THE TAX INSTITUTE

5 June 2019

The Hon Tim Pallas MP
Treasurer
Treasury and Finance Victoria
1 Treasury Place
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By email: **tim.pallas@parliament.vic.gov.au**

Dear Treasurer,

Expression of concern - *State Taxation Acts Amendment Bill* 2019

The Tax Institute wishes to provide its views on the proposed new economic entitlement provisions contained in Division 3 of Part 2 of the *State Taxation Acts Amendment Bill* 2019 (the **Bill**). In this submission, The Tax Institute also raises its concerns about the provisions proposed to impose duty on the acquisition of fixtures contained in Division 2 of Part 2 of the Bill and the retrospective nature of the provisions contained in Part 5 of the Bill which remove the special provisions for calculating the value of land on which a heritage building is situated.

Economic entitlement provisions – Summary of concerns

The Tax Institute is very concerned about the ambit of the proposed new economic entitlement provisions, the lack of consultation prior to releasing the Bill and the apparent rush to legislate what amounts to a new head of duty that not only has no comparison in other states, but which was not announced or foreshadowed in the 2019 Victorian Budget.

The proposed economic entitlement provisions are expressed to be intended to overcome the decision in *BPG Caulfield Village Pty Ltd v Commissioner of State Revenue* [2016] VSC 172 (the **BPG case**). On any view, they go far beyond the ramifications of that decision. In particular, the failure in the Bill to maintain the 50% threshold in terms of entitlement acquired makes it clear that the new provisions are a separate head of duty and an expansion of the revenue base in their own right.

With this in mind, the Victorian taxpayer public deserves an opportunity for proper consultation and The Tax Institute urges the government to at least remove the economic entitlement provisions from the Bill to allow for industry consultation and feedback. To date, the speed of the Bill through the Parliament without consultation sets an alarming

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precedent. It is no answer, if it be the case, to hastily pass insufficiently considered legislation and later announce that administrative arrangements (e.g. SRO website guidance) will be used to address unintended consequences. Deficiencies in hastily drafted legislation will ultimately be tested, at wasted time and great expense, in the VCAT and Supreme Court.

Should the government proceed with the Bill as tabled, The Tax Institute urges Treasury to introduce the following safeguards:

(a) Maintain the 50% threshold for the purposes of determining whether duty is payable upon acquiring an economic entitlement;

(b) Legislate carve outs to avoid unintended consequences (see below);

(c) Reconsideration of the 100% deeming interest in proposed section 32XE(2) (and the associated Commissioner's discretion in proposed section 32XE(3) – see below);

(d) Clarification of the transitional provisions; and

(e) Provision of a significantly longer period for commencement of operation.

The Tax Institute wishes to emphasise two further points. Firstly, the proposed section 32XE(3) confers on the Commissioner a discretion to determine a lesser percentage if considered appropriate. The legislation is silent about circumstances that would be considered appropriate. The Tax Institute considers that this confers unfettered and arbitrary discretions on the Commissioner rather than providing legislative clarity and certainty.

Secondly, The Tax Institute refers to your statement in the Legislative Assembly on 28 May 2019 that:

> “Further, to discourage taxpayers from *contriving arrangements* so that they fall just under the threshold and *evade duty,* no acquisition threshold will apply. It is highly unlikely that a natural person/transferee will be affected by these amendments, given the nature of the transactions to which the economic entitlement provisions apply. However, to the extent that any natural persons will now be unable to *evade paying duty* on the acquisition of an economic entitlement as a result of these amendments, such persons may be deprived of their property. *Any deprivation of property arising from the payment of duty under the economic entitlement provisions is justifiable since these provisions are anti-avoidance in nature*” [italics added].

Fundamentally, the choice by a taxpayer to structure their affairs to legitimately minimise their exposure to taxation does <u>not</u> in itself amount to a “contrived arrangement” or “avoidance”. The passage above exposes the substantive effect of the provisions - a new head of duty rather than anti-avoidance provisions. It sets a dangerous precedent that The Tax Institute submits should not be proceeded with.

