The Tax Institute

TIA Property Intensive

Session 5: Options for Disposing of Landholdings

Presented at the TIA Property Intensive on 1 November 2023

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1. Overview

Landholders have many options for disposing of their land, be it by simple sale, subdivision, development or some kind of joint venture (JV).

Just as important as the option taken is the manner in which the land was acquired, has been held and has been used.

The implications could be variable and result from any combination of capital gains tax (**CGT**), trading stock and revenue asset classifications, and whether the disposal was done as part of a business. In addition, the goods and services tax (**GST**) implications can be complicated at best.

Specific issues that will be covered in this session will be:[1]

- Whether activities in preparation for sale have been done as a business, isolated transaction or mere realisation.
- Whether a CGT event K4 has arisen, or some other mechanism for how a property may 'transition' or 'blend' between capital, revenue and trading stock;
- The most aggressive, but beneficial, tax planning for disposing of property – death;
- Using asset revaluations reserves to access the benefit of a property;
- Changing Trustees of a trust;
- Undertaking partitions of property;
- Landholder duty and the changes coming down the pike; and
- Using options when dealing with property.

Where possible practical examples will be used to tease out the issues being discussed.

In each section the opportunities (e.g. tips) and risks (e.g. traps) will be sought to be addressed in the hope that the paper will be a useful reference should specific issues arise in the reader's practice from time to time.

Though the paper is for general information purposes only and is not the provision of advice. Clients or readers should seek specific advice as their affairs from a qualified professional before acting in relation to any property interests they have.

[1] The Duty issues considered are based on the New South Wales regime, but common issues arise in the duty regimes of other Australian jurisdictions.

2. Property via Revenue, Profit Making Intention or Capital

There are materially different outcomes where a taxpayer holds land on revenue account – whether as trading stock or via a profit-making scheme – of on capital account. The convenient place to start in this paper is that distinction.

2.1 Income Tax Regimes Applicable to Property Transactions

The income tax consequences surrounding dealings with property may be subject to assessment under a number of different parts of the tax law. The result is that dealings in property may have a number of different taxation consequences flowing to vendors of real property.

Identifying the taxing regime is mostly dependent on the determination of two issues, being:

1. the characterisation of the transaction; and
2. the profile of the taxpayer in relation to the transaction.

The taxing regime that may apply in the context of a property transaction can be divided into three possibilities, being:

Account	Description
Capital	as a gain on the disposal of a CGT asset.[2]
Revenue	as a disposal of trading stock, where land is held for sale in the ordinary course of a taxpayer's business.[3]
	as part of a profit-making scheme.[4]

In broad terms, if the asset (i.e. the land) disposed of is characterised as an item of 'trading stock' or a 'revenue asset', then its disposal consideration it will be subject to income tax (being on 'revenue account'). However, if the asset is a 'CGT asset', then any gain or loss on disposal will be subject to the capital gains tax (i.e. CGT) provisions. The determination of the appropriate taxing regime depends on many factors and is a question of fact. Broadly, the characterisation of the three possibilities are:

Account	Description	Taxation Effect
Capital	Capital account	'Mere realisation' of an investment in land
Revenue	Trading stock	Land sold as part of a property development business, where the property is being held for the purpose of re-sale

[2] Section 6-10 of *Income Tax Assessment Act* 1997 (Cth) (the '**1997 Act'**) as statutory income (via Section 102-5 and Division 104 generally of the 1997 Act).

[3] Division 70 of the 1997 Act, see Section 70-80 where land sold in ordinary course of taxpayer's business, gross receipts assessable as ordinary income under Section 6-5.

[4] Section 6-5 of 1997 Act as ordinary income, Section 6-10 (via Section 15-15 or Section 25A of the *Income Tax Assessment Act* 1936 (Cth) (the '**1936 Act**')) as statutory income.

	Revenue asset	Land is sold as part of an isolated or 'one-off' transaction. The transaction has been entered into with a profit-making purpose, and in a sufficiently commercial / business-like manner.

2.2 Land as Trading Stock

2.2.1 Overview: definition of 'trading stock'

In the event that property is sold as part of a property development business, then the property will be subject to the trading stock provisions: Division 70 of the 1997 Act. The issue is therefore whether your activities amount to the carrying on of a property development business.

Although not extremely useful, the term 'business' is defined in section 995-1 of the 1997 Act as including '*… any profession, trade, employment, vocation or calling, but not occupation as an employee…*'. Regard needs to be given to the judicial interpretation of the term. Ascertaining whether a business is being carried on is a question of fact: *Ferguson v FC of T* (1979) 9 ATR 873.

Section 70-10 of the 1997 Act provides a definition of 'trading stock', as including:

> *'Anything produced, manufactured or acquired that is held for purposes of manufacture, sale or exchange in the ordinary course of a business'.*

As a result, taxpayers that are not carrying on a business of property development will not hold property as trading stock. The High Court upheld this view in the *FC of T v St Hubert's Island Pty Limited* 78 ATC 4104, where it was held that land would constitute trading stock if it has been acquired for the purpose of resale - including land that is purchased for the purpose of subdivision, development and resale.

Further, the property must not merely be held for the purpose of manufacture, sale or exchange by a business. Rather, it must be held for the purpose of manufacture, sale or exchange in the *ordinary* course of a taxpayer's business.

2.2.2 Holding land for purpose of resale – land originally acquired as trading stock

Before land will be considered trading stock, it must be held for sale in the 'ordinary course of business'. The holding of land as trading stock involves the taxpayer having dispositive power in relation to the land: *Sutton Motors (Chullora) Wholesale Pty Limited* 85 ATC 4398. Where the taxpayer has title to the land in question, this would be sufficient (in the context of the trading stock provisions) to arise when the contract for purchase of the land settles: *Gasparin v FC of T* 94 ATC 4280.

Broadly, virgin land will constitute trading stock *in globo* even before it is converted into a subdivided and improved condition for sale: *FC of T v St. Hubert's Island Pty Limited* 78 ATAC 4104. *In globo* trading stock will become converted into individual articles of trading stock upon being converted into subdivided and marketable components, e.g. when the plan of subdivision is registered: *Barina Corporation v FC of T* 85 ATC 4847 and *Kurts Developments Limited* 98 ATC 4847.

2.2.3 Holding land for purpose of resale – land not originally acquired as trading stock

While land may not be acquired for resale originally, it may subsequently be held for such purposes – i.e. be held in the ordinary course of a business, and therefore be characterised as an item of trading stock.

In such situations, it is the use or intention relating to land that has changed – resulting in a change in it's taxation characteristic from, for example, a CGT asset to an item of trading stock.

Section 70-30 of the 1997 Act deals with this situation, and provides that in such cases, the taxpayer holding the land will be deemed to have:

1. sold the land for its 'market value' or 'cost' (the taxpayer may elect which value to use); and
2. immediately reacquired the land for the same amount.

The value elected by the taxpayer then becomes the property's cost for trading stock purposes. The election must be made by the time of lodgement of the income tax return for the income year in which the item starts to be held as trading stock.

However, if the election is not made by the required time, because the taxpayer subsequently realises they started to hold the item as trading stock, the election must be made as soon as practicable after the land has changed its characteristic.

Further, the **Commissioner** of Taxation has a discretion to allow a taxpayer to make a later election: subsection 70-30(2) of the 1997 Act.

2.2.3.1 Cost Election

'Cost' is the value the land would it would have been, calculated as if it had it been acquired as trading stock.

If cost is elected, the deemed disposal will not give rise to any amount of tax payable by virtue of the CGT provisions. As a result, there are no negative cash flow consequences for the taxpayer: subsection 118-25(2) of the 1997 Act.

2.2.3.2 Market Value Election

In the event that a market value election is made, the deemed disposal and re-acquisition under Section 70-30 of the 1997 Act may have CGT implications. The result may be that there is an income tax liability for the taxpayer, notwithstanding that no actual proceeds are received.

Specifically, any capital gain will be any difference between the property's market value and cost base: refer to Section 104-220 of the 1997 Act - CGT event K6.

The Commissioner of Taxation, in Taxation Determination TD 97/1 entitled *If land, originally acquired as a capital asset, is later ventured into a business of development, subdivision and sale, how is the market value of the land calculated at the time it is ventured into the business?,* considers that the market value of the property is to be determined having regard to its 'highest and best use'.

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Such a determination involves a requirement to take into account the land's potential usages and the probability of council approval for any potential use. It is assumed that this would entail a higher value than cost on account of a venture being entered into.

It should be repeated that in the event that CGT event K4 applies, then the taxpayer may be subject to a negative cash flow impact, given that an amount of income tax may become payable notwithstanding that the taxpayer has not actually received any proceeds.

However, a market value election may be advantageous, for the following reasons:

1. the difference between the cost of the property and its market value at the time of the deemed disposal will be taxed under the CGT regime, and therefore may potentially attract some CGT concessions (e.g., 50% general discount in Division 115 of the 1997 Act);
2. the increase in the tax cost of the property will mean that any future gains subject to tax under the ordinary income provision are reduced; and
3. interest referable to borrowings used to fund any income tax liability may be deductible where connected with the carrying on of a business: Taxation Ruling IT 2582: *Income tax: Deductibility of interest incurred on moneys borrowed to pay income tax*.

2.2.4 Ceasing to hold land for purpose of resale but ownership continues

In the event that a taxpayer decides that property originally held as trading stock should be retained for investment or private purposes, section 70-110 of the 1997 Act will apply to deem the trading stock to be sold for its cost and reacquired for that same amount.

Section 70-110 of the 1997 Act provides that:

> *'If you stop holding an item as trading stock but still own it, you are treated as if:*
>
> *(a) just before it stopped being trading stock, you had sold it to someone else (at arm's length and in the ordinary course of business) for its cost; and*
>
> *(b) you had immediately bought it back for the same amount.'*

The amount for which the trading stock is notionally sold is assessable income just like the proceeds of sale of any trading stock. However, given the way in which trading stock is accounted for, the taxpayer receives a deduction for that same amount with the result that there is no actual tax liability.

In the event that the property is held as a CGT asset, then the cost base for the property will be the deemed purchase price.

The deemed sale at 'arms length' prevents the non-arms length rules contained in section 70-20 of the 1997 Act applying. Further, as the sale is deemed to be 'in the ordinary course of business' it is also not subject to section 70-90 of the 1997 Act dealing with assessable income on disposal of trading stock outside the ordinary course of business.

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2.2.5 Bringing to account trading stock acquisitions and disposals under Division 70 of the 1997 Act

Where a business is being carried on and land is being held for the purpose of resale, the trading stock provisions in Division 70 of the 1997 Act provide the manner in which outgoings and earnings are treated for income tax purposes.

Division 70 of the 1997 Act, which is intended to '*… produce an overall result that … properly reflects … activities with … trading stock during the income year…*' (section 70-5 of the 1997 Act) provides that:

1. acquisition and ancillary costs (eg development costs) of purchased trading stock are an allowable general deduction (section 8-1 of the 1997 Act) in the year the trading stock is held for sale in the course of a business (section 8-1 and section 70-15 of the 1997 Act);
2. the gross consideration received upon disposal of trading stock is assessable as ordinary income (section 70-80 and section 6-5 of the 1997 Act) upon being derived (which will be at the date of settlement in respect of trading stock - *Gasparin v FC of T* 94 ATC 4280); and
3. the excess of closing value (section 70-45 of the 1997 Act) of trading stock on hand at the end of the income year over the opening value (section 70-40 of the 1997 Act) at the start of the income year is assessable (section 70-35 of the 1997 Act);
4. and conversely, where the opening value of trading stock is greater than the closing value, the excess is allowable as a deduction (section 70-35 of the 1997 Act).

Deductions for the cost of the trading stock are only available in the income year in which it is sold. Further, the trading stock regime expressly provides that the cost of trading stock is not a capital outgoing that could otherwise be denied deductibility under the general deduction provision: section 70-25 of the 1997 Act.

As a result, it is important to determine the cost of trading stock, as it is this amount that is deductible to the taxpayer when the item is sold. Further, a choice must be made as to how trading stock will be valued for the purposes of the above. It is also important to note that the closing value of stock for one year becomes the opening value for the following year.

2.2.6 Valuation of trading stock

Section 70-45 of the 1997 Act permits three methods for valuing trading stock, being:

1. cost;
2. market-selling value; or
3. replacement cost.

The Commissioner will generally not accept amendment requests that involve changing valuation methods once an assessment has been issued. However, the amount of value under the chosen method can be changed.

2.2.6.1 Cost

When valuing stock according to the 'cost' methodology, an important issue to determine is what is actually included in such a valuation.

Cost is determined using absorption costing. The Commissioner of Taxation, in Taxation Ruling IT 2350 entitled *Income Tax: Value of trading stock on hand at end of year: Cost Price: Absorption costing,* considered that the following types of items are included when determining the cost of land as trading stock:

1. insurance costs in relation to equipment used in construction;
2. insurance of building being developed;
3. production supervisory wages (including payroll tax, superannuation, workers compensation and holiday pay);
4. depreciation on plant used during construction; and
5. electricity used on-site.

For a development site, when a parcel of land consists partly of infrastructure land, which vests in the Crown upon subdivision, the costs of infrastructure land and costs relating to infrastructure land will be included in the cost of trading stock: *FC of T v Kurts Development Limited v FC of T* 98 ATC 4877. These costs are made up of internal and external infrastructure costs:

1. internal infrastructure costs include drainage, kerbing, electricity, parks, roads, sewerage, and telephones; and
2. external infrastructure costs are those costs that relate to items physically external to the land of the developer but may be required as a condition of gaining approval from local council to undertake a subdivision. As the costs are required in order to gain approval they are incurred in bringing into existence individual subdivided lots and are therefore included in the cost of trading stock. Such costs can include upgrading sewerage, water mains or roads that are adjacent to the taxpayers land or contributions by the taxpayer in relation to upgrading such items.

Before registration of a developer's plan of subdivision creating individual subdivided lots, infrastructure land and the infrastructure costs relating to the infrastructure land are part of the cost of the developer's trading stock consisting of the un-subdivided land. Upon subdivision, those infrastructure costs become part of the cost of trading stock consisting of the individual lots: *FC of T v Kurts Development Limited v FC of T* 98 ATC 4877.

The costs of holding land are not included in the value of trading stock. Such costs, including interest, council rates, marketing expenses and land tax incurred on and after the purchase of land should be deductible in the year they are incurred: Tax Determination TD 92/132.

2.2.6.2 Market selling value

In falling property markets it is feasible that the market value of property may be less than the value of trading stock at the beginning of the year or from its current year cost. To secure potential deductions in the year, a taxpayer should ensure that he or she investigates obtaining a market valuation for the year-end. The valuation of development and partly developed land requires the usage of the land to be taken into account.

Where land is to be ventured into a business of development, subdivision and sale, the market value of land is to be determined having regard to the 'highest and best use' that can be made of the land. The value of land can be enhanced when it becomes suitable for subdivision (Taxation Determination TD 97/1).

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The land must be valued based on the current state of the land. When looking at subdivided land each lot will only be valued as a separate item of stock if each block is individually marketable. Un-subdivided land will be valued as one lot (*Barina Corporation Limited v FC of T* 85 ATC 4847).

The Commissioner in Taxation Determination TD 97/1 provides the following example:

> *A taxpayer acquired a rural property on which he conducted farming activity. Some years later, the property is ventured into a business involving the development and subdivision of the land into residential allotments.*
>
> *In calculating the net profit on sale of the residential lots, the taxpayer should take into account an appropriate proportion of the market value of the land when it was ventured into the business of development, subdivision and sale. The market value of the land is its value as broad acres but taking into account its potential for subdivision and the probability of consent being given for such potential use.*

Where undertaking a market valuation, the choice of who is to undertake a valuation will depend on the nature of the asset and the taxpayer's business circumstances – in particular factors such as:

1. the value of land versus its cost or opening value;
2. the complexity of the valuation;
3. the availability of in-house valuation expertise; and
4. use of an external valuer.

It is submitted that where a market value will significantly reduce tax payable, an independent valuation should be obtained.

Where a market value is used, it must be the value as at the end of the income year. This means events subsequent to year-end should not impact on the valuation.

2.2.6.3 Replacement Cost

Replacement cost method values land at the amount the taxpayer would have to pay for a replacement item in its normal buying market on the last day of the year of income. For this method to be appropriate, items must be available in the market and be substantially identical to the replaced items.

In *Parfew Nominees Pty Limited v FC of T* (1986) 85 FLR 370 (86 ATC 4673) the Victorian Supreme Court held that when valuing strata units at year-end, the taxpayer could not use as replacement cost an estimate of the cost of acquiring a similar block of land and developing identical strata units. The Court held that it was wholly unrealistic to postulate a notional rebuilding of a whole development and then to value the units as part of that development. If valuation at replacement cost were open, it was held, then the appropriate value would be the selling price of the units.

The replacement cost method is not generally appropriate to value land as trading stock.

2.3 Land as a Revenue Asset

The disposal of a revenue asset generates ordinary income for the taxpayer. Generally, a 'revenue asset' is one that is purchased with a view to profit upon its eventual realization: *FCT v Whitfords Beach Pty Ltd* 82 ATC 4031. It is more than 'merely' realised, but it is not held as an item of trading stock.

The Commissioner of Taxation considered in paragraph 6 of *Taxation Ruling TR 92/3* entitled *Income tax: profits from isolated transactions* that receipts derived from an 'isolated transaction' would be assessed as ordinary income under section 6-5 of the 1997 Act if:

> ***First*** - the taxpayer entered into the transaction with a profit-making purpose; and
>
> ***Second*** – a profit was made in the course of carrying on a business or in carrying out a business operation or commercial transaction.

That is, in *Taxation Ruling TR 92/3* the Commissioner of Taxation uses a broad approach to characterising business gains from isolated transactions. Indeed, at paragraph 12 the Commissioner asserts that for '… a transaction to be characterised as a business operation or a commercial transaction, it is sufficient if the transaction is business or commercial in character'.

However, Hill J in *Westfield Ltd v FCT* (1991) 21 ATR 1398 considered that a taxpayer must contemplate the means by which a taxpayer derives profit. In that case, a taxpayer who acquired an option for the purchase of land with the intention of designing, constructing, letting and managing a shopping centre was not assessed on capital account when, before exercising the option, the taxpayer sold the land. The Commissioner of Taxation assessed the taxpayer on the profit on the basis that it was income according to ordinary concepts. Justice Hill held that whilst a profit-making scheme may lack detail at the time of acquisition, the means of achieving the profit must have been considered by the taxpayer when the option was being acquired.

At 1406 Hill J observed that:

> *In a case where the transaction, which gives rise to the profit, is itself a part of the ordinary business (e.g. a profit on sale of shares made by a share trader), the identification of the business activity itself will stamp the transaction as one having a profit-making purpose. Similarly, where the transaction is an ordinary incident of the business activity of the taxpayer, albeit not its main business activity, the same can be said. The profit-making purpose can be inferred from the association of the transaction of purpose and sale with that business activity.*

Further, at 1408 Hill J concluded that:

> *… it is difficult to conceive of a case where a taxpayer would be said to have made a profit from the carrying on, or carrying out, of a profit-making scheme, where, in the case of a scheme involving the acquisition and resale of land, there was, at the time of acquisition, no purpose of resale of land, but only the possibility (present, one may observe, in the case of every acquisition of land) that the land be resold.*

That is, if the scope of the taxpayer's business / profit making means is narrowly defined, the gains may not be assessed on revenue account. Property developers do well to keep in mind this development tip.

The carrying on of a business is also not an essential element when considering whether there is a disposal of a revenue asset. In *FC of T v Whitfords Beach Pty Ltd* (1982) 12 ATR 692 at 710 Mason J observed that:

> *… it is enough that the statutory description that there was a profit-making undertaking or scheme which exhibited the characteristic of a business deal, even though it did not amount to the carrying on of a business. If what has happened amounted to no, more than a mere realisation of an asset then it was not a profit-making undertaking or scheme.*

It seems that profits from an isolated transaction will be treated as assessable income where a profit-making intention exists when a transaction is first entered into: *FC of T v Myer Emporium* 87 ATC 4363. This will typically be when a taxpayer purchases property.

