



Tax Insights

Build to rent measures pass through both houses of parliament

Snapshot

On 29 November 2024 the Australian parliament passed the [Capital Works \(Build to Rent Misuse Tax\) Bill 2024](#), and an amended version of the [Treasury Laws Amendment \(Responsible Buy Now Pay Later and Other Measures\) Bill 2024](#) ("the amended bill") which include measures to improve housing affordability through tax incentives for certain build to rent (BTR) developments, as part of the government's broader plan to increase housing supply in Australia.

The amended bill provides incentives for certain BTR developments through the following tax concessions:

- Access to a concessional 15% managed investment trust (MIT) withholding tax (WHT) rate for rental and capital gains in relation to dwellings that are part of an eligible BTR development (referred to as "active BTR developments" in the amended bill) and capital gains on disposals of membership interests in entities holding an active BTR development (to the extent referable to dwellings of an active BTR development) from 1 July 2024; and
- An increase in the capital works rate of deduction from 2.5% to 4% for active BTR developments in respect of capital works that commenced after 7.30 p.m. AEST on 9 May 2023.

It is important to note that the income tax incentives operate separately from state and territory initiatives designed to support the BTR sector and will have separate eligibility criteria.

While the incentives are welcomed, certain aspects of the amended bill are likely to reduce their attractiveness. These aspects include:

- **One ineligible dwelling compromises the entirety:** The “one out all out” rule which deems an entire BTR development to be ineligible for the concessions where a single dwelling no longer satisfies the eligibility criteria. The Commissioner has a discretion to disregard certain breaches, however the risk of being subject to the heavy-handed “misuse tax” remains;
- **Uncertainty on returns:** The ability to “regularly” change the discount to market rent and tenant income requirements will introduce uncertainty in the financial returns that can be generated by BTR developments, impacting on feasibility assessments;
- **Oversized impact of misuse tax:** The BTR development misuse tax, which is imposed on the owner of a BTR development where it ceases to qualify during the 15-year “BTR compliance period.” The misuse tax is calculated based on the maximum concessions potentially available plus an 8% uplift (not the actual concessions claimed), including maximum concessions available to previous owners. The misuse tax assumes that the maximum benefit of the concession was available, even if it could be shown that the actual benefit was less (e.g., no MIT WHT benefits were obtained as there were no nonresident investors);
- **Punitive tax rate:** The punitive 45% rate at which the misuse tax applies to the trustee or responsible entity of a trust, who are generally subject to a maximum tax rate of 30% on distributions to foreign investors;
- **Double tax where misuse tax applies:** An inability to uplift the tax cost base for assets that have had their concessional capital works deductions “clawed back” pursuant to the misuse tax;
- **Capital gains tax (CGT) concession limited to dwelling itself:** The MIT WHT concession only applies in respect of capital gains on the disposal of dwellings, and therefore excludes capital gains on adjacent land or parts of the building that are not dwellings;
- **Timing of choice:** Based on the requirement to lodge a choice with the Commissioner to form a BTR development to access the concessions, it seems it is not possible for a BTR development to qualify as an active BTR development until the legislation is enacted and the Commissioner receives the choice in the approved form. There is no scope to make a choice with retroactive effect, and given that the requirements for affordable dwellings and lease terms are not yet available, this may further delay the effective date of any choice.
- **Significant administrative cost:** Various administrative requirements, including a requirement for the vendor and purchaser to notify the Commissioner within 28 days of any changes in ownership, including disposals of membership interests in an entity holding a BTR development. There do not seem to be any concessions for transfers of membership interests in listed entities.

The amendments to the version of the bill introduced into parliament in June 2024 (“the original bill”) reflect some of the submissions made to the Senate Committee, and (to some extent) the policy positions of the Australian Greens.

This article outlines the amendments and then provides a summary of the BTR measures, reflecting the amended bill.

Summary of differences between the amended bill and the original bill

For those familiar with the history of these measures, the table below provides a summary of differences between the amended bill and the original bill.

