

**Australian Government****Inspector-General of Taxation****Taxation Ombudsman**

Telephone: 1300 44 88 29  
Facsimile: 02 8088 7815

GPO Box 551  
Sydney NSW 2001

27 September 2021

Mr Jason Falinski MP  
Chair  
House of Representatives Standing Committee on Tax and Revenue  
Parliament House  
CANBERRA ACT 2600

Dear Mr Falinski

**INQUIRY INTO HOUSING AFFORDABILITY AND SUPPLY IN AUSTRALIA**

The Inspector-General of Taxation and Taxation Ombudsman (**IGTO**) welcomes the opportunity to contribute to the House of Representatives Standing Committee on Tax and Revenue's (**Committee**) Inquiry into Housing Affordability and Supply in Australia (**Inquiry**).

The IGTO is an independent statutory agency that investigates taxation administration systems and laws, as well as the actions and decisions made by Tax Officials - of the Australian Taxation Office (**ATO**) or the Tax Practitioners Board (**TPB**). The IGTO seeks 'to assure and ensure that there is fair, equitable, and transparent administration of the tax system consistent with community expectations.'<sup>1</sup> We also undertake tax investigations for the purpose of providing independent advice and assurance to Government on the taxation administration laws and systems.

The IGTO is not empowered to investigate or advise on tax policy matters. Accordingly, this submission does not make (or intend to make) comment on the appropriateness of current (or proposed) tax settings as applied to housing affordability.

The main focus of this submission is to share with the Committee some insights from our taxation complaint investigation service in relation to the First Home Super Saver Scheme (FHSSS). This issue appears to be of relevance since one of its objectives was to assist first home buyers to save for the purchase of their first home. In particular, four primary issues of concern arise in our complaints – correction of errors, uncertainty of eligibility for certain applicants, practical outcomes which appear inconsistent with the aims of the scheme and delay in releasing funds.

These issues have been discussed with the ATO during the course of our investigations and we acknowledge that some of these issues may have been brought to the Treasury's attention and may be the subject of legislative change already announced, or that are currently under consideration. We highlight the issues seen in our taxation complaint investigation service to provide the Committee with insight into administrative matters that it may wish to consider when considering potential recommendations of new measures or strategies to improve housing affordability and supply.

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<sup>1</sup> Inspector-General of Taxation and Taxation Ombudsman, *Corporate Plan 2022 – 2025* (2021) p 5  
<<https://igt.gov.au/accountability-and-reporting/>>.

The submission is set out in six sections:

1. General information about the FHSSS
2. Complaints received by the IGTO
3. Correction of errors
4. Eligibility
5. Practical outcomes which appear inconsistent with the aims of the scheme
6. Delays in releasing funds

## 1. General information about the FHSSS

Since 1 July 2018, taxpayers have been able to apply to the ATO for a release of voluntary contributions made to their superannuation funds after 1 July 2017 along with any associated earnings to contribute towards the purchase or construction of a first home.<sup>2</sup> The FHSSS capped the amount of contributions that can be released at \$15,000 in any financial year, and a total maximum of \$30,000 across all years.<sup>3</sup> From 1 July 2022, the total maximum will be increased to \$50,000.<sup>4</sup>

Accessing funds under the FHSSS involves:

- applying to the ATO for a determination of the maximum amount that may be released – the timing of when a determination needs to be sought is presently the subject of two IGTO complaint investigations and is explored later in this submission;<sup>5</sup>
- applying to the ATO for a ‘release authority’ which specifies the amount that the superannuation fund must release to the ATO;<sup>6</sup> and
- receiving released amounts from the ATO,<sup>7</sup> minus any applicable withholding, in order to facilitate the purchase or construction of the home.

A taxpayer is required to enter into a contract for purchase or construction of the home within 14 days before, or 12 months after, applying to the ATO for release of the funds. However, the Commissioner may grant taxpayers an additional 12 months to enter into the contract.<sup>8</sup> Where, at the end of the extended period, no purchase has been made, the taxpayer may either re-contribute the released sums or choose to keep the amounts and be subject to FHSS tax.

There are requirements to notify the ATO of either entry into the contract of purchase or construction of the home or a re-contribution of the released amounts.

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<sup>2</sup> *Taxation Administration Act 1953*, Sch 1, Sub-div 138-A.

<sup>3</sup> *Taxation Administration Act 1953*, Sch 1, Sub-div 138-B.

<sup>4</sup> Australian Government, *Federal Budget 2021-22 – Budget Paper No 2* (2021) p 17.

<sup>5</sup> *Taxation Administration Act 1953*, Sch 1, s 138-10.

<sup>6</sup> *Taxation Administration Act 1953*, Sch 1, Div 131.

<sup>7</sup> *Taxation Administration Act 1953*, Sch 1, s 131-65.

<sup>8</sup> *Income Tax Assessment Act 1997*, s 313-35(2). The ATO has stated on its website that “we will grant you an extension of time to do so for a further 12 months. There is no need to apply for this extension, it will be automatically granted to you and we will notify you of this.”

## 2. Complaints received by the IGTO

We have undertaken a search of our case management system using key search terms and identified that since FY19 we have received a total of 48 complaints (approximately 5.1% of all superannuation complaints over that period):

| Financial year  | Complaints received |
|-----------------|---------------------|
| FY19            | 10                  |
| FY20            | 11                  |
| FY21            | 21                  |
| FY22 (to date*) | 6                   |
| <b>TOTAL</b>    | <b>48</b>           |

\* As at 2 September 2021.