2.3.1 Is realisation sufficiently business-like?

Where the taxpayer is not engaged in the business of a property developer, but subsequently sells the land, the manner in which the land is subdivided, developed and sold will provide the basis for determining whether the transaction amounts to a business operation or commercial transaction, such that the profit is potentially assessable as ordinary income.

It is considered that a more passive role rather than an active role is likely to cause land development and subsequent sale to be regarded as the mere realisation of a capital asset.

McCorkell v FCT 98 ATC 2199 provides an illustration of a passive role. In *McCorkell*, the taxpayer entered into two contractual arrangements. The first arrangement involved a surveyor and engineer who subcontracted the work on the subdivision. The second arrangement involved joint estate agents who recommended sale prices and dealt with all potential purchasers.

The taxpayer did not contract or deal with the contractors or purchasers and had no business office or letterhead. The taxpayer had minimal involvement with advertising. It was thus held that the adoption of a relatively passive role rendered the land development and sale of the allotments as the realisation of a capital asset.

In *Casimaty v FC of T* 97 ATC 5135, Ryan J held that the purpose for which the property was held remained unchanged - the taxpayer held land as a capital asset for income-producing purposes. Ryan J contrasted *Casimaty* with *Whitfords Beach* (where the profits made on the sale of land were held to be ordinary income of the taxpayer), imputing the change of purpose pertaining to the land to the change in ownership of the company incorporated by the fishermen to the three property development companies.

In contrast to the passive role, *Case W59* 89 ATC 538 provides an illustration of circumstances where a taxpayer has adopted an active role in the property development. In *Case W59*, the extent to which professional advice was received in respect of the subdivision and sale of the land was limited to the original planning application.

The taxpayer alone conducted the remainder of the subdivision and sale of the land. Thus the taxpayer made all decisions of significance, and directed the entire project. The taxpayer was directly involved in the negotiations with the local council and water authority, employed the contractors, and sought – and received – finance.

Moreover, the taxpayer controlled the sale of the allotments by instructing a number of local real estate agents to act on his behalf. Whilst no site office was constructed on the property, the taxpayer utilised a home office to manage the subdivision, including to maintain the associated accounts and to deal with prospective purchasers.

The Administrative Appeals Tribunal held that the taxpayer in *Case W59* was engaged in the business of subdividing, developing and selling land as opposed to merely realising the capital asset in the most advantageous way. The decision of the AAT was affirmed in the Federal Court on appeal by the taxpayer in *Stevenson v FCT* 91 ATC 4475.

Finally, It is in this context that *August v Commissioner of Taxation* [2013] FCAFC 85 is relevant and a cause of concern in this regard.

Mr August acquired various shops in the same centre from 1997 to 1999, renovated them, put tenants in them on long-term leases and sold them in 2006. Despite holding the properties for up to 9 years,

and claiming he intended to hold them until his death, the Full Court found his primary intention in purchasing the properties was to resell them at a profit.

Against his arguments of long-term investing was the following. First, Mr August had sought advice on where to purchase from a friend who was in the business of property investing. Secondly, soon after the last lease was secured Mr August had consulted a real estate agent about selling, though he said it was merely out of interest in the properties' then value. Mr August had also obtained a bank valuation 6 months prior and, although he subsequently wanted a non-bank[5] valuation, the court held the later valuation was unnecessary other than for sale purposes. Thirdly, that agent took it on themself to source potential purchasers and, having obtained a good offer, persuaded Mr August to sell. The Court did not accept the good offer as the reason for the sale. Finally, Mr August's circumstances did not change at the time of selling, "So why sell?" reasoned the court.

Although Mr August's explanations might be considered reasonable, especially in the face of 7 to 9 years of stated intention, the Full Court held the purchases were made to resell at a profit. It seems any taxpayers selling assets – or partitioning land in anticipation of sale – should consider their entire circumstances as their long held intentions may not be accepted.

2.3.2 Taxation implications when a property is a revenue asset

Where an asset is characterized as a 'revenue asset', income tax is levied on the 'profit' that the taxpayer derives upon sale. The High Court in *Whitfords Beach* held that the net profit on the land sales fell within the concept of 'gross income' under the ordinary income provision of section 6-5 of the 1997 Act.

That is, gains realized on the sale of revenue assets are assessed as ordinary income under section 6-5 of the 1997 Act and losses incurred on disposal are deductible under section 8-1 of the 1997 Act.

Given that gains made on revenue assets are taxed on a profit and loss basis outgoings are recognised as a cost when the gain is brought to account – with the deduction not recognised when the asset is initially acquired.

2.4 Land as a Capital Asset

When property acquired on or after 20 September 1985 is not held as trading stock of the taxpayer or otherwise on revenue account, but rather is held on capital account by the taxpayer, any gain or loss arising upon disposal of the land will be calculated and assessed under the CGT provisions.

As stated above, property held by a taxpayer may be characterised as either a:

1. ***a revenue asset*** - on the basis that there is an intention by the taxpayer to make a profits on the disposal of the property; or
2. ***a capital asset*** - on the basis that the property forms part of the profit yielding structure of the taxpayer therefore its disposal will be subject to CGT.

Scottish Australian Mining Co Ltd v FC of T (1950) 4 AITR 443 established that a profit derived from the sale of a capital asset, undertaken in an enterprising manner is not income according to ordinary concepts. A taxpayer is not assessable on the profits if the taxpayer does everything possible to realise

[5] Which can be significantly higher than a bank valuation.

to the best advantage a capital asset, and the asset was not initially acquired for the purpose of being eventually disposed at a profit. At 450-1 Williams J held that:

> *The crucial question is therefore whether the facts justify the conclusion that the appellant embarked on …[a profit-making] …business or undertaking or scheme. The facts would, in my opinion, have to be very strong indeed before a court could be induced to hold that a company which had not purchased or otherwise acquired land for the purpose of profit-making by sale was engaged in a business of selling land and not merely realising it when all that company had done was to take necessary steps to realise the land to best advantage, especially land which had been acquired and used for a different purpose which it was no longer businesslike to carry out.*

Land held on capital account will be a CGT asset: section 108-5 of the 1997 Act. Joint tenants are treated as owning separate CGT assets proportionate to each tenant's interest in the CGT asset: section 108-7 of the 1997 Act.

A disposal of a CGT asset occurs upon the occurrence of a 'CGT event'. Some of the relevant CGT Events applicable to property transactions include:[6]

CGT Event	Description
CGT event A1	disposal of a CGT asset by a change in beneficial ownership to another person
CGT event E2	transfer of a CGT asset to a trust
CGT event E4	capital payments from a unit trust to a unit holder
CGT event E5	a beneficiary of a trust becoming entitled to a trust's CGT asset
CGT event K4	a CGT asset becomes trading stock

2.4.1 Relevant CGT Concessions

For CGT assets acquired before 21 September 1999 and held for at least 12 months, the taxpayer can choose to calculate the capital gain based on either:

1. the indexed cost base (cost base adjusted for the 'consumer price index' up to 30 September 1999); or
2. by applying the 'CGT 50% discount', which is unavailable for companies (Division 115 of the 1997 Act).

Where the capital gain is made by a trust, the CGT 50% discount is applied and the balance distributed to an individual beneficiary, the beneficiary will 'gross up' the distribution apply losses if any then apply the CGT 50% discount to the grossed-up amount. That is the discount effectively flows from the trust to the beneficiary. A similar result occurs when the payment passes through a chain of trusts.

A number of other CGT concessions may apply, such as:

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[6] Though there may be more depending on the client's circumstances. For instance, CGT Event H2 – Receipt for an Event happening to a CGT Asset – can apply when compensation is paid for damage to property and no other CGT Event would on its face be applied.

1. The CGT main residence exemption (Division 118-B of the 1997 Act);
2. The CGT small business concessions (Division 152 of the 1997 Act); and
3. Situations of absolute entitlement (s 106-50 of the 1997 Act).

The general discount is relatively straightforward and won't be discussed further in this paper.

2.4.1.1 Small Business Concessions

The small business concessions contained in Division 152 of the 1997 Act may significantly reduce a capital gain made in respect of an 'active asset' of a 'small business taxpayer'.

The basic conditions of Division 152 must be satisfied by the taxpayer and the asset must be an *active asset*. An 'active asset' is an asset used or held ready for use in a business and, in certain circumstances, includes shares and trust interests in an entity that holds active assets: section 152-40 of the 1997 Act. However, an active asset does not include an asset whose main use in the course of carrying on the business was to derive rent, unless its main use for deriving rent was only temporary: subsection 152-40(4)(e) of the 1997 Act. This has particular significance for property developers that lease property to increase revenues pending its sale.

The exclusion of assets used to produce rental income effectively limits the availability of the concessions to property projects used by the taxpayer or a related entity in a business (e.g. a factory or shop). Accordingly, the concessions are of limited application to real estate unless it is used or held ready for use in the relevant business.

If the concessions apply, a useful provision to remember is s 152-49 of the 1997 Act which allows the sale of an asset at a time other than when business is being sold to benefit from the small business concessions, provided the sale was as part of the winding down of the business. The author has had a client use this provision twelve years after the assets of the business were sold and operations ceased, other than a property in which the business tools and equipment were stored.

2.4.1.2 Absolute Entitlement

Th effect of s 106-50 of the 1997 Act is that where absolute entitlement exist – such that the legal owner holds the property absolutely for the beneficial, who is not on the legal title to the property – you ignore the trustee for the purposes of CGT (e.g. for Parts 3-1 and 3-3 of the 1997 Act). Therefore, any dealing by the trustee, including the transfer of the property to the absolutely entitled beneficiary, is ignored for CGT purposes.

Where this applies the apparent purchaser concession in s 55 of the *Duties Act* 1997 (NSW)[7] may apply to limit *ad valorem* duty to only $50 concessional duty.

But there is a complication in the Commissioner's view of this provision.

Although the Commissioner agrees that a beneficiary can be absolutely entitled to certain assets, he does not include in this land if there is more than one beneficiary: *Taxation Ruling TR 2004/D25, Income Tax: capital gains: meaning of the words 'absolutely entitled to a CGT asset as against the trustee of a trust' as used in Parts 3-1 and 3-3 of the Income Tax Assessment Act 1997.*

[7] There are equivalent provisions in other jurisdictions.

This is a draft ruling that, for over 10 years now, has not been finalized. It is doubtful whether the Commissioner's reasoning would be accepted by a court or the Administrative Appeals Tribunal, as there seems no difference between land and a share in a company (which may not strictly be fungible as they are separately numbered and separately identifiable).

The Commissioner's reasons, so far as is relevant for present purposes, is as follows:

> ***Core Principle***
>
> *10. The core principle underpinning the concept of absolute entitlement in the CGT provisions is the ability of a beneficiary, who has a vested and indefeasible interest in the entire trust asset, to call for the asset to be transferred to them or to be transferred at their direction. This derives from the rule* Saunders v. Vautier *applied in the context of the CGT provisions (see Explanation paragraphs 41 to 50). The relevant test of absolute entitlement is not whether the trust is a bare trust (see Explanation paragraphs 33 to 40).*
>
> *…*
>
> ***Core principle: applying it practice***
>
> *20. The most straight forward application of the core principle is one where a single beneficiary has all the interests in the trust asset. …*
>
> ***One beneficiary with all the interests in a trust asset***
>
> *21. A beneficiary has all the interest in a trust asset if no other beneficiary has an interest in the asset (even if the trust has other beneficiaries).*
>
> *22. Such a beneficiary will be absolutely entitled to that asset as against the trustee for the purposes of the CGT provisions if the beneficiary can (ignoring any legal disability) terminate the trust in respect of that asset by directing the trustee to transfer the asset to them or to transfer it at their direction (see Explanation paragraphs 76 to 79).*
>
> ***More than one beneficiary with interests in a trust asset***
>
> *23. If there is more than one beneficiary with interests in the trust asset, then it will usually not be possible for any one beneficiary to call for the asset to be transferred to them or to be transferred at their direction. This is because their entitlement is not to the entire asset.*
>
> *24. There is, however, a particular circumstance where such a beneficiary can be considered absolutely entitled to a specific number of the trust assets for CGT purposes. This circumstance is where:*
>
> - *the assets are fungible;*
> - *the beneficiary is entitled against the trustee to have their interest in those assets satisfied by a distribution or allocation in their favour of a specific number of them; and*
> - *there is a very clear understanding on the part of all the relevant parties that the beneficiary is entitled, to the exclusion of the other beneficiaries, to that specific number of the trust's assets.*
>
> *25. Because the assets are fungible, it does not matter that the beneficiaries cannot point to* particular *assets as belonging to them. It is sufficient in these circumstances that they can*

point to a specific number of assets as belonging to them. See Explanation paragraphs 80-126.

…

54. Therefore, the requirements for absolute entitlement within the context of the CGT provisions cannot be satisfied if there are multiple beneficiaries in respect of a single asset such as land. While each beneficiary may have an interest in, and therefore be entitled to, a share of the land, the asset to which the provisions refer is the land and no beneficiary in this case is entitled to the whole of it.

55. Even if the asset to which the provisions refer is a beneficiary's undivided share in the land (and, as discussed, we do not agree that it is), the beneficiary could not insist upon having that undivided share transferred to them. To do so may prejudice the other beneficiaries because the sale of the remaining undivided share may not realize the same amount as if the whole of the land had been sold and the proceeds distributed: see Re Horsnaill *[1909] 1 Ch 631 and* Wilson v Wilson *(1950) 51 SR (NSW) 91.*

In this regard the Commissioner may take further comfort from more recent cases of:

- *Attorney General of New South Wales v Homeland Community Ltd & Ors* [2013] NSW 748 at [63] per Windeyer AJ;
- *Michael Victor Henley, in the Estate of Hedy Jadwiga Weinstock and Leo Arie Weinstock* [2013] NSWSC 975 at [46] and [65] per Slattery J; and
- *Feeney v Feeney* [2008] NSWSC 890 at [21] per White J.

But these cases deal with the real property and trust law considerations, not the fact that the relevant underlying asset, for CGT purposes, is the CGT asset.

It is also unsatisfactory that *Taxation Ruling TR 2004/D25* remains in draft form. In the National Tax Liaison Group meeting of December 2010 (at item 9 of the minutes[8]) the Australian Taxation Office ('**ATO**') representatives made clear that:

- the status of the ruling remains unclear; and
- the ATO considers the finalization of the ruling as intricately linked to how it will deal with bare trusts, which also remains an unresolved issue.

Regardless of the disputed views above, this issue clearly does not impact on property involving two co-owners, but any more and the Commissioner's view must be seriously considered (despite the criticisms raised).

2.5 CGT Event K4

In this context it is important to noted CGT Event K4 that is set out in s 104-220 of the 1997 Act.

CGT Event K4 happens if a taxpayer starts holding as trading stock a CGT asset already owned by the taxpayer but not held as trading stock and the taxpayer elects to be treated as having sold the asset for its market value. If the taxpayer elects the cost base of the CGT asset to apply for trading stock

[8] Arising in the context of insurance proceeds trusts and self-managed superannuation funds.

purposes then the event does not apply and any gain or loss is disregarded (Though this would put any gain during the time the CGT asset was held on capital account into revenue account assessment).

The time of the CGT Event K4 is when the taxpayer starts holding the asset as trading stock. This is clearly an evaluative matter in which all relevant circumstances are brought to bear.

If the election is made the taxpayer makes a capital gain or capital loss from CGT Event K4 if the market value of the the CGT Asset just before it becomes trading stock is more, or less, than its cost base as an asset held on capital account.

A capital gain or loss from the CGT Event K4 happening is disregarded if the asset was acquired before 20 September 1985 and that pre-CGT status has not been lost for any reason.

3. Aggressive, but beneficial, Tax Planning - Death

The two certainties – death and taxes – can actually offset each other. The use of estate planning, albeit a very aggressive way of tax planning, can use death to offset taxes (it offsets duty and delays CGT). The benefits are sufficiently helpful to justify a discussion of them.

3.1 Duty Considerations

The duty concessions are most beneficial because, unlike the CGT benefits that merely delay the CGT, the duty concessions remove what would otherwise be an impost because of the transfer.

By s 8 the ***Duties Act*** 1997 (NSW) imposes duty on the "transfer" of "dutiable property". Section 11(1)(a) of the Duties Act provides that land in New South Wales is dutiable property.

Although "transfer" is not defined by the Act Ormiston JA[9] defined "transfer":[10]

> Thus, however broadly the word 'transfer' be defined, it requires at the least that the transferee should, at the end of the transaction, have substantially the same right or interest in the subject matter as did the transferor before the transfer took place.

There is therefore a transfer of dutiable property to the extent that any of properties are dealt with by moving them from the Estate to a beneficiary. Subject to any exemptions or concessions, that duty would be calculated at *ad valorem* rates.

For duty purposes, the relevant provision for concessions, is s 63 of the Duties Act, provides:

> **63 Deceased estates**
>
> (1) Duty of $50 is chargeable in respect of:
>
> (a) a transfer of dutiable property by the legal personal representative of a deceased person to a beneficiary, being:
>
> (i) a transfer made under and in conformity with the trusts contained in the will of the deceased person or arising on an intestacy, or
>
> (ii) a transfer of property the subject of a trust for sale contained in the will of the deceased person, or
>
> (iii) an appropriation of the property of the deceased person (as referred to in section 46 of the *Trustee Act 1925*) in or towards satisfaction of the beneficiary's entitlement under the trusts contained in the will of the deceased person or arising on intestacy, and
>
> (b) (Repealed)

[9] With whom Winneke P agreed.
[10] *Coles Myer Ltd v Commissioner of State Revenue* [1998] 4 VR 728 at 740.

(c) a transmission application by a devisee who is also the sole legal personal representative, and

(d) a declaration by an executor of a will under section 11 of the *Trustee Act 1925* if the Chief Commissioner is satisfied that the declaration is consistent with the entitlements of beneficiaries under the trusts contained in the will.

(2) If a transfer of dutiable property is made by a legal personal representative of a deceased person to a beneficiary under an agreement (whether or not in writing) between the beneficiary and one or more other beneficiaries to vary the trusts contained in a will of the deceased person or arising on intestacy, the dutiable value of the dutiable property is to be reduced by the portion of the dutiable value that is referable to the dutiable property to which the beneficiary had an entitlement arising under the trusts contained in the will or arising on intestacy.

(2A) A transmission application made by a beneficiary under a will, with the consent of the legal personal representative of a deceased person, is taken, for the purposes of this section, to be a transfer of dutiable property by the legal personal representative to the beneficiary.

(3) Section 25 does not apply to a dutiable transaction to which subsection (2) applies.

(4) If the duty chargeable in respect of a transfer or transmission application referred to in subsection (1) would, but for that subsection, be less than $50, the duty chargeable is that lesser amount.

(5) This section is subject to section 273, which provides for a minimum duty of $10.

There is therefore three main ways to achieve the benefit:

1. the transfer to the beneficiary is in accordance with the Will or intestacy;
2. the transfer is not in accordance, but a court order is made to provide for the transfer (a court order acts as a codicil to the will); and
3. the legal personal representatives use a power of appropriation to allocate a particular asset to the beneficiary in satisfaction of the beneficiary's interest in the Estate.

Given (1) is straightforward, it won't be discussed further.

3.1.1 Court Orders

A process by which a better tax outcome can be achieved arises if the parties are able to commence family provision proceedings that, by way of settlement, include court orders to change the testator or testatrix provision in the will. Any such order, of course, would require the Court to be satisfied that it is an appropriate order to be made.

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3.1.2 Appropriation

Relevant to it is s 46 of the ***Trustee Act*** 1925 (NSW), which provides:

46 Appropriation

(1) A trustee may appropriate any part of the property subject to the trust or of the real or personal estate of a testator or intestate in the actual condition or state of investment thereof in or towards satisfaction of a legacy or of any share or interest in the property or estate, whether settled or not, as to the trustee may seem just and reasonable, according to the respective rights of the persons interested in the property or estate, provided that:

(a) the appropriation shall not be made so as to affect prejudicially any specific gift devise or bequest,

(b) the appropriation shall be made with the consent, if any, required by this section,

(c) in making the appropriation the trustee shall have regard to the rights of any person who may thereafter come into existence or who cannot be found or ascertained at the time of the appropriation or as to whom it is uncertain at that time whether he or she is living or dead, and of any other person whose consent is not required by this section.