Subject	Amended bill	Original bill
Lease term	Each dwelling must be made available to the public to be tenanted for a lease term of at least five years (a tenant can request a shorter lease term)	Previously this was three years
Other lease terms	Each dwelling must be made available to the public to be tenanted by way of lease in accordance with any requirements determined by the minister by legislative instrument. The explanatory memorandum (EM) suggests that this may include a prohibition on "no cause" evictions	N/A
Existing developments	Extends eligibility for the 15% MIT WHT concession to all BTR developments that satisfy the eligibility requirements, even if the development existed, or construction on the development had commenced, before or on 7.30 p.m., by legal time in the Australian Capital Territory, on 9 May 2023	The 15% MIT WHT concession was only available for developments where works commenced after this time
Meaning of affordable dwelling	<p>Amends the definition of "affordable dwelling" to provide that a dwelling is an affordable dwelling if it satisfies the requirements determined by the minister by legislative instrument. These requirements may include (but are not limited to) requirements relating to the rent payable under the lease, as well as requirements relating to the income of the tenant</p> <p>It is expected that the legislative instrument will provide a requirement that rent must be no more than 74.9% of market rent. It is also expected that there will be additional requirements, such as the use of separate low and middle-income thresholds and the involvement of community housing providers in managing affordable dwellings</p>	<p>The 25.1% discount was included as a requirement under the bill</p> <p>The minister could only impose requirements relating to the income of the tenant</p>
BTR misuse tax imposition	Revises the provisions that deal with the BTR misuse tax by imposing liability to pay the BTR misuse tax on the entity that owns the BTR development immediately before that development ceased to be an active BTR development	BTR misuse tax could apply to a previous owner based on a breach of the requirements by a subsequent owner

Subject	Amended bill	Original bill
BTR misuse tax calculation	<p>The way the BTR misuse tax is calculated has been changed to reflect maximum concessions potentially available including maximum concessions available (not actual) to any previous owner, plus an 8% "interest" mark-up</p> <p>In relation to the MIT WHT concession, the BTR misuse tax is based on the active BTR development rental or capital gains included in each fund payment made (including by previous owners). It does not take into account whether the 15% MIT WHT concession was actually available in respect of the fund payment (i.e., whether the fund payment was ultimately made to a qualifying nonresident)</p> <p>It is also not clear how the owner of the BTR development would access details of relevant fund payments made by previous owners, if the owner does not have this information</p> <p>The misuse tax relating to concessional capital works deductions is still based on a 47% tax rate for trustees and does not result in an increase in cost base</p>	<p>The BTR misuse tax was imposed on the entity that benefited from the concessional capital works deductions or 15% MIT WHT concession (i.e., for the 15% MIT WHT concession, the trust that made a relevant fund payment to a foreign resident), and only to the extent that the 15% MIT WHT concession was actually available</p> <p>To support administration of this rule, the 15% MIT WHT concession was only available if the trustee of the trust making the offshore distribution was the same as the trustee of the trust that owned the active BTR development (and any interposed trusts). The "same trustee" requirement was problematic because a wholly owned sub-trust with the same trustee would "merge" with the head trust rather than be treated as a separate trust. This requirement has been removed from the amended bill</p>

Active BTR developments

Number of dwellings

The BTR development must consist of at least 50 dwellings that are made available for rent to the public. If the dwellings are temporarily not available for rent because of the construction of an extension, alteration, improvement, or repairs, the dwellings would still be deemed to be available for rent. Furthermore, repurposed or build to sell developments converted to BTR are intended to qualify (although how this will work in practice is still a little unclear).

Terms of lease

Dwellings in the BTR development must be available to the public to be tenanted by way of lease for a period of at least five years. However, the requirement does not apply where a tenant requests a shorter-term lease, or where the dwelling is not available to be tenanted to tenants for lease terms of at least five years as a result of repairs, construction, improvements, and alterations. The terms of the lease must also meet any requirements determined by the minister by legislative instrument (unless such terms are noncompliant with a state or territory law). The EM suggests that this may include a prohibition on "no cause" evictions.

Ownership requirements

All dwellings and common areas for the dwellings in the BTR development must be owned by a single entity (which can include a group of owners that invest via a single entity or a new single entity owner). Accordingly, changes in ownership of the investment vehicle itself, such as introduction of new investors or a full disposal is possible without compromising the single entity requirement. Similarly, a previous owner can sell the entire active BTR development to a new single owner and the BTR development should still satisfy the single entity requirement as long as the dwellings and common areas of the dwellings continue to be owned by a single owner. For completeness, the BTR compliance period does not reset if the active BTR development is sold to a new owner.

Affordable dwelling requirements

At least 10% of the dwellings must be offered as affordable dwellings throughout the 15-year period. Dwellings will be considered affordable dwellings if they satisfy the requirements determined by the minister by legislative instrument. From the EM, these requirements may include (but are not limited to) requirements relating to the rent payable under the lease, as well as requirements relating to the income of the tenant. It is expected that the legislative instrument will provide a requirement that rent must be no more than 74.9% of market rent. It is also expected that there will be additional requirements, such as the use of separate low and middle-income thresholds and the involvement of community housing providers in managing affordable dwellings.

The EM notes that this delegation of legislative power is appropriate as the affordability requirements may need to be varied on a regular basis to respond to changes in the residential tenancy market and key considerations for affordability.

