

Chapter 1

Introduction

1.1 On 15 February 2018, the Senate referred the Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018 [Provisions] (Measures No. 2 bill) and the Foreign Acquisitions and Takeovers Fees Imposition Amendment (Near-new Dwelling Interests) Bill 2018 [Provisions] (Near-new Dwelling Interests bill) to the Senate Economics Legislation Committee (committee) for inquiry and report by 23 March 2018.¹

1.2 The government announced a comprehensive housing affordability plan in the 2017–18 Budget to improve housing affordability, encourage investment in affordable rental housing and improve the integrity of the tax system. The housing package included measures to:

- make changes to capital gains tax for foreign investors;
- streamline and enhance the foreign investment framework; and
- expand tax incentives for investments in affordable housing.

1.3 The Measures No. 2 bill contains three schedules which seek to implement these measures.² The Near-new Dwelling Interests bill contains technical amendments to support changes announced in the 2017–18 Budget that streamlined the foreign investment framework.³

1.4 The Measures No. 2 bill contains measures that support those already introduced as part of the Treasury Laws Amendment (Housing Tax Integrity) Bill 2017 and the Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 1) Bill 2017.⁴

1.5 In his second reading speeches, the Treasurer, the Hon. Scott Morrison MP, stated that the Measures No. 2 bill is 'an important step to ensuring homeownership is more achievable for Australians'⁵ and the Near-new Dwelling Interests bill is 'further

1 *Journals of the Senate*, No. 87, 15 February 2018, p. 2739.

2 The Hon. Scott Morrison MP, Treasurer, Second Reading Speech, Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018, *House of Representatives Hansard*, 8 February 2018, p. 710.

3 The Hon. Scott Morrison MP, Treasurer, Second Reading Speech, Foreign Acquisitions and Takeovers Fees Imposition Amendment (Near-new Dwelling Interests) Bill 2018, *House of Representatives Hansard*, 8 February 2018, p. 712.

4 The Hon. Scott Morrison MP, Treasurer, Second Reading Speech, Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018, *House of Representatives Hansard*, 8 February 2018, p. 710.

5 The Hon. Scott Morrison MP, Treasurer, Second Reading Speech, Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018, *House of Representatives Hansard*, 8 February 2018, p. 710.

evidence of the government getting on with the job, reducing compliance, making the law more fair and getting reforms done'.⁶

Conduct of the inquiry

1.6 The committee advertised the inquiry on its website and wrote to relevant stakeholders and interested parties inviting submissions by 5 March 2018.

1.7 The committee received 14 submissions, which are listed at Appendix 1.

1.8 The committee thanks all individuals and organisations who assisted with the inquiry, and took the time to make written submissions and provide responses to questions on notice.

Overview of the bills

Capital gains tax changes for foreign residents

1.9 Schedule 1 to the Measures No. 2 bill seeks to amend the *Income Tax Assessment Act 1997* (ITAA 1997) to:

- remove the entitlement to the capital gains tax (CGT) main residence exemption for foreign residents; and
- modify the foreign resident CGT regime to clarify that, for the purpose of determining whether an entity's underlying value is principally derived from taxable Australian real property (TARP), the principal asset test is applied on an associate inclusive basis.⁷

Changes to the main residence exemption

1.10 The amendments in Part 1 of Schedule 1 to the Measures No. 2 bill seek to remove the entitlement to the CGT main residence exemption for foreign residents that have dwellings that qualify as their main residence.

1.11 The main residence exemption disregards a taxpayer's capital gain or loss for CGT purposes (providing an exemption) if:

- the taxpayer is an individual; and
- the dwelling was the taxpayer's main residence throughout the ownership period.

1.12 In addition, the main residence exemption provides a partial exemption if the dwelling was the taxpayer's main residence for only part of the ownership period or if it was also used in part to produce assessable income.

1.13 For the purpose of the main residence exemption, a dwelling includes:

6 The Hon. Scott Morrison MP, Treasurer, Second Reading Speech, Foreign Acquisitions and Takeovers Fees Imposition Amendment (Near-new Dwelling Interests) Bill 2018, *House of Representatives Hansard*, 8 February 2018, p. 712.

7 Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018; Foreign Acquisitions and Takeovers Fees Imposition Amendment (Near-new Dwelling Interests) Bill 2018, Explanatory Memorandum, p. 7.