(2) The power of appropriation conferred by this section shall extend and apply to:

(a) property over which a testator exercises a general power of appointment,

(b) setting apart a fund to answer an annuity by means of the income of the fund or otherwise, provided that at the time of appropriation the fund would be sufficient, if it were invested in Government securities of the Commonwealth of Australia at par, to provide an income exceeding the annuity by at least fifteen per centum thereof,

(c) setting apart a sum of money in or towards the satisfaction of a legacy share or interest.

(3) For the purpose of an appropriation under this section the trustee may ascertain and fix the value of the respective parts of the property or estate and the liabilities to which the property or estate is subject as the trustee may think fit, and shall for that purpose employ a duly qualified valuer in any case where such employment may be necessary.

(4) An appropriation made pursuant to this section shall bind all persons interested in the property or estate, including the persons whose consent is not required, and to the extent to which the appropriation is made in or towards satisfaction of the legacy share or interest, the rights to which any person is entitled in virtue of the legacy share or interest shall be restricted to the part of the property or estate so appropriated and shall not extend to any other part thereof which may be dealt with or disposed of freed from any such rights.

(5) An appropriation of property whether it is or is not an investment authorised by law or by the instrument, if any, creating the trust for the investment of money subject thereto, shall not, except as otherwise provided by this section, be made thereunder for the benefit of a person absolutely and beneficially entitled in possession, unless the person is of the age of eighteen years or upwards and of full capacity and the person consents in writing.

(6) An appropriation shall not, except as otherwise provided in this section, be made thereunder in respect of any settled legacy share or interest, unless either the trustee thereof, if any, not being also the trustee making the appropriation, or the person who may for the time being be entitled to the income, consents in writing.

(7) If the person whose consent is required under subsection (5) or subsection (6), not being the trustee of a settled legacy share or interest:

(a) is a minor, the consent may be given on the person's behalf by the person's parents or parent with whom the person resides or in whose custody the person is, as the case may be, or by the person's testamentary or other guardian, or if there is no such parent or guardian, by the Court,

(b) is an insane or incapable person, the consent may be given on the person's behalf by the person's committee or manager, or if there is no such committee or manager, by the Court,

(c) is an insane patient, the consent may be given on the person's behalf either by the Master in Lunacy or by the Court,

(d) is a person who cannot be found or ascertained, or as to whom it is uncertain whether he or she is living or dead, the consent may be given on the person's behalf by the Court.

(8) If the appropriation is of an investment authorised by law or by the instrument, if any, creating the trust for the investment of money subject thereto no consent save of the trustee, if any, of a settled legacy share or interest shall be required on behalf of:

(a) a minor, where there is no parent or guardian,

(b) an insane or incapable person or an insane patient, where there is no committee or manager,

(c) a person who may come into existence after the time of appropriation, or who cannot be found or ascertained at that time, or as to whom it is uncertain at that time whether he or she is living or dead.

(8A) Notwithstanding anything contained in paragraph (b) of subsection (1) or in subsection (5) or subsection (7) the consent of the annuitant shall not be necessary in any case in which the trustee, after having set apart a fund to answer the annuity, which fund at the time of appropriation would be sufficient, if it were invested in Government securities of the Commonwealth of Australia at par, to provide an income exceeding the annuity by at least twenty per centum thereof, has actually invested the fund in such securities.

(9) Where an appropriation is made under this section in respect of a settled legacy share or interest, the property appropriated shall be subject to all trusts for sale and powers of leasing disposition management and varying investments which would have been applicable thereto or to the legacy share or interest in respect of which the appropriation is made, if no such appropriation had been made, provided that nothing in this section shall relieve the trustee of the settled legacy share or interest, where the trustee is not the trustee making the appropriation, from the obligation to obtain payment or transfer of the property appropriated, if or when the same is so payable or transferable.

(10) Where the exercise of any power of sale conferred on a legal representative by section 153 of the *Conveyancing Act 1919* is subject to any condition or to the leave of the Court being obtained, the legal representative shall not be

entitled to appropriate any part of the real estate under the powers conferred by this section, except with the leave of the Court.

(11) The trustee may make any conveyance or assent which may be necessary for giving effect to an appropriation under this section.

(12) Any appropriation or disposition of property made in purported exercise of the powers conferred by this section shall, in favour of a purchaser in good faith, be deemed to have been made in accordance with the requirements of this section, and after all requisite consents, if any, have been given.

The protection afforded by this subsection shall extend to the Registrar-General Crown Solicitor or other person registering or certifying title.

(13) In this section a ***settled legacy share or interest*** means a legacy share or interest settled by the trust instrument, if any, or by any other instrument, and includes any legacy share or interest to which a person is not absolutely entitled in possession at the date of the appropriation.

(14) In this section a ***manager*** means the person appointed under the *Lunacy Act 1898* to undertake the care and management of the property of an incapable person, and an ***insane patient*** means an insane patient within the meaning of that Act.

(15) This section shall not prejudice any other power of appropriation conferred by law or by the instrument, if any, creating the trust, and the powers conferred by this section shall be in addition to any such power.

(16) This section applies only if and as far as a contrary intention is not expressed in the instrument, if any, creating the trust, and shall have effect subject to the terms of that instrument and to the provisions therein contained.

(17) This section applies to trusts created either before or after the commencement of this Act.

3.1.2.1 General Comments on Appropriation

For the purposes of making an appropriation the legal personal representatives may ascertain and fix the value of the respective parts of the property or estate and the liabilities to which the property or estate is subject as they think fit and they may employ a duly qualified valuer in any case where it may be necessary: s 46(3) of the Trustee Act.

The power of appropriation, being a fiduciary power, must not be exercised so as to prejudice the interests of other beneficiaries.[11]

The principle on which the appropriation of specific assets to a beneficiary is exercised is derived from the power to sell the asset to the beneficiary and to set off the purchase money against the legacy.[12]

The appropriation of an asset towards satisfying a beneficiary's entitlement entails the valuation of it at the date of the appropriation so as to render it into an accountable figure. However, once a proper

[11] See Ford and Lee, *The Law of Trusts,* 4th Looseleaf end at [16.200] citing *Wigley v Crozier* (1909) 9 CLR 425 at 439 per Griffith CJ.

[12] See Ford and Lee, *The Law of Trusts,* 4th Looseleaf citing *Re Lepine* [1892] 1 Ch 210 at 215 per Lindley LCJ; *Wigley v Crozier* at 438.

appropriation is made subsequent changes in the value of the rest of the estate cannot affect its propriety or the manner in which the accounts should be finalised.[13]

In the case of realty, as here, where there is a trust to convert and divide, the trustees of a will may appropriate a separate parcel of the realty in satisfaction of the share of a beneficiary,[14] but not an undivided share, because that would make the disposition of the remaining undivided shares more difficult.[15]

If there is some dispute about appropriation then the administrators can apply to the Court for declaratory relief (which may involve joining parties).[16] Or, alternatively, judicial advice in respect of a proposed exercise of the power.

If the proposed *Deed of Family Arrangement* is entered the above falls away as the beneficiaries will have consented to the position.

3.1.2.2 Duty Issues on Appropriation

A relatively recent case – *Bloore v Chief Commissioner of State Revenue* [2020] NSWSC 502 per Stevenson J – requires consideration in applying the s 63(1)(A)(iii) of the Duties Act concession. His Honour confirmed that the property being appropriated *must* be equal to or less than the entitlement for which the property is being allocated. That is, if one of the beneficiaries remaining interest in the Estate is more than the value of the property being appropriated the concession cannot be applied.

This changed the earlier held view that exceed the value was permitted as the duty would only be applied on the excess; that is seems to no longer be the case and the entire appropriation becomes subject to duty.

3.2 Capital Gains Tax

Assuming an asset is held on capital capital account, such that Parts 3-1 and 3-3 of the 1997 Act apply, any gain or loss arising from the deceased's death is disregarded: s 128-10 of the Act 1997. By s 128-15 of the ITAA 1997 the legal personal representatives, or a beneficiary who receives a property in specie, will receive the asset with a cost base equal to:

1. its market value on the date of death of the deceased if either:

    (i) the deceased before 20 September 1985 (e.g. it is a pre-CGT asset); or

    (ii) it was the deceased's main residence and is therefore subject to the exemption in Subdivision 118-B of the Act 1997; and

[13] Ford and Lee, *The Law of Trusts,* 4th Looseleaf end at [16.210].
[14] *Re Beverly* [1901] 1 Ch 681 at 685.
[15] *Biggs v Peacock* (1882) 22 Ch D 284.
[16] *Carr v Carr* (1987) 8 NSWLR 492.

2. the cost base the deceased had if it was acquired by the deceased after 19 September 1985 (e.g. it is not a pre-CGT asset) and it is not subject to the main residence exemption in Subdivision 118-B of the Act 1997.

Therefore, if the Estate of a person passes a CGT asset to a beneficiary the embedded tax to that point – including tax free status if pre-CGT or main residence – is maintained so that it is only the later CGT event happening to the beneficiary that triggers the next tax impost.

Further, and unlike the duty position above, with the CGT provisions a *deed of family arrangement* is sufficient to invoke Division 128 of the 1997 Act. So, again unlike the duty position, it is not necessary to seek a court order or power of appropriation if the will does not provide the most beneficial tax distributions, provided all the beneficiaries agree and can enter a *deed of family arrangement.*

4. Using Asset Revaluation Reserves to Access a Property's Equity

Although notoriously disliked by the Commissioner, strategies to distribute asset revaluation reserves do not seem to be assessable to the recipient. They are a return of capital: the point to be made is that the asset revaluation reserve 'distribution' is in fact a distribution of capital of the trust estate or an advance of the capital of the trust estate and must be given strict effect to by the rules in the trust deed that allow the trustee to appoint or advance capital of the trust estate to a beneficiary.

If a trustee revalues an asset – a credit to an asset revaluation reserve account and a corresponding debit to the asset account – the gain is ordinarily not assessable income of the trust estate. It is merely the means by which the trustee accounts for the trust assets. A distribution to a beneficiary of an amount from an asset revaluation reserve (either in cash or by way of a journal entry) is ordinarily not assessable income of the beneficiary: *Taxation Ruling* 2005/2 at [30]. However:

1. a sale of or a dealing with a right to receive such a distribution could result in a receipt of assessable income: *FCT v McNeil* [2007] HCA 5 dealing with the sale of a right by a shareholder of an option to sell back to the company a share.
2. further considerations – such as repetition of receipt (see *Interpretative Decision* 2011/58) – may treat it as ordinary income.

4.1 Section 99B

It is necessary to consider s 99B of the 1936 Act in this context.

Although the purpose of s 99B of the 1936 Act was to assess trust income that had been accumulated overseas and not subject to Australian tax (as expressed in *Union Fidelity Trustee Co of Aust Ltd v FCT* (1969) 119 CLR 177), its literal terms are much wider than this. In my experience the Commissioner of Taxation does not apply the provision as widely as its literal terms would permit.

Subsections 99B(1) of the 1936 Act would apply to the distribution of the revaluation reserve. The operation of s 99C of the 1936 Act confirms this position. It is important, however, to set out the relevant passage of s 99B(2) of the 1936 Act in full. It provides:

> The amount that, but for this subsection, would be included in the assessable income of a beneficiary of a trust estate under subsection (1) by reason that an amount, being property of the trust estate, was paid to, or applied for the benefit of, the beneficiary shall be reduced by so much (if any) of the amount, as represents:
>
> (a) corpus of the trust estate (except to the extent to which it is attributable to amounts derived by the trust estate that, if they had been derived by a taxpayer being a resident, would have been included in the assessable income of that taxpayer of a year of income);

> (b) an amount that, if it had been derived by a taxpayer being a resident, would not have been included in the assessable income of that taxpayer of a year of income; …

The operation of s 99B(2)(a) of the 1936 Act was considered by the Full Court of the Federal Court in *Howard v FCT* [2012] FCAFC 149. The Court[17] held a resident taxpayer received over $6 million from a Jersey-based trust, the Esparto Trust. The Esparto Trust had received this amount as part of a share buy-back from another Jersey trust, the Juris Trust. The taxpayer asserted that the amount was a distribution of the corpus of the trust estate and was therefore a capital receipt. The Commissioner of Taxation did not take issue with this assertion, but said the amount was nevertheless assessable under s 99B of the 1936 Act to the extent that it was not assessable under s 97 of that legislation. The Full Court agreed, finding that the amount was caught by s 99B as it would have been assessable if derived by a resident taxpayer (i.e. the exception to the corpus exception in s 99B(2)(a) applied). This was because the distribution represented the proceeds of an off-market share buy-back, which would have been deemed (by s 159GZZZP of the 1936 Act) to be assessable dividends (under s 44 of the 1936 Act).

The Full Federal Court explained the "simple" application of s 99B(2)(a) to the complex facts of the case as follows (at [41]):

> In this case, having penetrated two layers of trusts – first the Esparto Trust; then the Juris Trust – one encounters for the first time a non-trust relationship. The trustee of the Juris Trust received non-trust distributions from another Jersey company called Esparto Ltd. Although the process of conjoining Mr Howard to the amounts paid by Esparto Ltd seems complicated, in reality it is not. Section 99B(2)(a) will simply apply as many times as there are interposed layers of trusts. Each application of s 99B(2)(a) leads to a hypothetical question about whether the amounts received by the trust estate would have been assessable income if they had been earned by a resident taxpayer. Once an answer to that question is known at the level of the deepest trust the answer cascades back up to the original (genuine) resident taxpayer. To unpick that slightly: if the Juris Trust estate had been a resident taxpayer and the amounts received by it had been assessable income, then the amounts received by the Esparto Trust, although corpus, would have fallen within the parenthetic excision in s 99B(2)(a) and would have been assessable income in its hands. This, in turn, provides the affirmative answer to the question posed by s 99B(2)(a) as to whether the amounts received by the Esparto Trust estate would have been assessable income on the hypothesis that the Esparto Trust estate was a resident taxpayer. But it is that answer on that hypothesis which applies to Mr Howard himself. What is revealed therefore is not complexity but repetition.

The issue therefore becomes whether the distribution of the revaluation reserve would be assessable to an Australian resident taxpayer. This is so because it is the question for the exception in s 99B(2)(a) and it is the question itself in s 99B(2)(b).

[17] Middleton, Perram and Dodds-Streeton JJ.

4.2 Two Problems with Asset Revaluation Proposal

There are two problems with the asset revaluation reserve proposal:

(a) It may cause CGT Event E4 to occur.

(b) The Trust may have received assessable income in a given year. If the trustee has an amount of taxable income in the year of receipt, it should distribute that amount to beneficiaries lest it pay top marginal tax rates pursuant to s 99A of the 1936 Act.

Private Binding Ruling PBR 90106 confirms that a distribution from the trustee of a unit trust, sourced from an asset revaluation reserve, is not assessable income of the unitholder, but will trigger CGT Event E4 happening. It is akin to the current situations and confirms the Commissioner of Taxation's views that CGT Event E4 would apply to the distributions.

4.3 Accounting Treatment Imperative

The following case shows the importance of the accounting and administrative treatment of an 'asset revaluation reserve' amount as it can easily be treated as income if the trustee is not particular to maintain the character of the distribution.

Part of Brereton's J decision in *Wood v Inglis* [2009] NSWSC 601 involved the question of whether movements in the value of assets can be treated as income or otherwise distributed to beneficiaries. In that case it was the movement in value of shares held by the trustee. His Honour held at [14] to [17]:

> I do not accept that it cannot be said that a profit has been made (or "incurred", for the purposes of clause 10 of the Trust Deed), just because it has not been realized. Comparison of the value of the assets of an entity at the end of the relevant period with their value at the beginning of that period is one well-recognised means of ascertaining profit [*Re Spanish Prospecting Co Limited* [1911] 1 Ch 92 at 98; *QBE Insurance Group v ASIC* (1992) 38 FCR 270 at 284-285]. …
>
> That conclusion is only reinforced by clause 6(f). I do not accept that the reference in clause 6(f) to "property or moneys held by the Trustee", coupled with the definition of "property", means that the reach of the clause does not extend to "unrealised capital gains"; the purpose of the clause is plainly to avoid disputation as to whether receipts, profits and distributions received by the trust are capital or income by empowering the Trustee to make that determination. The effect of treating "unrealised capital gains" as income is that so much of the value of a share (which is expressly within the definition of "property") as reflects that gain is treated as income. As has already been observed, the proviso contained in clause 6(f) demonstrates that the Trustee may chose to treat as capital in the Trust accounts what is income for income tax purposes (although a specific declaration to that effect is required); likewise it may (and without any such specific declaration) chose to treat as income in the Trust accounts what is capital for income tax purposes. In that context, submissions that "unrealised capital gains" are not income in the ordinary sense of the word are beside the point.
>
> Accordingly, the Trustee was entitled to treat the movements in the net value of investments as income. Accounts prepared on that basis were nonetheless "proper accounts". Moreover, even

> if the "unrealised capital gains" were not income, they could be distributed as capital under clause 5(a), which gave the Trustee a discretion to apply capital in favour of any eligible beneficiary at any time before the Perpetuity Date.

In that case at [66] Brereton J found that Dr Inglis was the corporate trustee's controlling mind and, therefore, in approving the financial accounts that provided for the unrealized gains being income it was the trustee's determining to so treat those gains. At [67] his Honour also found that Dr Inglis was acting on the corporate trustee's behalf in validly and effectively making distributions to his beneficiary loan account.

In *Clark v Inglis* [2010] NSWCA 144 the Court decided that, for the purposes of the trust deed provision concerning the distribution and allocation of trust 'income' of a year, unrealized gains arising upon revaluation of investments in accordance with a policy of annual 'marking to market' were property treated as part of a year's income. This issue arose in *Fischer v Nemeske Pty Ltd* [2015] NSWCA 6, but not party argued against that conclusion.

It is therefore clear that the trustee of a trust must properly account for the revaluation reserve lest it run the risk of being assessable to the beneficiary.

5. Changing Trustees

Section 54(3) of the Duties Act provides that duty of $50.00 is chargeable in respect of a transfer of dutiable property to a person other than a special trustee as a consequence of the retirement of a trustee or the appointment of a new trustee, if the Chief Commissioner is satisfied that, as the case may be:

1. none of the continuing trustees remaining after the retirement of a trustee is or can become a beneficiary under the trust, and
2. none of the trustees of the trust after the appointment of a new trustee is or can become a beneficiary under the trust, and
3. the transfer is not part of a scheme for conferring an interest, in relation to the trust property, on a new trustee or any other person, whether as a beneficiary or otherwise, to the detriment of the beneficial interest or potential beneficial interest of any person.

If the Chief Commissioner is not so satisfied, the transfer is chargeable with the same duty as a transfer to a beneficiary under and in conformity with the trusts subject to which the property is held.

There are therefore some requirements to fall within s 54(3): they are discussed below (which discussion is taken from *Revenue Ruling* DUT 037):

1. The transfer must be a consequence of, but not be solely because of, a change of trustee.
2. The trust must exist before the change of trustee, so no trust cloning or trust splitting will suffice. Further, it follows that, the section does not apply to a transfer of dutiable property to a person who has been appointed to perform a newly created trust: Commissioner of State Revenue v Victoria Gardens Developments Pty Ltd [2000] VSCA 233 at [27].
3. The new or continuing trustees cannot be existing beneficiaries of the trust and can never become beneficiaries of that trust. This requirement applies irrespective of the nature of the trust, although it will typically be a discretionary trust or a unit trust. This requirement also applies to all types of beneficiaries under the trust, however remote their actual or potential interest in the trust may be. There is no set form of words required to preclude either a continuing or new trustee from becoming a beneficiary under a trust. The Chief Commissioner will be satisfied that this is the case where the terms and conditions of the trust deed and any variation thereto provide that the new or continuing trustee is prohibited from being or becoming a beneficiary under the trust and where this prohibition is irrevocable: *Oates Properties Pty Ltd & Ors v Commissioner of State Revenue [2003]* NSWSC 596 at [35] and [38].
4. Finally, section 54(3)(c) requires the Chief Commissioner to be satisfied that the transfer is not part of a scheme for conferring an interest, in relation to the trust property, on a new trustee or any other person, whether as a beneficiary or otherwise, to the detriment of the beneficial interest or potential beneficial interest of any person.

