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Residential premises deductions: travel expenditure relating to rental investment properties

Relying on this draft Ruling

This Law Companion Ruling is a draft for consultation purposes only. When the final Ruling issues, it will have the following preamble:

This Ruling describes how the Commissioner will apply amendments made by Schedule 1 to the [Treasury Laws Amendment \(Housing Tax Integrity\) Act 2017](#).

If you rely on this Ruling in good faith, you will not have to pay any shortfall tax, penalties or interest in respect of matters covered by the Ruling if it does not correctly state how a relevant provision applies to you.

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What this draft Ruling is about

1. This draft Ruling considers amendments to the *Income Tax Assessment Act 1997* (ITAA 1997)¹ made by Schedule 1 to the *Treasury Laws Amendment (Housing Tax Integrity) Act 2017*. The broad purpose of these amendments is to deny a deduction for travel expenditure incurred in gaining or producing assessable income from certain uses of residential premises as residential accommodation.²

¹ All legislative references in this draft Ruling are to the ITAA 1997 unless otherwise stated.

² Such expenditure is also excluded from the cost base and reduced cost base of residential premises for CGT purposes; see subsections 110-38(4A) and 110-55(9J), respectively.

2. Prior to the amendments, travel expenditure was generally deductible under section 8-1 to the extent that it was incurred in gaining or producing assessable income from a rental property.
3. Under new subsection 26-31(1), you cannot deduct a loss or outgoing you incur to the extent that it is related to travel, if it is incurred to gain or produce assessable income from certain uses of residential premises as residential accommodation.
4. However, you may continue to deduct such losses or outgoings if:
 - you are an excluded entity³, or
 - the losses or outgoings are necessarily incurred in carrying on a business for the purpose of gaining or producing your assessable income.⁴
5. Specifically, this draft Ruling clarifies:
 - (a) the meaning of the term ‘residential premises’
 - (b) the meaning of carrying on a business for the purposes of paragraph 26-31(1)(b), and
 - (c) the application of section 26-31 to travel expenditure that serves more than one purpose.

Date of effect

6. When finalised, this Ruling will be a public ruling, effective for those who incurred a loss or outgoing on or after 1 July 2017 and who rely on the Ruling in good faith.

Meaning of ‘residential premises’

7. For the purposes of section 26-31, the loss or outgoing you incur must be incurred in gaining or producing assessable income from the use of residential premises as residential accommodation.
8. ‘Residential premises’ takes its meaning from the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act). ‘Residential premises’ is defined in section 195-1 of the GST Act as land or a building that⁵:
 - (a) is occupied as a residence or for residential accommodation; or
 - (b) is intended to be occupied, and is capable of being occupied, as a residence or for residential accommodation
9. To be residential premises as defined, the premises must be fit for human habitation. Premises that lack the features of shelter and basic living facilities are not residential premises. An objective consideration of the relevant facts and circumstances determines whether premises are fit for human habitation.
10. Premises, comprising of land or a building, are residential premises under paragraph (a) of the definition provided in section 195-1 of the GST Act where the premises are occupied as a residence or for residential accommodation, regardless of the term of occupation. The actual use of the premises as a residence or for residential accommodation is relevant to satisfying this limb of the definition.

³ Subsection 26-31(2).

⁴ Paragraph 26-31(1)(b).

⁵ See Goods and Services Tax Ruling GSTR 2012/5 *Goods and services tax: residential premises* for further discussion.

11. Premises, comprising land or a building, are also residential premises under paragraph (b) of the definition provided in section 195-1 of the GST Act if the premises are intended to be occupied, and are capable of being occupied, as a residence or for residential accommodation, regardless of the term of the intended occupation. This limb of the definition refers to premises that are designed, built or modified so as to be suitable to be occupied, and capable of being occupied, as a residence or for residential accommodation. This is demonstrated through the physical characteristics of the premises.

12. The premises may refer to land or buildings in their entirety, or as a part thereof. It may be in any of a number of forms, including detached buildings, semi-detached buildings, strata titled apartments, single rooms or suites of rooms within larger premises.

