The Tax Institute

6 September 2022

Renee Ow
Public Ruling Project Manager
State Revenue Office Victoria
Southern Cross Tower
121 Exhibition Street
Melbourne Vic 3000

By email: consultation@sro.vic.gov.au

Dear Ms Ow,

Draft Revenue Ruling DA.065 | Acquisition of economic entitlements in relation to land (service fees)

The Tax Institute welcomes the opportunity to provide comments to the Victorian State Revenue Office (**SRO**) in relation to draft Revenue Ruling DA.065 *Acquisition of economic entitlements in relation to land (service fees)* (**Draft Ruling**).

In the development of this submission, we have closely consulted with our Victorian State Taxes Committee to prepare a considered response which represents the views of the broader membership of The Tax Institute.

At the outset, and as previously submitted by The Tax Institute and various other bodies, we reiterate our view that Part 4B of Chapter 2 of the *Duties Act 2000* (Vic) (**Duties Act**) is overly broad and in urgent need of amendment to ensure that it brings to duty only those transactions which are intended to be captured. In the absence of these needed legislative amendments, we consider it all the more crucial for the Draft Ruling to expand on and clarify the current areas of uncertainty.

The SRO's current website guidance on the economic entitlement provisions currently has helpful calculation examples. However, the Commissioner is not administratively bound to follow website guidance in his interpretation and application of the legislation. The Tax Institute therefore supports the issuance of a public ruling on this topic.

We consider that there is scope for clarification on several aspects of the economic entitlement provisions to ensure that the Draft Ruling encompasses common market transactions and provides practical guidance to taxpayers and advisors. We also consider that the examples in the Draft Ruling would benefit from certain amendments that better reflect commercial practices, ensuring that taxpayers have useful examples on which they can rely. Further examples highlighting the calculations taxpayers and advisors need to undertake will assist taxpayers in navigating the complexities of the economic entitlement provisions.

Our detailed response is contained in **Appendix A**.

We consider that the Draft Ruling would benefit from roundtable discussions to examine the issues raised in our submission. The Tax Institute would be pleased to be involved in such a consultation process.

The Tax Institute is the leading forum for the tax community in Australia. We are committed to shaping the future of the tax profession and the continuous improvement of the tax system for the benefit of all. In this regard, The Tax Institute seeks to influence tax and revenue policy at the highest level with a view to achieving a better Australian tax system for all. Please refer to **Appendix B** for more information about The Tax Institute.

If you would like to discuss any of the above, please contact our Tax Counsel, Julie Abdalla, on (02) 8223 0058.

Yours faithfully,

Jerome Tse

President

APPENDIX A

We have set out below our detailed comments and observations for your consideration. All legislative references below are to the Duties Act, unless otherwise indicated.

Background

The Draft Ruling clarifies the application of the economic entitlement provisions on:

- ordinary fees for service; and
- acquisitions of shares in companies and units in unit trust schemes that may be outside the scope of Chapter 3 of the Duties Act.

Clarifying section 32XC of the Duties Act

Subsection 32XC(1) provides that a person acquires an 'economic entitlement' if, under an arrangement made in relation to relevant land that has an unencumbered value that exceeds $1,000,000, the person is or **will be entitled**, whether directly or **through another person**, to any one or more of the following:

(i) to participate in the income, rents or profits derived from the relevant land;

(ii) to participate in the capital growth of the relevant land;

(iii) to participate in the proceeds of sale of the relevant land;

(iv) to receive any amount determined by reference to subparagraphs (i), (ii) or (iii);

(v) to acquire any entitlement described in subparagraph (i), (ii), (iii) or (iv).

The phrases 'will be entitled' and 'through another person' are not explained in the Draft Ruling. We consider that clarity on the meaning of these phrases is required, supported by specific examples of the type of arrangements the Commissioner considers are intended to be captured by these phrases. In particular, clarification is recommended as to what preconditions or commercial hurdles distinguish a person's potential entitlement as one in which they 'will be entitled'[1] compared to one in which they 'may become entitled'[2].

Clarification on genuine categories of service fees

We consider that greater clarity can be achieved in the Draft Ruling if three categories of service fees are set out as follows and considered separately:

1. items that do not fall within the definition of economic entitlement under section 32XC(1)(b)(i) to (v) of the Duties Act;

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[1] This would give rise to the immediate acquisition of an economic entitlement under section 32XC when the arrangement is entered into, regardless of whether the entitlement ever crystalises.

[2] This would result in the acquisition of an economic entitlement being taken not to occur until a later event, if ever.

2. items that technically fall within the definition of economic entitlement, but the Commissioner is expressing a view that they are 'genuine service fees' that in practice he considers should not be subject to duty; and

3. items that fall within the definition of economic entitlement and are subject to duty.

The examples provided in the Draft Ruling, while helpful, could be more usefully categorised in the manner outlined above, to provide clarity and reduce potential confusion. For example, a fee paid to an architect based solely on a percentage of building costs likely falls into category (1) above. This is because the payment is calculated by reference to a cost (an outflow of the project) rather than development proceeds. It should be noted in the Draft Ruling that this example is not an economic entitlement within the meaning of section 32XC.

