TR 2023/3 - Income tax: expenses associated with holding vacant land

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Taxation Ruling

Income tax: expenses associated with holding vacant land

Relying on this Ruling

This publication (excluding appendix) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

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What this Ruling is about

1. From 1 July 2019, deductions are limited for losses or outgoings that relate to holding vacant land. Some exclusions apply. This Ruling explains the Commissioner's view of the application of and some of the exclusions of section 26-102 of the *Income Tax Assessment Act 1997*.

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

Scope of this Ruling

3. Section 26-102 applies only when a loss or outgoing would otherwise be deductible under section 8-1 or another provision of the tax law. This Ruling does not provide advice on any other provision governing deductibility, including section 8-1. The reasoning and conclusions expressed here should not be used in the context of any other provision.

4. The examples used in this Ruling all assume that the losses or outgoings described would be deductible if section 26-102 did not apply.

Ruling

5. Broadly, subsection 26-102(1) denies a deduction for losses or outgoings relating to holding land on which there is no substantial and permanent structure in use or available for use.[1] In certain circumstances you may be excluded from the operation of the section, such as if the land is used in carrying on a business[2], you lease the land to an entity carrying on a business[3], the land is held by primary producers[4], or you are a particular kind of entity.[5] There are other exceptions to this section. However, the operation of these exceptions is not addressed in this Ruling

[1] A lessee may also incur costs relating to holding land. See paragraph 3.28 of the Explanatory Memorandum to the Treasury Laws Amendment (2019 Tax Integrity and Other Measures No. 1) Bill 2019 (EM).
[2] See subsection 26-102(2). The business must have a purpose of gaining assessable income of you, your affiliate, spouse, child under the age of 18 or an entity connected with you.
[3] See subsection 26-102(9).
[4] See subsection 26-102(8).
[5] See subsection 26-102(5).

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6. Leaving aside business, entity, or primary production exclusions, 3 tests determine whether the section applies to a land holding:

- Is there a substantial and permanent structure on the land?
- If there is a structure, is it in use or available for use?
- If there is a structure available for use, is it independent of and not incidental to the purpose of any other structure, or proposed structure on the land?

7. A substantial structure is significant in size, value, or some other criteria of importance in the context of the property.[6] To be permanent, a structure needs to be fixed and enduring.[7]

8. We must consider whether any substantial and permanent structure has an independent purpose in the context of the land on which it is located. Structures that have the purpose of increasing the utility of another structure are not considered independent.[8]

9. For example, in the context of primary production, fencing, silos and sheds are substantial and permanent structures that serve independent purposes.

10. By contrast, in the context of residential land, fencing or a garage (though substantial and permanent structures) do not have a purpose independent of the residence. Rather, the purpose of these structures is to increase the utility of any existing or proposed residence on the land.[9]

Example 1 – manager's residence

11. *Jamilla owns a 100-hectare block of farmland on a single title that includes an established house previously used as a manager's residence. The house is currently vacant but is capable of being occupied.*

12. *The house is a substantial and permanent structure with an independent purpose that is not incidental to the purpose of any other structure. It enables someone to live on the land and oversee farming activities.*

13. *Subsection 26-102(1) does not apply to deny a deduction for the holding costs in relation to the land as the land is not vacant. This is the case, even though the area that contains the home is minimal compared with the farming land.*

Example 2 – residential vacant land

14. *Lien owns a vacant block in a residential area on which she intends to build a rental property. The block is fenced on 3 sides and has a small shed. Lien stores tools and equipment in the shed to maintain the block. The fence and shed are not substantial and permanent structures with a purpose that is independent of any other proposed structure on the residential block. They exist to support the use and function of the proposed rental property. For the purposes of subsection 26-102(1), the land is considered vacant and deductions for the costs of holding the land are denied.*

[6] Paragraphs 3.18 to 3.19 of the EM.
[7] Paragraph 3.20 of the EM.
[8] Paragraphs 3.21 to 3.22 of the EM.
[9] Paragraph 3.23 of the EM. See also Example 3.1 in the EM.