Of these, 20 cases have been progressed to complaint investigations while the remainder were dealt with by way of general information, referral to other agencies or referral to the ATO to allow it to resolve the issue in the first instance.

The complaints that have been investigated by the IGTO have raised a number of issues which we have summarised below for the Committee's consideration.

The IGTO notes that the ATO receives complaints directly in relation to the FHSSS and the Committee may wish to ask the ATO for statistics and details of these complaints and the issues that have been raised with them directly.

## 3. Correction of errors

As initially introduced, the FHSSS rules do not allow taxpayers to correct any errors once they have submitted their application for the release of funds. These errors may have been based on a misunderstanding or incorrect advice and resulted in them receiving amounts that were less than what they were entitled to seek. In one case, the error arose because the taxpayer experienced a medical episode whilst lodging the application.

The FHSSS rules do provide the ATO with discretion to amend a release authority within a limited timeframe, which is practically at any time before the ATO receives the released funds from the superannuation fund. However, the ATO considers its discretion is limited to jurisdictional errors<sup>9</sup> as the FHSSS law does not allow the application for the release authority to be revoked.

A number of complaints lodged with the IGTO dealt with these issues as taxpayers sought assistance to amend or correct FHSSS release authority applications. One such example is set out in **Appendix A** where the IGTO's intervention assisted the taxpayer to have the correct amounts released.

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<sup>9</sup> For example, an error which would invalidate the FHSS determination application, such as fraud or the decision-maker exceeding the power afforded to it.

As a result of complaints being raised on this issue, including those brought to the ATO's attention by the IGTO, a number of legislative changes are currently in train that are expected to come into effect from 1 July 2022 (with retrospective application from 1 July 2018):<sup>10</sup>

- increasing the discretion of the Commissioner of Taxation to amend and revoke FHSSS applications;
- allowing individuals to withdraw or amend their applications prior to them receiving an FHSSS amount, and allowing those who withdraw to re-apply for FHSSS releases in the future;
- allowing the Commissioner to return the released FHSSS money to super funds, provided that the money has not yet been released to the individual; and
- clarifying that the money returned to super funds is treated as non-assessable non-exempt income for the fund and does not count towards the individual's annual contribution caps.

Ultimately, the legislative changes and the details will be a matter for Government (as advised by Treasury) and the Australian Parliament. As part of our investigation as summarised in Appendix A, the IGTO made recommendations and the ATO agreed to review FHSSS cases (after the proposed legislative changes have passed).

The ability to correct errors efficiently and effectively assists taxpayers when navigating a complex system. It also fosters greater participation, reduces stress and anxiety and improves outcomes. Accordingly, the IGTO believes that good administration of any new measures that are proposed to be recommended to bolster housing affordability and supply should include express rights for taxpayers to amend or correct any genuine errors or mistakes.

#### 4. Eligibility

A small number of FHSSS cases currently under investigation by the IGTO touch on issues of statutory interpretation and eligibility of taxpayers in certain circumstances to access the FHSSS.

As noted earlier, there are certain steps that a taxpayer must take prior to being able to access their funds under the FHSSS. The timing of these steps is important as, presently, some taxpayers may be considered by the ATO to be ineligible to access the FHSSS. The two relevant points for the purposes of this discussion are:

- There is a window of time to enter a contract for purchase or construction beginning 14 days before and ending 12 months after the making of a request for release of funds – see section 313-35 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- The individual applying for a determination from the Commissioner must not, *inter alia*, have held a freehold interest in real property in Australia.

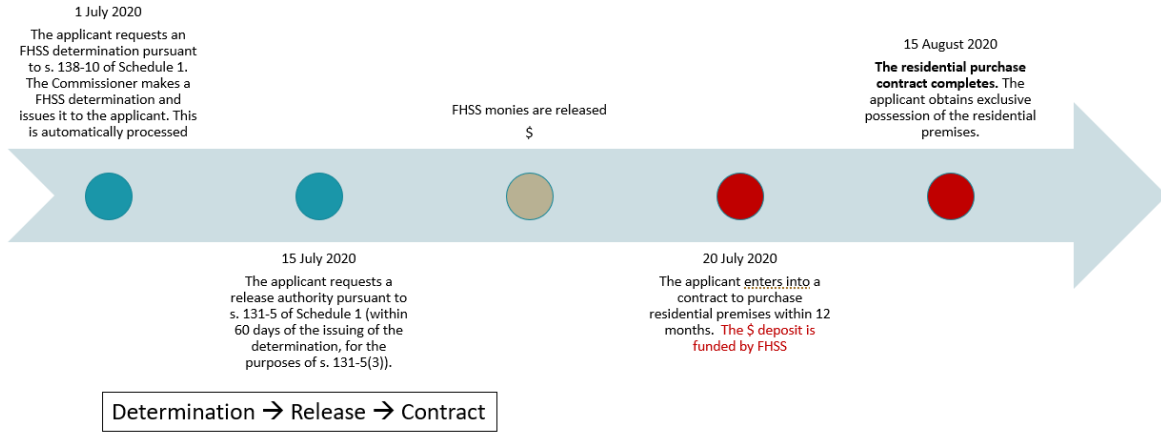
The eligibility issue is illustrated in three examples below.

There is no question that, in Example 1, the taxpayer is eligible for FHSSS as the sequence and timing of events results in the monies being released before any relevant contract is signed. In this example – the release of funds actually assists to fund the contractual deposit. However, this is not a requirement under the FHSSS.