Example 1: shelter and basic living facilities

13. *Julian owns a building that consists of a display area, a storage area, an office, a kitchenette and a toilet. The physical characteristics of the building together with its architectural plan show that the premises were designed as a shop. The building provides shelter and basic living facilities. Julian leases the building to a tenant who furnishes the premises in order to use it as their residence.*

14. *The tenant's occupation of the shop as a residence means that the shop satisfies paragraph (a) of the definition of residential premises in section 195-1 of the GST Act. Julian cannot deduct his travel expenditure incurred in gaining his rental income from the use of the residential premises as residential accommodation.*

Carrying on a business of property investing

15. There is an exception in paragraph 26-31(1)(b) which ensures that you can continue claiming travel deductions if you carry on a business of property investing or a business of providing retirement living, aged care, student accommodation or property management services.

16. The question of whether a business is carried on is a question of fact and depends on the circumstances of each case.⁶

17. Taxation Ruling TR 97/11 *Income tax: am I carrying on a business of primary production?* sets out the factors which are relevant to determining whether a taxpayer carries on a business of primary production for tax purposes. The indicators are no different, in principle, from the indicators as to whether activities of a non-primary production nature in any other area constitute the carrying on of a business.

18. The courts have held that the following indicators are relevant⁷:

- whether the activities have a significant commercial purpose or character
- the existence of a profit-making purpose and a prospect of profit
- the complexity and magnitude of the undertaking
- whether the activities involve a degree of repetition and regularity
- the size and scale of activities
- whether the activities are systematic and organised, and
- the amount of time, effort and capital employed.

⁶ *Brookton Co-operative Society Ltd v. FCT* (1981) 147 CLR 441 per Aickin J at p. 469; *Spriggs & Riddell v. FCT* (2009) 239 CLR 1; [2009] HCA 22 at [59].

⁷ *Spriggs & Riddell v. FCT* (2009) 239 CLR 1; *Ferguson v. FCT* (1979) 9 ATR 873 at 876-877; *YFPD and Commissioner of Taxation* [2014] AATA 9.

19. Whether a business is carried on must be answered based on a wide survey and the overall impression of the activities.⁸ No one indicator is decisive. They must be considered in combination and as a whole.

20. In determining whether you carry on a business of letting residential properties, some of the factors that the Commissioner may consider can include:

- the total number of residential properties that are rented out
- the average number of hours per week you spend actively engaged in managing the rental properties
- the skill and expertise exercised in undertaking these activities⁹, and
- whether professional records are kept and maintained in a business-like manner.

21. Generally, it is more difficult for an individual to demonstrate that they are carrying on a business of property investing than it is for a company.¹⁰ The receipt of income by an individual from the letting of property to a tenant, or multiple tenants, will not typically amount to the carrying on of a business as such activities are generally considered a form of investment rather than a business.

Travel expenditure that serves more than one purpose

22. Section 26-31 denies a deduction for a loss or outgoing you incur insofar as it is related to travel, if the conditions in paragraphs 26-31(1)(a) and (b) are satisfied. Thus, a loss or outgoing otherwise deductible under section 8-1 is disallowed to the extent that section 26-31 applies.¹¹

23. The use of the words ‘insofar as’ in subsection 26-31(1) determine the extent to which an outgoing is attributable to travel. However, the conditions in paragraphs (a) and (b) of the subsection do not contain the phrase ‘insofar as’ (or the phrase ‘to the extent that’ which appears in section 8-1).

24. We consider that an apportionment is required where you incur a travel-related loss or outgoing in gaining or producing income from the use of residential premises as residential accommodation, and also in gaining or producing other assessable income (for example, business or employment income).

25. Such an amount can be characterised as both a loss or outgoing incurred in gaining or producing income covered by paragraph 26-31(1)(a) and as a loss or outgoing incurred in gaining or producing other income. There is no apparent policy reason for concluding that subsection 26-31(1) is intended to entirely deny deductions for expenditure incurred for mixed income-producing purposes. In such cases, an implied apportionment supports the apparent intent of the provision, by only denying a deduction to the extent that the amount relates to the income specified in paragraph 26-31(1)(a).

26. Where a single outlay of travel expenditure is incurred partly for the purpose of gaining or producing income covered by paragraph 26-31(1)(a)¹², and partly for other income-producing purposes, you must make a fair and reasonable assessment of the extent to which the amount relates to each purpose. When apportioning an indiscriminate

⁸ *Martin v. FCT* (1953) 90 CLR 470 per Webb J at p. 474.

⁹ For example, personally attending to property maintenance and repairs, undertaking renovations, regular inspection of the properties and undertaking all financial planning and decision making.