To satisfy the Chief Commissioner, per paragraph 8 of *Revenue Ruling* DUT 037, when lodging a transfer for assessment under section 54 (3), the following evidence must be provided:

i. A complete copy of the relevant trust deed (stamped if applicable); and
ii. Evidence as to when the property in the transfer was acquired, such as a copy of the stamped front page of the Agreement for Sale or Transfer. Where it is not clear from the Agreement or transfer that the property was acquired as an asset of the trust, the taxpayer may be required to provide evidence that the trust provided the purchase money for the acquisition of the property; and
iii. A complete copy of any relevant amendments or variations to the trust deed made in accordance with the provisions of the trust (stamped if applicable); and
iv. Evidence of the appointment or retirement of trustees made in accordance with the provisions of the trust, such as a Deed of Appointment and Retirement, or some evidence in writing which has the same effect (such as minutes of a meeting); and
v. A copy of the register of unit-holders identifying all of the unit-holders, the number of units held by each of them and when the units were acquired (for unit trusts only).

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6. Partitioning Property

Partitioning a property is a way for more than one owner to take an entire interest in a part of the property in consideration for giving up their part interest in the entire property. It is a very useful device where more than one taxpayer owns land, either because of commercial necessity or legacy issues, and wants to hold it independently.

6.1 Partitioning Generally

In *Comptroller of Stamps (Vic) v Christian* 90 ATC 5046, Young CJ in Eq, as his Honour then was, referred to the following description of 'partition' given in the first edition of *Halsbury's Laws of England* (Vol 21, para 1512):

> *The legal term partition[(a)] is applied to the division of lands, tenements and hereditaments belonging to co-owners[(b)] and the allotment among them of the parts[(c)] so as to put an end to community of ownership between some or all of them[(d)].*

The parenthetical letters were footnotes, of which (c) reads:

> *Thus if three persons are co-owners, tenants in fee simple of Blackacre, Whiteacre and Greenacre, the transaction by which one of them becomes sole owner tenants in fee simple of Blackacre, another of Whiteacre, and the third of Greenacre, is a partition.*

and (d) reads:

> *Thus in the example given in note (c) supra, a transaction by which Blackacre, while the other two remain co-owners of Whiteacre and Greenacre, is a good partition. This can only be by agreement of those persons between whom a community of ownership is left subsisting.*

Therefore, partitioning refers to jointly held land (whether as joint tenants or tenants in common) being transferred to one or more of the co-owners of the land. That is, it is a 'partition' of the co-owner's interests in the land, and involves the disposal by each co-owner of their interest in one of the blocks to the other co-owner, and a corresponding acquisition by each co-owner from the other co-owner of their interest in the land.

A partition over land with more than two owners can be limited to some only of those multiple co-owners (and the other co-owners receiving monetary compensation).

A partition of land can, of course, be effected voluntarily between the co-owners; but it is not limited to these situations. There are circumstances in which a court may order partition. An often used example is s 66G of the *Conveyancing Act* 1919 (NSW),[18] where, in relation to land that is co-owned, the court may, on application of one or more of the co-owners, appoint trustees to hold the land on a statutory trust for sale or, on the basis of subsection (4), on a statutory trust for partition.

Subsection 66G(4) provides that if, on an application for the appointment of trustees on statutory trust for sale, any of the co-owners satisfies the court that partition of the property will be more beneficial for the co-owners interested to the extent of upwards of a moiety in value than sale, the court may (with the consent of the encumbrances of the entirety (if any)), appoint trustees of the property on statutory

[18] There are equivalent provisions in other jurisdictions.

trust for partition. The powers of the court under this provision extend to appointing a statutory trust for partition for part only of the property and a statutory trust for sale of the balance.

The cases show that, despite the significant costs of the application itself and of the trustee's effecting the sale, it is difficult to resist a s 66G application. The rationale of this approach is that the detriment to the petitioning co-owner is their being bound to the property of which they desire an exit whereas the detriment to the resisting co-owner is merely the costs involved in the transaction (it being assumed that an auction sale will bring about market value proceeds).

Although, on order of the court under s 66I of the *Conveyancing Act* 1919 (NSW) the co-owners may bid at the auction, it is a particularly expensive way to obtain the entire interest in the property. If at all possible, agreement between the co-owners before court adjudication is the commercial outcome.

The partitioning of land should not be confused with the subdivision of land:

- Torrens title subdivision is the vertical subdivision of land and involves the creation of new allotments from an existing block of land. Although, on application for subdivision the New South Wales Land and Property Information Department ('**NSW LPI**') (effectively the lands Registrar) often issues a new Deposited Plan comprised of the subdivided lots.
- Strata title subdivision is the subdivision (be it horizontal, vertical or both) of a building or buildings into strata lots and common property. Each of the owners will own a lot and the body corporation will have ownership of the common property, which may include external walls, roof and driveways.

Whilst the practical steps of partitioning may involve the subdivision of the land into smaller lots before the land is capable of being transferred to one or more co-owners, the partition process is essentially the transfer of the divided parts of the land between co-owners or, as parenthetical footnotes (c) and (d) above confirm, the transfer of jointly owned parts of different lots.

As considered below, subdivision, and in particular strata title subdivision, leads to issues with respect to partitioning because of the existence of common properties.

6.2 Relevant Steps

Using the simplest example, the 4 steps that typically occur in partitioning land are:

Step	Event
1	Owners X, Y and Z acquire land as co-owners.
2	Owners X, Y and Z enter into a deed of partition, where they agree to each take a lot of the land after the development in satisfaction of their interest.
4	Owners X, Y and Z develop the land.
5	By way of partition: 1. Owner X will transfer his interest in lot 2 to Owner Y and lot 3 to Owner Z 2. Owner Y will transfer his interest in lot 1 to Owner X and lot 3 to Owner Z 3. Owner Z will transfer his interest in lot 1 to Owner X and lot 2 to Owner Y The end result is that Owners X, Y and Z will be the sole owner of lots 1, 2 and 3 respectively.

As discussed under the:

- Capital Gains Tax heading below, the timing of the partition can affect the amount brought to tax under any subsequent CGT events; and
- Stamp Duty heading below, the timing of the partition can affect whether or not *ad valorem* or nominal duty is paid on the transfers.

The benefits of partitioning are that parties can come together to develop land into (hopefully) more valuable uses and (hopefully) profit from doing so. The partition allows the development to occur without additional stamp duty imposts (other than nominal duty) or capital gains tax imposts until the co-owner later takes steps in relation to their post-partition property

6.3 Income Tax and CGT Considerations of Partitioning

Whether or not property is held on revenue or capital account has been discussed above in this paper.

Where the real property is held on capital account – as, despite the decision in *August v Commissioner of Taxation,* is most likely to be the case – the partitioning of the real property would not of itself have any ordinary income tax consequences. The CGT consequence will be discussed below.

There would, however, be ordinary income tax consequences if, for instance, at the time of the partitioning the land is held as trading stock of a partnership carried on by the joint co-owners of the real property. In that event section 70-100 of the 1997 Act would apply such that there would be a deemed disposal at market value of each identifiable parcel of land by the partnership and an acquisition at market value by the partner or partners who continue to own a parcel. Though the partners would have the election for closing value rather than market value (if there is an at least 25 percent continuing ownership and certain other conditions are met). This is a limited situation and most property developers or investors need not worry themselves with this provision.

If land is held on capital account the partition of that land will have CGT consequences involving disposals and acquisitions. Often clients consider that there will be no CGT consequences of a partition because the parties never receive any monetary consideration as a result of the partition and they don’t end up with more or less than they had pre-partition.

For example, in *Johnson v FCT* [2007] ATAA 1322 Senior Member McCabe said at [15] and [16]:

> *Dividing the parcel in two for the purposes of a transfer to each joint owner effectively requires those owners to relinquish ownership of the CGT assets in the shares in the other parcel in return for clear title to the shares in the parcel they are acquiring. It is as if the CGT assets contained in each share have to be unpacked and redistributed so that the taxpayer ends up holding half the number of shares in his or her own right – and those shares do not contain any CGT assets belonging to the other (former) joint owner.*
>
> *This rearrangement and reallocation of the ownership of CGT assets constitutes a disposition of the CGT asset, and is therefore a CGT event [being A1]: s 104-10. Subject to the legislation, tax is levied on the capital proceeds from a CGT event less the cost base of the asset. The capital proceeds are the sum of the money received in respect of the transaction (no money changed hands in this case) and the market value of any other property received (in this case, the market value of the interest acquired in the shares): s 166-20.*

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An example will illustrate. Where Tim and Tom jointly hold land, the CGT consequences for Tim where the land is partitioned are:

1. Tim will acquire from Tom the interest formerly held by Tom in the part of the land that Tim continues to hold; and
2. Tim will dispose of to Tom the interest formerly held by Tim in the land that Tom continues to hold.

Tom's position is the reverse of the above.

Thus an owner that acquires the interest in the previously jointly owned property after 19 September 1985 will make a capital gain or capital loss from the partition by way of CGT event A1 happening. Whether it is a capital gain or capital loss that is made will depend on whether the market value of the disposal exceeds the owner's cost base of the interest in the land that has been disposed of.

The owner will also acquire their new interest, being the interest disposed of by the other co-owner, for market value. This further interest will be a separate CGT asset than the initial interest held: *Taxation Determination TD 45*. This applies to each interest as the number of co-owners increases. For instance, (being Example 3 taken from *GST Ruling GSTR 2009/2* discussed below) where Angie, Joanne and Nicole acquire interests in Purpleacre after 19 September 1985, after partition Angie would hold three separate CGT assets: her initial interest in Purpleacre, her interest acquired from Joanne and her interest acquired from Nicole.

That the various interests are separate CGT assets has relevance in a number of situations, including:

1. the application of the CGT small business concessions (in Division 152 of the 1997 Act) will be determined separately in relation to each CGT asset. For example, one separate CGT asset may, but another CGT asset may not, meet the active asset test despite their both being part of the property;

2. if the owner is an individual, trust or a regulated superannuation fund, the timing of the 12 months for the general discount in Division 115 of the 1997 Act will be applied separately to each CGT asset; and

3. where one or more, but not all, of the separate CGT assets were acquire before 20 September 1985.

There are two CGT exemptions that at first seem to be relevant to partitioning, but on closer examination are seen to be offering little assistance. They both relate to strata title conversions.

6.4 Section 118-42

This section applies to the transfer of units in a building that are not held by way of strata title into a stratum titled ownership structure. The section reads:

If:

(a) *you own land on which there is a building; and*

(b) *you subdivide the building into stratum units; and*

(c) *you transfer each unit to the entity who had a right to occupy it just before the subdivision;*

a capital gain or capital loss you make from transferring the unit is disregarded.

You require an existing building, and the ultimate recipients must have a right to occupy the particular unit(s), at the time of the subdivision for this to apply. These two requirements significantly limit the situations in which section 118-42 of the 1997 Act may assist when partitioning.

6.5 Strata Title Conversion Rollover

Capital gains tax rollover relief is available under section 124-190 of the 1997 Act where the ownership arrangement for a home unit or apartment is converted into strata title. The rollover is only available where:

- persons who formerly held units under the previous ownership scheme are, immediately after the conversion, the only holders of strata title units in the building; and

- the unit owners hold the same or substantially the same rights to occupy the units after the conversion as they did before.

The effect of the rollover is simply that the change in legal title to the home unit or apartment is treated for CGT purposes as if it were the same as the previous ownership interest. The Commissioner's views on this rollover are set out in *Taxation Ruling TR 97/4: Income tax: capital gains: roll-over relief for buildings subdivided under strata title law into stratum units and common property*.

6.6 Planning Ahead

Other than in relation to the stamp duty considerations, the timing of partitioning actions and the correct sequences of steps is most important for the CGT issues.

The concerns raised above can be addressed by planning. For CGT purposes it is therefore desirable to agree the partition as early as possible, as this will capture more of the gain in the concession. However, as set out below, in order to fall within the stamp duty relief, the partition cannot be entered prior to the co-owners jointly owning the relevant property.

If the co-owners enter into a deed whereby they acknowledge that the land is to be held on bare trust[19] for the benefit of each other in accordance with the proposed plan of subdivision each co-owner will hold their interest in the other co-owners post-partition lot on bare trust for that other co-owner. That is, the land is legally registered in the names of all co-owners as tenants in common in each shares but the each co-owner holds their interest in one post-partition lot absolutely and the balance of that post-partition is lost held for the benefit on bare trust by the other co-owner(s).

For example, the deed would give effect to the following ownership structure prior to the acquisition of the property:

<u>*Pre-partition*</u>

[19] But the Commissioner's view in *Taxation Ruling TR 2004/D25* at [10] is that being a 'bare trust' is not the test; rather, it's the ability to call fall the particular asset. The author comments below on the soundness of this view.

Post-partition	*Post-partition*	*Post-partition*
Lot 1	*Lot 2*	*Lot 3*
Co-owner 1:	*Co-owner 2:*	*Co-owner 3:*
Legally & beneficially owns 1/3	*Legally & beneficially owns 1/3*	*Legally & beneficially owns 1/3*
1/3 held by co-owner 2	*1/3 held by co-owner 1*	*1/3 held by co-owner 1*
1/3 held by co-owner 3	*1/3 held by co-owner 3*	*1/3 held by co-owner 2*

Post-partition

Lot 1 *(former) Co-owner 1*	*Lot 2* *(former) Co-owner 2*	*Lot 3* *(former) Co-owner 3*

The benefit of this ownership structure is that when the beneficially held interests are transferred to the beneficiary under the bare trust (this occurs on giving effect to the partitioning) it will not trigger a CGT event. This is because of section 106-50 of the 1997 Act, which states:

> *If you are absolutely entitled to a *CGT asset as against the trustee of a trust (disregarding any legal disability), this Part and Part 3-3 apply to an act done by the trustee in relation to the asset as if you had done it.*

That is, the beneficiary for whom the interest(s) are held on bare trust is treated as the owner of the CGT asset – for CGT purposes they are considered to own the interest from the time the property was acquired.

This solution helps when the co-owners know of their future partitioning at the time the property is acquired, or soon thereafter.

Further, a separately to s 106-50 of the 197 Act, the declaring of the trust will not be CGT event E1 or E2 because:

(a) the co-owner beneficiary is the only person absolutely entitled to that particular post-partition property held by the co-owner trustee; and

(b) the trust is not a unit trust.

See ss 104-55(5) and 104-60(5) of the 1997 Act.

The consideration of s 106-50 of the 1997 Act set out above in this paper ought to also be considered.

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6.7 Board of Taxation Review

On 14 February 2018, the Board of Taxation (**Board**) publicly released its Review of the Tax Treatment of Bare Trusts and Similar Arrangements (**Report**), which was prepared in June 2017.

The Report's key recommendation – in recommendations 1 to 8 – is for a legislated "look through" or essentially ignore certain bare trusts and similar arrangements for income tax purposes. At the same time, Treasury issued a press release stating that it supported the recommendations and will seek to implement them. Treasury flagged that it will undertake a public consultation process relating to the characteristics of the arrangements that are entitled to this relief.

Given the current uncertainty this will be a desirable outcome.

The consultation process is continuing.

6.8 No economic benefit

Importantly, the Full Court of the Federal Court decision in *Taras Nominees Pty Ltd as Trustee for the Burnley Street Trust v FCT* [2015] FCAFC 4 (Perram, Robertson and Pagone JJ) dealt with a "novel" argument, that no taxable gain could arise in circumstances where the taxpayer had not received any capital proceedings from a CGT event (such as with a partition).

For that submission the taxpayer called in aid the observation of Dixon CJ in *Commissioner for Railways (NSW) v Agalianos* (1955) 92 CLR 390, cited with approval in *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355, that:

> *The context, the general purpose and policy of a provision and its consistency and fairness are surer guides to its meaning than the logic with which it is constructed.*

The taxpayer also relied on dicta of the United Kingdom Court of Appeal in *Booth v Ellard* [1980] 1 WLR 1443. In upholding the first instance judge's (Kenny J) view that *Booth v Kenny* was not relevant, the Full Court said:

> *The Court of Appeal in* Booth v Ellard *was not, of course, concerned with the terms of the 1997 Act nor with the terms of the specific trust and joint venture agreement to which Taras is party. Significantly, however, s 22(5) of the UK Act with which the Court of Appeal was concerned in* Both v Ellard, *unlike the provisions in contention in this appeal, contemplated joint ownership Further more, a fundamental difference between the facts in that case and those in this appeal (and which points against the policy of nonassessability of a gain until receipt of 'capital proceeds' which Taras sought to invoke), is that Taras did receive something in return for the transfer of its land because upon transfer it became entitled to the benefits flowing from the contributions to the joint venture of the land of others as well as the commercial advantages flowing from participation in the joint venture. It would not, therefore, be 'capricious and unreasonable' for the legislature to contemplate the occurrence of a CGT event upon a transaction of the kind entered into by Taras and the other joint venturers because the disposal made by Taras of its land was in return for the acquisition of interests in the land of others and the commercial benefits from the bargain. Those interests and benefits included rights to the development of the land and to distributions of cash determined under clause 6.2 of the joint venture agreement. The restrictions that Taras had upon its beneficial interest in its land by*

these arrangements were matched by restrictions in its favour upon the rights attaching to the land contributed to the joint venture by the other land owners.

There will therefore be no comfort to partitioning parties, should they otherwise be liable to income tax or CGT, that no economic benefit of income or capital proceeds were received at the time of the partition.

6.9 GST Consequences of Partitioning

So far as GST is concerned the Commissioner of Taxation's views on partitioning are set out in *GST Ruling 2009/2 Goods and Services Tax: Partitioning of Land*. This applies to co-owners whether they are joint tenants or tenants in common.

The term 'partition' is not defined in the *A New Tax System (Goods and Services Tax) Act* 1999 (Cth) (the '**GST Act**') and, for the purposes of *GSTR 2009/2,* it refers to:

either:

- *the division of land and the transfer of the divided parts between the co-owners; or*
- *if the land is already divided and held by the co-owners, the transfer of the divided parts between the co-owners,*

so that one or more co-owners become the owner in severalty of a specifically ascertained part(s) of the land.

6.9.1 Mere Subdivision is not subject to GST

The usual course is that a single parcel of land is first subdivided and, once this has occurred, the post subdivision lots are subjected to the partition. This initial stage of subdivision, before the partitioning, is not subject to GST because the Commissioner does not consider there to be a supply. At [50] of *GSTR 2009/2* he says:

The Commissioner considers that the subdivision of land by co-owners does not constitute a supply for purposes of GST. All that results is that the subdivided land is held under different titles by the same owners. While the effect of the subdivision is to create new rights and titles in substitution of the original rights and titles, there is no change in the ownership of the subdivided land. Accordingly, where land is jointly held, a subdivision, by itself, does not involve a transfer of any interests in the land between the co-owners.

6.9.2 Partitioning

For the Commissioner to subject the post-subdivision property to GST there must be a "taxable supply" as defined by section 9-5 of the GST Act, which states:

You make a taxable supply if:

a) you make a supply for consideration; and

b) the supply is made in the course or furtherance of an enterprise that you carry on; and

> c) *the supply is connected with Australia; and*
>
> d) *you are registered, or required to be registered.*
>
> *However, the supply is not a taxable supply to the extent that it is GST-free or input taxed.*

Each relevant element of taxable supply will be considered in turn. However, the broad position is that the Commissioner considers the partitioning of real property is a taxable supply.

6.9.3 Supply for Consideration

The transfer of an interest by each co-owner to any other co-owner is a supply for consideration, in the Commissioner's opinion, because the transfer of property is the supply of that property and it is being supplied for consideration, being the property received under the partition. The following paragraphs of *GSTR 2009/2* explain the position adopted by the Commissioner.