Status: **legally binding**

Structure in use or available for use

15. In addition to there being a permanent and substantial structure on the land, subsection 26-102(1) requires the structure to be 'in use or available for use'. The purpose of the structure will partly determine what 'in use or available for use' means in context.

16. In the context of premises that are capable of being occupied (whether residential or commercial), those premises will be considered available for use unless they have been deemed unsafe to occupy by a council, relevant body or relevantly qualified professional.

17. Residential premises constructed or substantially renovated while you hold the land must be 'lawfully able to be occupied' and this would occur when the certificate of occupancy (or other local council approval) is received. They must also be leased, hired, or licenced or available for lease hire or licence.[10] These requirements are addressed in greater detail in paragraphs 20 to 22 of this Ruling.

Example 3 – demolishing an established house

18. *Arun purchased an established house which he has used as a rental property for several years. On 1 July 2019, he decides to demolish the existing house to build a townhouse. The tenants vacate the property in October 2019. The house is demolished in December 2019. The property was in use or available for use until the date of demolition. Any holding costs that Arun may otherwise be entitled to deduct until the property was demolished would not be limited by section 26-102.*

Example 4 – existing residential premises that are not in use or available for use are demolished

19. *Continuing from Example 3 of this Ruling, the tenants vacate the property in October 2019 because the residential premises has been declared by the local council as being structurally unsafe to occupy.*[11] *Arun demolishes the property in December 2019. Any holding costs that Arun would otherwise be entitled to deduct from October 2019 when the residential premises were not legally able to be occupied would be limited by section 26-102 as the house is not 'in use or available for use'.*

Residential premises constructed or substantially renovated while you hold the land

20. Pursuant to subsection 26-102(4), residential premises[12] that you construct or substantially renovate are disregarded as a 'substantial and permanent structure' unless they can lawfully be occupied and are leased, hired, or licensed (or available for lease, hire or licence).

[10] Subsection 26-102(4).
[11] In Example 4 of this Ruling, we assume that there was not an exceptional circumstance or natural disaster under subsection 26-102(6) that led to the residential premises being structurally unsafe to occupy.
[12] 'Residential premises' is defined in section 195-1 of *A New Tax System (Goods and Services Tax) Act 1999*. For further guidance refer to GSTR 2012/5 *Goods and services tax: residential premises*.

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21. 'Substantial renovations'[13] is defined in section 195-1 of *A New Tax System (Goods and Services Tax) Act 1999* as being:

> … renovations in which all, or substantially all, of a building is removed or replaced. However, the renovations need not involve removal or replacement of foundations, external walls, interior supporting walls, floors, roof or staircases.

22. Subsection 26-102(4) applies throughout your ownership period of the land. This means that at all times, newly-constructed or substantially renovated residential premises must be:

- lawfully able to be occupied, and
- either
  - leased, hired, or licensed, or
  - available for lease, hire or licence.

Example 5 – new construction

23. *Harry purchases vacant land on 1 July 2019 and builds a house on the land. He obtains an occupancy certificate on 9 February 2020. Harry lists the property with a real estate agent for lease on 1 March 2020. Any holding costs that Harry would otherwise be entitled to deduct from 1 March 2020 will not be denied by section 26-102, as from this date the house is lawfully able to be occupied and is available for lease.*

Loss or outgoing relating to holding land

24. Subsection 26-102(1) clarifies that any interest or ongoing borrowing costs to acquire land are included as a cost of holding land. Examples of other costs of holding land include council rates, land tax and maintenance costs.

25. Where section 26-102 prevents a deduction for holding costs, the expenses may form part of the third element costs of owning the asset.[14]

26. 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.

[13] Subsection 995-1(1) provides that 'substantial renovations' have the same meaning as in the *A New Tax System (Goods and Services Tax) Act 1999.* Further guidance on what comprises a 'substantial renovation' is contained in Goods and Services Tax Ruling GSTR 2003/3 *Goods and Services Tax: when is a sale of real property a sale of a new residential premises?*

[14] 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.