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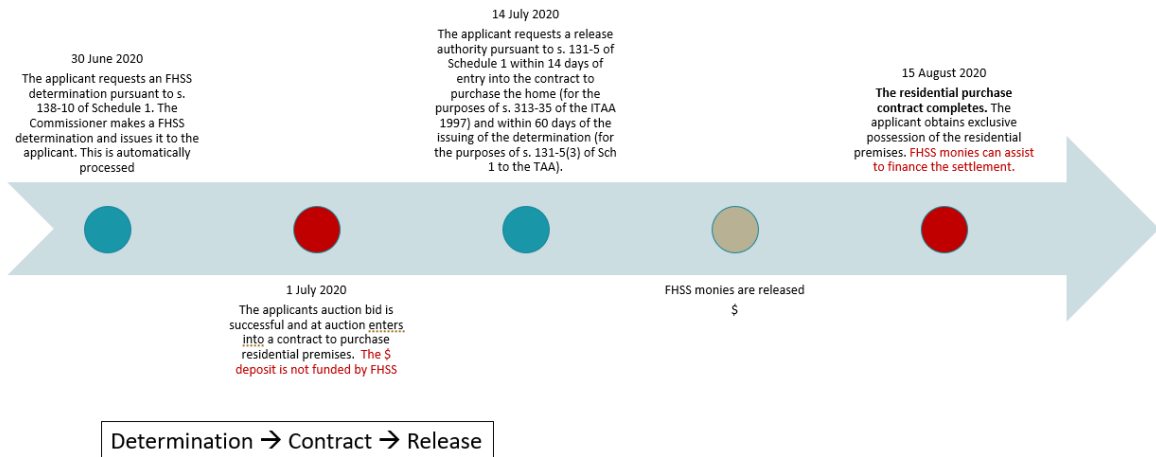
<sup>10</sup> Australian Government, *Federal Budget 2021-22 – Budget Paper No 2* (2021) p 17. See also: Australian Taxation Office, *First Home Super Saver Scheme – increasing the maximum releasable amount to \$50,000 and technical amendments* (11 May 2021).

## Example 1 – Purchase of residential premises by private treaty



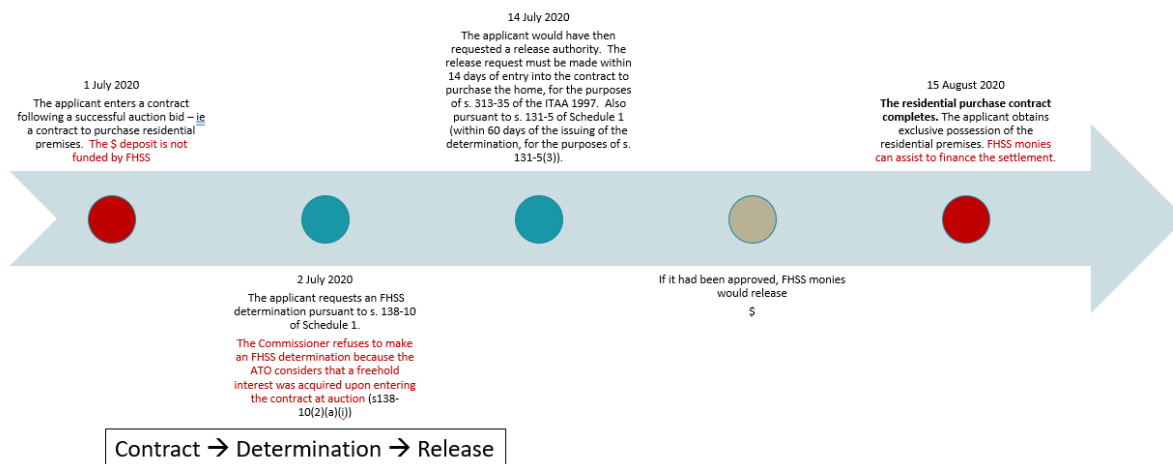
In the case of purchases made at auction, where contractual success is not guaranteed until the auction day, the legislation also provides a pathway for accessing the FHSSS, as illustrated in Example 2A.

## Example 2A – Purchase of residential premises at auction



However, if a taxpayer has attended an auction and entered a contract of sale *prior* to lodging the application for determination, the ATO has taken the view that they hold a freehold interest and are therefore presently ineligible to access the FHSSS – see Example 2B.

## Example 2B – Purchase of residential premises at auction



The above examples highlight that there is a risk that a taxpayer may ultimately be denied access to the FHSS by reason of not following a specific and particular administrative pathway, even where they contributed monies to their superannuation fund with an intention to access those funds for the purchase or construction of a home. The IGTO also notes that where access would only be available in a narrowly defined sequence of events, it would be expected that this was made clear as part of the governing provisions and related announcements.

### 5. Practical outcomes which appear inconsistent with the aims of the scheme

In some cases, outcomes which are inconsistent with the aims of the scheme can arise as a result of administrative practice or where the legislation gives rise to interpretation issues that create uncertainty. This section provides a summary of the issues. Further detail can be found in **Annexure B**.

The aim of the FHSS is to provide access to superannuation savings for those who require additional financial assistance to enter the residential housing market<sup>11</sup>. People who already hold real property generally do not require this additional assistance as the property already held can be used as security for financial assistance. This is reflected in the requirement that in order to access the FHSS, the taxpayer must not already be holding a ‘freehold interest’.

