Vacant Residential Land Tax: Important changes to be aware of for this unfamiliar tax!

Introduction

Vacant Residential Land Tax ("VRLT") was introduced in 2018 to address housing supply shortages across Melbourne. The State Revenue Office ("SRO") is the government body responsible for administering VRLT in Victoria. Although the SRO administers both land tax and VRLT, it is important to note these are distinct taxes – you can be liable to pay both in the same year.

Where does VRLT apply?

VRLT applies to <u>residential property</u> that has remained <u>vacant</u> for more than <u>6 months</u> in a calendar year (1 January to 31 December). The 6 months does not have to be continuous and can be aggregated across the year.

From 2018 to 2023, VRLT applied only to taxable residential land situated in inner and middle Melbourne (16 local councils are affected) and was set at 1% of the capital improved value ("CIV") of the residential property.

The CIV includes the value of the land, buildings and capital improvements. This differs from general land tax which is assessed on the unimproved [site] value of the land. The annual council rates notice displays both the CIV and site value of the property, for your reference.

An example of how VRLT applies:

- A home with a CIV of $1,000,000 that is vacant for more than 6 months in a calendar year would be liable to pay $10,000 in VRLT (1% of the CIV).

The financial liability was thus substantial, increasing as the CIV of the property increased.

Important changes to VRLT that apply from 2024

The Victorian Government passed *The State Taxation Acts and Other Acts Amendment Act 2023 (Vic)* (the New Scheme) which has significantly broadened the application of VRLT. The New Scheme comes into effect on 1 January 2025 but applies to the 2024 calendar year.

Under the New Scheme, residential property situated anywhere in Victoria that is vacant for more than 6 months between 1 January and 31 December 2024 is liable for VRLT.

The New Scheme introduces the following significant changes:

- VRLT now applies to all residential property in Victoria (no longer just select council areas).

- A progressive rate of VRLT is applied based on the number of calendar years the residential property remains vacant. The accelerating rates are applied as follows:

    - 1% of the CIV of the property for the first year the property is vacant and liable for VRLT;

    - 2% of the CIV of the property for the second consecutive year the property is vacant; and

    - 3% of the CIV of the property for the third consecutive year (and subsequent years) the property is vacant.

  For example, a property with a CIV of $500,000 that remains vacant in a calendar year has a VRLT liability of $5,000 for the first year, $10,000 the second consecutive year, and $15,000 for the third consecutive year. The liability therefore can be substantial.

- The Holiday Home exemption has been expanded to now include occupation by relatives of the owner who use the property as a holiday home – discussed further below.

- From 1 January 2025, new residential premises will not be subject to VRLT for a maximum period of 3 years on the condition the owner has made genuine and reasonable efforts to try and sell the property. If the property is not sold after three years, VRLT will be set at a rate of 1% until sold.

- From 1 January 2026, VRLT will apply to unimproved residential land in metropolitan Melbourne which has remained undeveloped for five years or more but which is capable of residential development. The purpose of this is to discourage land banking and encourage developments.

As the New Scheme applies to the 2024 calendar year, it is particularly important to be aware of the changes to VRLT and how they may impact you – as well as what you may be able to do to avoid paying this tax.

What is "residential land"?

VRLT only applies to taxable residential land, namely land capable of being used solely or primarily for residential purposes. It ordinarily includes houses, units and apartments.

In 2020, the definition of residential land was extended to include property that has been uninhabitable for two or more years. This change was intended to encourage owners to make their property habitable and lease it out to prospective tenants. In addition, residential land requiring only minor reinstatements or repairs are considered capable of being occupied as a residence and will be subject to VRLT if left vacant.

Residential land does **not** include the following:

- Commercial residential premises
- Residential care facilities
- Supported residential services
- Retirement village land

What is "vacant" residential land?

A residential property must be 'vacant' for VRLT to apply.

A property is considered 'vacant' if it has not been lived in for more than 6 months in the calendar year preceding the tax year by:

- The owner as his or her principal place of residence ("PPR"); or
- A person or persons under a lease or short-term letting arrangement.

The 6-month period does not need to be continuous. It can be aggregated.

A residential property will still be considered vacant and subject to VRLT in the following circumstances:

- It was listed on a short-term rental website and ready to be lived in, but no person actually occupied the property or it was occupied for less than 6 months in the relevant year.
- Friends or family stay in the property on an intermittent or casual basis (note: see Holiday Home Exemption).