There is a further requirement that the number of comparable nonaffordable dwellings must be greater than or equal to the number of comparable affordable dwellings. The number of comparable dwellings broadly refers to the number of dwellings that have the same number of bedrooms and a floor area that is at least equal to but does not exceed 110% of the floor area of the test (affordable) dwelling. This formulation allows for certain classes of dwelling to be offered on a nonaffordable basis only, and ensures there are sufficient nonaffordable dwellings of the same type as the affordable dwellings.

The ability to “regularly” change the discount to market rent and tenant income requirements will introduce uncertainty in the financial returns that can be generated by BTR developments, affecting feasibility assessments.

When does a BTR development cease to be an active BTR development?

A BTR development will cease to be an active BTR development at the first time that any dwellings that make up the active BTR development fail to satisfy the requirements. For example, if one dwelling is offered to the public for a term of less than five years, the entire BTR development (i.e., a minimum of 50 dwellings) becomes ineligible for the concessions and the misuse tax may arise. There is no pro-rata mechanism to apportion eligible and ineligible dwellings or to apportion eligible and ineligible years based on the period of ownership. The Commissioner may exercise discretion to permit a breach relating to lease terms, affordable dwelling requirements, and/or comparable affordable dwellings requirements if the failure arose due to events outside the entity's control, the entity took all reasonable steps to ensure the dwellings would satisfy the criteria as soon as practicable, the dwellings satisfied the criteria at the time the Commissioner makes a determination, and the entity intends for each dwelling to satisfy the criteria for the remainder of the BTR compliance period.

Some examples of events outside the control of the entity include unforeseeable events (such as fire or flood) that may result in a dwelling not being available to the public for rent, or an inadvertent failure of tenant income thresholds.

Form of choice

Finally, a choice must be made to form a BTR development and the Commissioner must be notified of the choice in the approved form. The choice comes into effect on a nominated day after the Commissioner receives the choice, or (if no date is nominated) on the day the Commissioner receives the choice. As the amended bill has not yet been legislated and there is no scope to make a choice with retroactive effect, and given that the requirements for affordable dwellings and lease terms are not yet available, the actual benefit of the concessions will necessarily be delayed beyond the 1 July 2024 start date.

Reduced MIT WHT

Normally fund payments made to foreign investors from a withholding MIT attributable to rental income or capital gains in respect of residential housing are subject to MIT WHT at a rate of 30%.

The amended bill provides for the concessional MIT withholding tax rate of 15% to apply in relation to fund payments made to foreign investors treated as resident of a relevant exchange of information jurisdiction to the extent the amount is:

- Rental income attributable to dwellings of an active BTR development;
- A capital gain from a CGT event in relation to the dwelling; or
- A capital gain from a CGT event in relation to membership interests in an entity that holds dwellings of an active BTR development (based on the proportion of the market value of the membership interest reflecting such dwellings).

The concessional MIT WHT rate does not apply to the disposal of assets that are not dwellings. This would capture land adjacent to the building, common areas, and presumably various components of the building structure such as elevators. The specific methodology that applies to determine the extent to which the concessional MIT WHT rate applies to a capital gain on membership interests also excludes the value of other assets. Accordingly, it would be expected that some of the capital gain would not qualify, and the nonqualifying component could potentially be significant.

The 15% MIT withholding tax rate is available beyond the 15-year BTR compliance period if the active BTR development continues to satisfy all of the active BTR development requirements. Note that this differs to the accelerated capital works deductions that only require the single entity ownership (and use) condition to be satisfied after the 15-year BTR compliance period has ended.

The concessional MIT withholding tax rate will still apply from 1 July 2024 (subject to making the active BTR development choice, see above); however, under the amended bill, the 15% MIT WHT rate will be available for all active BTR developments, even if the development existed, or construction on the development had commenced, before or on 7.30 p.m. (AEST) on 9 May 2023. This differs to the accelerated capital works deductions which are only available for capital works that began after this time.

BTR concessional capital works deduction

Normally, a 2.5% rate of deduction applies for capital expenditure incurred in relation to capital works for BTR developments. The amended bill provides for a 4% rate of deduction for active BTR developments where capital works began after 7.30 p.m. (AEST) on 9 May 2023.

No other entity (apart from entities providing management services) can be using the eligible BTR development (or any part of the eligible BTR development) for the purpose of producing assessable income.

The 4% accelerated capital works deduction can extend beyond the 15-year BTR compliance period irrespective of whether the BTR development continues to satisfy all of the active BTR development requirements, provided the single entity ownership requirement continues to be satisfied.

