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## ATO SETS OUT RULES ON HOLIDAY HOMES, JUST IN TIME FOR SUMMER HOLIDAYS!

The summer holidays are approaching. For some, they are already here! To celebrate the season the ATO has issued Draft Taxation Ruling 2025/D1 that sets out its position on income and deductions for rental properties and holiday homes. This replaces a ruling from July 1985 and also comes with two Draft Practical Completion Guidelines that sets out the ATO's compliance approach. PCG 2025/D6 sets out the differing apportionment methods that can be used in relation to deductions, while PCG 2025/D7 applies risk ratings to the behaviours surrounding the use of holiday homes to determine if the ATO is likely to review deductions for that property.

The distinction between a rental property and a holiday home is a key element of being able to deduct costs for holding, using, operating, maintaining or repairing the property, such as interest expense and repairs and maintenance. For the purposes of the ruling, a holiday home refers to "a property that is used (or held ready for use) for your holidays or recreation (or the holidays or recreation of your family members and friends for no rent or at a reduced rate)." If the property fits this definition, then any deductions would be limited to those directly related to the renting out of the property such as agent and cleaning fees.

There is an out clause as such, with the deduction restrictions not applying where the holiday home is used, or held ready for use, mainly to produce assessable income such as rent. To determine whether is it mainly used for such a purpose, various factors need to be taken into consideration, such as the:

- way the holiday home was actually used?
- time the holiday home was dedicated to earning rental income
- time the holiday home was used or held for private purposes
- extent that the holiday home was actually available for rent during peak holiday periods, such as school holidays, public holidays or peak seasonal demand periods.

The risk ratings provided in PCG 2025/D7 align with the above factors. The higher the risk rating, the more likely the ATO will apply compliance resources to the property. A low-risk rating is unlikely to be reviewed.

A holiday home with high occupancy, very little private use (particularly during peak seasons), where it can be shown that the renting out of the property is given priority over private purposes, will fall into the low-risk zone. One of the low-risk examples given had 1 week total of private use per year during the "peak period" (not a typo-apparently there was only one peak period).

A holiday home with high occupancy, a larger amount of private use (particularly during peak periods), where there are limited attempts to maximise the rental income, will fall into the risk zone.

The high-risk zone applies to holiday homes with low occupancy, where private use is prioritised, with significant blockout periods, where major features of the property are not available to renters or unreasonable restrictions are placed on renters, and there are limited attempts to derive rental income, including advertising the property at above market rates.

For rental properties, or holiday homes with the main use of deriving rent, any deductions relating to holding, using, operating, maintaining or repairing the property, may not be able to be claimed in full. Where 100% of the property was not rented out, available for rent, or available for use by the tenants, only a percentage of the deduction can be claimed. This extends to any private use of the property, or if there is a blackout period where it cannot be rented.

Such an apportionment can be made based on the percentage of time the property is rented or available for rent. An apportionment can also be made based on the percentage of the property area that is rented or available for rent. It is possible that it is appropriate to use both methods to determine the percentage of the expense that is deductible. Apportionments can also apply where the type of use changes during the year.

40 years have passed between the ATO providing guidance on rental property and holiday home income and deductions, and in that time the amount of data the ATO is able to collect in relation to property usage has increased significantly during that time.

Holiday home owners may find themselves in the firing line if they over-use their properties during peak demand periods. Unfortunately, there's not too much guidance on what over-use is!

If you would like to discuss this matter further, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

## PROPERTY ACTIVITIES - IS YOUR CLIENT "REQUIRED" TO REGISTER FOR GST?

As the property market continues climbing to new heights, the key question facing clients engaging in property activities is whether their property activities constitute an enterprise and if they are 'required to register for GST'. Whilst this appears to be an innocuous question, the impact of getting this wrong can be costly.

Essentially, an entity will be liable to pay GST where it makes a 'taxable supply'. This will occur where:

a) it makes the supply for consideration; and
b) the supply is made in the course or furtherance of an enterprise that it carries on; and
c) the supply is connected with the indirect tax zone; and
d) it is registered, or required to be registered.

However, the supply is not a taxable supply to the extent that it is GST-free or input taxed.

As such, GST is payable on the supply of certain types of property if the supplier (seller or vendor) makes a "taxable supply" and is registered or required to be registered for GST purposes. Generally, your client will not be required to register for GST if:

- their property transactions are for private use, such as constructing or selling their family home; or
- they only receive residential rent from your property.

However, an entity may be required to register for GST, (even if they are not a business), where:

- their turnover from property transactions and other taxable transactions is more than the $75,000 GST registration threshold; and
- their activities are regarded as an 'enterprise', for example – if they buy land with the intention of developing it for resale at a profit.

The crucial issue is determining whether the property activities amount to an "enterprise". Two cases on this matter have resulted in taxpayers having to pay GST even where they were not registered for GST at the time of the sale of their property due to the property activities constituting an enterprise.