> 46. *Under a partition by agreement, the transfer or conveyance by each co-owner of their respective interest in the land to be taken by the other co-owners in severalty is a supply as defined in subsection 9-10(1).*
>
> 47. *The term 'supply' is broadly defined in subsection 9-10(1) as 'any form of supply whatsoever'. This wide definition of the term includes the transfer or conveyance of an interest in or right over land and by a co-owner.*
>
> 48. *To effect a partition under an agreement, all the co-owners agree to divide the land and to mutually transfer or convey their respective interests in the parts to be taken and enjoyed in severalty by the other. Each transfer or conveyance is a supply.*
>
> …
>
> 90. *In* Commissioner of Taxation v Reliance Carpet Co Pty Ltd *[[2008] HCA 22] the High Court noted that, under section 9-15, consideration includes, among other things, any payment 'in connection with' a supply of anything. In analyzing the decision of the European Court of Justice in* Societe thermal d'Eugenie-les-Baines v Ministere de l'Economie, des Finances et de l'Industrie *[[2007] 3 CMLR 1003], the High Court gave some indication that the connection between consideration and a supply need not be direct (see paragraph 30 of the judgment), though it did not expand on what the extent of the connection needs to be.*
>
> 91. *For land transactions 'consideration' may be regarded as anything that 'moves' the transfer. In* Re Navakumar v Commissioner of State Revenue *[[2007] VCAT 476] Deputy President Macnamara of the Victorian Civil Administrative Tribunal said:*
>
> > *Consideration is a very wide concept. In Equity consideration generally denotes something of significant value, at common law something purely nominal such as $1, a peppercorn or a chocolate wrapper may constitute consideration. In revenue law the meaning of consideration is wider still, it is that which 'moves' the conveyance or transfer. See* Archibold Howie Pty Ltd v Commissioner of Stamp Duties (NSW) *(1948) 77 CLR 143, 152 per Dixon J.*
>
> 92. *Although a partition ordinarily does not involve a monetary payment, consideration is not limited to a payment of money. It includes a payment in a non-monetary or in an 'in kind' form. This includes acts, forbearances, and goods or property.*

> 93. *The consideration for a co-owner transferring their interest in land to the other co-owners is the transfer or conveyance made by the other co-owners of their respective interests in another part of the land to the first co-owner. The transfer or conveyance by the other co-owners together with any owelty money paid or payable is consideration received by the first co-owner for the supply of their interest to the others.*
>
> …
>
> 97. *The value of the consideration is the sum of the GST inclusive market value of all the other co-owners' interests in the part of the land acquired by a co-owner plus any owelty money received in respect of the partition.*
>
> 98. *The Commissioner considers that the transfer of an interest in a part of the land by a co-owner is 'in connection with', 'in response to' or 'for the inducement' of the supply by each of the other co-owners of their respective interests in a part of the land.*

The above paragraphs show how broad the supply for consideration net is cast. It will be extremely difficult to argue that there is no supply for consideration when a partition occurs.

Further, an 'owelty' (or a sum of money) may be given to make up for any differences in value of the land the co-owners receive after a partition, or to compensate for the value of land given up without receiving an interest in any other land in return: *GSTR 2009/2* at [30] and [31].

6.9.4 Enterprise

The Commissioner takes a very wide view of what will be in furtherance of an enterprise. Practically, a partition by a co-owner who carries on an enterprise will be in furtherance of that enterprise. This is so even where the partition brings the enterprise to an end.

At [57] and [58] of *GSTR 2009/2* the Commissioner says:

> *It is the Commissioner's view that if land is applied or intended to be applied in an enterprise carried on by a co-owner, a supply of that co-owner's interest in the land under a partition by agreement or court order for co-owners to effect a partition is in connection with the enterprise and is a supply in the course or furtherance of that enterprise.*
>
> *Further, where the partition of that land results in the termination of the enterprise which was carried on, the supply of the interest in the land by the co-owners would still be in connection with the enterprise carried on by the co-owner and is a supply in the course or furtherance of the enterprise.*

Thus, where property developers effect a partition to complete the development, it will still be in furtherance of the development enterprise.

The focus on this issue is therefore on whether or not an enterprise is being carried on in the first place. In this regard the Commissioner sets out his views as to what factors, which must be determined on a case-by-case basis, are relevant to determining the existence of an enterprise in *Miscellaneous Taxation Ruling MT 2006/1*.

It is possible that a partition will be in furtherance of an enterprise of some but not all of the co-owners. In these circumstances only the co-owner(s) carrying on an enterprise will make a taxable supply. The following example from [79] to [85] of *GSTR 2009/2* illustrates the point:

Example 6 – Supply in the course or furtherance of an enterprise carried on by one co-owner and no the other co-owner

Two friends, Caroline and Shaun, purchase a block of land as tenants in common in equal shares with the intention to subdivide the land, to construct two houses and to take a house each.

Caroline's intention in entering into the arrangement is to use the house she acquired as her primary residence. Caroline is not carrying on an enterprise in these circumstances. In Caroline's case, the purpose of the arrangement is private and domestic in nature.

Shaun's intention in entering into the arrangement is to sell the house he acquires for a profit. Shaun is carrying on an enterprise in these circumstances because the activities are business activities or activities in the conduct of a profit making undertaking or scheme and therefore an adventure or concern in the nature of trade.

Shaun and Caroline agree that Shaun will take Lot 1 which includes House 1 and Caroline will take Lot 2 which includes House 2.

Caroline and Shaun give effect to the partition, after the completion of construction, by Shaun transferring his interest in Lot 2 to Caroline and by Caroline transferring her interest in Lot 1 to Shaun.

The transfer by Caroline of her interest in Lot 1 to Shaun is not in the course or furtherance of an enterprise she carries on. Caroline's transfer of her interest in Lot 1 to Shaun does not have any connection with an enterprise that she carries on.

In contrast, the transfer of his interest in Lot 2 to Caroline is in the course or furtherance of an enterprise he carries on. Shaun's transfer of his interest in Lot 2 to Caroline is connected with his enterprise of selling new residential premises for profit.

As the example shows, this is a situation that may arise fairly regularly. It would also apply where the co-owner (in this example Shaun) was to hold their property for long term rental derivation.

Importantly, however, the carrying on of an enterprise will only require GST registration if it is done on a regular and continuous basis and derives at least $75,000 in income: see *GST Determination 2000/9 Goods and Services Tax: if you let out residential premises do you need to get an ABN for PAYG purposes or register for GST?*

In the above example Shaun, whether seeking to turn a profit under $75,000 or to derive rental income under $75,000 per annum, would not need to register for GST.

6.9.5 Connected with Australia / Registration

Whether or not a supply is connected with Australia (see section 9-25 of the GST Act) or whether the entities are registered / required to be registered (Part 2-5 of the GST Act) are, in the context of this paper, straightforward issues and will not be discussed any further.

6.9.6 No Supply to yourself

If the partition is a taxable supply and therefore subject to GST, the co-owners will only be supplying so much of the property that they provide to the other co-owners; that is, they will not 'supply' their own

interest to themselves. At [49] of *GSTR 2009/2* the Commissioner says "*a co-owner does not make a supply of its own interest in the land that it is to take in severalty.*"

6.9.7 Court ordered partition

In relation to a court ordered partition the Commissioner considers the fact that the partitioning is involuntary (in the sense that it is required in order to comply with a direction of a Court) does not of itself remove the GST liability of the taxable supply.

The Commissioner's view is expressed at [51] to [56] of *GSTR 2009/2:*

> *If a court makes an order for partition under which the co-owners are directed to execute a transfer or conveyance of their interests in the parts of the land to be taken by the others, the Commissioner considers that each co-owner makes a supply of each interest transferred. Each co-owner is required to comply with the order by doing something.*
>
> *In* Goods and Services Tax Ruling GSTR 2006/9 Goods and services tax: supplies*, the Commissioner takes the view that to make a supply 'an entity must do something'.*
>
> *The above view receives support in the decision of* D*eputy Presidents Walker and Block in* Re Hornsby Shire Council v Commissioner of Taxation *[[2008] AATA 1060]. The Deputy Presidents considered at [70], held that the judgment in* Westley Nominees Pty Ltd & Anor v Coles Supermarkets Australia Pty Ltd & Anor *[[2006] FCAFC 115] provides support for the Commissioner's view that positive action (that is by doing something) is required to make a supply. Accordingly, the making of a supply by a co-owner of their interest in land, pursuant to section 9-10, requires there to be some positive action on behalf of the co-owner.*
>
> *In* C & C *[[2001] FMCfam 194], in the context of Family Court proceedings, the Federal Magistrates Court in that case ordered '… the Wife … do all acts and things necessary to seek a partition of the title to the real property …'.*
>
> *Further, in* Schnytzer v Wielunski *[[1978] VR 418 at 430], the Supreme Court of Victoria '… ordered that the said land the subject of the action be partitioned between the parties and that the parties join in a transfer of the lot numbered 2 … to the defendants absolutely and … lot numbered 1 … to the plaintiffs absolutely.' It was also '… ordered that the conveyancing and like costs of giving effect to the partition so ordered be borne by the plaintiffs … and the defendants … in equal shares.'*
>
> *It is evident from the above cases that a co-owner is required to do something to effect the partition. The transfer or conveyance by the co-owner of its interest in the land is a supply. It is irrelevant that the co-owners were compelled by the order to make the supply. In accordance with the Commissioner's view, in order to make a supply a co-owner has to do something, that is the making of a supply by the co-owner requires positive action by the co-owner. However it does not require that act to be voluntary.*

Whether this is correct is open to further consideration. Whether the effect of a court ordered partition involves the co-owner taking a step is open to doubt. See, for instance, the authorities on s 71 and 78 of the Trustee Act dealing with vesting orders following a change of trustee.

Regardless, the Commissioner's current view is that a court ordered partition will be subject to GST and needs to be factored into any decision to approach the court for relief. It is unlikely, however, to of itself provide a defence to the resistant co-owner.

6.9.8 Margin Scheme and Partitioning

Depending on the circumstances of the property the margin scheme (in Division 75 of the GST Act) may be used to reduce the GST payable on a taxable supply. When it applies the margin scheme calculates the GST liability of certain taxable supplies of real property based on the difference between the consideration for the supply and the cost of its acquisition (that is, the so called margin) rather than on the amount of consideration for the supply (as is the general liability rule).

This calculation does not, however, take into account any input tax credits otherwise available from acquiring or developing the interest supplied. That is, those input tax credits are not able to be claimed. It is therefore a matter of 'running the numbers' on whether the margin scheme is the more beneficial way to calculate the GST liability.

The Commissioner takes the view that the margin scheme can be applied to a taxable supply of land by a co-owner under a partition by agreement or a court ordered partition if the requirements of Division 75 of the GST Act are otherwise satisfied: *GSTR 2009/2* at [100]. In this regard the Commissioner considers the requirement for a 'sale' despite that term usually requiring the interest in land being supplied in exchange for a monetary price. He says, in *GSTR 2009/2* at [105]:

> *the Commissioner considers that the ordinary meaning of "sale" and "selling", the context provided by section 9-70 and the policy underlying Division 75 support a broader interpretation of the term 'selling' in section 75-5.*

The alternative argument, that a partition does not constitute a 'sale' because of the lack of monetary consideration is acknowledged but not favored by the Commissioner.

The calculation of the margin may differ, depending on:

- whether the land was acquired before or after 1 July 2000; and
- whether a partition occurs before 17 March 2005 on the one hand or on or after 17 March 2005 on the other hand. This date is relevant on the basis that section 75-11 of the GST Act, instead of section 75-10, applies to certain supplies made on or after 17 March 2005.

In the case of land acquired after 1 July 2000, to calculate the margin where a partition occurred prior to 17 March 2005, s 75-10 of the GST Act applies and the margin is the amount by which the consideration for the supply exceeds the consideration for the acquisition. Where land was acquired prior to 1 July 2000 and a partition occurred prior to 17 March 2005, the margin would be the difference between the consideration for the supply and the value at the valuation date as prescribed in Division 75 of the GST Act.

If the circumstances in section 75-11 apply – for example, if the land was acquired from an associate or from a joint venture operator – the margin must be calculated under s 75-11 and not under section 75-10.

6.9.9 Partnerships

A partnership is an entity for the purposes of the GST Act. In *GSTR 2009/2* the Commissioner states that an in-specie distribution of real property from a partnership to a partner is a supply of that land. It can be a supply of an interest by way of a partition. The consideration for the in-specie distribution is the reduction in the value of the receiving partner's interest in the partnership. The Commissioner also

states that the margin scheme can apply to such taxable supplies provided the requirements of Division 75 of the GST Act are satisfied.

The Commissioner acknowledges an alternative view; that partnership land cannot be partitioned because it can only be sold on dissolution of the partnership. The Commissioner considers that despite a court potentially ordering a sale rather than a partition where a partnership exists, this fact does not preclude the partners agreeing to the partition of partnership land as between them.

6.9.10 Joint Ventures

Often when undertaking a property development the co-owners will do so via a joint venture. Transfers between co-owners who are joint venturers are treated in the same way as the supplies described above – the Commissioner does not distinguish between a GST joint venture and other joint ventures for this purpose.

Under a partition, the transfer by each participant in a joint venture of their interest in land is a taxable supply provided all the conditions of s 9-5 of the GST Act are satisfied: *GSTR 2009/2* at [161]. Transfer of interests between the participants in the joint venture is a supply made for consideration *GSTR 2009/2* at [163].

Particularly, the rule in section 51-30(2) of the GST Act, relating to supplies between a GST joint venture operator and a GST joint venture participant, does not, in the Commissioner's opinion, apply to negate the taxable treatment of a partition supply made between a GST joint venture operator and a GST joint venture participant. The rationale for this is that on partition a GST joint venture participant would be acquiring the interest in the land for his or her own purposes and not for purposes of the GST joint venture activities.

6.10 Stamp duty implications

Although there are provisions of the stamp duty legislation dealing with partitions (s 30 of the *Duties Act* 1997 (NSW) (the '**Duties Act**'), and this will be the focus of this section of the paper, it is also necessary to consider the apparent purchaser concession (s 55 of the Duties Act), which can afford concessional duty in specified dealings between parties with interests in land.

They will be considered in turn.

6.10.1 Partitioning

In New South Wales, the Duties Act provides specifically for the partitioning of land in section 30,[20] which states:

> ***30 Partitions***
>
> ***(1) What is a partition?***

[20] See also s 27 of the *Duties Act* 2000 (Vic); s 31 of the *Duties Act* 2001 (Qld); s 26 of the *Duties Act* 2001 (Tas); s 39 of the *Duties Act* 2008 (WA); and s 29 of the *Duties Act* (ACT). South Australia and the Northern Territory, which retain their *Stamp Duty* legislation (from which other jurisdictions have moved to the *Duties Act* legislation) have more limited provisions.

For the purposes of this section, a partition occurs when dutiable property comprised of land in New South Wales that is held by persons jointly (as joint tenants or tenants in common) is transferred or agreed to be transferred to one or more of those persons.

(2) Single dutiable transaction

For the purposes of this section and sections 16 and 18, a partition is taken to be a single dutiable transaction.

(3) Dutiable value

The dutiable value of a partition is the greater of:

(a) the sum of the amounts by which the unencumbered value of the dutiable property transferred, or agreed to be transferred, to a person by the partition exceeds the unencumbered value of the interest held by the person in the dutiable property transferred, or agreed to be transferred, to each person by the partition immediately before the partition, and

(b) the sum of any consideration for the partition paid by any of the parties.

(3A) (Repealed)

(4) Minimum duty

The minimum duty chargeable on a transaction that effects a partition is $50.

(5) Who is liable to pay the duty?

Duty charged by this section is payable by the persons making the partition or any one or more of them.

(6) Anti-avoidance criteria

This section does not apply in respect of a partition if the Chief Commissioner is satisfied that the partition is part of a scheme to avoid duty on an exchange of land that was not jointly held by the parties before the scheme was entered into.

For stamp duty purposes, under section 30(1) of the Duties Act, a partition is taken to occur in New South Wales when dutiable property comprised of land that is held by persons jointly (as either joint tenants or tenants in common) is transferred or agreed to be transferred to one or more of those persons. The partitioning of land is a dutiable transaction under Chapter 2 of the Duties Act.

The ‘dutiable value’ of the partition (on which *ad valorem* duty will be charged) is provided for by subsection 30(3) of the Duties Act. However, the minimum duty chargeable is $50.

If the unencumbered value of the undivided share of the co-owner in the property immediately before partition were:

- equal to or less than the unencumbered value of the divided part taken by the co-owner on partition, then the total excess value would be nil; and
- more than the unencumbered value of the divided part taken by the co-owner on partition, then the total excess value would be that amount.

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Consequentially, if no additional consideration is paid in relation to the partition, the dutiable value will be nil and the partition will be charged with the minimum duty of $50 under section 30(4) of the Duties Act.

6.10.2 Timing

Timing of the partition is important as the maximum benefit of the provisions only apply if the partition occurs in the appropriate sequence. The joint parties must hold the land: subsection 30(1). That is, the partition cannot be entered *before* the land is purchased.

There is a motivation to enter the partition as early as possible – because the earlier the partition the greater the amount of capital appreciation, which is likely if there are development or subdivision works undertaken to improve the property's value, will be protected from CGT until a subsequent CGT event happening to the co-owner. This tension with the stamp duty provisions is resolved by entering the partition agreement as early as possible, but only after the co-owners jointly hold the land.[21]

6.10.3 Revenue Ruling No DUT 35

The Chief Commissioner of State Revenue (the '**Chief Commissioner**') has issued a ruling in relation to s 30 of the Duties Act.[22] It is Revenue Ruling No DUT 35, entitled *Partitions of Land* (the **'Partition Ruling'**), [6] of which states:

> *A partition under Section 30 is confined to dutiable property comprised of land in NSW. All other property, both dutiable and non-dutiable (such as shares, land not in NSW and cash) is to be disregarded when calculating duty on a partition.*

The Partition Ruling also confirms that s 30 will not apply to deceased estates, for which s 63 of the Duties Act is relevant: Partition Ruling at [13].

The evidentiary requirements of the Chief Commissioner are set out in the Partition Ruling, at [14], as follows:

> *In addition to the documents effecting the partition, the following documents are required to be lodged to enable assessment of duty on a partition:*
>
> *i. evidence of value (and a copy) for each parcel of land subject to the partition. The evidence of value should be in accordance with Revenue Ruling DUT 012.*
>
> *ii. a current Certificate of Title or each parcel of land subject to the partition.*

Revenue Ruling No DUT 12, entitled *Dutiable Transactions Evidence of Value* deals specifically with land at [12] to [15]. It provides:

> *12. Where evidence of value of land is required to determine the adequacy of the consideration as outlined in paragraph 8 above, the following are acceptable:*
>
> *a. a "declaration by a competent valuer" as outlined in paragraph 13; or*

[21] But note the Commissioner's views on CGT Events E1 and E2, which suggests that the partition agreement should predate purchasing the relevant property. The author questions the Commissioner's view underlying this reasoning.

[22] Footnotes now update the ruling to ensure the nominal duty is $50, rather than the previous $10.

b. a private opinion or expression of value by a registered valuer, identifying the specific property; or

c. an agreement which is evidence of a recent arm's length sale of the property; or

d. a valuation required by a financial institution for finance purposes, with the proviso that such valuations are often conservative and may indicate that the property has a higher unencumbered value.

If this evidence of value indicates that the consideration is adequate, no further evidence of value will be required.

13. If the above evidence of value indicates that the unencumbered value of the land exceeds the consideration by a significant amount, a "declaration by a competent valuer" will be required, being either:

a. a valuation by the Valuer General of the improved land value; or

b. a valuation by a registered real estate valuer within the meaning of the Valuers Registration Act 1975 of the full market value, being a comprehensive valuation of the property in its present condition indicating that an inspection of the property has been undertaken. (Brief market appraisals, estimates of value or other statements that do not indicate a full inspection of the subject property has been undertaken will not be acceptable.)

14. If there is no consideration or nominal consideration, evidence of value must consist of either a "declaration by a competent valuer" as referred to in paragraph 10 or an agreement which is evidence of a recent arm's length sale of the property.

15. Where the property is vacant and unimproved land, the most recent notice of valuation by the Valuer General for rating purposes would be acceptable.