Therefore, to avoid a property falling within the definition of vacant, it must be used and occupied as either:

- a PPR by the owner; or
- subject to a lease or letting arrangement entered into in good faith.

Exemptions

The *Land Tax Act* 2005 (VIC) ("the Act") provides some exemptions to VRLT. You can only claim one exemption to VRLT per calendar year under the Act. The exemptions to VRLT include the following:

Principal place of residence or primary production land

A property exempt from general land tax will also be exempt from VRLT – the most common examples being:

- a person's PPR; or
- primary production land.

These exemptions apply regardless of whether the property was occupied for more than six months or not.

Change of ownership

Property that has changed ownership during the relevant year is exempt from VRLT.

Holiday Homes

Property used and occupied as a holiday home by an owner or vested beneficiary of a trust may be exempt from VRLT on the following conditions:

- The property is occupied as a genuine holiday home by the owner or vested beneficiary of a trust for more than 4 weeks in each calendar year (continuous or aggregate);
- The owner or vested beneficiary of a trust has other property in Australia that is occupied and used as their PPR;
- The owner or vested beneficiary of a trust is a natural person; and
- Under the New Scheme, a relative of the owner or vested beneficiary may also use and occupy the property as a holiday home to satisfy the exemption.

In determining whether the property, for which the exemption is being claimed, is a genuine holiday home, the SRO consider the following:

- The location of the property; and
- The distance between the owner's actual home and the holiday home; and
- The frequency and nature of the use of the holiday home.

In other words, the property must be genuinely and honestly used as a holiday home and not used, for example, as a second property to store belongings and possessions.

You can only apply the exemption to one holiday home, not multiple holiday homes. You must nominate one property as your holiday home in the relevant calendar year.

Holidays homes that are owned by a company, association or the trustee of a trust cannot currently satisfy this exemption – however the Victorian Government had expressed an intention to revisit the idea of expanding the holiday home exemption beyond natural persons in 2024.

Nevertheless, for now, a holiday home owned by a company, association or trustee of a trust will be subject to VRLT. Given this, you may consider transferring any property owned by your company, association or trust to a natural person and avoid VRLT. Please bear in mind that other tax consequences (such as capital gains tax or duty) may flow from such a transfer.

- **Property attended for workplace or business**

Property used and occupied for the purpose of attending work or conducting business may be exempt from VRLT on the following conditions:

- The owner or vested beneficiary of a trust occupied the property for the purposes of work or business for at least 140 days (continuous or aggregate) in a calendar year; and
- The owner or vested beneficiary of a trust has other property in Australia that is occupied and used as their PPR; and
- The owner or vested beneficiary of a trust is a natural person; and
- The property falls within one of the specified geographic areas.

As with holiday homes, you can only nominate one property for the purpose of this exemption. In addition, the workplace/business exemption does not apply to property owned by companies, associations or trusts.

- **New scheme exemptions**

Under the New Scheme the following new exemptions to VRLT now apply from 1 January 2026:

- Unimproved residential land that is contiguous to a PPR.
- Unimproved residential land incapable of being developed or used for residential purposes.

- **Significant construction and renovation**

Properties undergoing significant construction or renovation will not be considered vacant for up to two (2) years from the date the building permit is issued. The construction or renovation therefore must be significant enough to warrant a building permit. The SRO may extend the two (2) year grace period provided the owner gives an acceptable reason for the extension. Under the New Scheme, a five-year grace period may apply to residential land under construction or renovation within certain areas of metropolitan Melbourne.

- **Notifying the SRO of vacant land**

  If residential property has remained vacant for more than 6 months during a calendar year, the owner is responsible for notifying the SRO by 15 January of the following year using the SRO's online portal.

  Failure to notify the SRO as required will likely result in your being liable for penalty tax on the amount of VRLT assessed. This may be a penalty tax of:

  - 5% if you voluntarily notify the SRO the property was vacant.

  - 20% if you subsequently tell the SRO after an investigation has commenced by the SRO.

  - Up to 90% if the SRO believes you have intentionally disregarded the law or hindered the investigation.

- **Conclusion**

  The widening of VRLT to apply to all Victorian vacant residential properties together with the introduction of progressive tax rate means that significant financial and legal consequences may follow for owners who are unaware of VRLT and its recent changes.

  We encourage you to contact McKean Park Lawyers about VRLT if you are concerned that it may apply to you now or in the future. We would be pleased to discuss your particular circumstances and advise you on the best way forward.

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