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- a building (for example a house) or part of a building (for example, an apartment or townhouse) that consists wholly or mainly of accommodation;
 - a caravan, houseboat or other mobile home; and
 - any land immediately under the unit of accommodation.

1.14 The main residence exemption may also apply to:

- an individual who is a beneficiary in, or any entity that is a trustee of, a deceased estate of a deceased person who used the dwelling as a main residence; and
- the trustee of a trust that is or has been a special disability trust where the dwelling was the main residence of the individual who is or has been:
 - the principal beneficiary of the trust; or
 - another beneficiary who inherits the dwelling upon the death of the principal beneficiary.⁸

1.15 The amendments contained in the Part 1 of Schedule 1 to the Measures No. 2 bill will mean that individuals who are foreign residents at the time a CGT event occurs to a dwelling in which they have an ownership interest are not entitled to the main residence exemption for any part of the exemption that arises from their use of the dwelling.⁹

1.16 According to the explanatory memorandum, an individual is a foreign resident if they are not an Australian resident for taxation purposes—as defined in section 6 of the Income Tax Assessment Act 1936 (ITAA 1936).¹⁰

1.17 Section 6 of the ITAA 1936 defines a 'resident' or 'resident of Australia' as follows:

- (a) a person, other than a company, who resides in Australia and includes a person:
 - (i) whose domicile is in Australia, unless the Commissioner is satisfied that the person's permanent place of abode is outside Australia;
 - (ii) who has actually been in Australia, continuously or intermittently, during more than one-half of the year of income, unless the Commissioner is satisfied that the person's usual place of abode is outside Australia and that the person does not intend to take up residence in Australia; or
 - (iii) who is:

8 Explanatory Memorandum, p. 12.

9 Explanatory Memorandum, p. 16.

10 Explanatory Memorandum, p. 16.

- (A) a member of the superannuation scheme established by deed under the *Superannuation Act 1990*; or
 - (B) an eligible employee for the purposes of the *Superannuation Act 1976*; or
 - (C) the spouse, or a child under 16, of a person covered by sub-subparagraph (A) or (B); and
- (b) a company which is incorporated in Australia, or which, not being incorporated in Australia, carries on business in Australia, and has either its central management and control in Australia, or its voting power controlled by shareholders who are residents of Australia.

1.18 This measure does not affect individuals who are Australian residents for taxation purposes at the time a CGT event occurs to a dwelling.¹¹

Transitional provisions

1.19 The amendments to the main residence exemption in Part 1 of Schedule 1 to the Measures No. 2 bill generally apply to CGT events happening at or after their announcement at 7.30 pm, by legal time in the ACT, on 9 May 2017 (application time). The transitional provisions do not apply to properties purchased after the application time. However, a transitional arrangement will apply for properties that were held before the application time, if the CGT event occurs on or before 30 June 2019 if:

- an individual, or trustee of a special disability trust held an ownership interest in the dwelling to which the CGT event relates at all times from immediately before the application time until immediately before the CGT event happens; or
- an individual acquired the property as a beneficiary of a deceased estate and at all times from immediately before the application time until immediately before the CGT event happens to the dwelling, the following entities held the ownership interest in the dwelling:
 - that individual;
 - the deceased person;
 - the trustee of the deceased estate of the deceased person;
 - the trustee of a special disability trust on behalf of a principal beneficiary; or
 - a combination of these entities.¹²

11 Explanatory Memorandum, p. 16.

12 Explanatory Memorandum, pp. 29–30.

Principal asset test

1.20 The amendments in Part 2 of Schedule 1 to the Measures No. 2 bill seek to modify the foreign resident CGT regime to clarify that, for the purpose of determining whether an entity's underlying value is principally derived from TARP, the principal asset test is applied on an associate inclusive basis. This measure is intended to remove any doubt that disaggregated holdings of membership interests are properly taken into account when applying the principal asset test.¹³

1.21 The Treasurer explained in his second reading speech:

This reform addresses an integrity issue with one of these tests—the principal asset test—to require a foreign resident to consider any interests held by its associates, if it disposes of an indirect interest in Australian real property for example by selling shares in a land rich company.