Example 6 – interest expense for multiple purposes

27. *Giovanna takes out a mortgage to purchase a vacant block of land in September 2019. Giovanna intends to build a house on the land (which she will rent out). Giovanna does not carry on a business. Giovanna takes out a separate loan for the construction of the house. Giovanna will not be able to claim a deduction for her interest expense which relates to acquiring the land until the house is lawfully able to be occupied and leased or available for lease. If a deduction is otherwise available for the construction loan interest expense, Giovanna will not be prevented from deducting the expense by section 26-102.*

Interest incurred after land is sold or business activity has ceased

28. Taxation Ruling TR 2004/4 *Income tax: deductions for interest incurred prior to the commencement of, or following the cessation of, relevant income earning activities* considers the deductibility of interest expenses incurred before income-earning activities have begun and after they have ceased.

29. Paragraphs 10 to 11 of TR 2004/4 note that where interest has been incurred over a period after the relevant borrowings (or assets representing those borrowings) have been lost to the taxpayer and relevant income-earning activities (whether business or non-business) have ceased, it is apparent that the interest is not incurred in gaining or producing the assessable income of that period or any future period. However, the outgoing will still have been incurred in gaining or producing the assessable income if the occasion of the outgoing is to be found in whatever was productive of assessable income of an earlier period.

30. If you sell the land, the critical time for considering the application of section 26-102 to deductible expenses is just before you ceased to hold the land.[15] The interest will continue to be deductible[16] if the land was not vacant immediately before you ceased to hold the land.

31. If you cease carrying on a business and a cost of holding vacant land relates to an earlier time or period, the expense will still be deductible to the extent that the land was being used to carry on a business at that earlier time or period.[17]

Example 7 – land vacant immediately before sale

32. *Michael owns a residential investment property which he constructed on vacant land that he purchased. Michael decides to sell the property, and on the advice of his real estate agent, he waits until the tenants move out in order to offer vacant possession to potential buyers. The residential premises are the only substantial and permanent structure on the land.*

33. *Pursuant to subsection 26-102(4), once the current lease ends, the structure is disregarded, and the land is considered vacant for the purposes of subsection 26-102(1). Any interest expense associated with purchasing the land is not deductible from the time*

[15] Subparagraph 26-102(1)(b)(ii).
[16] The interest expense must have been deductible under section 8-1 or another relevant provision, and not specifically denied by section 26-102.
[17] Subsection 26-102(3).

the premises are no longer leased, or available for lease, and will not be deductible after the property has sold.

34. *However, interest expenses associated with the construction of the residential premises is not a cost of holding land and will be deductible after the property has sold if it continues to be incurred and is otherwise deductible in accordance with TR 2004/4 (refer to paragraph 28 of this Ruling).*

Land in use or available for use in carrying on a business

35. Subsection 26-102(1) does not limit deductions for holding costs of vacant land to the extent that the land is in use, or available for use, in carrying on a business for the purpose of gaining assessable income of you, your affiliate, any entity of which you are an affiliate, your spouse, your child under the age of 18 or an entity connected with you.[18]

36. In addition, subsection 26-102(1) will not apply to limit deductions where the land is leased at arm's length to another entity and that land is used or available for use by that entity in carrying on a business.[19]

37. 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.[20]

38. Where vacant land has mixed uses, subsection 26-102(1) will not apply to limit a deduction to *the extent* that the land is in use, or available for use, in carrying on a business. If only part of the land is used or available for use in carrying on a business, you will need to apportion your holding costs on a fair and reasonable basis in the context of that use.[21] An example of this is given in Example 13 of this Ruling.

39. Property developers will generally not be affected by subsection 26-102(1) provided they are carrying on a business satisfying the requirements outlined in paragraph 37 of this Ruling. There is no requirement for the land to be in active use in the business. Land held by a developer for future development would be considered 'available for use'.[22]

40. However, where the land is held separately from the property development business, for example, by a special purpose vehicle (SPV), regard must be had to whether the SPV is subject to the limitation in subsection 26-102(1). A SPV that is a discretionary trust would not come within the 'kind of entity' exception in subsection 26-102(5). Accordingly, consideration may need to be given to whether the SPV carries on business for the purposes of subsections 26-102(1) and (2).