The term ‘freehold interest’ is well defined in the context of property law and the Commissioner of Taxation has also issued his own views on the definition of ‘freehold interest’ in a number of different contexts including Self-Managed Superannuation Funds (SMSFs)<sup>12</sup>, Capital Gains Tax (CGT)<sup>13</sup> and Goods and Services Tax (GST)<sup>14</sup>.

<sup>11</sup> Explanatory Memorandum to the First Home Super Saver Tax Bill 2017, para 1.6.

<sup>12</sup> See for example: Commissioner of Taxation, *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*.

<sup>13</sup> See for example: Commissioner of Taxation, *Taxation Ruling TR 94/29 Income tax: capital gains tax consequences of a contract for the sale of land falling through*; Commissioner of Taxation, *Taxation Ruling TR 2006/14 Income tax: capital gains tax: consequences of creating life and remainder interests in property and of later events affecting those interests*.

<sup>14</sup> See for example: Commissioner of Taxation, *Goods and Services Tax Ruling GSTR 2006/7 Goods and services tax: partitioning of land*; Commissioner of Taxation, *Goods and Services Tax Ruling GSTR 2006/8 Goods and services tax: the margin scheme for supplies of real property acquired on or after 1 July 2000*, and Commissioner of Taxation, *Goods and Services Tax Ruling GSTR 2009/2 Goods and services tax: partitioning of land*.

An extract summarising these views and definitions is provided in **Appendix B** to this submission.

However, in the context of the FHSSS, the Commissioner has adopted a broader view of ‘freehold interest’ which narrows the eligibility circumstances for FHSSS and which is not consistent with his views expressed in other contexts. In particular, the ATO view adopted is:

- an individual can hold a freehold interest in land even if he or she does not have exclusive possession of land for an indefinite period of time;
- when an individual enters into a sale contract for the acquisition of land, the individual holds a freehold interest in land because of equitable rights acquired on entry into the contract, even if the individual does not have any right of possession and even if the individual is not yet the legal or beneficial owner of the land;
- the individual can hold a freehold interest in land, even if the relevant lot will not come into existence until subdivision occurs at a later time;
- the individual is, nevertheless, not taken to have held a freehold interest in land if the sale contract does not complete.

The ATO has not been able to point to any legal authorities to support this particular interpretation of ‘freehold interest’.

The adoption of the broad definition can operate to prevent certain types of first home purchasers from accessing the FHSSS, as illustrated in Examples 3 and 4.

### Example 3

|                 |   |
|-----------------|---|
| 1 July 2020     | The applicant requests a FHSS determination pursuant to s. 138-10 of Schedule 1 to the <i>Taxation Administration Act 1953</i> (TAA 1953). The Commissioner makes a FHSS determination and issues it to the applicant.  |
| 15 July 2020    | The applicant enters into a contract to purchase vacant land on which to construct his first home.  |
| 15 August 2020  | The contract for the purchase of vacant land completes and the applicant obtains exclusive possession of the land for an indefinite period of time. The applicant liaises with architects and builders with a view to making arrangements for the construction of his first home. |
| 20 August 2020  | The applicant requests a release authority pursuant to s. 131-5 of Schedule 1 to the TAA 1953 (this is within 60 days of the issuing of the determination, for the purposes of s. 131-5(3)).  |
| 31 October 2020 | The Applicant enters into a contract for the construction of his first home. Entry into the contract occurs within 12 months of the making of the release request, for the purposes of s. 313-35 of the ITAA 1997.  |

In Example 3, applying the ATO’s current view of ‘freehold interest’, the taxpayer would be eligible to apply for access to funds under the FHSSS as, at the time the FHSSS determination was sought, the taxpayer was not taken to be holding a ‘freehold interest’.

**Example 4**

|                 |   |
|-----------------|---|
| 1 July 2020     | The applicant enters into a contract to purchase vacant land on which to construct his first home.  |
| 15 July 2020    | The applicant requests a FHSS determination pursuant to s. 138-10 of Schedule 1 to the TAA 1953. The Commissioner makes a FHSS determination and issues it to the applicant.  |
| 15 August 2020  | The contract for the purchase of vacant land completes and the applicant obtains exclusive possession of the land for an indefinite period of time. The applicant liaises with architects and builders with a view to arranging the construction of his first home. |
| 20 August 2020  | The applicant requests a release authority pursuant to s. 131-5 of Schedule 1 to the TAA 1953 (within 60 days of the issuing of the determination, for the purposes of s. 131-5(3)).  |
| 31 October 2020 | The Applicant enters into a contract for the construction of his first home. Entry into the contract occurs within 12 months of the making of the release request, for the purposes of s. 313-35 of the ITAA 1997.  |

In contrast to Example 3, the taxpayer in Example 4 would not be permitted to access monies under the FHSSS by reason of the fact that the contract for the purchase of vacant land was entered prior to the request for a FHSSS determination. In this scenario, the ATO adopts the view that the taxpayer is holding a ‘freehold interest’ (i.e., in the vacant land), and therefore they are ineligible to access the FHSSS resulting in them being unable to use released monies towards a contract for construction of a home on the vacant land.

The IGTO is currently progressing two investigations that deal with these issues and has been engaging with senior ATO and Treasury officers to understand the underlying reasons for the ATO’s interpretative approach to the meaning of “held a freehold interest”. It is not clear to the IGTO whether the ATO’s interpretation aligns with the overall aim of assisting taxpayers who require additional financial assistance to enter the residential housing market, for example, to access savings to purchase or construct their first home.