This integrity fix will ensure that the principal asset test cannot be circumvented by disaggregating holdings of membership interests.¹⁴

1.22 The amendments to the principal assets test in Part 2 of Schedule 1 to the Measures No. 2 bill will apply to CGT events happening on or after the announcement at 7.30 pm, by legal time in the ACT, on 9 May 2017.¹⁵

Consultation

1.23 Treasury released exposure draft legislation for the measures in Schedule 1 and conducted a brief consultation process from 21 July to 15 August 2017.¹⁶

Financial Impact

1.24 The measures contained in Schedule 1 were announced in the 2017–18 Budget as part of 'Reducing pressure on housing affordability—capital gains tax changes for foreign Investors'. This Budget announcement also included a measure relating to foreign resident capital gains withholding payments which was enacted separately in the Treasury Laws Amendment (Foreign Resident Capital Gains Withholding Payments) Act 2017. Together, the measures have the following revenue implications:

13 Explanatory Memorandum, p. 27.

14 The Hon. Scott Morrison MP, Treasurer, Second Reading Speech, Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018, *House of Representatives Hansard*, 8 February 2018, p. 711.

15 Explanatory Memorandum, p. 31.

16 Treasury, 'Housing tax integrity—Capital gains tax changes for foreign residents', <https://treasury.gov.au/consultation/c2017-t204155/> (accessed 19 March 2018). At the time of reporting, the submissions for this consultation process had not been published on the consultation website.

Table 1: Financial impact (as set out in Explanatory Memorandum)¹⁷

2016–17	2017–18	2018–19	2019–20	2020–21
*	\$150m	\$100m	\$150m	\$170m

* *Unquantifiable*

1.25 The revenue gain over the forward estimates has been updated since the 2017–18 Budget announcement to reflect a minor policy change to the measure that will ensure only Australian residents for tax purposes can access the main residence exemption.¹⁸ This change was announced in the 2017–18 Mid-Year Economic and Fiscal Outlook. The announcement indicated that the government decided to make this amendment to the policy following consultation.¹⁹

Reconciliation payment for near-new dwelling exemption certificates

1.26 Schedule 2 to the Measures No. 2 bill seeks to amend the *Foreign Acquisitions and Takeovers Act 1975* (Foreign Acquisitions Act) to enable a reconciliation payment to be made by developers who sell dwellings to foreign persons under a near-new dwelling exemption certificate. Near-new dwellings are dwellings that have previously been subject to a failed settlement.²⁰

1.27 On 24 June 2017, the Foreign Acquisitions and Takeovers Regulation 2015 was amended to introduce a near-new dwelling exemption certificate. The near-new dwelling exemption certificate enables property developers to sell near-new dwellings to foreign persons under the Foreign Acquisitions Act in the same way as they sell new dwellings. Prior to the introduction of a near-new dwelling exemption certificate, a foreign person had to submit an individual application for approval to purchase the near-new dwelling.²¹

1.28 The measures in Schedule 2 to the Measures No. 2 bill are complemented by the provisions of the Near-new Dwelling Interests bill, which makes consequential amendments to the *Foreign Acquisitions and Takeovers Fees Imposition Act 2015* (Fees Act) in order to impose the amount of the fee payable by developers. As a result of these changes, this bill also includes editorial amendments to the Fees Act.²²

17 Explanatory Memorandum, p. 7.

18 Explanatory Memorandum, p. 7.

19 Commonwealth of Australia, *Mid-Year Economic and Fiscal Outlook 2017–18*, December 2017, p. 109.

20 Explanatory Memorandum, p. 8.

21 Explanatory Memorandum, pp. 33–34.

22 Explanatory Memorandum, p. 36.

Financial impact

1.29 This measure forms part of a package of measures aimed at streamlining the foreign investment regime with a cost of \$20.4 million over the forward estimates.²³

Capital gains tax incentive for investments in affordable housing

1.30 Schedule 3 to the Measures No. 2 bill seeks to amend the ITAA 1997 and the *Taxation Administration Act 1953* (TAA 1953) to provide an additional affordable housing capital gains discount of up to 10 per cent if a CGT event occurs to an ownership interest in residential premises that has been used to provide affordable housing.²⁴

1.31 Several measures in the 2017–18 Budget housing package were specifically designed to address housing affordability for members of the community earning low to moderate incomes, by providing incentives for investors to increase the supply of available affordable housing.²⁵

1.32 The amendments contained in Schedule 3 seek to provide an additional CGT incentive to increase private investment in affordable rental housing by providing individual and institutional investors (including resident investors in MITs) with the option to retain an increased amount of the capital gains they realise from their investments in affordable housing. Individual investors may invest by holding an ownership interest in affordable housing directly or through certain types of trusts or partnerships (other than public unit trusts and superannuation funds).²⁶

1.33 The explanatory memorandum outlines the eligibility conditions which must be met in order to receive the additional affordable housing capital gains discount.