In the absence of clarification on this point, some taxpayers and advisers may consider this to be an example of a service fee that is an economic entitlement by reference to the legislative provisions (which in our view it is not) and is only excepted from the application of Part 4B of Chapter 2 by virtue of the Commissioner's practice in relation to 'genuine fee for service'.

We also consider that further clarity should be given on the scope of the Commissioner's exemption for contingency fees paid to private advisory firms. That is, whether this is an example of an item that is technically an economic entitlement within the meaning of section 32XC but the Commissioner has determined is a genuine fee for service (and therefore not an economic entitlement) (i.e. within category (2) above). If so, the example should refer to one of the enumerated matters listed in section 32XC. We understand that it is not the Commissioner's view that a contingency will evidence the acquisition of an economic entitlement in every instance.

Further, The Tax Institute is of the view that Draft Ruling should clarify whether a contingency fee is only permissible in the context of a private advisory firm, or whether a contingency fee may be acceptable in other contexts.

Clarification on a genuine industry fee for services and 'industry parameters'

The stated purpose of the Draft Ruling is to clarify the application of the economic entitlement provisions to ordinary fees for service. This requires certainty in the Draft Ruling as to the Commissioner's view on the criteria that must be satisfied for a fee for service to be a genuine industry fee for service that is not an economic entitlement. In our view, the following section of the Draft Ruling is likely to create confusion by merging the concepts of what the Commissioner considers to be a genuine fee for service with the circumstances that necessitate the lodgment of the service agreement:

> *Accordingly, where a person providing a genuine service in relation to land:*
>
> - *is normally engaged in a full-time capacity in providing those services*
> - *the agreed fee/rate is within industry parameters, and*
> - *the person is unconnected (i.e. not an associated person) to any other person who has an economic entitlement in relation to the land,*
>
> *it is unnecessary for the service agreement to be disclosed to the Commissioner by the service provider.*

We consider that these concepts should be instead dealt with separately in the Draft Ruling.

Further, an important aspect of the Draft Ruling is the reference to 'industry parameters' that is referenced in the section extracted above. We are of the view that the Draft Ruling should provide guidance on what this term means, including how the Commissioner will determine if a fee/rate is within industry parameters (i.e. the sources to which the Commissioner will have regards). Taxpayers and advisers should be able to determine whether a proposed fee/rate is within 'industry parameters' by reference to the same external sources/indicia that the Commissioner considers relevant. This guidance will reduce the need for taxpayers to apply to the SRO for private rulings, and provide greater certainty of what may be described as the Commissioner's safe harbour requirements for a genuine fee for service.

Clarification where a service provider is 'connected' or 'associated to'

We consider that the Draft Ruling should confirm if it is the Commissioner's position that where a service provider is 'connected' or 'associated to' a person who has an economic entitlement to the land, the fee for service must be disclosed to the Commissioner. We note that it is common for groups to have a separation of a landowner and a 'service provider' for risk and business efficacy reasons, and that the 'service provider' entity would typically be engaged full time in providing these services and charging fees within industry parameters. These arrangements also typically cover a landowner and a developer or builder.

Clarification on the application of a corporate reconstruction concession

We recommend that the Draft Ruling should confirm whether a corporate reconstruction concession may apply to an acquisition of an economic entitlement. We note that this is likely to fall within the scope of an 'eligible transaction' within paragraph 250A(1)(i) of the Duties Act.

Responsible entities, trustees and fund manager fees

Feedback from our members indicates that it is relatively common for a developer to undertake a development for a fund where a related entity of the developer is the responsible entity, trustee or fund manager of the fund. This is particularly common among listed stapled groups. These transactions are often undertaken for fees that are within the accepted industry parameters. We consider that the Draft Ruling should more clearly outline why the Commissioner notes the related nature of the developer and fund responsible entity/trustee/manager means the fees paid are not genuine service arrangements, if they are otherwise within industry parameters. If the Commissioner is of the view that a safe harbour approach cannot be taken to these arrangements, and that they must be lodged for determination but may be treated as not dutiable if within industry parameters, this should be more clearly expressed.

We also consider that the approach adopted for responsible entities, trustees and fund manager fees should be extended to similar fees. These include those fees paid to asset and investment managers.

Example 2: Non-genuine service fees

We recommend that example 2 of the Draft Ruling should be clarified to expressly state that Company A has acquired an economic entitlement which is subject to duty. Further, the inclusion of a worked example on how the Commissioner would levy duty in this situation across Company A, Trust B and C would assist taxpayers and advisers.

Additionally, given that Company A is a genuine developer, the Draft Ruling would provide more helpful guidance if it included another example which illustrates what would be considered an acceptable percentage based on net sale proceeds leading to an alternative result. That is, what is considered to be within industry parameters.