In relation to the provisions relating to fixtures in Division 2 of Part 2, The Tax Institute contends that the proposal to impose duty on the acquisition of interests in fixtures creates uncertainty. Should the government proceed with the Bill as tabled, The Tax Institute proposes the following amendments:

(a) Extension of the carve-out for security interests, options to purchase and (non-dutiable) leases of fixtures;

(b) Clarification by way of examples as to scenarios in which fixtures at law and tenant's fixtures are dealt separately to an estate or interest in land on which fixtures are located; and

(c) Provision of a longer period for commencement of operation to allow for clarification and consultation to resolve the above uncertainties.

The current economic entitlement rules

The current economic entitlement rules are contained in the landholder duty provisions in Part 2 of Chapter 3 of the *Duties Act 2000* (Vic) (**Duties Act**). Primarily, the landholder duty provisions were enacted in response to tax avoidance behaviour, to prevent taxpayers circumventing duty on a direct acquisition of a property by instead acquiring an interest in a company or a unit trust that holds the property that was so 'significant' so as to equate that to direct ownership of the property.

Under the current rules, a person acquires an economic entitlement if the person acquires shares or units in a private landholder or enters an arrangement in relation to a private landholder under which the person is entitled, essentially, to all or any of the returns stated in s 81(2)(a) to (f) of the Duties Act. Critically, an acquisition of an economic entitlement is only subject to duty if it amounts to an interest <u>of 50% or more</u>.

The intention of the economic entitlement rules was to operate as an integrity measure to capture the acquisition of entitlements which, while falling short of an interest in a landholder, still amount to an equivalent interest in economic terms. Accordingly, the current entitlement provisions are anti-avoidance in nature, intended to fill a gap and no more. It is noted that the existing economic entitlement provisions are unique to Victoria and capture arrangements and transactions not dutiable in any other Australian state. However, the provisions contained sufficient safeguards such as the 50% threshold and the location of the provisions in the landholder regime that did not constitute a head of duty in its own right.

The proposed economic entitlement changes

As it stands, the amendments are purported to address the decision in the BPG case. That case concerned the situation where a taxpayer acquired an economic entitlement to some, but not all, the landholdings of a landholder, where the Supreme Court held that

BPG did not acquire an economic entitlement and therefore was not liable to pay duty under the economic entitlement provisions.

Rather than simply addressing the BPG Case, the Bill almost completely re-writes the economic entitlement provisions. A new set of economic entitlement rules will be introduced into the transfer duty provisions in Chapter 2 of the Duties Act, which will dramatically broaden the revenue base and result in almost all land development arrangements (and potentially many other arrangements – refer below) being subject to duty.

The key changes seek to:

- remove the '50% or more' threshold that applies for the purposes of determining whether the interest acquired under the economic entitlement(s) is dutiable;

- expand the economic entitlement provisions to land held by persons and entities other than private companies, private unit trusts and wholesale unit trust schemes; and

- in certain circumstances deem the acquisition of a 100% economic entitlement. In particular, this will occur if the arrangement under which the economic entitlement is acquired:

    - does not specify the percentage of the relevant economic entitlement acquired; or

    - specifies the percentage but also includes any other entitlement or amount payable to the person or an associated person; or

    - the person or an associated person is entitled to 2 or more types of economic entitlements.

Issues and concerns

Creation of a new head of duty liability and inconsistency with purported policy intention

The Tax Institute is extremely concerned with the sweepingly broad nature of these provisions and the scope for unintended consequences that could be associated with these changes. The changes go significantly beyond addressing any perceived mischief as a result of the BPG Case, which could have been addressed by simply clarifying that the provisions apply to the land that is subject to the relevant arrangement, not all the land owned by the landholder.