1.34 An individual is eligible for an additional affordable housing capital gains discount (direct investment) if they:

- make a discount capital gain from a CGT event happening in relation to a CGT asset that is their ownership interest in a dwelling; and
- used the dwelling to provide affordable housing for at least three years (1095 days) which may be aggregate usage over different periods.

1.35 An individual will also be eligible for an additional affordable housing capital gains discount on a capital gain (trust investment) if:

- that capital gain was distributed or attributed to them:
 - directly from a trust; or
 - from a trust through a partnership or another trust;
- the capital gain was a discount capital gain for the trust that realised that gain;

23 Explanatory Memorandum, p. 8.

24 Explanatory Memorandum, p. 8.

25 Explanatory Memorandum, p. 41.

26 Explanatory Memorandum, p. 41.

- the dwelling was used to provide affordable housing for at least three years (1095 days) which may be aggregated use in different periods; and
- the trust which used the dwelling to provide affordable housing and any interposed entities (if any) through which the capital gain was distributed or attributed to the individual was one of the following specified entities:
 - a trust (other than a public unit trust or a superannuation fund);
 - a MIT; or
 - a partnership.²⁷

1.36 In order to be eligible for the additional affordable housing capital gains discount, the property management condition requires the tenancy of the additional affordable housing capital gains discount dwelling or its availability for rent to be exclusively managed by an eligible community housing provider.²⁸

Consultation

1.37 Treasury released exposure draft legislation for the measures contained in Schedule 3 and conducted a brief consultation process from 14 September to 28 September 2017. This consultation process also included exposure draft legislation for another measure which was announced in the 2017–18 Budget housing package, but is not included in the Measures No. 2 bill—affordable housing through managed investment trusts (MITs).²⁹

Financial impact

1.38 This measure is estimated to result in a cost to revenue of \$15 million over the forward estimates period comprising:

Table 2: Financial impact (as set out in Explanatory Memorandum)³⁰

2016–17	2017–18	2018–19	2019–20	2020–21
-	-	*	-\$5m	-\$10m

* *Unquantifiable*

- *Nil*

Legislative scrutiny committees

1.39 The explanatory memorandum to the bills states that the proposed legislation is compatible with the human rights and freedoms recognised or declared in the

27 Explanatory Memorandum, p. 45.

28 Explanatory Memorandum, p. 51.

29 Treasury, 'Increasing the supply of Affordable Housing', <https://treasury.gov.au/consultation/increasing-affordable-housing/> (accessed 19 March 2018). At the time of reporting, the submissions for this consultation process had not been published on the consultation website.

30 Explanatory Memorandum, p. 8.

international instruments listed in section 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011*.

1.40 The Parliamentary Joint Committee on Human Rights considered the Near-new Dwelling Interests bill in its *Report 2 of 2018* and found that it did not raise human rights concerns.³¹ The Human Rights Committee deferred consideration of the Measures No. 2 bill.³²

1.41 The bills were also considered by the Senate Standing Committee for the Scrutiny of Bills in its *Scrutiny Digest 2 of 2018*.

1.42 The Scrutiny of Bills Committee raised concerns that all the measures in the bills would apply retrospectively. In respect to the bills, the Scrutiny of Bills Committee reiterated its long-standing concern that 'provisions with retrospective application (including where provisions are back-dated to the date of announcement of an initiative) challenge a basic value of the rule of law that, in general, laws should only operate prospectively'.³³

31 Parliamentary Joint Committee on Human Rights, *Report 2 of 2018*, 13 February 2018, p. 42.

32 Parliamentary Joint Committee on Human Rights, *Report 2 of 2018*, 13 February 2018, p. 119.

33 Senate Standing Committee for the Scrutiny of Bills, *Scrutiny Digest 2 of 2018*, 14 February 2018, pp. 19 and 62.