The IGTO makes two broad points in relation to the current issues. Firstly, that it is not controversial for legislated measures to have specific eligibility criteria. However, such criteria, where they need to be adopted, ought to be clearly stated and free from doubt both for the benefit of the ATO as administrator and for taxpayers seeking to access the measures. In the present case, the use of a well-understood and well-defined term, such as ‘freehold interest’ without further statutory clarification has resulted in an interpretative approach that has caused confusion, increased costs and delay and (potentially) resulted in outcomes that do not appear to align with the aims of the measure.

Secondly, we appreciate and support the need for strong integrity measures in relation to any strategies to be implemented to aid in improving housing affordability. Such integrity measures should balance the overall objectives of the strategies with the risk of abuse of the system and ensure that legislative provisions, as enacted, align with the overall aims of the scheme and minimise the risk of unintended outcomes. In doing so, the IGTO believes that the overall design of any proposed measures should be implemented only after broad-based consultation and testing with relevant industry and professional stakeholders. The IGTO is also available to contribute views on any administrative considerations, given our role and insights gained from resolving complainants’ disputes with the ATO.



## 6. Delays in releasing funds

As set out earlier, the release of funds under the FHSSS requires taxpayers to lodge two separate applications with the ATO – first to seek a determination from the Commissioner of Taxation and second to apply for release of the superannuation amounts.

The FHSSS does not impose any statutory processing timeframes on the Commissioner, although superannuation funds are required to make payment within 10 business days following the Commissioner's issuing of a release authority<sup>15</sup>. The ATO has estimated that the release of funds can take between 15 to 25 business days after an application for release has been lodged.

Some complaints received by the IGTO have raised concerns about delays in receiving money under the FHSSS which have, in turn, affected the taxpayer's ability to progress with their property purchase and expose them to contractual penalties for non-performance. In cases that were the subject of complaint investigation by the IGTO, the causes for delay in taxpayers receiving their monies include miscommunications between the superannuation fund and the ATO, ATO officer error or the time taken by the ATO to verify claims.

In relation to the latter cause, there is a legislative requirement for the ATO to credit the amounts to the applicant's tax account (after withholding amounts for tax) once the monies are received from the superannuation fund<sup>16</sup>. However, the ATO has advised that it may retain these monies pending the finalisation of its verification activities and relies on the principle of unjust enrichment under the general law of restitution to do so. This ATO view is not free from doubt.<sup>17</sup> After the ATO was alerted to concerns with its view, proposed legislative changes<sup>18</sup> were announced. Once enacted, these changes will improve the options available to rectify genuine errors in FHSS applications.

With respect to minimising the adverse consequences arising from delays, there is limited recourse for a taxpayer in these circumstances as there is no pathway for urgent consideration and approval, save where the taxpayer raises their concern with the ATO's complaints unit or through the IGTO. It should also be noted that both these complaint processes would have additional timeframes of their own.

The Committee may wish to consider whether it is appropriate to include statutory timeframes in any measures that it recommends to Government and providing channels for urgent action where those statutory timeframes are not met.

The IGTO thanks the Committee again for the opportunity to make this submission. If we may be of any further assistance to the Committee, please don't hesitate to contact me on [REDACTED].

Kind regards,

[REDACTED]

Karen Payne  
Inspector-General of Taxation and Taxation Ombudsman

<sup>15</sup> *Taxation Administration Act 1953*, Sch 1, s131-35(1).

<sup>16</sup> *Taxation Administration Act 1953*, Sch 1, s131-65.

<sup>17</sup> See for example, *FCT vs Multiflex Pty Ltd* 2011 ATC 20-292.

<sup>18</sup> Australian Government, *Federal Budget 2021-22 – Budget Paper No 2* (2021) p 17. See also: Australian Taxation Office, *First Home Super Saver Scheme – increasing the maximum releasable amount to \$50,000 and technical amendments* (11 May 2021).

## **Annexure A – Complaint Investigation Case Study – First Home Super Saver Scheme (pre-legislative change)**

A complainant contacted the IGTO raising concerns that the ATO had unreasonably withheld amounts released by her superannuation fund under the First Home Super Saver scheme (FHSS scheme). She explained that she had applied to access the FHSS scheme to buy her first home and obtained a FHSS Determination from the ATO which specified the maximum amount she could withdraw. After obtaining the FHSS Determination, the complainant was able to secure the mortgage finance needed to purchase her first home and requested the ATO to authorise her superannuation fund to release the monies. After the ATO issued this authority to the complainant's superannuation fund, she entered into a contract to purchase her home.

The superfund released the monies to the ATO but before releasing the monies to the complainant, the ATO identified errors in the complainant's application that, if corrected, would reduce the amount that she was eligible to release. However, these errors were identified too late for the ATO to correct the application or Determination. As a result, the ATO decided to cancel the Determination and the release authority on the basis that the errors had invalidated the Determination. The ATO then returned the monies back to the fund. The law prevents the complainant from amending or applying for release again under the FHSS scheme. The complainant sold her furniture to raise funds to cover the amount she expected from the FHSS release and incurred costs in extending the settlement date for her contract.