The current regime is effectively an anti-avoidance regime to stop taxpayers using 'other' arrangements to avoid the landholder duty regime. The new provisions operate outside of the landholder duty provisions and, in the absence of the 50% threshold, amount to another head of duty. Further, the provisions now capture land held by any person or entity, not just 'landholders' (noting that individuals and discretionary trusts in particular are not 'landholders' for the purposes of the Duties Act).

If the Bill is enacted in its current, unrestricted form, it would result in significant additional stamp duty being paid by Victorian developers and other real estate industry participants, where no such equivalent legislation exists in other states.

Impact on developers and property market

Victorian developers commonly enter into development agreements, whereby they agree to develop land first and receive their development fees when the land is sold. Critically, at no point during the development process does the developer acquire a beneficial or legal interest in the land being developed. These agreements have been instrumental in facilitating Greenfields developments throughout Victoria through a period of rapid expansion.

Development Agreements are integral to the continued development of land in Victoria. Without these agreements, many commercially viable arrangements under the current system may well either stall and/or become unviable. The increased upfront costs under the proposed Bill would be likely to negatively impact the supply of residential, commercial, retail, office and industrial property projects in Victoria.

Further, Development Agreements are standard practice for both large and small-scale developments in all areas of Victoria. They provide familiarity to users and have the potential to benefit projects of all sizes by enhancing efficiency and mitigating against the risks of PSPs and other red tape delays. Ultimately, Development Agreements are legitimate joint ventures used by taxpayers in all sectors of the economy and are particularly beneficial with respect to landowners who lack experience in this area.

We note that the Victorian Government itself requires a development agreement model to be used in respect of the development of some of its significant landholdings. That model involves a revenue or profit-sharing component, which benefits the government as the land owner because it incentivises the developer to maximise the return to the government. The costs to a project contractor of duty will invariably impact the economics of government projects.

Under the proposed amendments, even if in most instances no revenue will have flowed from a development until after the sale of a property, the amendments require stamp duty to be paid within 30 days after the interest exists on paper. As Development Agreements can last for substantial periods of time, the proposed amendments could render projects unviable given the upfront burden placed on taxpayers.

The Tax Institute is extremely concerned by the proposed amendments, with the potential that current projects will be stalled, and future projects rendered unviable. Of primary concern is the obligation to pay stamp duty upfront, which will have a material impact on the developer's rate of return and could simply lead to developments becoming unsustainable. These measures are likely to adversely impact an already strained property market, especially when further consideration is given to the compounding effect this will have on foreign developers of land.

Accordingly, The Tax Institute is concerned as to whether, if duty is made immediately payable on this type of arrangement, there is a risk that this type of agreement will become unviable, leading to a negative impact on supply and affordability of housing in Victoria, which would be contrary to various measures by the Victorian Government in recent times to improve housing affordability for all Victorians and to ensure that contribution to the supply of housing stock in Victoria is encouraged, rather than stifled. To this end, we note, by way of an example, that an important criterion for obtaining relief from the Foreign Purchaser Additional Duty for foreign purchasers of residential property is that the foreign purchasers significantly contribute to the supply of Victorian housing stock. It would be completely contrary to introduce the new economic entitlement provisions which constitute a measure that would have the opposite effect.

Unintended consequences

The breadth of the new provisions and lack of relevant carve-outs may capture project management arrangements, sales or rental commissions, performance fees and other forms of typical commercial arrangements involving payments referable to sale or rental proceeds.

A number of unintended consequences would arise under the breadth of the new provisions. See below for a list of examples of unintended consequences that could arise:

- Real estate agents' commissions for leasing or selling could be captured as participation in the income, rents, or proceeds from the relevant land;

- Project and development managers who often charge a certain percentage of the project value could be captured as participation in the income or profits derived from the relevant land. Further, project managers who manage development entities could be subject to duty in addition to the development entities, although the development entities essentially act as intermediaries in relation to the project management fee component;

- Incentives for consultants, managers and contractors to value add and receive even a small percentage of the upside profit could be captured as participation in the profits derived from the relevant land;

- Management and performance fees received from hotel operators could be captured as participation in the income, rents or profits derived from the relevant land;

- Further, other contractors and consultants such as architects and valuers could also be subject to duty if their fee increases alongside or is set by reference to project value; and

- One-off or "mum and dad" developments could also be exposed, when a developer is engaged to develop property for sale or for rent and the fee is captured as participation in rents, profits or proceeds of the relevant land, and the additional duty costs incurred are recovered as a development cost and therefore passed on to the "mum and dad" landowner.