6.10.4 Consolidation and Partitioning

Also important for s 30 of the Duties Act is the issue of consolidated lots. The Chief Commissioner further states, in the Partition Ruling at [5], that the extent of the application of section 30 to partitions of land:

> *… is not restricted to instances where the partition involves one parcel of land or adjoining parcels of land. Section 30 also applies to that is held by partners in a partnership, that is, the partnership factor will be ignored and for the purposes of a partition, it would be the partners legal ownership of the land that is relevant.*

The Chief Commissioner at [11] and [12] also referred to the ‘dual entitlement’ practice that transfers between proprietors in dual entitlement is subject to *ad valorem* duty:

> *Section 30 only applies to land in NSW that is held by persons jointly either as joint tenants or tenants in common. Land that is not held jointly cannot be assessed under Section 30. Land held in the form of a dual entitlement is not held jointly because the ownership is in severalty.*

> *A dual entitlement is a practice of the Department of Lands which acts as a stay of registration until single ownership of an entire lot is obtained. Dual Entitlement titles can arise following a consolidation of adjoining parcels of land and the creation of a new consolidated lot.*

As the consolidated lots are 'Dual Entitlement' titles, the registered proprietors of the consolidated lots are not held jointly, as owners, by the registered proprietors on the new titles . Section 30 of the Duties Act provides that:

> For the purposes of this section, a partition occurs when dutiable property comprised of land in New South Wales that is **held by persons jointly (as joint tenants or tenants in common)** is transferred or agreed to be transferred to one or more of those persons. [emphasis added]

As a result, if the consolidated lots are subdivided, the 'partitioning' concession contained in section 30 of the Duties Act will not apply, as the registered proprietors do not jointly hold the consolidated lots.

This is confirmed by *Aoun Investments Pty Ltd v Chief Commissioner of State Revenue* [2006] NSWSC 1394 in which Gzell J held that:

> *To constitute a partition ... [for the purposes of section 30 of the Duties Act] ... the lots the subject of the transfers in question had to be held by the plaintiffs as joint tenants or tenants in common. The lots were not so held.*

There the parties held their interests in severalty rather than as joint proprietors (this was a result of the NSW LPI's practice of registering interest via a dual ownership or multiple ownership folio upon consolidation where the are not lodge transfers between the co-owners). As there was no partition within the meaning under section 30 of the Duties Act, section 30 did not apply and the plaintiffs were liable for *ad valorem* duty on the transfers.

6.10.5 Apparent Purchaser Provisions

Dealings in land in similar, but obviously not identical, circumstances to partitioning may benefit from the apparent purchaser provisions in s 55 of the Duties Act. This is the exemption that applies to afford relief from double duty where a limited recourse borrowing arrangement is used by a regulated superannuation fund pursuant to s 67A or 67B of the *Superannuation Industry (Supervision) Act* 1993 (Cth).

It is not applicable to partitions of land, because the co-owners have paid for their own interest. But it is worth keeping in mind when considering land transactions entered by clients as the circumstances, especially if they attend on you after steps to effect the transaction have been undertaken, may not fall within the partition provisions. It is therefore useful to be aware of s 55, and indeed the other concessions in Part 6 of the Duties Act.

Section 55 of the Duties Act provides:

> *(1) Duty of $50 is chargeable in respect of:*
>
> > *(a) a declaration of trust made by an apparent purchaser in respect of identified dutiable property:*
> >
> > > *(i) vested in the apparent purchaser upon trust for the real purchaser who provided the money for the purchase of the dutiable property, or*

(ii) *to be vested in the apparent purchaser upon trust for the real purchaser, if the Chief Commissioner is satisfied that the money for the purchase of the dutiable property has been or will be provided by the real purchaser, or*

(b) *a transfer of dutiable property from an apparent purchaser to the real purchaser if:*

(i) *the dutiable property is property, or part of property, vested in the apparent purchaser upon trust for the real purchaser, and*

(ii) *the real purchaser provided the money for the purchase of the dutiable property and for any improvements made to the dutiable property after the purchase.*

(1A) *For the purposes of subsection (1), money provided by a person other than the real purchaser is taken to have been provided by the real purchaser if the Chief Commissioner is satisfied that the money was provided as a loan and has been or will be repaid by the real purchaser.*

(1B) *This section applies whether or not there has been a change in the legal description of the dutiable property between the purchase of the property by the apparent purchaser and the transfer to the real purchaser.*

Note. *For example, if the dutiable property is land, this section continues to apply if there is a change in the legal description of the dutiable property as a consequence of the subdivision of the land.*

(2) *In this section,* ***purchase*** *includes an allotment.*

The Chief Commissioner has summarised the provision as follows in Revenue Ruling No DUT 30, entitled *Property Vested in an Apparent Purchaser* (the **'Apparent Purchaser Ruling'**):

> *Section 55 therefore provides concessional duty treatment in the context of resulting trusts under which the apparent purchaser is trustee and the real purchaser is the beneficial owner of the trust property. …*

The Apparent Purchaser Ruling confirms a number of important aspects of the s 55 concession. They follow.

The real purchaser need not have provided all of the funds themselves; if borrowed funds for the purchase (or part thereof) it will be sufficient if they are liable to repay those funds: Apparent Purchaser Ruling at [6]. However, it does require that the real purchaser provide the whole of the purchase money (whether by available funds or borrowings for which the real purchaser is liable to repay): Apparent Purchaser Ruling at [11].

It also applies where the relevant transfer to the real purchaser, from the apparent purchaser, is of part only of the relevant property: Apparent Purchaser Ruling at [10].

The evidence required to apply the apparent purchaser concession is set out in Apparent Purchaser Ruling at [13] thus:

The apparent purchaser (trustee) must furnish a statutory declaration stating:

(a) the intention of the parties regarding the beneficial ownership of the property at the time of purchase by the apparent purchaser,

(b) why the property was purchased in the name of the apparent purchaser,

(c) who actually provided the purchase money for the property, including any deposit payable under the agreement for the purchase of the property, and

(d) the date of birth of the real purchaser (if he or she was under 18 years of age at the time of the purchase by the apparent purchaser) or, if the real purchaser is a company, the date of its incorporation.

Generally, evidence of bank statements showing the payments is required: Apparent Purchaser Ruling at [14]. If any improvements were undertaken on the property documents showing the real purchaser effecting them or, if the apparent purchaser that he or she did so as agent, should be provided: Apparent Purchaser Ruling at [15].

It is also said, in Apparent Purchaser Ruling at [18], that to stamp the declaration of trust with nominal duty under s 55(1)(b) requires the following evidence:

- *statutory declaration by the purchaser named in the agreement stating:*

  (a) who actually provided the money, including the deposit if any, for the purchase of the trust property; and

  (b) if the beneficiary is a company, the date of its incorporation,

- *the stamped agreement evidencing the purchase of the trust property by the trustee, (or a copy of the stamped transfer where no agreement was executed), and*

- *the evidence referred to in paragraph 14 above.*

Improvements to the property are also permitted under the apparent purchaser concession. It is partly for this reason that advisors should remember this concession when dealing with a client with development and subdivision intentions. The changes arose from amendments taking effect 20 June 2006. They amended s 55(1)(b) and inserted s 55(1B) of the Duties Act. The changes were consistent with Gzell's J decision in *Sportscorp Australia Pty Ltd & Ors v Chief Commissioner of State Revenue* [2004] NSWSC 1029 discussed below.

6.10.6 Platinum Investments – timing is important

An important case in relation to s 55 of the Duties Act is the Court of Appeal of the Supreme Court of New South Wales' decision in *Chief Commissioner of State Revenue v Platinum Investment Management Ltd* (2011) 80 NSWLR 240. In *Chief Commissioner of State Revenue v Platinum Investment Management Ltd* the majority of the Court[23] held that *ad valorem* duty was payable on a declaration of trust over shares that came into existence two days after the declaration. It was held that there could be a declaration of trust over future property. In doing so the majority held that the words 'to be vested' and 'to be held in trust' contain the concept of futurity with respect to the declaration of

[23] Campbell JA and Handley AJA, Macfarlan JA dissenting.

trust. It was further held that the 'identifiable property' for the purposes of duty on a declaration of trust does not require that the property exist at that time.

All three judges, however, held that apparent purchaser concession did not apply on the basis of *Commissioner of Stamp Duties (NSW) v Pendal Nominees Pty Ltd* (1989) 167 CLR 1, which was to the effect that the apparent purchaser provision is not available if a declaration is made before there is an apparent purchaser. But the previous exemption being there considered, under the *Stamp Duty Act* 1920 (NSW), did not have the futurity elements contemplated by ss 55(1)(a) of the current legislation. The outcome of this matter is therefore questionable.[24]

6.11 Further complications with Strata Titles

Another issue to consider is whether the property to be developed will be strata titled. In both the decision in New South Wales, in *Sportscorp Australia Pty Ltd & Ors v Chief Commissioner of State Revenue* [2004] NSWSC 1029, and in Queensland in *Growing Wealth Pty Ltd & Ors v Commissioner of Stamp Duties* [200] QCA 418, Courts have separately concluded that a completed strata titled lot is not the same property as was held by the trustee / agent when the beneficiary / principal first became entitled. This is problematic particularly with respect to the stamp duty implications, where the transfer will be assessed for *ad valorem* duty twice. That is, *ad valorem* duty is charged on the acquisition of the property by the trustee / agent from third party, and subsequently charged again on the transfer by the trustee / agent to the beneficiary / principal.

If the transfer to the beneficiary / principal by the trustee / agent is a transfer of an interest in the land prior to the registration of the strata title plan (i.e., the property is strata titled when held by the investors), then adverse stamp duty consequences may be averted. Therefore, consideration must be given as to whether the property should be acquired by an agent / nominee initially, and when the property should be transferred to the principal / beneficiary (i.e., whether before or after strata titling).

[24] The Property Council of Australia's July 2011 submissions to the NSW Office of State Revenue, in relation to the Apparent Purchaser Concession, are useful in this regard.

7. Landholder Duty

When dealing in shares in a company or units in a Unit Trust, there won't be any duty implications under Chapter 2 of the Duties Act because:

1. the units and shares are marketable securities, the dealing in which is not subject to duty: s 34 and the note to s 11 of the Duties Act; and
2. the consideration for the marketable securities is cash, which itself not *dutiable property*: s 11 of the Act.

The issue then becomes landholder duty in Chapter 4 of the Duties Act, comprising ss 145 to 163L. Where a company or trust holds property worth more than $2 million it will be a *landholder*: s 146 of the Duties Act. If it is a private unit trust or a proprietary limited company it is a *private landholder*[25]: s 146(2) of the Duties Act. The issue or transfer of units is an acquisition: s 151(2)(b) of the Duties Act. Should any such acquisition be of a *significant interest* will be a *relevant acquisition* that is subject to duty: ss 148 & 149 of the Duties Act.

A *relevant interest* is 50% or more of the private landholder: s 150 of the Duties Act.

The concern is whether the acquisition is to be aggregated with other holdings or other transactions. There are two ways this could occur: multiple purchases being considered part of one transaction or the entities being linked entities.

7.1 Aggregating Relevant Acquisitions

Section 149 of the Duties Act allows aggregation of transactions in certain circumstances. So far as is relevant, it provides:

149 What is a "relevant acquisition"?

(1) For the purposes of this Chapter, a person makes a ***relevant acquisition*** if the person—

(a) acquires an interest in a landholder that is of itself a significant interest in the landholder, or

(b) acquires an interest in a landholder that (when aggregated with other interests in the landholder held by the person or an associated person) results in an aggregation that amounts to a significant interest in the landholder, or

[25] There are higher thresholds for *public landholders* but this paper does not consider those entities.

(c) already having a significant interest, or an interest described in paragraph (b), in a landholder, acquires a further interest in the landholder.

(1A) For the purposes of this Chapter, a person also makes a ***relevant acquisition*** if the person acquires an interest in a landholder that (when aggregated with other interests in the landholder acquired by the person or other persons under acquisitions that form, evidence, give effect to or arise from what is substantially one arrangement between the acquirers) results in an aggregation that amounts to a significant interest in the landholder.

(1B) In determining whether acquisitions form, evidence, give effect to or arise from what is substantially one arrangement between the acquirers, the following circumstances are to be taken into account—

(a) whether any of the acquisitions are conditional on entry into, or completion of, any of the other acquisitions,

(b) whether the parties to any of the acquisitions are the same,

(c) whether any party to an acquisition is an associated person of another party to any of the other acquisitions,

(d) the period of time over which the acquisitions take place,

(e) whether, before or after the acquisitions take place, the interests were, are or will be used together or dependently with one another,

(f) any other relevant circumstances.

Any advisor must carefully consider if those provisions aggregate transactions.

7.2 Linked Entities

By s 158A of the Duties Act, an entity is taken to own the land held by a “linked entity”. Whether entities are “linked” is governed by s 158 of the Duties Act, which provides:

158 Meaning of "linked entity"

(1) A ***linked entity*** of a private unit trust scheme or private company (a ***principal entity***) means an entity (other than a public unit trust scheme or a listed company) that is part of a chain of entities:

(a) that starts with the principal entity and is comprised of one or more links, and

(b) in which one or both of the following apply:

(i) at each link between 2 entities in the chain—one of the entities would be entitled, in the event of a distribution of all the property of the other entity (and without regard to any liabilities of any entity in the chain), to receive not less than 50% of the value of the property of the other entity,

(ii) in the event of the distribution of all of the property of entities in the chain (except for the principal entity)—the principal entity would be entitled (without regard to any liabilities of any entity in the chain) to receive not less than 50% of the value of that property.

(2) A ***linked entity*** of a public unit trust scheme or listed company (a ***principal entity***) means an entity that is part of a chain of entities:

(a) that starts with the principal entity and is comprised of one or more links, and

(b) in which, at each link between 2 entities in the chain—one of the entities would be entitled, in the event of a distribution of all the property of the other entity (and without regard to any liabilities of any entity in the chain), to receive not less than 50% of the value of the property of the other entity.

(3) For the purposes of this section:

(a) a trust is to be regarded as entitled to receive property (whether as a principal entity or as a linked entity of a principal entity) if a trustee of the trust is entitled to receive the property in its capacity as a trustee, and

(b) a partnership or other unincorporated body is to be regarded as entitled to receive property, as a linked entity of a principal entity, if a member of the partnership or other unincorporated body is entitled to receive the property as a member of the partnership or the other unincorporated body.

(4) In this section and in section 158A:

entity means any of the following:

(a) a corporation,

(b) a unit trust scheme,

(c) a trust,

(d) a partnership or other unincorporated body.

(5) In this section and in section 158A:

(a) a reference to a ***trust*** includes a reference to a unit trust scheme, and

(b) a reference to a ***trustee*** of a trust includes a reference to a custodian of the trustee of the trust in its capacity as custodian or a sub-custodian of the custodian of the trustee of the trust in its capacity as sub-custodian.

Again, any advisors should carefully consider if any linkages exist before effecting a transaction.

For completeness I note that if the purchasers were acting as trustees of discretionary trusts, and they had a common beneficiary, then they would *associated persons* by reason of clause 2(1)(d) and (e1), of the *Dictionary* to the Duties Act.

7.3 Important Upcoming Date

The Duties Act is amended by the *Treasury and Revenue Legislation Amendment Act* 2023 (NSW) makes a number of significant changes to the Duties Act, including reducing the threshold for a *relevant acquisition* – either individually or via *linked entities* – from 50% to 20%. That change takes effect on 1 February 2023, after which the threshold for *private landholders* drops from 50% to 20%.

This is a material change and any transactions on or before that date should not be delayed.

8. Options for Property

Option Deeds, particularly in respect of real property, are becoming more common in light of the number of clients seeking to profit from property development.

There is good reason for their popularity; they provide developers with flexibility and assist in managing cash flow and liabilities in the development process. Common uses of option deeds include:

1. to secure development rights over a potential site without having to pay stamp duty or buying time to enable the developer to assemble the site and obtain development consent;
2. to defer stamp duty where a development may not be competed before the deadlines for purchase contracts for sale;
3. to secure purchase rights over a property and lock in a price but defer duty to a future tax year;
4. to gain the exclusive right to market lots for sale for specified period of time;
5. to permit flexibility in choosing the actual entity that will purchase the property; and
6. as sale guarantees to a developer if a buyer cannot be found on the open market.

But the assignment, nomination or novation of such deeds raises problems from a stamp duty, and other Commonwealth taxes, point of view. The problems are often not known to the clients nor, unfortunately, considered significant enough to justify the time or cost in dealing with them. Often a short calculation of the stamp duty or tax costs of getting them wrong is enough to ensure the client's become aware of their importance.

The issue arises because of the tension between obtaining flexibility in dealing with property and triggering adverse stamp duty, income tax or GCT, or GST liabilities. For instance:

- the assignment of rights under a call option may result in call option assignment duty under s 107 of the *Duties Act*, which is assessed on the value of the underlying property; and

- the novation, assignment or nomination of an option will attract duty under s 9B of the Duties Act, though here a credit for this duty will be applied to any later duty payable when the underlying property is acquired via the option.

This paper will consider the following issues:

1. What are option deeds?

2. What is an assignment of, a nomination under, or a novation of an option deed?

3. When does stamp duty arise in relation to an option deed, its execution or the assignment of, a nomination under, or a novation of an option deed?

4. How do the put and call option provisions apply?

5. The importance of carefully drafting option deeds.

6. Valuation of option deeds.

7. What income tax and CGT concerns arise for option deeds?

8. What GST concerns arise for option deeds?

9. Case report: *CTI Joint Venture Company Pty Ltd v Chief Commissioner of State Revenue* [2013] NSWSC 20.

As the Supreme Court's decision led to amendments in the way option deeds are assessed for stamp duty, it is appropriate to consider that case before turning to how the stamp duty regime now applies to option deeds.

It will be seen that option deeds are useful tool in a property developer's arsenal – and, indeed, can be a profitable form of property investment in their own right – but that the duty legislation is cognizant of these facts and will apply unless the options are carefully prepared and dealt with.

Although beyond the scope of this paper, developers considering using option deeds should also give consideration to how they manage their liability, for instance in relation to the statutory warranties for residential building work under the *Home Building Act* 1999 (NSW) and other relevant legislation.

8.1 Option Deeds

An option is a right conferred by agreement to buy, or to sell, certain property within a specified time period. An option is generally categorized as a:

- call option, which provides for the purchase of the specified property;
- put option, which provides for the sale of the specified property; or
- a put and call option, which provides one party with the right to require the sale, and the other with the right to require the purchase, of the specified property.

The types of options will be separately considered below.

It is to be noted that an option may be a call option, or a put option and call option together, but, in relation to real property, it is less common to have a put option on its own.

8.1.1 Nature of Option Deeds

There has been judicial discourse, and commentary of academics and the profession, on the legal nature of options. The issue is whether they are properly characterized as:

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- an irrevocable offer (*Karagueleski v Vasil Bros & Co Pty Ltd* [1981] 1 NSWLR 2677 and *Commissioner of Taxes (Qld) v Camphin* (1937) 57 CLR 127 at 132), that is, an offer to sell with an agreement not to revoke; or

- a conditional contract (*Laybutt v Amoco Australia Pty Ltd* (1974) 132 CLR 57), that is, an agreement to sell upon a condition.

In *CTI Joint Venture Company Pty Ltd v Chief Commissioner of State Revenue* [2013] NSWSC 20 at [33] Gzell J said:

> It has been suggested that the view that commands most support in Australia is that of an irrevocable offer coupled with a promise by the grantor not to revoke the offer for a given period (JW Carter, Elisabeth Peden and GJ Tolhurst, *Cases and Materials on Contract Law in Australia,* 5th ed (2007) LexisNexis Butterworths at [8-31]).

Presumably his Honour was endorsing that view.

Whether a particular option is an irrevocable offer or a conditional contract is a matter of construction of the instrument creating it. Relevant factors include:

- the drafting of the instrument by the parties;

- the nature of the property (see below); and

- whether the option allows a right of nomination to the grantee as, if it does, it suggests an irrevocable offer on the basis that an offer can be made to the world at large but can be accepted only by a definite person or persons.

Unless the context requires otherwise an option is not a transfer, for no existing property moves to the grantee of the option; nor for the same reason is there a sale: *Commissioner of Taxes (Qld) v Camphin* (1937) 57 CLR 127. The option, if specifically enforceable, may operate to create in the grantee an equitable interest (see below), but that interest is not sold to the grantee.

However, in the correct circumstances the granting of an option has been held to be an agreement for sale. In *A Raptis & Sons Holdings Pty td v Commissioner of Stamp Duties (Qld) (No 2)* (1997) 97 ATC 4842 an option to purchase shares exercisable within 99 years (with only a nominal amount payable on exercise), coupled with a power of attorney enabling the grantee to exercise the rights of a shareholder, was held to effect a disposition of the shares, although not a sham.

8.1.2 Commercial Aspects of Option Deeds

There are some commercial factors that must be borne in mind when using options to purchase or sell property.

