised in our previous submission.

In particular, the inappropriate consequences outlined in our previous submission need to be addressed. To address these inappropriate consequences, we suggest that:

- The provisions only be activated if the income from the property is less than the losses or outgoings to be deducted;
- The paragraph immediately following proposed section 26-102(1)(b) be revised to remove the complexity; and
- The definition of land needs to be reconsidered in the context of outgoings relating to one part of the land which contains no structure (e.g. rates on an adjoining block which contains no structure), which is used in conjunction with the structure on the other block).

Schedule 4 – Circular trust distributions

The Institute has concerns about the uncertainty and potential for unintended outcomes in relation to the circular trust distribution provisions.

Inherent issues

- There are difficulties in determining which trustee the measure will apply to. For example, if A and B both distribute to each other and it is not possible from the resolutions to determine which distribution occurred first (for example, both resolutions are dated 30 June) it is unclear where the circular distribution starts.

Unclear interactions

- The interaction with family trust distribution tax is unclear. Given the proposed measures apply to family trusts and trusts with interposed entity elections, there is potential for circular distributions involving an entity in a family group and an entity outside that family group to result in both taxes applying to the distribution. At a minimum, this overlap should be avoided by making it clear that only one of the taxes should apply to any component of a distribution.

Unnecessary breadth / unintended outcomes

- The provisions, as drafted, potentially apply to 'circular' distributions made several years after the first distribution in the 'circle'. However, such distributions will have been subject to taxation and, as such, should not as a matter of policy be captured by the provisions.
- For example, if in year 1 Trust A distributes to Trust B (both being family trusts with the same test individual) and Trust B then distributes to Company C, the provisions should not be activated, and Company C will pay tax on the distribution. However, if Company C in a future year pays a dividend which directly or indirectly is included in Trust A's income, it would appear arguable on the current drafting that the provisions apply.
- As a further example, present entitlement to after-tax capital could be circular and result in double tax due to section 102UJ of the *Income Tax Assessment Act 1936*. If Trust A distributes to Trust B in year 1 where Trust B accumulates the income and pays tax under section 99A and then Trust B makes a capital distribution of the after-tax amount to Trust A in a later year, this may be seen as circular under the test in section 102UM.
- This problem can be solved by making it clear that the legislation only applies if initiating trust includes in its income some part of a distribution that it has made in the same income year.

Schedule 5 – Tax debt disclosure

The Tax Institute is strongly opposed to the tax debt disclosure provisions as they are currently drafted. In our opinion, the current proposal does not provide adequate checks and balances. Given the potential detriment that can be caused as a result of the application of the provisions, more checks and balances are required.

Further, the provisions need to provide clear and adequate remedies and compensation if a mistake is made and an incorrect report made to a credit bureau.

We note the following issues:

- Given the potential detriment of being reported to a credit bureau there needs to be more checks and balances.
- The approach taken in New Zealand should be considered. In New Zealand all the thresholds are higher than those proposed in Australia. For example, debts need to be outstanding for 12 months and notice periods are longer. We question why the proposed Australian thresholds are all much lower than New Zealand.
- Under the provisions the ATO can report debts unless the taxpayer is disputing the debt under Part IVC. The proposed provisions do not provide for the fact that some debts cannot be disputed via Part IVC. For example, the proposed provisions would permit reporting where the disputed amount relates to PAYG(W), estimates of PAYG(W), estimates of GST and director penalty notices. These examples cannot be disputed through Part IVC. The provisions should prevent the reporting of a debt unless the taxpayer has had adequate opportunity to dispute the debt and has failed to do so (or the dispute action has failed).

- We note that the proposed notice period of 21 days under proposed section 355-72(1)(e)(ii) is unlikely to be sufficient in circumstances where it is intended that notification may be made by way of ordinary post – given that Australia Post can now take 7 to 10 days to deliver mail.

If you would like to discuss, please contact either me or Tax Counsel, Angie Ananda, on 02 8223 0050.

* * * * *

Yours faithfully,

Tim Neilson
President

Annexure A

TTI Submission – Vacant Land

tax-institute-submission---vacant-land.pdf

THE TAX INSTITUTE

2 November 2018

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

By email: vacantland@treasury.gov.au

Dear Sir/Madam:

Enhancing the integrity of tax deductions in relation to vacant land

The Tax Institute welcomes the opportunity to make a submission in relation to the exposure draft legislation and explanatory material for the amendments announced in the 2018-19 Budget to improve the integrity of the tax system by denying certain deductions for expenses associated with holding vacant land.