In the Administrative Appeals Tribunal (AAT) decision in Lance's Case (Lance v Commissioner of Taxation (Taxation) [2024] AATA 11) Mr Lance failed to prove that the development works relating to the subdivision of his property were not carried on in the course or furtherance of an enterprise. The AAT noted that Mr Lance's actions—subdividing, rezoning, engaging experts, and lodging development plans were consistent with conducting a business or at least an adventure in the nature of trade.

The AAT held that evidence showed Mr Lance was enhancing the property's value with the clear intention of selling at a profit and not simply holding it for private enjoyment. The Tribunal rejected the argument that the works were just a "realisation" of a private asset and instead that the activities were commercial development activities with a trade purpose.

In the Collins SMSF Case, (Ian Mark Collins & Mieneke Mianno Collins ATF The Collins Retirement Fund and FCT [2022] AATA 628, AAT, Olding SM, 4 April 2022), the AAT has held that the Collins Fund, was subject to GST on the sale of their subdivided residential lots (despite having deregistered prior to development activities). This was on the basis that it was 'required to be registered'. The Collins SMSF contended that the sales were the mere realisation of a capital asset and thus, under s 188-25(b) of the GST Act ought to be disregarded as the sales were of a capital asset made as a consequence of the ceasing of an enterprise. The Tribunal rejected this, finding the subdivision and sale were part of a commercial venture, not a passive realisation.

The key learning from these cases is that significant development works and commercial intent will prevent sales being treated as mere capital realisation, resulting in sales being considered part of a commercial venture. Both cases demonstrate how the enterprise test applies; if activities look like trade, an enterprise is being conducted and GST applies.

The cases reinforce the ATO's view that property development and subdivision, even if argued as "one-off" or "capital realisation," can be treated as a commercial venture subject to GST. Importantly, it demonstrates that advice should be obtained if there is any doubt and, if not properly planned for, the GST implications can be substantial.

If you would like to discuss this matter further, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.

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## DIVISION 296 REVAMPED, FOR BETTER OR WORSE?

The Government, after much push back from industry and the community has announced sweeping changes to their proposed Division 296 tax applying to larger Superannuation Funds.

The start date for the new measure has been pushed back by twelve months to 1 July 2026, with the first measurement point now set for 30 June 2027.

Under the announced changes, Division 296 tax will no longer be levied on unearned income or unrealised capital gains, but on the realised or 'earned' income of the superannuation fund. Whilst the details on how this will be calculated are still to be disclosed, it's expected that the realised earnings of each member will more closely resemble the taxable income of the superannuation fund.

The $3 million threshold will now be indexed in line with increases in CPI. Instead of adjusting annually, the threshold will only increase in $150,000 increments meaning it will only rise once cumulative CPI growth exceeds $150,000.

The additional tax applied will be 15 per cent on the income that is attributable or apportioned to the share of the member's balance that exceeds $3 million. The Government has also introduced a second superannuation balance threshold of $10 million. Members whose balance exceeds $10 million will have an additional tax levied at 10 per cent of the superannuation fund earnings that apply to the income that is attributable to balances above $10 million.

This $10 million threshold will also be indexed, which will increase in $500,000 increments. With these changes the proposed legislation needs to be redrafted, and the superannuation industry is expecting the draft legislation to be introduced into Parliament in early 2026 following a period of industry consultation.

An example of how the proposed changes may work:

1. Ben is the sole member of his self-managed superannuation fund (SMSF)
2. Ben has a total superannuation balance at 30 June 2027 of $11,000,000
3. The Fund has (taxable) earnings for the 2027 financial year of $500,000.

Under the new measures the fund will pay Income Tax of $75,000. ($500,000 x 15%)

Ben will further receive a Div 296 assessment for $59,091 which is calculated as:

- 15% of the earnings attributable to the balance from $3 million to $11 million. (72.72%)
- 10% of the earnings attributable to the balance above $10 million. (9.09%)

There are several facets of the calculation of realised earnings that are yet to be clarified. These include:

1. Whether realised capital gains will be those gains that only accrue after the start date of the legislation on 1 July 2026, or whether they are the full realised capital gain from an assets' acquisition date. This would be similar to what occurred when the Transfer Balance Cap was introduced.
2. Whether realised capital gains will be subject to the normal capital gains discounting that applies where an asset is owned for more than 12 months, or whether it will be on a gross capital gains basis.
3. Whether the 'realised earnings' can be reduced by exempt current pension income (if the superannuation fund is supporting the payment of pensions for members).

Whilst the new changes have been widely welcomed as a good step forward as it removes taxes on unrealised gains and will be subject to indexation, there are a couple of drawbacks to this.

1. The details in regard to the calculation method and whether cost base relief will be available have not yet been announced. As such if no cost base relief is in the measures many fund members may actually be worse off with the proposed changes than the original Division 296 measures.
2. The second-tier tax rate effectively means that for members with large superannuation balances they will effectively be paying a higher rate of tax for assets held within superannuation (40%) than the corporate tax rate. This issue is further compounded if members are too young to withdraw excess capital out of their funds to restructure.

If you would like to discuss these matters further, please contact Andrew Lowry or Leonard Tebbutt on 08 9444 9711.