

TR 2023/3EC - Compendium



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Public advice and guidance compendium – TR 2023/3

❶ Relying on this Compendium

This Compendium of comments provides responses to comments received on Draft Taxation Ruling TR 2021/D5 *Income tax: expenses associated with holding vacant land*. It is not a publication that has been approved to allow you to rely on it for any purpose and is not intended to provide you with advice or guidance, nor does it set out the ATO's general administrative practice. Therefore, this Compendium does not provide protection from primary tax, penalties or interest for any taxpayer that purports to rely on any views expressed in it.

Summary of issues raised and responses

All legislative references in this Compendium are to the *Income Tax Assessment Act 1997*, unless otherwise indicated.

Issue number	Issue raised	ATO response
1	The Explanatory Memorandum makes it clear that the provisions apply to lessees as well as landowners. This aspect should be included in the final Ruling.	Paragraph 5 of the final Ruling has been updated to include a footnote to reference that a lessee may also incur costs relating to holding land (consistent with paragraph 3.28 of the Explanatory Memorandum to the <i>Treasury Laws Amendment (2019 Tax Integrity and Other Measures No.1) Bill 2019</i> (EM).
2	<p>There are 'black hole' expenses which would be denied deductibility by section 26-102 and are:</p> <ul style="list-style-type: none">• ineligible for inclusion in element 3 of cost base, and• ineligible for 'black hole' business expenditure relief under paragraph 40-880(1)(b). <p>Examples include:</p> <ul style="list-style-type: none">• vacant land assets acquired on or before 20 August 1991• vacant land where a capital loss is incurred (per subsection 110-55(3))• pre-CGT vacant land (as cost base inclusion will be of no benefit), and	<p>Paragraph 25 of the final Ruling has been updated to note that expenses that are not able to be deducted may form part of the third element costs of owning the asset. Footnote 14 has been updated to acknowledge that the cost base rules in Division 110 will apply to determine if any costs that are denied a deduction by virtue of section 26-102 may be included in the cost base of a relevant asset. This includes application of the reduced cost base rules as outlined in Subdivision 110-B.</p> <p>Black hole expenditure deduction under section 40-880 is only available to business capital expenditure. We invite taxpayers to engage with us to discuss their personal circumstances.</p>

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	<ul style="list-style-type: none"> vacant land that is trading stock (as cost base inclusion is inapplicable). 	
3	<p>While property developers may benefit from the subsection 26-102(5) of exception by holding land in a company, some may hold vacant land in a trust which is trading stock under Division 70 for a business conducted by a related entity, and does not meet the connected entity or affiliate status exception in subsection 26-102(2). It is noted that section 70-15 states that deductions for trading stock must be deductible under section 8-1.</p> <p>The effect of these provisions is likely to result in potentially substantial section 26-102 non-deductible holding costs associated with vacant land (which may be genuine trading stock of an active business).</p> <p>We appreciate the ATO's only potential solution to the above issues might be a concessional 'substantial and permanent structure' interpretation to reduce instances of land being vacant. However, this may not assist residential property developers due to subsection 26--102(4).</p>	<p>Paragraphs 39 and 40 of the final Ruling have been updated to address this. A number of entity types are excluded from the vacant land provisions under subsection 26-102(5). A discretionary trust is not an excluded entity from the vacant land provisions.</p> <p>Developers who hold their land in trusts will have to meet the tests of being in business or being a connected entity (noting discretionary trusts cannot be affiliates), per subsection 26-102(2).</p>
4	<p>We agree with your interpretation of the ongoing requirement to meet conditions of subsection 26-102(4) where a landholder has constructed or substantially renovated residential premises. Noting your concessional compliance approach for short-term vacancies of residential rental properties to conduct repairs we provide the following related examples which potentially produce unforeseen consequences due to the ongoing application of subsection 26-102(4):</p> <ul style="list-style-type: none"> A doctor purchases an established home to live in, but with 50% usage as a surgery (business), this would not be vacant land. However, if the same doctor constructed or substantially renovated a home to use as a combined home and business the 	<p>The final Ruling has been updated to include mixed use premises at paragraph 38.</p> <p>The distinction between established properties and newly-constructed or substantially renovated properties is a product of the function of subsection 26-102(4).</p> <p>We have also updated paragraph 20 of the final Ruling to include a footnote that references that:</p> <ul style="list-style-type: none"> 'residential premises' is defined in section 195-1 of <i>A New Tax System (Goods and Services Tax) Act 1999</i>, and for further guidance refer to Goods and Services Tax Ruling GSTR 2012/5 <i>Goods and services tax: residential premises</i>.