BTR development misuse tax

Should any of the active BTR development requirements not be met (at any time during the 15-year compliance period) for any of the dwellings that comprise the BTR development, subject to the availability of the Commissioner's discretion to permit a temporary breach of certain requirements, a nondeductible BTR development misuse tax applies.

The misuse tax is payable by the owner of the BTR development in the income year in which the BTR development ceases to meet the requirements. For a trust, any misuse tax is therefore payable by the trustee (not the beneficiaries or by way of withholding).

The misuse tax is based on the maximum concessions potentially available (plus an 8% uplift), including the maximum concessions available to any previous owners. The misuse tax assumes that the maximum benefit of the concession was available, even if it could be shown that the actual benefit was less.

In the context of MITs which may have different investors over the BTR compliance period, the application of the misuse tax may unfairly affect incoming investors. Investors in an MIT in the income year when a BTR development ceases to qualify ultimately bear the cost of the misuse tax. As such, if the investors in an MIT have changed over time, investors in the year that an MIT is liable for misuse tax may effectively be subject to the misuse tax for periods that pre-date their investment.

The historical risk of misuse tax will be a key issue for tax due diligence on any entity holding an active BTR development and may promote more transactions at the asset level. Nevertheless, the current eligibility of a BTR development would require close scrutiny even for an asset acquisition, as the accumulation of misuse tax effectively runs with the property. For transactions in the later stages of the BTR compliance period, the amount of accumulated misuse tax could be very significant.

The fixed 8% gross up is intended to act as a notional interest charge. While a time value of money element is understandable given the time frame over which the BTR misuse tax relates (i.e., it applies to the maximum concessions potentially available referable to up to 15 years in the past), an arbitrary rate with no links to market conditions could very well give rise to inequitable outcomes.

MIT WHT concession

In relation to the MIT WHT concession, the BTR misuse tax is based on the rental attributable to dwellings of an active BTR development or relevant capital gains included in each fund payment made (including by previous owners). It does not take into account whether the 15% MIT WHT concession was actually available in respect of the fund payment (i.e., whether the fund payment was ultimately made to a qualifying nonresident). It is also not clear how the owner of the BTR development would access details of relevant fund payments made by previous owners, if the owner does not have this information.

Capital works concession

The BTR misuse tax for the capital works concession is based on the difference between the normal 2.5% rate and the concessional 4% rate for an active BTR development. It does not take into account whether the deduction resulted in less tax actually being payable (as opposed to, for example, being reflected in carry forward tax losses) or the amount of any tax savings based on applicable tax rates.

The capital works concession misuse tax is based on a 47% tax rate for trustees or 30% for companies. For trusts there is therefore no recognition that (broadly) withholding MITs are likely subject to a maximum tax rate of 30% in respect of distributions to foreign investors or the actual tax rate applicable to resident investors, and the misuse tax amount will therefore nearly always exceed the amount actually necessary to "neutralize" tax benefits claimed.

The capital works concession misuse tax also does not result in an increase in cost base (i.e., the cost base would still have been reduced by the 4% deduction). Double taxation may therefore arise on a future disposal of the BTR development.

Administrative issues

There are several market-based and administrative requirements that create additional uncertainty and complexity when ensuring compliance with the rules. For example, the affordable dwellings requirement is expected to require substantiation that the rent in respect of the dwellings is 74.9% or less than the comparable market rate, with no clear definition of market rate or guidance on the ascertainment of market rate.

There are requirements to notify the Commissioner within 28 days of any of the following events occurring in relation to a BTR development:

- A development commences to be an active build to rent development;
- A development expands to include additional dwellings;
- An ownership interest in the development is acquired by another entity; or
- The development ceases to be an active BTR development.

Both the vendor and purchaser of an ownership interest must notify the Commissioner.

An ownership interest includes an interest in an entity that holds a BTR development, therefore any changes in unitholders or shareholders would require notification. There do not seem to be any concessions for listed entities or for small changes in ownership.

There is an unlimited period for the Commissioner to amend income tax returns where the concessions were incorrectly claimed (e.g., where the qualification criteria were not met). This operates separately from the misuse tax which applies where the concessions were available, but the BTR development has ceased to qualify as an active BTR development within the BTR compliance period.

Conclusions

Whilst the incentives under the amended bill will generally be welcomed, particularly access to the 15% concessional MIT WHT rate, there a number of issues that will reduce the impact on investment in the sector (some of which seem to be deliberate and others which are perhaps unintended). It is hoped that further refinements could be made to the legislation as these types of issues are identified and the impacts assessed, in order to promote achievement of the government's housing objectives.

The legislative instruments setting out the affordable housing and lease terms requirements will also be critical in assessing the relative benefits of seeking to qualify for the concessions.

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