From 1 July 2019, the proposed legislation will limit deductions for expenses associated with holding vacant land. The measure does not apply to expenses associated with holding vacant land that is used by the owner or a related entity to carry on a business.

Summary

Members are concerned that the Government has significantly underestimated the scale and scope of arrangements that are going to be affected under the proposed legislation. Further, in our opinion, the proposed legislation creates significant uncertainties.

As the law is currently drafted, if land is not genuinely held for the purpose of generating assessable income, the costs are not deductible. In our opinion, the integrity issues should be addressed through better enforcement rather than making the tax system more complex by introducing further legislation.

Technical Comments

We have outlined issues below to illustrate our concerns in relation to the scope and uncertainty under the proposed legislation.

1. Under the proposed legislation there will be significant uncertainty in relation to the apportionment of costs where there is vacant land adjoining a pre-existing

Level 10, 175 Pitt Street
Sydney NSW 2000
Tel: 02 8223 0000
Fax: 02 8223 0077
info@taxinstitute.com.au
taxinstitute.com.au
ABN 45 008 392 37

structure. In this regard, there will be issues in relation to whether the land is in fact "vacant" and how the apportionment is done.

2. Proposed section 26-105(1)(b) reads as if there is **no** need to apportion any part of outgoings provided there is a substantive permanent building/structure on the land (i.e. it is not "vacant"). That is, apportionment is only required if there is **no** substantive permanent building/structure on the land.

    a. The explanatory memorandum in paragraph 1.5 suggests that "vacant" can apply to part of the land (on a single property title) which is not evident from the wording of the law (presumably inferred from the word "substantial").

    b. To reduce ambiguity a sub-section or a note should be added in the law which clearly states that part of the land which is "unoccupied and unused" is considered "vacant". That way, the section should be read as:

        - First look at the area without a substantive structure which is "unoccupied and unused" *in relation* to the structure; and
        - Then apportion the remaining area to the extent it is not "used" in a business of you or your connected entity/affiliate/spouse/adult child.

3. Where the proposed legislation denies deductions, deductions for outgoings are eliminated completely. However, it appears any income derived will still be assessable for arrangements that fall within the provisions. This is not consistent with the basic principles of our taxation system in relation to the assessment of income and deduction of expenses.

4. There are many genuine commercial reasons land may not have a substantive permanent building or structure (eg holding yards for goods that are awaiting transport or customs clearance, parking areas for trucks/buses for a logistics company) as not all business operations/activities require structures and buildings. If the owner of land used for these purposes is a private trust or individual who does not have the requisite connection to the business being carried on (especially where there is a genuine commercial lease to an unrelated third party), all deductions will be denied notwithstanding the "vacant land" is an essential part of the business activities.

5. It is uncertain how the provisions will apply to adjoining parcels of land on separate titles that are effectively one parcel of land, but not all titles have a substantive permanent building or structure on them.

6. The requirement that the business be carried on by an entity connected to, affiliate of, spouse or child of the land owner is very restrictive. Further, it could potentially create family succession issues, especially where a primary production business is involved. In a deceased estate situation, it is not unusual for property to be left to multiple children, but only one operates the business. In this situation, the

requisite connection between the land owner and the business operator for deductibility of expenses may not exist.

7. The terms “substantive” and “permanent” are very subjective. To avoid uncertainty and potential disputes with the ATO, Treasury should consult on definitions for “substantive permanent building” and “substantive permanent structure” to be included in the proposed law.

8. A common scenario is for land to be held by an entity controlled by the spouse of the controller of a business entity. It would appear from Section 26-105 of the proposed legislation that in these situations, unless there is an affiliate relationship, if the land does not meet the substantive permanent building or structure test, deductions relating to the land will be denied as the business use exclusion from the provisions does not apply to entities controlled by a spouse. This is not an appropriate outcome.

9. It appears that in circumstances where an income producing residential building (or commercial building where the land does not meet the business use exception) is destroyed, no deductibility would be allowed for expenses incurred in holding the land for the duration of reconstruction, even though any insurance proceeds to cover loss of rent are likely to be assessable. Again, this is not an appropriate outcome.

10. The proposed legislation indicates that the deductions will be claimable once there are residential premises that are lawfully able to be lived in on the property. However, it is unclear what the impact of the provisions may be on potential issues affecting a residential premise that might affect a pre-existing rental property, caused by fire, floods, or other natural disasters. To the extent a property is unable to be lawfully lived in and/or is not available for lease due to damage caused to it, it is unclear whether these costs are claimable while repair or rebuild costs are incurred in order to bring the building back to a state where it can be lawfully occupied and available for lease.