Unclear transitional provisions

Section 47 of the Bill seeks to grandfather arrangements entered into before commencement of the provisions. It is not clear how the transitional rules work.

For example, it is unclear whether negotiations in relation to a proposed development agreement can constitute an 'arrangement' or whether something more formal is required, for example, an agreement.

Lack of consultation

The Tax Institute is also concerned that this major change was not subject to any consultation with key stakeholders, or any announcement (whether as part of the release of the Victorian Budget or otherwise) and was instead quietly introduced in the Bill. As noted above, the change has a significant impact on a significant portion of the Victorian community and it is disappointing that no consultation was undertaken.

Further, the new provisions will come into effect the day after Royal Assent, giving the industry no time to transition to new arrangements. There is a vast range of these development agreements currently under consideration which would have to have their feasibility redone and all of their legal agreements reworked as a result, assuming that the project continued to be viable which is not a given.

The property industry would have an insubstantial amount of time to transition to these new arrangements as they come into effect.

Fixtures - the proposed amendments

The proposed amendments to the Duties Act to introduce the new fixtures provisions are said to ‘support the collection of duty on arrangements where fixtures are acquired independently from underlying land’.

Relevantly, the amendments seek to include, within the definition of ‘dutiable property’ under the Duties Act by new section 10(1)(ad), ‘an interest in fixtures that is created, dealt with or held separately from an estate or interest in the land on which the fixtures are located’. Further, a ‘fixture’ is defined to mean ‘anything that constitutes a fixture at law’; or ‘any other items fixed to land, including tenant’s fixtures’.

Issues and concerns

The Tax Institute submits that the proposed amendments will create confusion, despite the Explanatory Memorandum stating that these amendments will provide ‘greater certainty to taxpayers’.

There is some difficulty in understanding scenarios in which fixtures at law and tenant’s fixtures are dealt separately to an estate or interest in land on which fixtures are located (an enquiry which is relevant to determine whether or not such fixtures constitute dutiable property under new section 10(1)(ad)). It is questionable as to what circumstances, if any, in which it is possible to ‘deal with’ a fixture at law separately to an estate or interest in land. The Tax Institute submits that examples should be provided to clarify what types of situations are intended to be captured under section 10(1)(ad) in relation to items constituting fixtures at law.

Further, there is uncertainty as to how the new provisions interact with the current provisions. To the extent that there is a dealing with tenant’s fixtures (which retain their character as goods at law) or goods attached to land, it is also uncertain as to how the goods would be treated, if they are held or used in connection with primary production (exempted under section 10(1)(d)(iv) of the Duties Act)?

Additionally, The Tax Institute notes that under the current provisions of the Duties Act and the SRO’s policy, a transfer of a lease of land (which is an interest in land) of a non-dutiable kind which includes a transfer of common law fixtures or tenant’s fixtures would not be subject to duty. Such fixtures should not be caught by new section 10(1)(ad) which seeks to include fixtures that are dealt with <u>separately to the estate or interest in the land</u> on which the fixtures are located within the scope of dutiable property. The Tax Institute seeks confirmation that section 10(1)(ad) is not intended to now subject such fixtures to duty.

