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Dear Ms Gainford

#### **TR 2021/D5 - Income tax: expenses associated with holding vacant land**

The Property Council welcomes the opportunity to comment on the ATO's draft taxation ruling TR 2021/D5 (the draft ruling).

The draft ruling provides welcome clarity on the ATO's view of the application and the exclusions of section 26-102 of the *Income Tax Assessment Act 1997* and some of the practical compliance approaches for certain situations.

However, the draft ruling does not adequately address situations where property developers use special purpose vehicles (SPVs) such as discretionary trusts as part of a broader property development business. This has led to uncertainty on how the 'carrying on a business' test, and the 'land in use'/'available for use' tests are applied, therefore leading to concerns that certain property developers may not be entitled to deductions for costs incurred as part of their property development activities. This is not consistent with the policy intent of the legislation which was targeted at taxpayers who were not genuinely holding land for the purpose of gaining or producing assessable income.

Our submission recommends two simple amendments to the draft ruling to ensure the provisions dealing with expenses associated with holding vacant land operate as intended:

- Clarify that when determining whether an SPV is carrying on a business, regard will be given to the activities carried out by the wider group; and
- Acknowledge that land acquired in an SPV trust for the purpose of construction and use in that business should be regarded as land 'available for use' or in 'actual use' by that business.

#### **Background and policy intent of the vacant land provisions**

The *Treasury Laws Amendment (2019 Tax Integrity and Other Measures No. 1) Bill 2019* was introduced to deny deductions for losses or outgoings incurred that relate to holding vacant

land. Importantly, the measure didn't apply to outgoings related to holding vacant land in the course of carrying on a business.

The explanatory memorandum (the EM) of that bill highlights that the policy intent behind the introduction of the rules was about entities "incorrectly claiming deductions". Paragraphs 3.4-3.5 of the EM state that some taxpayers had been claiming deductions when the land "is not genuinely held for the purpose of gaining or producing assessable income" and that "there is often limited evidence about the taxpayer's intent other than statements by the taxpayer".

The focus of the measure was to provide more integrity around individuals who may buy small parcels of land to develop where it is not clearly part of an established or ongoing business. This is supported by the special rule in subsection 26-102(4) which denies any deductions for holding costs during the construction phase of residential rental properties not used in a business.

### **Use of special purpose vehicles as part of property development business**

Property developers generally use SPVs for each asset or site that they are developing, as a way of managing the risks of each property development project.

While there is clarity given to corporate entities, managed investment trusts (MITs) and public unit trusts – all of which are exempt from the vacant land provisions under subsection 26-102(5) – the law is silent on discretionary trusts.

This means property developers who set up discretionary trust SPVs (or other forms of an SPV) need to satisfy the 'carrying on a business' test to claim deductions for any expenses incurred associated with holding vacant land.

The draft ruling broadly focuses on individuals who either hold passive rental properties or operate farms and there is little focus at all on larger property developers (e.g. those who develop office blocks or shopping centres) who operate through trusts that are not MITs or public unit trusts. The focus of the draft ruling and all the examples tend to involve individuals with smaller scale land holdings and developments, as opposed to larger property developers. This creates uncertainty for property developers who use discretionary trust SPVs as part of their business.

### **Carrying on a business as part of a wider group**

In determining whether an SPV is carrying on a business, we understand that there have been instances where the ATO has taken a narrow view and only considered the activities of the SPV, rather than the broader group. This could lead to deductions being denied for legitimate business expenses merely because an SPV is a new entity with no corporate history.

The better view would be to consider the SPV's activities in the context of the broader group's business. The Appendix to this submission examines a number of recent court case decisions and private binding rulings which consider the holding of land through an SPV and the broader activities of the group when determining whether the SPV is carrying on a business.

Based on these decisions and rulings (specifically the Federal Court's decision in *Grollo Nominees* [1997] FCA 659), we believe that an SPV that constructs the property is a vehicle through which it carries on the broader group's business of constructing properties to rent/operate/manage.

It is important that the business can be characterised as involving the initial construction and development and not merely the operating and managing activities of that asset. The SPV is merely continuing on the broader business of the group of developing properties for rent.

We note that the ATO have been willing to look at the broader group in a similar context, when considering SPV trusts and commercial buildings for the purpose of the temporary full expensing measures. For example, PBR 1051811942103 involved SPV trusts that were held to be carrying on a business with regard to the broader group (even in the case where the employees were employed by a separate entity).

### **Land in use or available for use**

A consequential issue that should be dealt with in the draft ruling is to do with the 'available for use' test. If an SPV is deemed to be carrying on a business from the day it acquires vacant land, then from that point on the land should also be treated as land in use or available for use. Any outgoings incurred in holding the land from the date of acquisition should be deductible and not subject to the s26.102(1) limit on deductions.

Again, consideration for the wider group is critical in this assessment. There is support for this view in the EM:

#### *Example 3.3: Expenditure incurred in carrying on a business deductible*

*Albert carries on business as a property developer and owns a significant property portfolio of vacant land in Melbourne. He incurs outgoings relating to holding the vacant land including interest payments and council rates. Some of this vacant land is currently in use. **Other areas are being held available for use in future developments.***

*As Albert incurs the expenditure to hold the land in carrying on his business for the purpose of producing assessable income it is deductible. **It does not matter whether the land is currently being developed or if it is held for future use.*** (emphasis added)

Accordingly, if land that is merely set aside for some future development can be said to be available for use in that business, based on the EM it should follow that land currently being constructed for long-term rental should also be available for use (if not 'actual use') on the basis that the business of the SPV includes any construction or development activities on that land.