8.1.2.1 Caveatable Interests

As to the nature of the property, the High Court held that an option to purchase land will normally be regarded as a conditional contract creating proprietary rights in the grantee: *Laybutt v Amoco Australia Pty Ltd* (1974) 132 CLR 57. This is significant for the grantee of a call option as it will enable the grantee to lodge a caveat on the title of the specified property: *Laybutt v Amoco Australia Pty Ltd;* see also *Mackay v Wilson* (1947) 47 SR (NSW) 315 at 325.

If, however, the option deed specifically expresses itself to be personal to the parties there is a personal contract only and an interest in land may not be created. This, in turn, means that there is probably no caveatable interest on the part of the grantee.

8.1.2.2 No Cooling Off Peirod

The use of an option deed – whether it is to create a call option only, a put option only or a put and call option – to ultimately acquire property is contemplated by the *Conveyancing Act* 1919 (NSW) (the '**Conveyancing Act**').

Section 66T of the Conveyancing Act provides that there is no cooling off period in relation to a contract for the sale of residential property if the contract is made in consequence of the exercise of an option to purchase the property, other than an option that is void under s 66ZG. That later section provides for options for residential property being void unless granted by way of exchange of counterparts and if it is exercisable within 42 days after it is grated.

Section 66ZB of the Conveyancing Act provides that there is a cooling period for every option to purchase residential property. The cooling off period may be shortened by a provision in the option, or by separate written or oral agreement of the parties, which provision or agreement only takes effect once a s 66ZF certificate is provided. This can occur before, at or after the time the option is granted. As the provision does not speak of a waiver of the cooling off period it seems s 66ZF certificates merely reduce the cooling off period from 5 business days to nil business days. If the certificate is provided before the cooling off period would otherwise have started there will be no cooling off period.

The Courts are yet to resolve whether wording in these provisions, of "option to purchase" restricts these provisions to "Call options", or the call option component of a "Put and Call Option", rather than to "Put Options" also.

8.1.3 What is a Call Option?

The common option to purchase property (usually referred to as a call option) can be characterized as follows:

- it is a right granted by a person owning property (the '**grantor**') to another person (the '**grantee**') to purchase that property on terms and conditions set out in the instrument creating the option.

- the right is usually exercisable only for a specified time (the '**option period**').
- the grant is generally irrevocable by the grantor during the option period without the grantee's consent, to distinguish it from an offer to sell.
- The option is usually exercised by the grantee giving a notice of exercise to the grantor, and normally the option instrument specifies that this notice must be in writing.
- Often, especially in relation to land, the option will specify that, on exercise, the grantee must also pay a deposit and/or deliver a duly executed counterpart of an agreement for the sale of the property.
- For the grant of the option the grantee often pays a sum of money (the '**option fee**') which is either (a) merely the cost of the option regardless of its being exercised or not, (b) forfeited to the grantor if the option is not exercised or (c) credited towards the purchase price if the option is exercised.

8.1.4 What is a Put Option?

A put option is an option granted by a potential purchaser of property (the '**grantor**') to the owner of property (the '**grantee**') permitting the grantee at its election to require the grantor to purchase the property. That is, the roles of the property owner and the potential purchaser in a put option are reversed from their roles in a call option.

Otherwise, the characteristics set out in relation to call options generally apply equally to put options. However, unlike a call option, a put option can never be characterized as the grant of a right in property as the grantee already owns the subject property.

8.1.5 Options that are Puts and Call Options

An option deed may contain both a put option and a call option, commonly known as a "Put and Call".

A put and call option is an agreement between the potential vendor of a property and prospective purchaser pursuant to which:

- the grantor gives the grantee a call option to buy the property from the grantor; and
- the grantee gives the grantor a put option to sell the property to the grantee.

This creates the effect of a contract for sale, whilst delaying the formation of the final contract. They have become increasingly common (though they might be subject to the duty discussed below) because they permit:

- the purchaser to determine whether to purchase the property at all, for instance where the property is intended to be part of a proposed multiple lot development and it is unclear whether all other relevant lots can be purchased or whether development approval will be obtained; and

- there is an intended 'on-sale', usually via a nomination process (though again not below).

The call option is normally exercisable within a defined period. Often the put option period follows the call option period, to enable the grantor to compel the grantee to buy the property in the event that the grantee does not exercise the call option.

Under the *Stamp Duties Act* 1920 (NSW) the duty on agreements of the sale of property could be deferred by the granting of a simultaneous put and call option. So long as the transaction was a real one and not a sham transaction, duty was deferred until one or other party exercised the option, thereby creating for the first time an agreement for the sale or conveyance of the property which had been the subject of the options. To overcome this device former s 40B was inserted. It provided that where there was both a put and a call option in force at the same time involving the same parties, any instrument creating the options was liable to ad valorem duty as if a conveyance. If both options expired the duty paid was refundable under former s 40C. This anti-avoidance device has not been inserted in the Duties Act.

8.1.6 Stamp Duty Approach to Option Deeds

Under the *Stamp Duties Act* 1920 (NSW) put and call options over any property other than stock or marketable securities were rendered dutiable under then s 40A. This approach was strange in that it first deemed the interest created by the option agreement to be property before subjecting the option agreement to duty as if it were an agreement for the sale or conveyance of that property. This may well have been intended to do away with arguments which might otherwise have arisen as to whether a particular option agreement in fact created an interest in property.

Under the stamp duty rewrite the grant of an option, whether a put option or a call option, is not itself a dutiable transaction. The list of dutiable transactions in s 8 of the Duties Act does not include the grant of an option. Instead, options over real property are treated as dutiable property so that an agreement for sale or transfer, or a transfer of an option will be subject to duty.

The current taxing regime of the Duties Act is discussed at below.

8.2 Assignment, Nomination and Novation

Before considering the stamp duty consequences of option deeds and dealings with them it is necessary to discuss the nature of executing an option, assigning an option, nominating under an option and novating an option.

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8.2.1 Execution / Grant of Option

A distinction must be drawn between the granting of an option, which creates rights, and the assignment of it, nomination under it or novation of it which deals with the rights created on the initial grant.

It is uncontroversial that the Duties Act does not extend the concept of sale or transfer to the granting of an option, which creates the rights, rather than those rights being transferred: *CTI Joint Venture Company Pty Ltd v Chief Commissioner of State Revenue* [2013] NSWSC 20 at [24] and [29].

In *Commissioner of Taxes (Qld) v Camphin* (1937) 57 CLR 127 at 133-134 Latham CJ said:

> The result of giving an option for value is that the person to whom the option is given acquires an equitable interest. But this equitable interest has not, in my opinion, been sold to him. The equitable interest is measured by what a court of equity would decree in an action for specific performance. The right of the person who may be called the owner of the option is a right to prevent the owner of the property in question from disposing of it inconsistently with the option, together with a right, if he exercises the option, to compel the owner of the property to carry out the contract which has been made by the exercise of the option. This right of the optionee is a right which has been created by the option, but it is not a right which the owner of the property ever possessed. He has created a new right in the optionee which is a right of property, but he has not transferred to the optionee any right which previously belonged to him as the owner of the property in relation to which the option was given. Thus there has been no sale of any property.

In the context of this paper, therefore, there is therefore no need to further consider the granting of the options.

8.2.2 Assignment

The Court of Appeal has confirmed that Party A to a contract can prospectively authorize Party B to that contract to transfer Party B's rights and obligations under the contract without Party A being a party to the arrangement between Party B and the transferee: *CSG Ltd v Fuju Australia Pty Ltd* [2011] NSWCA 335 at [134].

If the option is assigned it is likely to be a 'transfer' on which duty.

8.2.3 Nomination

Option deeds often include a right for the grantee to "nominate" the entity that will be the purchaser under the contract that comes into existence on the exercise of an option. This right enables the grantee to negotiate to assign the benefit of the option and to nominate the assignee as the purchaser when exercising the option.

In *Nguyen v Taylor* (1992) 27 NSWLR 48 at 60-61 Meagher JA said (emphasis added):

> There is nothing formal, complicated or mysterious about making a "nomination" for the purposes of exercising an option given in favour of the grantee "or his nominee". It need not even be in writing… *The making of a nomination of itself does not dispose of or create any interest in property*: cf *Re Danish Bacon Co Ltd Staff Pension Fund Trusts* [1971] 1 WLR 248; [1971] 1 All ER 486. *At the moment of making a nomination the interests of both grantor and grantee of an option remain exactly what they were before the nomination.* All that is involved in the making of a nomination by a grantee of an option is the signification by him that on exercise of the option the purchaser will be some person or persons other than himself.

This passage was cited with approval in a passage quoted by Gleeson CJ (with whom the other members of the Court agreed) in *Trust Company of Australia Ltd v Commissioner of State Revenue* [2003] HCA 23 at [112].

The significance of Meagher JA statement is that there is no transfer of the option or the rights under the option where a nomination is made by the grantee to the person in whose favour the nomination was made.

To avoid any difficulties of interpretation it is prudent to insert express provisions in the terms of the option deed itself as to how and when nomination rights may be used. But not point 7.4 below.

It is common to see options deeds provide that the right to nominate can only occur at the time the option is exercised; that is, the entity exercising the option to become the purchaser under the contract is the nominee. This reduces the likelihood of the nomination triggering a duty liability as being some type of transfer of dutiable property. It also places some control with the grantor as to the number of times the right to nominate can be used.

8.2.4 Novation

After considering novations, and some of what is set out below, Gzell J succinctly states in *CTI Joint Venture Company Pty Ltd v Chief Commissioner of State Revenue* [2013] NSWSC 20 at [41] a common reason for novations:

> It is common ground [in that case] that the benefit of a contract can be transferred but the burden of a contract cannot. That requires novation.

In its simplest sense a novation refers to a circumstance where a new contract takes the place of the old. By a novation, the grantor accepts that the original grantee no longer has any interest in the option rights and that, by the terms of this novation, some new party has the rights formerly vested in the original grantee.

In *Olsson v Dyson* (1969) 120 CLR 365 at 388-389 Windyer J described it thus:

> In my view the facts establish a novation of the contract between Dyson and the Company. That the result of a novation may be the same, or much the same, as if there had been an effective assignment is not surprising. At one stage of the history of our law, when debts were not freely assignable at law, novation was a common method of circumventing the common law rule and accomplishing the same result as can now be accomplished directly by assignment pursuant to the statute. Novation can still be used as it was in earlier times. It can still be the means to the end which the law now allows to be reached by other means. The ultimate distinction, in juristic analysis, between a transfer of a debt by assignment and by novation is simple enough. Novation is the making of a new contract between a creditor and his debtor in consideration of the extinguishment of the obligations of the old contract: if the new contract is to be fully effective to give enforceable rights or obligations to a third person he, the third person, must be a party to the novated contract. The assignment of a debt, on the other hand, is not a transaction between the creditor and the debtor. It is a transaction between the creditor and the assignee to which the assent of the debtor is not needed. The debtor is given notice of it; for notice is necessary to complete an assignment pursuant to the statute or in the case of an equitable assignment to preserve priorities. But the debtor's assent is not required. He is not a party to the transaction.
>
> In *Scarf v Jareine* Lord Selborne said novation "means this – the term being derived from the civil law – that there being a contract in existence, some new contract is substituted for it, either between the same parties (for that might be) or between different parties; the consideration mutually being the discharge of the old contract". In that sense "novation" means simply a new contract standing the place of the old. It may be a new contract between the parties to the old contract, A (in this case Dyson) and B (in this case the company); or it may be a contract between them and a new party, or parties, e.g., between A, B and C (in this case the respondent). It is in the later sense that the word is most often used in common law countries in connexion with the transfer of debts from one creditor to another.

The High Court in *ALH Group Property Holdings Pty Ltd v Chief Commissioner of State Revenue (NSW)* (2012) 86 ALJR 287 at [12] confirmed this by explaining that a novation, in its simplest sense, refers to a circumstance where a new contract takes the place of the old.

It is therefore incorrect to describe a novation as involving the succession of a third party (or the same party where it remains only A and B) to the rights of the purchaser under the original contract. Nor is it correct to describe a third party undertaking the obligations of the purchaser under the original contract as a novation.

The effect of a novation is upon the obligations of both parties to the original, executory, contract.

The inquiry in determining whether there has been a novation is whether it has been agreed that a new contract is to be substituted for the old and the obligations of the parties under the old agreement are to be discharged. This is a broad question that renders attempts to avoid stamp duty from a novation difficult to obtain. Further, whether there has been a substitution of new for old and a discharge of obligations under the old agreement may, if not expressed in the agreement, be inferred from conduct or as a matter apparent from the agreement: see *ALH Group Property Holdings Pty Ltd v Chief Commissioner of State Revenue (NSW)* (2012) 86 ALJR 287 at [32] to [38].

As to "inferred" and "apparent" the following comments from *Hillam v Iacullo* [2015] NSWCA 196 are relevant:

> [51] Where a later contract between the same parties deals with the whole of the subject matter of the former in a way that is inconsistent with the continued existence of the former, then it must necessarily rescind the former by implication even in the absence of express language.
>
> …
>
> [64] However plain and unambiguous contractual terms may be in themselves they are always capable of being controlled by an inconsistent context.

If the new contract is to be fully effective, the third person must be a party to the novated contract. However, it does not follow that it is impossible for one party to a contract to prospectively authorize a novation to be made by another party unilaterally: *Leveraged Equities Ltd v Goodridge* (2011) 191 FCR 71 at [299]-[302] and also *CSG Ltd v Fuji Xerox Australia Pty Ltd* [2011] NSWCA 335 at [134].

Indeed, in *CTI Joint Venture Company Pty Ltd v Chief Commissioner of State Revenue* [2013] NSWSC 20 at [78] to [81] Gzell J expressly rejected the argument that a nomination notice being bipartite, it followed that there must have been a transfer. His Honour considered that the initial other party to the initial option deed – having authorized in that deed the power to assign, novate or nominate – resulted in their being the tripartite nature of the transaction.

8.3 *CTI Joint Venture Company Pty Ltd v Chief Commissioner of State Revenue*

CTI Joint Venture Company Pty Ltd v Chief Commissioner of State Revenue [2013] NSWSC 20 is significant because the current regime of how options are liable to duty arose in response to it. The judgment at [1] made plain the issues being there considered:

> The review in this matter is of narrow compass. The question is whether the substitution of one party for another as the holder of call options was effected by transfer or by novation.

This had relevance because of ss 11(1)(k) and 8(1)(b)(i) of the Duties Act which provide that an option to purchase land in New South Wales is 'dutiable property' and an agreement for sale or transfer of it is a 'dutiable transaction'. Should a transfer have occurred duty would follow; if a novation, rather than a transfer, occurred there would be no duty.

8.3.1 Facts

Transport for New South Wales (as grantor) entered into four call option deeds, all of which contained materially the same times. The deeds were in favour of CRI Chatswood Pty Ltd ('**CRI**') (as grantee) over contiguous parcels of land at Chatswood in New South Wales. The option deeds were granted as part of a wider transaction whereby Transport granted development rights to CRI in respect of developing the area in and around Chatswood railway station.

The option deeds were amended by substantially the same terms. Under the option deeds, the call option fee was $10, the price for the land was $1.00 and the contract was to be the form annexed to the deeds.

There were two option exercise periods and CRI was able to exercise the call options granted in each of these periods or nominate another party to exercise them. If CRI nominated another person to exercise the call options, CRI was required by clause 10.1 of the option deeds to give a 'Call Option Nomination Notice' to Transport. Clause 10.1 also noted that:

- CRI guarantee the performance of the nominee's obligations under the call option deeds; and
- the nominee assumes CRI's obligations under the call option deeds and the land contracts subsequently entered into.

In November 2010, CRI entered into a nomination deed with CTI Joint Venture Company Pty Ltd ('**CTI**') whereby CRI nominated CTI as the 'nominee' under each of the option deeds. A nomination fee of $60,518,675 was paid by CTI to CRI. CTI was the taxpayer in this dispute.

Later in November 2010 CTI executed, under each of the option deeds, the following:

- a nomination notice;
- a call option exercise notice; and
- the land contract.

In early December 2010, the nomination notices were delivered to CRI for execution and CRI, after executing them, delivered them to Transport.

CTI lodged the four land contracts, with the appropriate transfers, for stamping with the Chief Commissioner. It paid stamp duty assessed on the contract of $3,524,641 and $40 on the associated transfers. This was based on the dutiable value equating to the nomination fee of $60,518,675 (plus GST) and the aggregate consideration payable on the contracts of $3,829,461.90. There was no dispute as to these amounts.

8.3.2 Submissions

As noted above, it was not disputed that the rights under the call option deeds were dutiable property under s 11(1)(k) of the Duties Act.

The Chief Commissioner submitted that the nomination notices under which CRI nominated CTI as grantee under the call option deeds were agreements for the transfer of dutiable property and therefore dutiable under the Duties Act. This was because they could not amount to a novation on the basis that the nomination clauses in the call option deeds did not operation so that a new contract was entered into replacing the original call option contracts, which remained in place. Further, the nomination process in question was said to be a bipartite arrangement between CRI and CTI, which therefore did not involve Transport, a party to the option deeds. The Chief Commissioner submitted that for a novation a tripartite agreement is required to ensure the new agreement replaces the old.

At [42] of the judgment Gzell J summarized the Chief Commissioner's position as follows:

> It is not in issue that the rights held by CRI under each Call Option Deed were dutiable property. The Chief Commissioner raises two issues:
>
> - Whether the Nomination Deed constituted a dutiable transaction as an agreement for the sale or transfer of the Call Options under s 8(1)(b)(i) of the [Duties] Act; and
> - Whether each Call Option Nomination Notice constituted a transfer of dutiable property under s 8(1)(a) of the Act.

CTI submitted that the nomination notices were not agreements for the transfer of dutiable property as they gave effect to a novation, and not a transfer, of the call option deeds because new call option deeds were substituted for the original call option deeds with the latter expiring. Accordingly, on the basis that the nomination notices gave effect to a novation and not a transfer of rights under the existing call option deeds, it followed that a novation was not a transfer or a sale and the nomination notices were not agreements to transfer or sell dutiable property. There therefore were said not to be agreements for the sale or transfer of dutiable property or otherwise subject to liability under the Duties Act.

8.3.3 The Decision

Justice Gzell agreed with CTI's submission (at [43] and [55]) and, in so doing, examined the various clauses of the option deeds and the nomination process.

His Honour also examined the difference between a novation and a transfer and held that a novation does not amount to a transfer. His Honour relied on the High Court's reasoning in *ALH Group Property Holdings Pty Ltd v Chief Commissioner of State Revenue (NSW)* (2012) 86 ALJR 287 and found:

- The effect of a novation is upon the obligations of both parties to the original, executor, contract. The Chief Commissioner was therefore incorrect in submitting the nomination process was bipartite; because Transport had given the nomination rights under the option deed it was a party to the nomination process.
- It is incorrect to describe a novation as involving a succession of a third party to the rights of the party under the original contract (*ALH Group* at 346,[12]).
- It is common ground, and well established, that the benefit of a contract, but not the burden, can be transferred. To transfer the burden a novation is required.
- As a transfer requires the passing of right from one party to another, so as to vest those rights in that person, a novation cannot be a transfer as there is no passing of rights as part of the novation process. One contract comes to an end and a new contract is entered.
- The inquiry in determining whether there has been a novation is whether it was agreed that a new contract be substituted for the old and the obligations under the old agreement are to be discharged. In undertaking this inquiry a broad commercial view is to be preferred.

In the result CTI was not liable for stamp duty on the nomination process.

8.4 Duty Being Imposed

The Duties Act was amended in 2014 to change the way stamp duty is imposed on assignments, novations, nominations and other transfers of options in New South Wales. These amendments arose in response to the Supreme Court's decision in *CTI Joint Venture Company Pty Ltd v Chief Commissioner of State Revenue* [2013] NSWSC 20.

8.4.1 Options are Dutiable Property

By s 11(1)(k) of the Duties Act '***Dutiable property*** is… an option to purchase land in New South Wales'. Should a 'dutiable transaction' occur in relation to it, therefore, stamp duty will arise.

Prior to s 9B being introduced into the Duties Act it was only the transfer of an option that created a liability to duty.

