Bentleys
THINKING AHEAD

Vacant Land Deductions

You may have a tax problem…

Do you own land in a trust or in your own name?

Is the land undeveloped or does it only have a residential property on it which is not currently leased?

You may have a tax problem…

A **bill** currently before parliament proposes to deny deductions for property holding costs on certain land held by individuals and trusts[1].

Although the expenses may not be deductible, income you receive from the property (e.g. from leasing or agistment) may still be assessable.

When will these rules apply?

The law will apply to deny deductions for expenses incurred in holding vacant land from 1 July 2019. This includes interest on financing, property rates and taxes, and maintenance costs.

We have set out below:

- What entities are affected;
- What is vacant land; and
- What business activities on the land will mean it is not considered 'vacant'?

What entities are affected?

The law applies to trusts, individuals & self-managed superannuation funds (SMSFs). The following entities are excluded:

- Companies and entities taxed like companies;
- Widely-held trusts: This includes Public Unit Trusts (generally >50 members) & Managed Investment Trusts (generally >25 members));
- Superannuation Funds other than SMSFs; and
- Trusts & partnerships where all the interests are held by the above entities.

The law will apply to property syndicates between unrelated parties which do not necessarily meet the widely-held tests. Likewise, a trust or partnership where any interests are held by an SMSF, individual or trust may be caught.

[1] Except Managed Investment Trusts (MITs) and certain widely-held trusts

What is vacant land?

A structure needs to be substantial & permanent on the land to prevent it being ‘vacant’. A structure which is dependent on other structures will not be eligible (e.g. a shed which depends on there being a residential property). Where the structure is a residential property, it must be capable of rental and available for rent to be eligible.

Examples of land which may be caught by the measures:

- Farmland which is leased out, agisted or set aside for non-business activities;
- Land used for car parking where there is no substantial structure on the land (query whether asphalt areas would be ‘substantial’); and/or
- Land held for future development on a ‘hold’ basis rather than ‘sell’.

The Government noted media reports that landholding costs for the failed ‘Opal’ or ‘Mascot’ apartment tower complexes may now not be deductible where the building is not fit for habitation. This demonstrates there is a real risk that ordinary rental arrangements may be impacted by these measures.

Eligible business activity

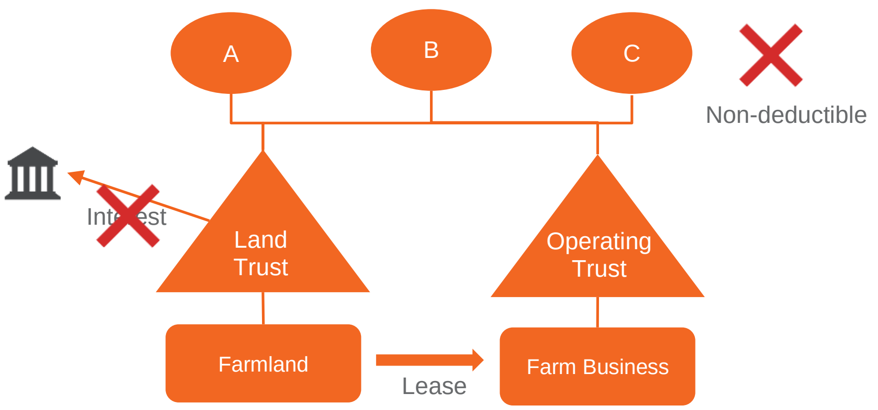
Where the property is used or held for use in carrying on a business it will not be subject to the new rules.

The law uses the ordinary meaning of ‘carrying on a business’. The mere holding of land for lease is not likely to be considered a business activity. This may include a lease to a ‘related’ party.

Land used in a business by certain related parties will be excluded from the rules. The scope of ‘related’ entity is limited to:

- A spouse or child under 18;
- Affiliated entity: an individual or company (but not a trust) which acts in accordance with the wishes of an entity;
- Connected entity: Generally an entity which has more than 40% of the interests in another entity or both are under common control.

Example 1: ‘Connected’ entities carrying on a business



A, B & C are unrelated investors into a farming venture. They hold the land in a unit trust in which they each hold 1/3rd of the units. The land is leased to an operating trust. The operating trust is not connected with the land trust, as none of A, B or C have a common 40% interest. The operating trust cannot be an affiliate. Therefore, the land is 'vacant' land that is not used in a related business for the purposes of the rules.