The complainant raised a complaint with the ATO, explaining that her error was due to a genuine misunderstanding, that the ATO website and online application form was unclear and she had also sought assistance from a number of ATO officers before lodging her application. However, no ATO officer had correctly addressed her misunderstanding, for example, during a call with the ATO call centre to seek assistance with lodging her application, she was assured that if she made a mistake on the application forms, she would be able to correct it later. The ATO reconsidered her circumstances, however, it did not change the earlier decisions.

The IGTO conducted an investigation by reviewing the ATO's records, call recordings and systems documentation. The IGTO found that the complainant had taken steps to understand what was needed and to obtain ATO assistance. However, she had made errors on her application form that were likely due to a genuine (but erroneous) belief which was not dispelled by ATO assistance, anxiety with a pending deadline, and frustration with the difficulties she encountered with the online application form. The IGTO also found that the ATO had failed to consider relevant information when forming impressions of the complainant's errors and had cancelled the FHSS Determination without lawful authority which was likely due to a genuine (but erroneous) ATO belief that the errors had invalidated the Determination. The IGTO also communicated to the ATO its views on particular tax administration laws that impacted on this case.

The IGTO recommended that the ATO:

- take remedial action to address the shortcomings in this matter, including by providing an equitable remedy and appropriate apology, as well as considering compensation for the loss caused; and
- improve the ATO's administration of the FHSS scheme, including measures to rectify the unfairness that arises from the ATO conducting FHSS compliance activities after it is too late to remedy errors, and providing clear public guidance regarding FHSS applications and associated risks; and

- improve governance of ATO officer adherence to the Taxpayers' Charter and their assistance in IGTO complainant investigations, as well as the ATO's communication of rights of review in FHSS decisions and quality assurance of those decisions.

As the Government has announced an intention to make technical amendments to the FHSS legislation with retrospective effect to assist individuals and the ATO rectify errors made on FHSS applications, the IGTO also recommended the ATO to take steps to address the risk of individuals suffering adverse consequences due to making errors on applications prior to the enactment of the legislation.

Following consideration of a lengthy IGTO report which detailed the evidence, the ATO ultimately agreed to release the FHSS amounts to the complainant with an apology and advised that it had made improvements to its administration of the FHSS scheme. The ATO also agreed to review all FHSS cases in which it had made adverse decisions (after the proposed amendments to the FHSS legislation have been enacted) and offer all those individuals the opportunity to amend their FHSS applications without disproportionate adverse consequence.

## Annexure B – Aims of the FHSSS and the Definition of ‘Freehold Interest’

### Aims of the FHSSS

The explanatory memorandum (EM) to the First Home Super Saver Tax Bill 2017 provides that:

*Australians are entering the housing market later in life than previous generations. With house prices high, difficulty saving a deposit is a key barrier to getting into the market. The FHSS Scheme will help Australians boost their savings for their first home by allowing them to build a deposit inside superannuation.<sup>19</sup>*

The aim of the FHSSS is for any funds released under the scheme to go towards the deposit for the purchase or construction of a home rather than for the purchase settlement or the mortgage repayments. This aim is achieved by the timing requirements in section 313-35 of the *Income Tax Assessment Act 1997* (ITAA 1997), which broadly states that a contract to purchase or construct a home can only be entered into within a certain period: being within 14 days before and 12 months after the making of the release request.

Paragraph 1.67 of the EM states:

*The requirement that an individual has never held a freehold interest in real property in Australia, certain leases of land in Australia or a company title interest in land ensures that individuals who have previously owned a home are unable to use the FHSS Scheme.<sup>20</sup>*

The EM goes on to state at paragraph 1.71:

*Because of this scope, the restrictions about real property are broader than simply having owned a home as they also cover an investment property or commercial property. However, the scope is appropriate for determining eligibility to access the FHSS Scheme because another interest in real property in Australia (or proceeds from an earlier sale of such property) can be used as security for a home deposit, and is an indicator that the individual does not require additional assistance for entry into the residential housing market.<sup>21</sup>*

This reflects the aim that the FHSSS only be accessible to individuals who have never owned a home, investment property or commercial property which could be used, or the proceeds of which could be used, as security for a home deposit. This is achieved by s. 138-10(2) of Schedule 1 to the *Taxation Administration Act* (Schedule 1) which provides that an individual can apply for a determination if he or she, *inter alia*, has never held a “freehold interest” in real property in Australia.

### Definition of “Freehold Interest”

As can be seen from the extracts of the EM, a core eligibility threshold is the requirement that applicants to the FHSSS have never held a ‘freehold interest’ in Australia. However, the IGTO has observed in cases investigated that the ATO interpretative approach adopted in relation to what constitutes a ‘freehold interest’ creates uncertainty and confusion for prospective applicants.

<sup>19</sup> Explanatory Memorandum to the First Home Super Save Tax Bill 2017, para 1.6.

<sup>20</sup> Explanatory Memorandum to the First Home Super Save Tax Bill 2017, para 1.67.

<sup>21</sup> Explanatory Memorandum to the First Home Super Save Tax Bill 2017, para 1.71.

The term ‘freehold interest’ is a term of art in the law of real property in Australia.