Example 3: Non-bank third party financier

For example 3, we consider that that it would be helpful if the Commissioner could provide further details on his reasoning as to why a priority payment out of a 'waterfall clause' is not 'tied to the performance of the development'. This may be aided by detail as to how the Commissioner would treat the same arrangement if it were a limited recourse arrangement[3], and whether higher interest rates are reflective of the limited recourse risk and within industry parameters for a limited recourse loan in the Commissioner's view.

Where parties have had regard to reasonable benchmarks, such as those published by the Reserve Bank of Australia (**RBA**) or Australian Taxation Office (**ATO**), we consider that the loan arrangements should be accepted as being within industry parameters. We note that the relevant benchmarking exercise accommodates the expected term of borrowing, its limited or unlimited recourse nature, and its secured or unsecured position. Confirmation from the Commissioner that these variables alone will not result in the arrangement constituting the acquisition of an economic entitlement, would provide greater clarity to taxpayers. We note that the arrangement as a whole will need to be within industry parameters.

Example 4: Project management service fees

Example 4 states that the 'initial project management fee' is based on a percentage of estimated project cost. We consider that the Draft Ruling should provide further clarity as to whether a fee that is based on a percentage of the estimated project costs would ever constitute an economic entitlement for the purposes of the Duties Act. That is, whether the percentage of estimated project costs needs to be 'within industry parameters' for the Commissioner to take a view that the fee is not an economic entitlement.

We note that on a practical level, there are many genuine fee arrangements that have 'contingencies' as to whether they are payable and/or have some calculation which uses the economic entitlement categories as a reference point. These elements are often structured to incentivise genuine service providers to maximise the returns to the landowner. In our view, the existence of these elements should not necessarily 'convert' or indicate that a fee for service is the acquisition of an economic entitlement by the service provider.

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[3] That is, if the sale proceeds were not sufficient to discharge repayment in full, and the balance was non-recoverable by the borrower.

To elaborate, using the facts and terminology of example 4, the 'initial project management fee' does not incentivise the project manager to seek cost efficiencies (i.e. the greater the project costs – the higher the fee it receives). However, the 'final project management fee' does incentivise the project manager to do this.

As a result, we consider that the Draft Ruling should confirm that, if the sum of the 'project fees' received was within industry parameters, the Commissioner would not seek to characterise the fees as the acquisition of an economic entitlement by the project manager. Further clarity on the outcome if the final project management fee remained calculated as a percentage of project costs would also assist.

Example 5: Acquisition of units in a unit trust scheme

Example 5 of the Draft Ruling deals with the issue of units in a unit trust. It appears to indicate that the Commissioner's view is that the issue of the Class A units did not have a collateral purpose of reducing the duty chargeable under Chapter 2, such that the issue of units remains an 'excluded transaction' under subparagraph 7(1)(b)(vi) (that is, that subsection 7(2A) does not apply, leaving dutiability of the unit issue to Part 4B of Chapter 2).

We consider that it would be useful if the Draft Ruling expressly states this in the example.

Further calculation examples

The Tax Institute is of the view that the Commissioner should provide specific guidance on how he would calculate duty on the acquisition of an economic entitlement, particularly under section 32XE. We note that this guidance may be suited to a separate ruling.

Pursuant to subsections 32XE(1) and (2), the Commissioner has a broad ability to impose duty on a deemed acquisition of 100%, if the arrangement under which the economic entitlement is acquired:

- does not specify the percentage of economic entitlement acquired;
- includes an acquisition of a percentage of economic entitlement and any other entitlement or amount payable; or
- entitles a person or associated person to 2 or more entitlements referred to in subparagraphs 32XC(1)(b)(i), (ii), (iii), (iv) and (v).

Further, subsection 32XE(3) specifies that the Commissioner may determine a lesser percentage of economic entitlement was acquired if the Commissioner considers it appropriate in the circumstances. Further calculated examples would better assist taxpayers and advisors understand the application of the economic entitlement provisions and the calculation of duty in this regard.

APPENDIX B

About The Tax Institute

The Tax Institute is the leading forum for the tax community in Australia. We are committed to representing our members, shaping the future of the tax profession and continuous improvement of the tax system for the benefit of all, through the advancement of knowledge, member support and advocacy.

Our membership of more than 11,000 includes tax professionals from commerce and industry, academia, government and public practice throughout Australia. Our tax community reach extends to over 40,000 Australian business leaders, tax professionals, government employees and students through the provision of specialist, practical and accurate knowledge and learning.

We are committed to propelling members onto the global stage, with over 7,000 of our members holding the Chartered Tax Adviser designation which represents the internationally recognised mark of expertise.

The Tax Institute was established in 1943 with the aim of improving the position of tax agents, tax law and administration. More than seven decades later, our values, friendships and members' unselfish desire to learn from each other are central to our success.

Australia's tax system has evolved, and The Tax Institute has become increasingly respected, dynamic and responsive, having contributed to shaping the changes that benefit our members and taxpayers today. We are known for our committed volunteers and the altruistic sharing of knowledge. Members are actively involved, ensuring that the technical products and services on offer meet the varied needs of Australia's tax professionals.