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	<p>land could be considered vacant as it is not available for lease, hire or purchase.</p> <ul style="list-style-type: none"> • A mining entity caught by section 26-102 may rely on a number of mining dongas used as worker accommodation to ensure the land is not considered vacant. Once again, if the land was purchased with dongas on site it would not be captured under subsection 26-102(4), while if the dongas were constructed by the entity they would have to meet the condition of being leased, hired or licensed or available for same. <p>It is suggested that many landholders (including those with residential premises constructed or substantially renovated before 1 July 2019) and their professional advisers may be unaware of this issue and how to practically manage it to ensure holding costs remain deductible.</p> <p>The draft Ruling only discusses the meaning of 'in use or available for use' in the context of residential premises. It is suggested the final Ruling should also address the meaning of being 'available for use' in the context of commercial premises.</p>	
5	<p>There is an extremely broad definition of residential premises relevant to subsections 26-102(4) and 26-102(8) and (9). Reading the definition as per section 195-1 of <i>A New Tax System (Goods and Services Tax) Act 1999</i>, in conjunction with GSTR 2012/5, all of the following meet the definition of 'residential premises':</p> <ul style="list-style-type: none"> • an apartment, house or townhouse • business premises using a building with similar characteristics to a house or townhouse (for example, a law firm located in a former home, even if zoned commercial) 	<p>Paragraph 20 of the final Ruling has been updated to include a footnote that references that:</p> <ul style="list-style-type: none"> • 'residential premises' is defined in section 195-1 of <i>A New Tax System (Goods and Services Tax) Act 1999</i>, and • for further guidance refer to GSTR 2012/5 <i>Goods and services tax: residential premises</i>.

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	<ul style="list-style-type: none"> hotels, holiday villages, hostels and similar transportable/demountable residential premises mixed-use structures (for example, central business district office building with apartments on top floor) hospitals, nursing homes and similar premises without a residential character but being used as a residence (for example, an employee living in an office), and floating homes (unless able to self-propel). <p>It is highly likely that many landholders and their professional advisers are unaware of the consequences of this broad definition. Extensive and clear taxpayer education to alert affected land holders to the non-deduction risk and how it should be addressed is likely to be required.</p>	
6	<p>Would permanent and substantial structures beneath the land's surface (such as irrigation piping, or mining infrastructure) qualify as permanent and substantial structures?</p>	<p>We have not updated the final Ruling to consider the circumstances outlined here.</p> <p>Whether something is a substantial or permanent structure will be dependent on the facts and circumstances and the context of the land. The land may also be excluded from the operation of section 26-102 depending on whether the land is being used in business or primary production. While paragraph 3.22 of the EM provides that structures that exist to support the use or functioning of another structure, such as pipes or powerlines, will not satisfy this requirement, we consider that irrigation piping or mining infrastructure may be substantial structures depending on the context of the land.</p>
7	<p>If Example 1 of the draft Ruling was not in a primary production context, but rather a 'lifestyle' Airbnb or longer-term residential property would the outcome be the same?</p>	<p>We have not updated the final Ruling to cover the circumstance outlined here.</p> <p>The structure in Example 1 is an 'established house', meaning that subsection 26-102(4) does not apply. In this example, the primary production context does not affect the outcome.</p>

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8	<p>The outcome of section 26-102 is unclear where the residential premises are across multiple titles of land, for example residence on one title and swimming pool on another.</p> <p>If a suburban residential property and an associated swimming pool or tennis court were on separate titles, would the ATO be likely to treat the pool or tennis court as a substantial and permanent structure? Would the outcome be different if there was a pool house or tennis court shelter on the title?</p> <p>Clearer advice and examples will assist taxpayers.</p> <p>If the 100 hectares in Example 1 of the draft Ruling were held under multiple titles, and there were no other permanent and substantial structures, would it only be the title containing the manager's residence that would not be considered vacant land?</p>	<p>We have updated the final Ruling to consider each outgoing as it relates to the relevant area of land.</p> <p>Paragraphs 45 to 48 of the final Ruling confirm that the loss or outgoing will determine the area of land that is relevant for the purposes of section 26-102. This approach acknowledges that in most cases, holding costs will relate to land covered by a single property title, in which case the relevant land will be the land under that title. However, some holding costs may relate to only part of the land under a property title while others may relate to land covered by multiple titles.</p>
9	<p>The draft Ruling has clarified that interest and borrowing costs directly relating to the costs of constructing a substantial and permanent structure on the land is not a loss or outgoing relating to holding land.</p> <p>It is requested that the final Ruling confirm the same analysis would apply to interest and borrowing expenses for loans obtained for:</p> <ul style="list-style-type: none"> substantial renovations to a substantial and permanent structure, or repairs or improvements to a substantial and permanent structure. 	<p>We have updated paragraph 26 of the final Ruling as follows (emphasis added):</p> <p>In the context of section 26-102, we do not consider the costs of repairing, renovating or constructing a structure on the land, or any interest or borrowing costs (to the extent they are associated with repairs, renovation or construction), to be a loss or outgoing related to holding land.</p>