¹⁰ See *American Leaf Blending Co. Sdn Bhd v. Director-General of Inland Revenue (Malaysia)* [1978] 3 All ER 1185 and *London Australia Investment Co Ltd v. FCT* [1977] HCA 50; (1977) 138 CLR 106 per Gibbs J. Contrast with the discussion in Draft Taxation Ruling TR 2017/D7 *Income tax: when does a company carry on a business within the meaning of section 23AA of the Income Tax Rates Act 1986?*

¹¹ Paragraph 8-1(2)(d).

¹² And that purpose is not subject to the exception in paragraph 26-31(1)(b) (about carrying on a business).

sum, factors to be taken into account may include floor-area ratio, rental income and travel time spent attending to each purpose. What is considered a fair and reasonable basis would depend on the facts of each case.

Example 2: mixed-use property

27. *Anna owns multiple workshops across Australia as part of her business operations. She owns a two-storey brick shop-house in Melbourne. The building comprises a workshop on the ground floor and an apartment on the first floor.*

28. *The apartment is rented out separately to a couple, Leon and Michelle. Anna derives assessable income from both her workshop and the apartment.*

29. *The apartment satisfies the definition of residential premises within the meaning of the GST Act.*

30. *Anna travels from her hometown in Canberra to her property in Melbourne for the sole purpose of carrying out maintenance on the walls and roof of the building. This maintenance activity is related to gaining or producing assessable income from both the workshop and the apartment.*

31. *Anna incurs airfare costs associated with this travel. Anna must apportion her travel expenditure on a fair and reasonable basis to determine how much is deductible.*

32. *Anna cannot deduct her travel expenditure to the extent that it reasonably relates to gaining or producing assessable income from using her apartment for residential accommodation. She can only deduct the amount that reasonably relates to gaining or producing assessable income from her workshop.*

Commissioner of Taxation

2 May 2018

Your comments

33. You are invited to comment on this draft Ruling including the proposed date of effect. Please forward your comments to the contact officer by the due date.

34. A compendium of comments is prepared for the consideration of the relevant Public Advice and Guidance Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments
- be published on the ATO website at www.ato.gov.au.

Please advise if you do not want your comments included in the edited version of the compendium.

Due date: 1 June 2018
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References

ATOlaw topic(s)	Income tax ~~ Deductions ~~ Rental property expenses ~~ Other
Legislative references	ITAA 1997 ITAA 1997 8–1 ITAA 1997 8–1(2)(d) ITAA 1997 26-31 ITAA 1997 26-31(1) ITAA 1997 26-31(1)(a) ITAA 1997 26-31(1)(b) ITAA 1997 26-31(2) ITAA 1997 110–38(4A) ITAA 1997 110–55(9J) ITAA 1997 960-115 ITAA 1997 995-1 ANTS(GST)A 1999 ANTS(GST)A 1999 195-1 Treasury Laws Amendment (Housing Tax Integrity) Act 2017
Related Rulings/Determinations	GSTR 2012/5 TR 2017/D7 TR 2003/4 TR 93/32 IT 2423
Case references	American Leaf Blending Co. Sdn. Bhd v. Director-General of Inland Revenue (Malaysia) [1978] 3 All ER 1185 Brookton Co-operative Society Ltd v. Federal Commissioner of Taxation - (1981) 147 CLR 441; (1981) 55 ALJR 479; (1981) 35 ALR 295; (1981) 11 ATR 880; 81 ATC 4346; [1981] HCA 28 Ferguson v. Federal Commissioner of Taxation - (1979) 37 FLR 310; (1979) 26 ALR 307; (1979) 9 ATR 873; 79 ATC 4261; [1979] FCA 29; 79 ATC 470 Martin v. Federal Commissioner of Taxation (1953) 90 CLR 470 Spriggs v. Federal Commissioner of Taxation - [2009] HCA 22; (2009) 72 ATR 148; (2009) 83 ALJR 749; 2009 ATC 20-109; (2009) 256 ALR 596; [2009] ALMD 4628; [2009] ALMD 4629; [2009] ALMD 4631; [2009] ALMD 4633; (2009) 239 CLR 1 Re YPFD and Federal Commissioner of Taxation - [2014] AATA 9; 2014 ATC 1-063; (2014) 94 ATR 484
Other references	Rental properties 2017 NAT 1729-06.2017
ATO references	1-BQJE100
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