The Tax Institute also notes that while a security interest, option to purchase or a lease (other than dutiable leases) are not treated as ‘dutiable property’ pursuant to section 10(1)(ac) of the Duties Act, the proposed amendments do not appear to ensure that this position is also extended to ‘fixtures’ (as relevantly defined). It is uncertain if this is deliberate (and if so, we query the policy basis upon which the decision is made to not extend the protection to ‘fixtures’), or whether this is an oversight.

Lastly, The Tax Institute is also concerned that this change was not subject to any consultation, or any announcement (whether as part of the release of the Victorian Budget or otherwise) and was instead quietly introduced in the Bill.

Valuation of land on which a building is situated – the proposed amendments

The proposed amendments to the *Valuation of Land Act* 1960 (Vic) (**VoL Act**) in Part 5 of the Bill repeal the special provisions for calculating the value of land on which a heritage building is situated or where removal of a heritage building is prohibited, without replacement provisions to set out an alternate statutory methodology for these land types. The Explanatory Memorandum for the Bill provides that:

> "The amendments will ensure that, consistent with valuations of other properties, the site value of heritage properties will be determined according to their highest and best use, taking into account the effects of heritage status."

The amendments also specifically displace the operation of section 14(2) of the *Interpretation of Legislation Act* 1984 (Vic) (**Interpretation Act**). Section 14(2) of the Interpretation Act provides that where a provision of an Act is repealed, the repeal shall not affect the previous operation of that Act or anything duly done or suffered under that provision, or affect any right, privilege, obligation or liability acquired, accrued or incurred under that provision, unless the contrary intention expressly appears in the repealing legislation (as is the case with the Bill). The Bill provides that statutory valuers, the Valuer-General, VCAT or the Court are not to take any account of the repealed provisions when undertaking their respective roles in respect of valuations conducted as at 1 January 2018 or any later date (in determining objections, recommending adjustments, or determining any review or appeal).

The Explanatory Memorandum for the Bill provides that:

> "The amendments also ensure the consistent treatment of all landowners for land tax purposes by providing that any objections, reviews and appeals to site values issued for heritage registered properties against the 2018 valuations onwards will be considered in light of the amendments being made by this Bill."

Issues and concerns

The statutory clarity around valuing heritage affected land has been convoluted in recent years, leading to many objections and VCAT appeals. The Tax Institute submits that the outright removal of the special provisions for calculating the value of land on which a heritage building is situated, without the inclusion of alternative provisions, is likely to lead to greater confusion in this area of valuation moving forward and risks causing the heritage status of relevant landholdings not being taken appropriately into account (contrary to the intention noted in the Explanatory Memorandum). This runs the likelihood of valuation continuing to be tested in VCAT or the Supreme Court, at wasted time and great expense to landowners, Councils and the state.

Of greatest concern though to The Tax Institute is the alarming precedent set by displacing section 14(2) of the Interpretation Act and making the amendments in Part 5 of the Bill of practical (if not actual) retrospective effect. The Tax Institute understands that numerous valuation objections are currently on foot in respect of the 1 January 2018 valuations which are utilised for the 2019 land tax year.

Relevant taxpayers have expended great cost in engaging independent valuers and lawyers in mounting objections to the methodology used in valuing their heritage impacted lands. Many of these objections have been finalised on the basis of the valuation principles examined by VCAT in *ISPT Pty Ltd v Melbourne City Council* [2018] VCAT 1647. However those objections or appeals that remain on foot are directly nullified by these changes with little prospect of success, placing those taxpayers on unequal footing (on many cases, purely from luck of order of administrative processing at relevant Councils).

Implementing legislation with retrospective taxing effect creates dangerous uncertainty for Victorian taxpayers moving forward as to the management of their state taxation affairs, and deprives them of comfort that their objection and appeal rights and privileges will not be stripped mid-proceedings. While no adversarial proceedings are guaranteed of success, intervention by Parliament to directly nullify such is generally unprecedented.

If you would like to discuss any of the above, please contact the Chair of The Tax Institute's Victorian State Taxes Committee, Simon Tisher on 03 9225 7416, in the first instance.

Yours faithfully,

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