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10	<p>The compliance approach for minor repairs and renovations between tenancies in the draft Ruling should be expanded to provide clarity about whether the compliance approach applies to improvements.</p> <p>Also, further explanation of what constitutes 'minor' is required, or removal of the word 'minor' all together.</p>	<p>The final Ruling has not been updated in this regard.</p> <p>The key phrase of the compliance approach is 'short periods of time when residential premises are unavailable for lease, hire or licence'. The term 'minor maintenance and repairs' is only used in an example of what may necessitate the short period of unavailability, it is not intended as a criterion for the compliance approach.</p> <p>It is unlikely that more substantial improvements would allow for the compliance approach as the period of unavailability is unlikely to be 'short'.</p>
11	<p>Regarding the continuing deductibility of interest where an income-producing activity ceases:</p> <p>Provide an example of a taxpayer who sells a former rental property untenanted and therefore any ongoing interest expense is not deductible due to the vacant land provisions meaning it was not deductible immediately before the sale of the property.</p>	<p>The final Ruling has been updated at Example 7 to include this scenario.</p>
12	<p>The draft Ruling does not adequately address the issue of property developers and whether land held for development is 'available for use'. Example 3.3 from the EM makes it clear that land held by property developers for future use is held in carrying on a business. A similar example should be included in the final Ruling.</p>	<p>Paragraph 39 of the final Ruling has been updated to address this.</p>
13	<p>The draft Ruling does not address a circumstance where a taxpayer has to dissect the land under a single title because it is being used for multiple purposes, and only a portion of holding costs will be deductible.</p>	<p>We have updated the final Ruling to consider each outgoing as it relates to the relevant area of land.</p> <p>Paragraphs 45 to 48 of the final Ruling confirm that the loss or outgoing will determine the area of land that is relevant for the purposes of section 26-102.</p>
14	<p>The draft Ruling does not address the issue of whether a one-off profit-making venture is considered a business for the purpose of section 26-102</p>	<p>The final Ruling has been updated at paragraphs 35 to 40 in respect of land in use or available for use.</p> <p>The final Ruling makes it clear that whether the activities on the land amount to 'carrying on a business' is a question of fact determined by reference to the indicia of carrying on a business as set out in the case law.</p>

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15	<p>The draft Ruling does not address the situation where property developers use a special purpose vehicle (SPV) as part of a broader property development business.</p> <p>The SPV may be a discretionary trust and hence subject to section 26-102. Considered in isolation, land held by the SPV may be deemed not to be in use, or available for use, in carrying on a business.</p> <p>However, following <i>Grollo Nominees Pty Ltd & Ors v The Commr of Taxation of the Cth of Australia</i> [1997] FCA 659 the broader activities of the group should be considered in determining if the SPV is carrying on a business.</p> <p>The draft Ruling should be amended to clarify that the business of an SPV trust must have regard to the broader group.</p>	<p>Paragraphs 39 and 40 of the final Ruling have been updated to address this. A number of entity types are excluded from the vacant land provisions under subsection 26-102(5). A discretionary trust is not an excluded entity from the vacant land provisions. Developers who hold their land in trusts will have to meet the tests of being in business or being a connected entity (noting discretionary trusts cannot be affiliates).</p>
16	<p>We consider these to be additional considerations to determining if a lessee is using the land in carrying on a business:</p> <ul style="list-style-type: none"> • whether the lessee is involved in repairs and maintenance of the property • how lease payments are determined, and • whether the lessee has constructed or restored substantial and permanent structures. 	<p>The compliance approach in the final Ruling has not been updated to include these points, as the list is a non-exhaustive list of the main factors to consider and it is unclear that the additional factors identified would point to the lessee being in business.</p>
17	<p>The draft Ruling will benefit from an example where the land is not trading stock or being physically used, but there are activities being undertaken (such as seeking zoning approval) so it could be used in business.</p>	<p>The final Ruling has been updated to include footnote 20 (at paragraph 37) which refers to the relevant ATO views on when an entity is carrying on a business. These views encompass at what point a business might commence.</p>