[18] See subsection 26-102(2). An entity is connected with you in the circumstances described in section 328-125.
[19] See subsection 26-102(9). This exception will not apply if the land contains residential premises, or such premises are being constructed on it.
[20] Guidance relevant to identifying whether an individual is carrying on a business is contained in Taxation Ruling TR 97/11 *Income tax: am I carrying on a business of primary production.* See also Self-Managed Superannuation Funds Ruling SMSFR 2009/1 *Self-Managed Superannuation Funds: business real property for the purposes of the Superannuation Industry (Supervision) Act 1993.*
[21] Paragraph 3.34 of the EM.
[22] Paragraph 3.31 of the EM.

Example 8 – carrying on a business

41. *The John and James Smith Partnership operates a property development business and, as part of its business, acquires land in preparation for the development of a new apartment complex. As the land is being used in carrying on a business*[23]*, subsection 26-102(1) does not limit the holding costs that can be deducted by the partnership. It does not matter whether the land is being developed currently or is being held for future development.*

Example 9 – land used in family business

42. *Amanda owns 1,000 hectares of bare cropping land over multiple titles. Amanda leases her land to a trading entity that is controlled by her parents. The trading entity runs a business selling the produce from the land. Amanda is employed by the trading entity but is not an affiliate of, or connected with, the trading entity.*[24] *The rent on the land is at market value. The exception in subsection 26-102(9) applies to Amanda as the lease was a result of an arm's length dealing and the lessee is using the land in carrying on a primary production business. Accordingly, subsection 26-102(1) will not prevent Amanda from claiming deductions in relation to her land.*

Land held by primary producers

43. Subsection 26-102(1) does not limit your deductions for holding costs of vacant land where you or a related entity[25] carry on a primary production business[26] and you lease, hire or licence the land to another entity.[27] For this exception to apply, the land must not contain residential premises (including residential premises that are under construction).

Example 10 – land held in carrying on a primary production business

44. *A family trust holds 200 acres of farming land and carries on a business of primary production. The trustee leases 10 acres of vacant land on commercial terms*[28] *to a family member for their personal use. Section 26-102 does not limit any otherwise deductible holding costs that the trustee can claim in relation to the land used by the lessee because of the exception in 26-102(8).*

[23] In this example, it is assumed that the business satisfies the requirement in subsection 26-102(2).
[24] For the purposes of this example, it is assumed that Amanda is neither 'connected with' nor an 'affiliate' of the trading entity. Whether an entity is connected with or an affiliate of another entity within the meaning of sections 328-125 and 328-130 will depend on the relevant facts and circumstances. If Amanda was either 'connected with' or an 'affiliate' of the trading entity, subsection 26-102(2) would apply (and there would be no need to consider the exception in subsection 26-102(9)).
[25] Within the meaning of subsection 26-102(2).
[26] 'Primary production business' is defined in subsection 995-1(1).
[27] Subsection 26-102(8).
[28] While section 26-102(8) does not require the lease to be at arm's length, we note that a deduction for a loss or outgoing relating to the holding of land may not be allowable (either in full or in part) under section 8-1 in circumstances where the land has been leased to a party on non-arm's length terms.

Relevant area of land

45. The loss or outgoing will determine the area of land that is relevant for the purposes of section 26-102.

46. 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.[29]

47. If a loss or outgoing relates to only part of the land under a property title then for the purposes of determining if there is a substantial and permanent structure on the land, it is sufficient that such a structure exists somewhere on that part of the land.[30] The structure does not need to take up all of that part of the land or all the land under the property title.

48. Similarly, if a loss or outgoing relates to land held under multiple titles, you need to determine whether that land contains a substantial and permanent structure. Again, it will be sufficient that such a structure exists somewhere on the area of land to which the loss or outgoing relates.