For there to be a transfer the same rights must exist in the transferee after the transfer as existed in the transferor before the transfer. In *Coles Myer Ltd v Commissioner of State Revenue* [1998] 4 VR 728 at 730 Ormiston JA, with whom Winneke P agreed, defined transfer as follows:

> There are two parties to every transfer, the transferor who disposes of all rights in the transferred property and the transferee who receives or acquires them so as thereafter to have the power to exercise effectively the same rights in the future. For an instrument properly to be characterised as a 'transfer' on must be able to find that the property has passed from transferor to transferee so that the property is vested in a transferee who for all practical purposes is then capable of exercising the same rights as were capable of being exercised by the transferor before the transfer was executed.

His Honour concluded at 740:

> Thus, however broadly the word "transfer" be defined, it requires at the least that the transferee should, at the end of the transaction, have substantially the same right or interest in the subject matter as did the transferor before the transfer took place.

The nomination under an option deed, or the novation of it, would therefore not otherwise be a transfer but for s 9B. Nor would it be an assignment: the definition of assign is "to transfer property to" another: Bird R, *Osborn's Concise Law Dictionary,* 7th ed, Sweet & Maxwell, London, 1983 at 35.

8.4.2 The Amendments

The *State Revenue Legislation Further Amendment Bill* 2014 (NSW) received royal assent as the *State Revenue Legislation Further Amendment Act* 2014 (NSW) and came into effect on 23 October 2014, amending legislation that included the Duties Act. These amendments have significant implications for how stamp duty is assessed on assignments, novations, nominations and other transfers of options in New South Wales. They apply to options granted before or after the 23 October 2014.

In short the amendments have the effect that:

- transfers (including novations, assignments and nominations) of any option that includes an option to purchase land will be subject to duty;
- the amount of duty payable by the transferee on the transfer or assignment of an option to purchase land will be consideration for the transfer or assignment (i.e. a nomination fee or assignment fee payable by the transferee) plus ad valorem duty on the value of the underlying land; and
- purchasers of land under a contract for sale that arises as a consequence of the exercise of a call option (whether it was a "Call Option" or the call option component of a "Put and Call Option") will receive a credit for duty paid by the transferee on the transfer or assignment of the option when stamping the contract for sale.

The effect of the amendments is to bring forward the time for paying the stamp duty.

The amendments also dealt with "call option assignment duty", which is dealt with separately at point 6 below.

An important timing issue (though possibly less relevant now) is where the option was entered into prior to 1 July 1998 (the move to the Duties Act from the *Stamp Duties Act* 1920 (NSW)) and exercised after that date. In these circumstances no credit against duty payable on the contract or transfer is available. The contract will be dutiable under the Duties Act, but no credit is provided for duty paid on an option. The credit previously provided by s 40A of the *Stamp Duties Act* 1920 (NSW) will not be available because that section does not apply to contracts entered into after 30 June 1998: see Item 2.2(1) of Schedule 2 to the Duties Act.

8.4.3 Section 9B

The 2014 amendments introduced into the Duties Act the current s 9B, which provides:

9B Transfer of option occurring on nomination or other change

(1) A transfer of an option to purchase land in New South Wales is taken to occur if, for valuable consideration:

(a) another person is nominated to exercise the option, or

(b) another person is nominated as purchaser or transferee of the land the subject of the option on or before the exercise of the option, or

(c) the option holder agrees to a novation of the option, or otherwise relinquishes rights under the option, so that another person obtains a right to exercise the option or to purchase the land.

(2) For the purposes of this Act, in a case referred to in subsection (1) (a) or (b):

(a) the option is taken to be transferred when the nomination is made (and a reference in this Act to the time at which a transfer occurs includes a reference to such a time), and

(b) the person nominated is taken to be the transferee of the option (and a reference in this Act to a transferee includes a reference to such a person).

(3) For the purposes of this Act, in a case referred to in subsection (1) (c):

(a) the option is taken to be transferred when the option holder agrees to the novation or otherwise relinquishes rights under the option (and a reference in this Act to the time at which a transfer occurs includes a reference to such a time), and

(b) the person who obtains a right to exercise the option or to purchase the land is taken to be the transferee of the option (and a reference in this Act to a transferee includes a reference to such a person).

(4) This section applies regardless of when the option is exercisable.

(5) For the purposes of this section, anything done by a person under a power of appointment or other authority granted by an option holder is taken to have been done by the option holder.

(6) To avoid doubt, a person who has a right to accept an offer to sell land has a right to purchase the land.

(7) To avoid doubt, a transfer of an option to purchase land that is taken to occur under this section is a transfer of dutiable property and a reference in this Act to a transfer of dutiable property or a dutiable transaction includes a reference to such a transfer.

(8) In this section:

option holder, in relation to an option to purchase land in New South Wales, means a person who has a right to purchase the land under the option (whether vested or contingent).

There are a number of aspects of this provision requiring consideration

8.4.3.1 Land Only

These provisions are limited to options in relation to land in New South Wales; they do not apply to options concerning other types of property (dutiable or otherwise).

8.4.3.2 Grouping as a Transfer

The most significant aspect of s 9B of the Duties Act is the deeming of a nomination or novation of the option deed as a transfer such that a dutiable transaction arises. The notation in s 8 of the Duties Act confirms this approach.

There would otherwise be no “transfer”.

8.4.3.3 Time and Person Liable

If s 9B of the Duties Act applies the person liable to pay the duty is the person who is nominated as purchaser or transferee of the land or who acquires the right to exercise the option. The duty is payable within three months of the event that triggers s 9B of the Duties Act occurring.

8.4.3.4 Need for Consideration

However, for s 9B to operate valuable consideration is required and the absence of valuable consideration passing from transferee to transferor would seem, prima facie, not to enliven the section.

8.4.3.5 Basis of Liability

Where s 9B of the Duties Act applies duty is calculated on the higher of the consideration provided for the nomination or novation (which will include any non-monetary consideration) and the value of the option. The basis of valuing options is discussed below.

8.4.3.6 Is it a Mere Timing Issue?

If the option is exercised – whether by the entity nominated by, or introduced through novation of, the original grantee of the option – the consideration for the transfer of the land is taken to include the consideration provided by ultimate purchaser. There is then a reduction of the duty payable on the contract formed upon exercise of the option by the amount of duty paid by the ultimate purchaser: s 64D of the Duties Act. That section provides:

> The duty chargeable in respect of a transfer of land in New South Wales that occurs as a consequence of the exercise of an option to purchase land is to be reduced by the amount of duty (if any) paid by the transferee on the transfer of the option to the transferee.

However, there is still additional duty payable because of s 9B than would otherwise be the case for someone who acquires rights (whether through a novation or a nomination) and then exercises the option.

If the nominated entity, or the entity introduced by the novation, ultimately:

- exercises the option there will be duty payable, directly under s 9B, on that step and then later on the transfer of the underlying property;
- does not exercise the option there will be duty payable that will not have otherwise been paid prior to the introduction of s 9B of the Duties Act; and
- sells the option – whether by way of further nomination or further novation – for valuable consideration there will be duty payable (on the initial nomination or novation) that will not have otherwise been paid prior to the introduction of s 9B of the Duties Act.

If there are a series of nominations or novations duty will be applied to each level of the series and the ultimately exercising entity of the option (if it be exercised) will obtain the credit under s 64D of the Duties Act.

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8.4.3.7 The Option Holder

The width of the definition of "option holder" in s 9B(8) is to be noted. It extends the whole operation of s 9B to rights to purchase which are either vested or contingent. Such a contingent right would include a right vested in a person whose right to exercise the option or to nominate the buyer is subject to some condition precedent.

8.4.3.8 First Right of Refusal

It is here necessary to recall the juridical discussion of the nature of the option deeds. In that context there is a theoretical difference there is often no practical one for stamp duty purposes. One area it is practically different.

Generally speaking, the giving of an option to purchase land prima facie implies a continuing offer to sell, it has more than a contractual operation, and confers upon the option holder an equitable interest in the land, but a right of "first refusal" confers no immediate right upon the prospective purchaser. The right is purely contractual and confers no equitable interest in land: see *Mackay v Wilson* (1947) 47 SR (NSW) 315 at 325 per Street J and see also *Pritchard v Briggs* [1980] 1 All ER 294 at 305 where Goff LJ adopted Street's J observations.

Hence a right of first refusal is not within the purview of s 9B of the Duties Act.

8.5 Put and Call Option Duty Provisions

It was noted at point 2.5 above that there is no equivalent in the Duties Act of former ss 40B and 40C of the *Stamp Duties Act* 1920 (NSW). There is now, however, a regime that creates multiple and significant stamp duty liabilities. It was introduced by the *State Revenue Legislation Amendment act* 2005 (NSW).

8.5.1 Part 2 of Chapter 3

Part 2 of Chapter 3 of the Duties Act, comprises sections 106 to 111, provides for 'call option assignment duty' and 'surcharge call option assignment duty'. The provisions are set out in Annexure A to this paper.

The Office of State Revenue's website succinctly outlines this duty as follows:

> … upon the assignment of a call option over dutiable property in respect of which a put option is also in existence, the assignment of the call option will be liable to duty as if it were an agreement for the sale or transfer of the underlying option property. The person liable to pay the duty is the assignor.

If more than one assignment occurs, each assignment would trigger a liability to duty. However the duty paid by the assignor is reduced to by the duty already paid (if any) by that person under Chapter 2 on the assignment of the option to them.

Example:

B grants A a call option that confers a right on A (or any assignee of A) to purchase land from B. A also grants B a put option that confers on B a right to require A (or any assignee of A) to purchase the land from B. No duty is payable at this point.

A then transfers the call option to C. Duty is payable as follows:

(a) A (as the option holder) must pay call option assignment duty as if the transfer of the option were a transfer of the land. Duty is payable on the dutiable value of the land.

(b) C (as the transferee of the option) must pay duty under Chapter 2 on the transfer of the option. Duty is payable on the dutiable value of the option (Determined as provided for by Chapter 2).

(c) C then transfers the option to D. C (as the option holder) is required to pay call option assignment duty as if the option were a transfer of the land. However, in this case C will receive a credit for the duty paid by C on the transfer of the option to C. D (as the transferee of the option) is required to pay duty under Chapter 2 n the transfer.

(d) If D then exercises the option it would pay duty under Chapter 2 on the agreement as purchaser of the property.

The dutiable value of the dutiable property that is subject to a call option assignment is taken to be the greater of:

(a) the sum of the consideration for the assignment of the call option and the consideration payable in the event that the call option is exercised (being in either case the amount of monetary consideration or the value of non-monetary consideration); and

(b) the unencumbered value of the dutiable property."

Some specific aspects of this duty need to be considered.

8.5.2 Relinquishment of Rights

In addition to the "creation" of call option assignment duty under s 107(1) of the Duties Act, s 107(2) of the Duties Act introduces the concept of a "relinquishment" of rights and deems a relinquishment of rights as being an "assignment" of rights.

This is the area of most concern for "put and call options". This is because it results in **double duty** on the same transaction.

8.5.3 Call Option Assignment Duty

The option holder who relinquishes their rights under the option pays this duty: s 108(1) of the Duties Act. Section 108(2) provides:

> Accordingly, the option holder is taken, for the purpose of charging duty under Chapter 2, to be the transferee of the dutiable property.

That is, there is double duty. Section 108(3) provides:

> The call option assignment duty payable by the option holder is additional to the duty (if any) payable under Chapter 2 by a transferee on the transfer of an option to purchase land in New South Wales.

There is, however, a credit for any duty paid by the option holder under Chapter 2 on the transfer of the call option to the option holder: s 108(4) of the Duties Act. There will therefore be a cascading duty liability if a series of transfers occur and the option's value increases on each transfer.

8.5.4 Surcharge Call Option Assignment Duty

A further duty, in addition to the call option assignment duty, is payable in certain circumstances. Section 107(1A) of the Duties Act provides:

> Duty under Chapter 2A is also chargeable on the assignment if A is a foreign person and the dutiable property concerned is residential-related property. The duty chargeable on that assignment is additional to call option assignment duty and is referred to in this Part as ***surcharge call option assignment duty***.

The foreign person who assigned the rigs under the call option is liable to the duty: s 108A(1) of the Duties Act. Section 108A(2) provides:

> Accordingly, the option holder is taken, for the purpose of charging duty under Chapter 2A, to be the transferee of the residential-related property.

That is, there is double duty. Section 108A(3) provides:

> The duty payable by the foreign option holder is additional to the duty (if any) payable under Chapter 2A by a transferee on the transfer of an option to purchase residential land in New South Wales.

There is, however, a credit for any duty paid by the option holder under Chapter 2A on the transfer of the call option to the option holder: s 108A(4) of the Duties Act. There will therefore be a cascading duty liability if a series of transfers occur and the option's value increases on each transfer.

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This is an additional layer of duty on foreign investors.

8.5.5 Dutiable Value

By s 109 of the Duties Act, for the purposes of “call option assignment duty” or “surcharge call option assignment duty” the dutiable value is taken to be the greater of:

- the sum of the consideration for the assignment of the right under the call option and the consideration payable in the event that the call option is exercised (being in either case the amount of monetary consideration or the value of non-monetary consideration); and

- the unencumbered value of the dutiable property.

This is significant as the value can be the consideration paid for to the option holder for relinquishing their rights *together with* what the underlying real property will be bought for if exercised. This can obviously make many put and call options uncommercial.

8.5.6 Exemptions

Section 111 of the Duties Act provides limited exemptions to this duty. The exemption applies if the Chief Commissioner is satisfied that one of the following circumstances applies:

- the option was created for the sole purpose of obtaining finance;

- the put and call options form part of a scheme used by a business for the sole purposes of facilitating the continuation of the business by one or more of the proprietors and can only be exercised on the occurrence of a specified event that would cause the continuing proprietors to seek to acquire the interest of the outgoing proprietors;[26]

- the option relates to underlying land on which the assignee who is authorized to do residential building works under the *Home Building Act* 1989 (NSW).

The exemption does not apply to the duty otherwise payable under s 9B: s 111(2) of the Duties Act.

8.6 Valuing Option Deeds

In former *Ruling SD130,* the Chief Commissioner discusses the question of the valuation of options for the purposes of calculating stamp duty under s 40A of the *Stamp Duties Act* 1920 (NSW).

The ruling notes that an option agreement granted for consideration will be assumed to have been made at arm’s length unless on its face the option agreement shows to the contrary or the lodging parties disclose such a relationship. The ruling continues:

[26] That is, insurance to permit business partners to buy out each other.

(5) The value of an option will be the amount by which the value of the property over which the option is grated exceeds the expressed exercise price. If there is no difference, or the exercise price exceeds the property value, the option will be taken to have a nominal value.

(6) Should the exercise price be lower than the value of the property over which the option is granted, duty will be assessed on the amount of consideration **or** the difference between the expressed exercise price and the value, whichever is the greater.

While the value of an option will approximate the difference between the value of the property over which the option is granted and the exercise price, that difference will rarely give the true value of the option. Other factors that need to be considered would be the prospective profit that an arm's length purchaser acquiring the property might make, but more significantly, the period over which the option is capable of exercise and the expected growth in the value of the property over that period. The value of an option exercisable in the future will be depended upon the prospective valuation of that property at the time the option is exercised: cf *Donaldson v Commissioner of Taxation* [1974] 1 NSWLR 627.

There are no rulings made under the Duties Act for the purposes of valuing options; *Revenue Ruling DUT 12* considers evidentiary requirements for dutiable transactions but it does not address options specifically.

8.7 Income Tax and CGT and Options Deeds

If a taxpayer is sufficiently involved in property development, or investing, that they derive income from the activity, as opposed to holding that property on capital account, any income derived from the use of option deeds would be assessable income.

However, if the taxpayer is holding the option deeds (and indeed, and underlying property) on capital account there will be two specific CGT Events that occur in relation to the option deeds.

On the creation of rights, such as when the option is granted, or the extension or renewal of a previously granted option, in relation to real property CGT Event D2 will occur: s 104-35 of the *Income Tax Assessment Act* 1997 (Cth) (the '**1997 Act**'). This will occur even if the grantor of the option does not own the underlying property at the time of the granting the option. There will be a capital gain from the CGT Event D2 if the capital proceeds exceed the expenditure incurred in allowing the event to occur. No general discount in Division 115 of the 1997 Act is available for the happening of CGT Event D2: s 115-25(3) of the 1997 Act.

If an option expires without being exercised CGT Event C2 will happened: s 104-25 of the 1997 Act. This can only occur the lapse or effluxion of time; it cannot occur by voluntary termination: *Taxation Determination TD* 1999/76.

8.8 GST and Option Deeds

It is convenient to discuss GST generally before considering a particular problem of option deeds in a property context when applying the GST provisions.

8.8.1 General GST Approach to Option Deeds

If someone is granted a right or option to acquire something, including real property, that is a supply. If the option is later exercised, that is a further supply. The amount paid, if any, for each supply is separately treated.

This means, for example, that the second supply is not subject to GST unless there is an extra amount payable on the exercise of the option: s 9-17 of the GST Act.[27]

GST will also potentially apply where an option is assigned or renewed for consideration, but apparently not where the option simply expires.

If the supply is GST-free the supply of a right to that supply is itself GST-free. Similarly, if a supply is input taxed, the supply of a right to that supply is itself input taxed: s 9-30 of the GST act. See here *Interpretative Decision* ID 2005/182, *Interpretative Decision* ID 2005/183 and *Interpretative Decision* ID 2005/184.

Whether the supply is a taxable supply will depend on the circumstances. The supply of a right to receive a taxable supply (e.g. commercial property) is itself taxable if it meets the usual requirements as to consideration, connection with Australia et cetera.

8.8.2 Margin Scheme Problem

A significant issue for the use of option deeds is how the margin scheme in Division 75 of the GST Act applies to their use.

The Commissioner of Taxation's view is that any amount paid for the option (that is, the option fee) is not part of the costs of acquisition of the land if the option is ultimately exercised. Therefore any application of the margin scheme does not include the amount paid for the option itself. See s 75-10(2) of the GST Act.

In *Goods and Services Tax Ruling GSTR* 2014/2 the Commissioner of Taxation uses the following example:

> 2. *Martin is registered for GST and for a fee of $22,000 he grants a call option to SlamRock Constructions (SlamRock) to purchase vacant land for $660,000 (exclusive of the call option fee).*

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[27] It should be noted that this does not apply to certain redeemable vouchers, which issue is not further relevant to this paper.

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3. *SlamRock exercises the call option and pays $660,000 for the purchase of the land. Martin and SlamRock agree in writing that the margin scheme is to apply to the supply of the vacant land.*

4. *The supply of the call option and the supply of the vacant land are two separate taxable supplies and as a consequence of subsection 9-17(1), the consideration for the supply of the vacant land is limited to any consideration provided in addition to the call option fee. This means that the consideration for the supply of the call option is the fee of $22,000 and the consideration for the vacant land is $660,000.*

5. *SlamRock constructs six strata titled residential units on the vacant land. Once the development is complete, SlamRock makes taxable supplies of the six new residential premises to various third party purchasers who agree that the amount of GST is to be worked out under the margin scheme. One of these units is purchased by Sandy for $550,000.*

6. *In order to work out the amount of GST on the supply to Sandy, section 75-10 states that the amount of GST on the supply is 1/11th of the margin, which is the amount by which the consideration for the supply exceeds the consideration for the acquisition of the interest, unit or lease.*

7. *Under paragraph 75-15(2)(a), the consideration for the acquisition is the corresponding proportion of the consideration provided to Martin by SlamRock for the purchase of the vacant land that is applicable to the sale of the unit to Sandy. As there are six residential units, SlamRock decides that it is reasonable that the relevant proportion of the consideration for the acquisition will be $110,000.*

8. *Therefore the calculation for the amount of GST on the supply to Sandy is as follows:*

$550,000			
- $110,000			
$440,000	x	$1/11^{th}$	= $40,000

9. *The total amount of GST payable on the supply to SlamRock is $40,000.*

10. *Under section 75-20, SlamRock is not entitled to input tax credits relating to the acquisition of the land as it was acquired under the margin scheme. SlamRock is however entitled to an input tax credit of $2000 relating to the acquisition of the call option.*

There is a net benefit if the seller of the option was also registered for GST, as the GST on the option fee can be claimed as an input tax credit. But this can only arise if the option is acquired from an option holder, rather than if granted by the vendor, as where the vendor of land is registered for GST and an input tax supply is claimed the margin scheme provisions are not available.