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18	<p>Further clarification on the application of subsection 26-102(6) where structures are affected by natural disasters or other exceptional circumstances the:</p> <ul style="list-style-type: none"> • exemption does not apply in circumstances that do not affect the structure, for example, financial hardship that causes delays to renovations, and • Commissioner's discretion relates only to the timing of the exception, not the circumstances allowing the exception. 	<p>The final Ruling has not been updated to include reference to the application of subsection 26-102(6). The ATO advice and guidance on this point is located on our webpage at Deductions for vacant land</p>
19	<p>Given the delay in providing guidance the Commissioner should take a lenient approach to penalties and interest where taxpayers need to amend returns based on the Ruling.</p>	<p>This comment is not relevant to the Ruling.</p> <p>Note that the policy and legislation around shortfall interest charges and tax shortfall penalties already requires the Commissioner to consider the circumstances leading to the shortfall.</p>
20	<p>Interest incurred at investor level – the draft Ruling should clarify whether interest on borrowings to acquire equity in an entity that holds land is an outgoing relating to holding land. Our view is that only the outgoings of the entity that directly holds the land are outgoings relating to holding land.</p>	<p>The final Ruling has not been updated to include this point. We consider that a natural reading of the law demonstrates that it is only the direct holder of the land that would be impacted.</p> <p>However, footnote 1 of the final Ruling has been updated to note that a lessee may also incur costs relating to holding land.</p>
21	<p>The compliance approach at paragraphs 57 to 58 of the draft Ruling should be expanded to cover the general requirement for a structure to be in use or available for use in subsection 26-102(1) and not be limited to the unavailability of residential property coming within subsection 26-102(4).</p>	<p>The final Ruling contains a compliance approach for short absences from the requirement in subsection 26-102(4) for newly-constructed premises to be in use and available for use and available for lease, hire or licence.</p> <p>We do not consider it appropriate to expand this approach for structures more generally. The types of structures that exist on land are infinitely varied as are the circumstances in which they become unavailable for use.</p>
22	<p>There is ambiguity in subsection 26-102(2) arising from the concept of a business 'carried on for the purpose of gaining or producing the assessable income' of various related entities. What does it mean to carry on a business for the purpose of producing income of another entity? For example, if land held by one entity is used by another entity, a trust or company, which would produce income</p>	<p>We do not agree that subsection 26-102(2) requires the carrying on of a business for the purpose of producing income <i>of another entity</i>. Rather, <i>any entity</i> listed in paragraphs 26-102(2)(a) to (d) can be the relevant entity carrying on business for the purpose of gaining or producing the assessable income. This is reflected in Example 9 in paragraph 42 of the final Ruling.</p> <p>We note the final Ruling has been updated at paragraph 40 to acknowledge that particular entities are excluded from the application of the vacant land measures per subsection 26-102(5).</p>

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	<p>for related entities through dividends or distributions would this fit the circumstance of subsection 26-102(4)?</p> <p>It is noted that the EM appears to have used a different test in paragraphs 3.10 and 3.29 where it refers carrying on a business 'by certain entities related to the taxpayer' (emphasis added).</p> <p>Given the ambiguity further guidance by the ATO would be appreciated.</p>	<p>In addition, paragraph 37 of the final Ruling has been updated to note that whether a business is being carried on by an entity is a question of fact determined by reference to the indicia of carrying on a business as set out in case law. Further, footnote 20 (at paragraph 37 of the final Ruling):</p> <ul style="list-style-type: none"> notes that guidance relevant to identifying whether an individual is carrying on a business is contained in Taxation Ruling TR 97/11 <i>Income Tax: am I carrying on a business of primary production</i> refers also to Self-Managed Superannuation Funds Ruling SMSFR 2009/1 <i>Self-Managed Superannuation Funds: business real property for the purposes of the Superannuation Industry (Supervision) Act 1993</i>.
23	<p>The exception in subsection 26-102(8) would appear to apply to all land held by a primary production business, regardless of whether the land itself is used in primary production. For example, a business engaged in primary production in Perth may hold vacant land in Melbourne that is not used in primary production. It would appear they can still access the exception in subsection 26-102(8). ATO guidance on this issue would be welcomed.</p>	<p>The final Ruling has been updated at Example 10 (paragraph 44) to include a scenario applicable to subsection 26-102(8). We note that subsection 26-102(8) has 4 conditions:</p> <ul style="list-style-type: none"> the taxpayer or a related entity (within the meaning of subsection 26-102(2)) is carrying on a business of primary production the land is leased to another entity it does not contain residential premises, and residential premises are not being constructed.