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Ref: AMK

13 March 2018

Mr Mark Fitt
Committee Secretary
Senate Standing Committees on Economics
Parliament House, PO Box 6100
CANBERRA ACT 2600

By Email: *economics.sen@aph.gov.au*

Dear Mr Fitt

TREASURY LAWS AMENDMENT (REDUCING PRESSURE ON HOUSING AFFORDABILITY MEASURES NO. 2) BILL 2018

1. We welcome the opportunity to provide comments with respect to the Treasury Laws Amendment (Reducing Pressure on Housing Affordability Measures No. 2) Bill 2018 (“**the Bill**”). Our comments below are limited to Schedule 3 – Additional capital gains discount for affordable housing (“**Schedule 3**”) of the Bill.

SUMMARY OF PROBLEM

2. We support the proposal to provide an incentive for the increase in the capital gains tax discount rate of 10% for individuals investing (directly or indirectly) in affordable housing.

3. However, it has come to our attention that there is likely to be one significant technical issue with Schedule 3 that may result in the provisions becoming inoperative in almost all cases.

4. In summary, due to the expected low rental yield on affordable housing and the expected short period of holding (i.e. 3 years), we believe that there is a significant risk that the ATO would classify a gain on the disposal of such property as being on revenue account rather than as a capital gain. Where this occurs, the disposal will not be subject to the capital gains tax regime and thus the additional discount percentage will have no application. This risk of this potential view would act as a serious deterrent to investing in affordable housing projects.

FURTHER BACKGROUND

5. We note that there are a number of occasions where similar capital gains tax concessions have not worked due to the same issue identified above.

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6. For example, we highlight that a 50% capital gains tax concession has previously been provided to Listed Investment Companies ("**LICs**") in Subdivision 115-D of the Income Tax Assessment Act 1997 ("**Tax Act**"). However, the ATO has held that such holdings are on revenue account in Taxation Ruling TR 2005/23 and thus the concession is not generally available. The effect of the ATO view in TR 2005/23 has been to effectively nullify the concession.

7. We are concerned that a similar view could eventuate for those looking to access a capital gains discount on affordable housing. Our main concern is that the low rental yield on affordable housing will indicate that the purpose of holding the property is to generate a profit on sale in the short term (and thus be regarded as being on revenue account rather than on capital account).

8. Recently, a capital gains tax concessions has been provided on the disposal of shares subject to the Early Stage Investment Company ("**ESIC**") provisions in Division 360 of the Tax Act. As shares need only be held for 12 months under the ESIC provisions, the disposal of such shares would also run the risk of being classified on revenue account.

9. However, the ESIC provisions deal with this issue through section 360-50 of the Tax Act. Under section 360-50, a sale of ESIC qualifying shares is deemed to be on "capital account" rather than on revenue account. This ensures that the concessions provided are not nullified by the fact that a holding of an asset for a short period of time (with little or no yield) is not treated on revenue account.

RECOMMENDED SOLUTION

10. Due to the risk that a gain would be on revenue account, we are concerned that the lack of a "deemed capital account" provision could render Schedule 3 inoperative.

11. We highlight that the loss of the capital gains tax discount could have a material effect on the commercial returns and viability of an investment in such a project to the investor. Accordingly, we are concerned that a properly advised taxpayer would be unlikely to invest in affordable housing projects where the capital gains tax concessions are an important aspect of the investment decision.

12. We therefore strongly recommend that a provision, similar to that contained in section 360-50 of the Tax Act, be included in Schedule 3 to ensure that a gain on the disposal of affordable housing (which otherwise satisfies Schedule 3) be deemed to be treated on capital account.

If you would like to discuss any aspect of this submission, please contact either me on [redacted]

Yours sincerely

[redacted]

A M KOKKINOS
Executive Director