### **Recommended solution**

We believe that the draft ruling should be amended to clarify that the business of an SPV trust must have regard to the broader group, as accepted in the decision of *Grollo*. There have been at least 19 PBRs in the last few years which have accepted this principle and thus the draft ruling needs to at least refer to this case and other cases that are substantially the same in principle and acknowledge that a business can be defined with reference to its broader group.

In addition, where the broader group conducts a commercial property rental business, the draft ruling should generally accept that land acquired in an SPV trust for the purpose of construction and use in that business should be regarded as land 'available for use' or in 'actual use' by that business.

If you would like to discuss any aspect of this submission further, please contact Kosta Sinelnikov on 0422 168 720 and [ksinelnikov@propertycouncil.com.au](mailto:ksinelnikov@propertycouncil.com.au), or myself on 0400 356 140 and [bngo@propertycouncil.com.au](mailto:bngo@propertycouncil.com.au).

Yours sincerely



**Belinda Ngo**  
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## Appendix: Court decisions and ATO guidance relating to carrying on a business and SPVs

In relation to the “use in carrying on a business” exception, there are many ATO rulings which support the proposition that where an SPV is used to hold the land, taxpayers can consider the broader activities of the group when determining whether that SPV is carrying on a business.

These rulings stem from the decision of *Grollo Nominees* [1997] FCA 659 where the Full Federal Court stated:

*“The starting point for a consideration of the problem here is the fact that Grollo Australia was one of the Grollo Group of companies. The Group carried on business as substantial builders of commercial and industrial buildings. Over the years it had also engaged in construction work for public authorities. It had been in business for over ten years, that is at the time these transactions were entered into. Grollo Australia was a new member of the Group. It was the vehicle which was used for this project.*

*Grollo Australia, at least up to the stage of this project, had not been engaged in the building industry in the sense of having carried out other building projects as had Grofam. **But it would not be correct to treat its activities in isolation of those of the remainder of the Group.** It was part of a group which was regularly carrying out building projects, whether for the Grollos themselves or for other persons. It is true that the project in question was very large and was probably the largest project which the Group had on hand during the years of construction which began in 1981. But it was, nevertheless, but one more project.” (emphasis added)*

In a recent AAT decision in *Doyle* [2020] AATA 345, the tribunal stated:

*“Considering all of this, I find that from 6 April 2005 at the latest, the ordinary business of the Doyle Group included the acquisition and development of land for industrial use with a view to deriving profit by selling and/or leasing it, whichever proved more advantageous in the circumstances. **As each trust was the vehicle by which this facet of the Doyle Group’s business was carried out with respect to the property it acquired, it follows that its ordinary business was the same.**” (emphasis added)*

We highlight that the ATO have accepted this general principle in over 19 private binding rulings (PBRs) recently dealing with questions such as revenue and capital. In one such PBR, being PBR 1051390163304, the ATO articulated this view as follows:

*As highlighted by *Western Gold Mines N.L. v. Commissioner of Taxation (W.A.)* (1938) 59 CLR 729, the Commissioner is required ...to make both a wide survey and an exact scrutiny of the taxpayer's activities. This principle was further extended by such cases as *GRE insurance Limited and Unitraders Investments Pty Ltd v FCT* (1992) 92 ATC 4089 and *Grollo Nominees Pty Ltd v FC of T* 97 ATC 4585 which specifically demonstrates that the Commissioner not only can, but he must consider the relationship that the entity/taxpayer in question has with the wider economic / family group, when determining these type of cases.*

Both of the cases referred to above (*Grollo* and *Doyle*) involved developments on revenue account (i.e. for the purpose of sale). Where land is acquired as trading stock, there will be less of an issue about whether the entity carries on a business. However, another AAT decision in the past month cited both of these decisions in considering whether a trust carried on a

business of property investment (i.e. to derive rental income), see *Allzams Trust* [2021] AATA 2767:

*"The scheme facts make no mention of the activities of the trustee in his own right. In other areas of income tax and Goods and Services Tax (GST), in determining whether a receipt is income or capital, of whether there is an enterprise for GST purposes, there is a legal principle stemming from the decision in Grollo Nominees Pty Ltd and Ors v The Commissioner of Taxation where the Full Federal Court decided it would not be correct to treat a single purpose entity's activities in isolation of those of the other entities of a group.*

*This principle has recently been adopted by the Tribunal in Doyle and the Commissioner of Taxation.*

In a related case (involving the same ultimate individual) the AAT concluded that he was in the business of renting properties (see *Allen* [2021] AATA 2768). He held 9 units which were valued at approximately \$6m. Additionally, see example 14 of [SMSFR 2009/1](#) where an individual holding 20 residential units rented out on long-term leases is said to carry on a property investment business. An element of this is that the landowners manage the properties on a full-time basis and live off the income (e.g. rather than use their investments to supplement a wage or other business).

Therefore, there is strong support for the position that entities can carry on a business of renting out properties, even at a relatively small scale when comparing to large buildings such as offices and shopping centres.