The term “freehold” connotes *ownership* of land and has an extensive history in common law. This is reflected in the Encyclopaedic Australian Legal Dictionary, which includes the following in its definition of “freehold”:

*Real property*

*1. Ownership of land.*

*2. In feudal times, the character of land held by a freeman, and subject to feudal services and incidents thought to be appropriate to the status of a freeman. The common law recognised three types of freehold estate: fee simple, fee tail (now obsolete in most jurisdictions), and life estate.*

The Australian Law Dictionary (2nd ed.) states the following in relation to “freehold estate” in the definition of “title”:

*A freehold estate in land (freehold title) is the most comprehensive form of title that can be held in private ownership (see DOCTRINE OF ESTATES; DOCTRINE OF TENURE; FEE).*

In the Oxford Dictionary of English (3rd ed.), “freehold” is defined as:

*...permanent and absolute tenure of land or property with freedom to dispose of it at will.*

In Halsbury’s Laws of Australia, the meaning of “freehold” is considered in the context of the Doctrine of Estates.<sup>22</sup> The following is explained under the heading, “What is an Estate?”

*Estates in land are classified according to the length of time for which they are to endure. There were estates of freehold and estates less than freehold, which initially included the leasehold estate which was an estate for a fixed term of years. Estates of freehold are created where the length of the duration of the estate is uncertain.*

*By the thirteenth century courts recognised only three freehold estates:*

- (1) the fee simple;*
- (2) the fee tail; and*
- (3) the life estate.<sup>23</sup> [Footnotes omitted.]*

### **The Commissioner’s views on the definition of ‘Freehold Interest’**

The Commissioner has published views on the meaning of “freehold interest” in the context of SMSFs. This is because the term “freehold interest” appears in the definition of “business real property” at s. 66(5) of the *Superannuation Industry (Supervision) Act 1993* (Cth) (SIS Act) and is not defined in the statute.

In the Superannuation Funds Ruling SMSFR 2009/1 *Self Managed Superannuation Funds: business real property for the purposes of the Superannuation Industry (Supervision) Act 1993*, the Commissioner states:

“Freehold and leasehold interests in real property

<sup>22</sup> Accessed via LexisNexis, current to 21 September 2015.

<sup>23</sup> Halsbury’s Laws of Australia [355-90], accessed via LexisNexis, current to 21 September 2015.

...

13. **In ordinary terms, a 'freehold interest' in real property entitles the interest holder to ownership of the property. Such an interest entitles the entity holding it to exclusive possession of the property for an indefinite period of time.**

14. It is possible for an entity to co-own real property with other entities and still hold a freehold interest in the property. In these circumstances, each co-owner will hold a freehold interest in the real property. Similarly, an entity may hold a freehold interest in property that is strata titled."

...

16. Other more limited rights of possession, occupation or use over real property may be granted to an entity. These rights are not a freehold or leasehold interest in the property and therefore cannot give rise to business real property for the entity unless they satisfy paragraphs (b) or (c) of the business real property definition." (Bolding added.) [Footnote omitted.]

A more comprehensive explanation is provided under the heading, "What is a freehold interest in real property" at paragraphs 88 to 97 of SMSFR 2009/1. The explanation includes the following view on the ordinary meaning of "freehold interest":

*"Ordinary meaning*

88. In broad terms, a 'freehold interest' in real property conveys ownership of the property. A 'freehold interest' entitles the owner to exclusive possession for an indefinite period of time.

89. In Australia, ownership of real property is derived from registration of title. Such an interest in real property is registered in the State or Territory in which the land is located." [Footnote omitted.]

The term "freehold interest" is used in a similar way by the ATO in the context of CGT. Taxation Ruling TR 94/29 *Income tax: capital gains tax consequences of a contract for the sale of land falling through* (TR 94/29) sets out a comprehensive analysis in support of the ATO's preferred view that disposal of land occurs at settlement and not upon entry into a contract. Whereas the statute provided that, where there was a change of ownership, disposal was to be taken to have occurred on the making of a contract, the Commissioner clarifies in TR 94/29 that the actual disposal / change of ownership occurs at settlement. Included in the analysis is a comparison between the nature of equitable rights obtained upon entry into a land contract and the nature of a freehold interest:

*"Disposal at completion of contract - the preferred view*

39. Completion of an ordinary contract for the sale of land takes place at the time of settlement. At this time the purchaser hands over the balance of the purchase money and the vendor delivers the transfer or some similar instrument together with the title deeds. Generally speaking, the purchaser also obtains possession of the land at this time.

40. **On settlement the purchaser is, therefore, in relation to land under the Torrens system placed in a position to acquire the protection of the Land Transfer Acts by registering the transfer. In relation to land not under the Torrens system, the purchaser obtains absolute ownership.**

41. **The opposing view that disposal takes place at the time of contract concentrates on the nature of the equitable interest which emerges under a contract for the sale of land. The case**

**law on the matter express varying opinions as to the existence, nature and effect of that interest.** The cases show a divergence of opinion as to when the equitable interest, in whatever form, actually passes to the purchaser. There is support for the view that the equitable interest does not pass until completion of the contract as well as for the view that the equitable interest passes at the time of the contract. We have also noted that equitable interests are recognised as assets for CGT purposes just as much as legal interests and the objects themselves.