Examples in practice

Some of our members have provided us with examples that they have seen in practice where the application of the proposed legislation would appear to result in inappropriate outcomes.

1. Five siblings inherit farming land from their parents, and the land is leased at market value to one sibling to operate the business. The expenses of holding the land would not be deductible to four of the siblings as the operator of the business would not meet the requirements of proposed s 26-105(2) (ie not connected or an affiliate, nor a spouse or child of the business operator).

2. A relocatable warehouse that has been located on a piece of land for over thirty years, where the warehouse is owned by an individual and leased at market value

(and returns a positive net income) to a company (that carries on a distribution business) controlled by the spouse of the land owner. The spouse is not an affiliate of or connected with the business entity and it is uncertain whether the warehouse would be considered a substantive 'permanent' building. In such a case, the land owner would not be entitled to deductions for holding costs.

3. Surplus parcels of commercial land held by a private unit trust. There are no buildings or structures on the land and it is adjacent to a logistics company warehouse held by a private unit trust. The logistics company (which is unrelated to the land holder) leases the vacant land at market value as a holding site for trucks that are not on the road. It does not seem appropriate to deny deductions in these circumstances.

4. Caravan park/mobile home village/camping grounds where land is leased to the operator by an entity that falls within the provisions of proposed s 26-105, but the operator of the business does not come under proposed s 26-105(2). It is unclear if the only permanent structure on the land is an amenities block and camp kitchen would that be a substantive permanent building. As mentioned, above the question of what will constitute a substantive permanent building creates uncertainty. For example, if there is a reception area and small shop (and possibly a manager's residence) on the land would that be a substantive permanent building or structure?

5. The proposed provisions allow the deductions to the extent the land owner is carrying on a business in relation to the land themselves. This represents significant issues for farm landowners where the land may be used:

    - For agistment purposes only;
    - For share farming;
    - For leasing to third parties.

    In each of these cases, the landowner may not be carrying on a business in their own right. Accordingly, they are likely to be regarded as being in receipt of rental income, rather than business income. Based on the proposed legislation, the deductions for the holding cost of the land would be denied, even though the income received is likely to exceed the costs incurred. In addition, the legislation, while denying the deduction, does not make the income non-assessable.

6. In our opinion, the impact on owners of farming land who do not themselves carry on the farming business but may allow a related party to do so needs to be considered in detail. Based on the proposal, we have concerns in relation to the reliance on the "connected entity" and "affiliate" tests in the following situations:

    - Farming land owned by an SMSF;
    - Farming businesses conducted by a discretionary trust which the land owners neither (i) receive trust distributions nor (ii) control the trustee; and

- Farming business conducted by the children or partnerships of children (and/ or spouses).

In the first two instances neither the SMSF nor trust will meet the test of being a connected entity or affiliate. In the third instance, the test for determining an affiliate is a subjective one, looking at various factors relating to how the land owner interacts with the children. This will create uncertainty that may require landowners to undertake detailed analysis in making an assessment and possibly obtaining expensive advice.

7. It is not clear whether costs incurred post sale will be deductible. The provision refers to a loss or outgoing related to holding land – is this only for present ownership of land or land which was held. Many taxpayers acquired rental properties in regional areas during the mining boom which have significantly fallen in value. Some may have been forced to sell the property at a loss, meaning they still have mortgages on these to pay. The question is whether the interest deductions on these loans would still be deductible given they no longer hold the land. If the interest is not deductible to holding the land, then confirming that these costs incurred post sale (which may be a number of years later) are included in the tax cost base calculation for claiming a capital loss would at least clarify that point for landowners.

8. Other examples where there will be uncertainty include:

   a. farming land is divided by a public road and all substantive permanent buildings are located on one section. It is not clear whether the land will be considered to be a single parcel.

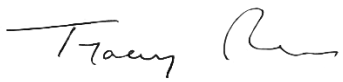
   b. Whether crops, vines or trees would be considered to be substantive permanent building/structure. If not, such land which is genuinely used in the business of an unrelated party would be caught by the rule (noting that leasing to a related party seems to be ok).

   c. Whether fallow or grazing land genuinely used in a business of an unrelated party would also be caught by the rule (i.e. as there is no substantive permanent building/structure).

* * * * *

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

Yours sincerely



Tracey Rens
President