Example 11 – multiple titles, residential premises

49. *James purchases a vacant block of land in October 2019 and subdivides the block into 2 lots shortly thereafter (Lot A and Lot B). James intends to build a new house on each of the new lots (which he will rent out). James does not carry on a business and each of the lots is on a separate title. The house on Lot A is completed in August 2020 and the certificate of occupancy is issued in September 2020. James immediately lists the house for rent with a local real estate agent.*

50. *James first needs to distinguish between holding costs that relate to the individual titles (such as council rates) and holding costs that relate to both titles (such as interest on the loan obtained to purchase the land). James needs to consider, for each cost, whether section 26-102 applies to limit any deductions that would otherwise be available.*

51. *Holding costs associated only with Lot B will not be deductible as the land remains vacant and section 26-102 applies. Holding costs associated with Lot A are not deductible until September 2020 when the house can be lawfully occupied and is available for lease.*[31] *Holding costs associated with both lots also won't be deductible until September 2020.*

Example 12 – multiple titles where all land titles are used in carrying on a business

52. *A family trust holds 10,000 hectares of farming land. The land is on 5 separate titles which are not co-located. The land is leased, at arm's length, to Allan and Mary who, in partnership, carry on a wheat-growing business on the land. Allan and Mary have reduced their capacity to farm the land over several years. In the current year, they have left 2 of the 5 titles to rest because access to external water sources on those titles is expensive. Section 26-102 does not limit any otherwise deductible holding costs that the trustee can claim in relation to the land used by the partnership in carrying on its wheat-growing business. The exception in subsection 26-102(9) applies even though 2 of the individual*

[29] Paragraphs 3.15 and 3.17 of the EM.
[30] See note 2 to subsection 26-102(1) and paragraphs 3.13, 3.14 and 3.17 of the EM.
[31] See subsections 26-102(1) and (4).

titles are not presently being used because they remain available for use in carrying on a business.

Example 13 – multiple titles where only some of the land titles are used in carrying on a business

53. *Continuing from Example 12 of this Ruling, rather than leaving the 2 titles of land to rest, the trustee as owner of the land terminates the lease in relation to those titles so that it can construct a residential rental property on each title. The exception in subsection 26-102(9) does not apply to those 2 titles of land as they are no longer leased and available for use in carrying on a business.*

54. *Assuming the trustee is not in the business of property development, it will need to apply section 26-102 to each holding cost to determine whether the provision limits any otherwise deductible holding costs associated with the vacant titles. The trustee will also need to determine when the 2 titles cease being used or available for use in carrying on a business so that, if necessary, any expenses can be apportioned. Any apportionment should be done on a fair and reasonable basis. Once the residential premises are complete and the conditions in subsection 26-102(4) are satisfied, any otherwise deductible holding costs would no longer be limited by section 26-102.*

Date of effect

55. The legislative changes received royal assent on 28 October 2019. They apply to costs incurred on or after 1 July 2019, even if the land was held before that date.

56. This Ruling will be effective from 1 July 2019, being the application date of section 26-102. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10 *Public Rulings*).

57. The Commissioner notes that the views set out in this Ruling in paragraphs 45 to 49 (relevant area of land) may be more favourable to some taxpayers than the approach for multiple titles taken in paragraphs 39 to 41 of Draft Taxation Ruling TR 2021/D5 *Income tax: expenses associated with holding vacant land* which was published on 4 August 2021. If you have been impacted by this change, we encourage you to contact the ATO to determine how the change impacts your circumstances.

Commissioner of Taxation
27 September 2023

Status: **not legally binding**

Appendix – Compliance approach

❗ ***This Appendix sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow the advice in this appendix in good faith and consistently with the Ruling section, the Commissioner will administer the law in accordance with this approach.***

Newly-constructed property temporarily unavailable for lease, hire or licence

58. We recognise that there will naturally be short periods of time when residential premises are unavailable for lease, hire or licence for reasons other than an exceptional circumstance or natural disaster.[32] For example, it would be expected that between tenancies there will be a brief period when the premises cannot practically be made available for lease because it is necessary for the owner to undertake minor maintenance and repairs.