The net cashflow position of the venture is:

Operating profit	$100,000
Less: holding costs of land	($100,000)
Less: Interest on loan to fund land	($150,000)
Net cashflow position	($150,000)

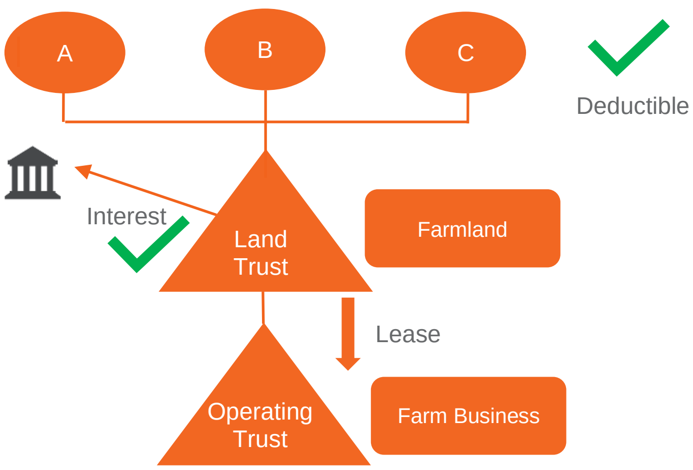
The operating trust pays a $200,000 p.a. lease payment to the Land Trust.

The tax position of the land trust under the proposed law will be:

Lease payment received	$200,000
Deduction for holding costs	- (non-deductible)
Deduction for interest	- (non-deductible)
Taxable income	$200,000
Tax at 47%[2]	$ 94,000

Therefore, despite the arrangement being in a cashflow negative position, the venture will incur a $94k tax liability.

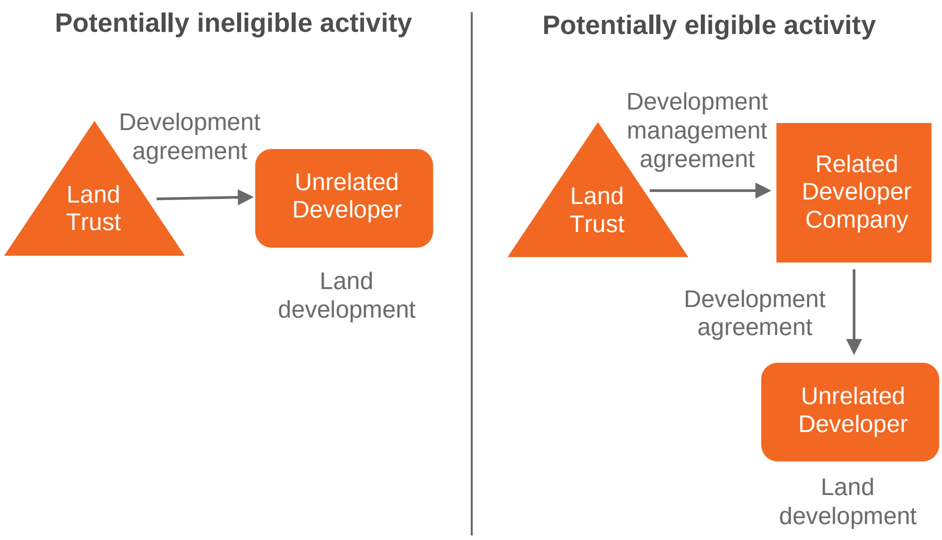
Where the operating trust owned the units in the land trust the holding costs would be deductible:



[2] There is likely no 'income' of the trust. Therefore, the trustee may be taxed on the profit.

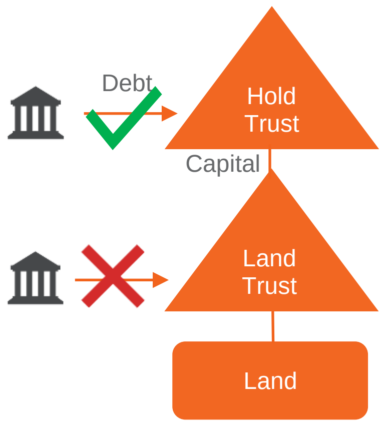
Example 2: Related business

The following example shows that merely having the property used in a business by a related entity may mean the rules will not apply.



Example 3: Changing the funding structure

The land in the following arrangement may be vacant. However, the funding structure may mean the interest is not a holding cost of the land subject to the rules and may continue to be deductible.



What should you do?

Where you hold vacant land that is not clearly associated with a related business, you should talk to us in relation to the deductibility risk of the holding costs. This will be particularly important for property development and agricultural land.

We will be able to help you quantify the risk and implement appropriate strategies to help you maximise a deduction for the costs.

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