42. Support for the preferred view may be got from the following passages from the joint judgment of Deane and Dawson JJ in *Stern v. McArthur* (1988) 165 CLR 489 which discuss the nature of the equitable interest. At 521-523 they say:

'It has been said in a variety of ways that a vendor under a valid contract for the sale of land holds the land as trustee for the purchaser. He is, however, a trustee only in a qualified sense and the qualifications are such as to rob the proposition of much of its significance or, for some purposes, its validity. **The vendor must make title before there can be any alteration in the equitable ownership of the land, although the alteration may then relate back to the date of contract. Even so the vendor retains a substantial interest in the property until the whole of the purchase money is paid.** He is entitled, subject to the contract, to possession and to the rents and profits in addition to a lien on the land as security for any amount outstanding. **Any right to equitable ownership on the part of the purchaser is contingent only, being subject to the payment of the purchase money and being said to exist only so long as the contract remains specifically enforceable at his suit.**

As Deane J pointed out in *Kern Corporation Ltd v. Walter Reid Trading Pty Ltd* (1987) 163 CLR 164 at p. 191, it is not really possible with accuracy to go further than to say that the purchaser acquires an equitable interest in the land sold and to that extent the beneficial interest of the vendor in the land is diminished. The extent of the purchaser's interest is to be measured by the protection which equity will afford to the purchaser.

To put the matter in this way is to say little more than that the equitable interest of a purchaser under a contract for the sale of land is that which equity recognizes and protects: *Hewett v. Court* (1983) 149 CLR 639 at pp. 665-666, per Deane J. The relationship of trustee and beneficial owner will certainly be in existence when the purchase money specified in the contract has been paid, title has been made or accepted and the purchaser is entitled to a conveyance or transfer. At that point the purchaser is entitled in equity to the land and the vendor is a bare trustee: *McWilliam v. McWilliams Wines Pty. Ltd.* (1964) 114 CLR 656 at p. 660, per McTiernan and Taylor JJ. Otherwise there is no unanimity upon when the relationship of trustee and beneficial owner arises: *Chang v. Registrar of Titles* (1976) 137 CLR 177 at p. 184, per Mason J. **But that does not mean that before that time has arrived the purchaser may not be entitled to a lesser equitable interest than ownership.'**

43. **Another way of looking at the problem is to concentrate on the nature of the asset that is being disposed of rather than the individual rights comprising it or arising under the contract.** In *Zim Properties Ltd v. Proctor* (1984) 58 TC 371 Warner J saw no difficulty in accepting that not every right to a payment is an asset within the meaning of that term in the United Kingdom capital gains tax legislation. The most obvious example, he says, of one that is not is the right of a seller of property to payment of its price - the relevant asset, then, is the property itself. The new subsection 160MA(2) introduced by the TLA (No 4) 1992 recognises that it is the land that is the relevant asset being disposed of and not the various rights created under the contract of sale. **Land is property known to the common law. The asset to be disposed of is therefore legal property not an equitable property. Looked at in the language of jurisprudence, it is the fee simple, the legal estate, the freehold interest.**" (Bolding added.)

This analysis, which is supported by High Court authority, clearly equates the term “freehold interest” with the fee simple or legal estate and describes it as an interest in legal property, not equitable property.

The view that a freehold interest is a legal interest, and not an equitable interest, is reiterated by the Commissioner in TR 2006/14 *Income tax: capital gains tax: consequences of creating life and remainder interests in property and of later events affecting those interests* as follows:

“178. 'Life interest' and 'remainder interest' are terms used to describe the interest that an entity has as either a beneficiary of a trust (equitable interest) or, less commonly, as the owner of a freehold estate in land (legal interest).”

The term “freehold interest” appears in the *A New Tax System (Goods and Services Tax) Act 1999* (GST Act) in a number of contexts, including in the context of:

- Supplies made under the margin scheme (Division 75 of the GST Act); and
- GST free supplies of land (including of a freehold interest or a lease) made by the Commonwealth, a State, a Territory or an Australian Government Agency (Division 38 of the GST Act).

The term is not defined in the GST Act. In the context of the margin scheme, the Commissioner sets out his views on the meaning of freehold interest in GSTR 2006/7 *Goods and services tax: how the margin scheme applies to a supply of real property made on or after 1 December 2005 that was acquired or held before 1 July 2000* (GSTR 2006/7) as follows:

“When do you supply or acquire real property?”

42. Most legal interests in Torrens title land are created or transferred only upon registration of the relevant instrument.

43. However, because of the practical difficulties of determining precisely when the instrument is registered or lodged for registration, that would arise if a literal interpretation of the law is to be taken, the Commissioner considers that Parliament would have intended that, in the context of GST, a less strict approach should apply.

44. For that reason, the Commissioner considers that for the sale of a freehold interest or stratum unit, the supply and the acquisition is made at settlement as this is when the purchaser (or the purchaser's agent) obtains:

- unconditional possession of a registrable instrument of transfer; or
- an instrument of transfer that would be registrable once stamped.”

That is, the view in GSTR 2006/7 is that the “freehold interest” is obtained on registration of the relevant interest but, for practical reasons, is taken to occur on settlement. Any view that a freehold interest is obtained on exchange of contracts is manifestly inconsistent with this analysis.

The same analysis is reproduced *verbatim* in GSTR 2006/8 *Goods and services tax: the margin scheme for supplies of real property acquired on or after 1 July 2000* (GSTR 2006/8) at paragraphs 36 – 38.

The Commissioner also discusses the nature of a freehold interest in GSTR 2009/2 *Goods and services tax: partitioning of land*. He states at paragraph 108:

“108. In the Commissioner's view, the intention behind limiting the margin scheme to taxable supplies by way of sale of a freehold interest in land or stratum units is to exclude taxable



supplies consisting of temporary disposals (such as a lease, hire or licence). The margin scheme should only be available when the freehold interest is wholly and permanently disposed of.”  
[Footnote omitted.]

In expressing this view, the Commissioner acknowledges that usage of the term “freehold interest” connotes a more whole and permanent disposal of an interest.