59. These circumstances are outside the contemplation of subsection 26-102(4) and we will not apply resources to review compliance with subsection 26-102(4) provided that you continue to meet the requirements for deductibility under section 8-1 or another provision of the tax law.

Example 14 – short absence to undertake repairs

60. *Mohammad owns a residential rental property that he constructed on land that he holds. The tenants vacate the property leaving minor damage to some of the walls and fixtures. Mohammad is keen to maximise the amount of rent from the property and decides to repair the damage to the property before relisting it for rent. The property is off the market for 4 weeks while the repairs are undertaken. Mohammad's intention is always to lease the property and his holding costs remain deductible under section 8-1. This short period of vacancy is a normal incidence of the transition between tenancies. In these circumstances, we would not seek to apply compliance resources to determine whether subsection 26-102(1) applies to deny Mohammad's deductions for holding costs during the vacant period.*

Determining if a lessee is using land to carry on a business

61. We accept that when leasing vacant land to an unrelated entity, it will not always be obvious whether the lessee is carrying on a business. The holder of the land may not have sufficient information to ascertain whether the usual indicia of a business are present in the activity conducted by the lessees.

62. When leasing vacant land to an unrelated entity, you should make a reasonable assessment of the other entity's use of the land. Considerations include, but are not limited to:

- whether the lessee has an active Australian business number
- whether the lessee is registered for goods and services tax
- whether the lessee requires a tax invoice or receipt for lease payments

[32] Subsection 26-102(6) contains an exception to the general rule in cases of structures affected by natural disasters or other exceptional circumstances.

- the lessee's stated intention regarding use of the land – using the land for primary production is likely to indicate that the lessee is carrying on a business
- the amount of the lease payments – nominal or sub-commercial rates may indicate that the lessee is not in business
- the terms of a formal lease agreement may be an indicator that the lease is commercial in nature, and therefore more likely that the lessee is carrying on a business, and
- where the lessee is an entity of the type that is referenced in subsection 26-102(5), this may indicate that the lessee is in business.

63. This compliance approach is designed to give you confidence that, if you make a reasonable assessment that the lessee is carrying on a business having regard to these factors, and where the land is leased to an unrelated entity, we will not allocate additional compliance resources to determine whether a lessee is carrying on a business for the purposes of subsections 26-102(1) and (9), except to confirm that your assessment is reasonable.

Example 15 – lease to an unrelated entity in business

64. *Jill is a retired primary producer. She owns a 2-acre paddock that is completely vacant. Jill enters into a formal agreement with an unrelated entity to lease the land. The lease agreement outlines the lessee's intention to store excess farm machinery and appliances on her land, for use in their farm equipment sales and repairs business. The lease amount is commensurate with normal commercial rates. Based on these factors, Jill makes a reasonable assessment that the lessee is using the land in the course of carrying on a business.*

Status: **not legally binding**

References

Previous draft:

TR 2021/D5

Related Rulings/Determinations:

TR 97/11; TR 2004/4; TR 2006/10; GSTR 2003/3; SMSFR 2009/1

Legislative references:

- ITAA 1997 8-1
- ITAA 1997 26-102
- ITAA 1997 26-102(1)
- ITAA 1997 26-102(1)(b)(ii)
- ITAA 1997 26-102(2)
- ITAA 1997 26-102(3)
- ITAA 1997 26-102(4)
- ITAA 1997 26-102(5)
- ITAA 1997 26-102(6)
- ITAA 1997 26-102(8)
- ITAA 1997 26-102(9)
- ITAA 1997 328-125
- ITAA 1997 328-130
- ANTS(GST)A 1999 195-1

Other references:

Explanatory Memorandum to the Treasury Laws Amendment (2019 Tax Integrity and Other Measures No. 1) Bill 2019

ATO references

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