

# Revenue Rulings

## Lease Provisions - Meaning of 'Consideration'

### Revenue Ruling DA.053

Ruling history	
Ruling no.	DA.053
Status	Current
Issued date	November 2010
Replaces	-
Dates of effect	
From	21 November 2008
To	-

#### Preamble

The Duties Act 2000 (the Act) was amended with effect from 21 November 2008 to ensure that certain leasing arrangements concerning land in Victoria are not used as a mechanism to avoid duty.

Under sections 7(1)(b)(v) and (va) of the Act, duty is payable on the grant, transfer or assignment of a lease if consideration (other than the rent reserved on the grant of the lease) is paid or agreed to be paid in respect of the lease or in respect of:

- a) a right to purchase the land or a right to a transfer of the land;
- b) an option to purchase the land or an option for the transfer of the land;
- c) a right of first refusal in respect of the sale or transfer of the land;
- d) any other lease, licence, contract, scheme or arrangement by which the lessee, transferee or assignee, or an associated person of the lessee, transferee or assignee, obtains any right or interest in the land that is the subject of the lease other than the leasehold estate.

In determining the duty payable on a dutiable transaction concerning a lease referred to in sections 7(1)(b)(v) and (va) of the Act, section 20(3) provides that the dutiable value is the greater of –

- (a) any consideration (being the amount of a monetary consideration or the value of a non-monetary consideration) other than rent reserved that is paid or agreed to be paid; and
- (b) the unencumbered value of the land that is subject to the lease.

The purpose of this Ruling is to provide guidance on the meaning of the term 'consideration' under sections 7(1)(b)(v) and (va) of the Act and to explain what factors the Commissioner of State Revenue (the Commissioner) will take into account in determining whether consideration has been paid or agreed to be paid for the purposes of the provisions. The Ruling also provides a number of examples on what will and will not constitute consideration for the purposes of the provisions.

For guidance on the general application of the lease provisions, please see Revenue Ruling DA-052. For information on the types of payments that may qualify as payments of rent, please see Revenue Ruling DA-050.

#### Ruling

The term 'consideration' is not defined in the Act. There is, however, an abundance of authority which shows that in a stamp duty context the word has a broad meaning and includes all things that a party would receive in order to move a transaction. In the context of the lease provisions, the term refers to all monetary or non monetary consideration, which is consistent with the reference in section 20(3) of the Act to 'monetary consideration and the value of a non-monetary consideration' in determining the dutiable value of a lease referred to in sections 7(1)(b)(v) and (va) of the Act.

The provision of non-monetary consideration can include covenants given by a lessee to a lessor (or an associated third party) under the terms of a lease or a separate but connected agreement to the lease. Often these covenants are provided to secure the right to use the land under the lease and will have nil or nominal value. However, covenants can have a significant value where they require the lessee to undertake substantial works to improve the land and those improvements become the property of the lessor at the end of the lease. For example, where a lease requires a lessee to fit out the premises or to construct other improvements on the premises such that the improvements will become the property of the lessor at the end of the lease, the value of the improvements may be regarded as consideration.

In determining whether any covenant given in respect of the grant, transfer or assignment of a lease or a right or option to acquire the underlying land constitutes consideration for the purposes of the relevant provisions of the Act, the Commissioner will have regard to the following factors –

- a) the nature and circumstances of the transaction as a whole, including the rights, obligations and responsibilities of the parties to the transaction (whether contained in one or more agreements);

- b) the value of the covenant (in terms of its benefit to the lessor and/or cost to the lessee, including associated persons of the lessor and lessee) relative to the value of the underlying land;
- c) whether the covenant imposes a positive obligation on the lessee to make improvements to the land which is the subject of the lease or is merely a permissive right subject to the consent of the landlord;
- d) where a covenant requires the lessee to make improvements, the nature of the improvements and whether they will yield a long-term enduring benefit to the lessor or are merely made to allow the lessee to fully use and enjoy the land for the permitted purpose during the lessee's tenancy;
- e) the rent payable under the lease and whether it is at a market rate; and
- f) the term of the lease.

Where covenants are the subject of a separate agreement the Commissioner will have regard to whether there is adequate consideration supporting the mutual promises and obligations of the parties and whether any part of the consideration and/or the covenants can be or should be construed as consideration in respect of the leasing arrangement. Where the covenants are not supported by adequate consideration it is likely that the Commissioner will regard the value of the covenants as consideration for the lease arrangement.

Where a lease permits, but does not require, a lessee to modify or improve the leased premises for its use and enjoyment, the value of the modifications/improvements would generally not be regarded as consideration for the lease even if the terms of the lease provide that the modifications/improvements become the lessor's property on expiration of the lease. Similarly, 'make good' payments on the conclusion of a lease will generally not be regarded as consideration under the lease provisions.

If an arrangement provides a positive obligation on the lessee to make improvements to the leased premises and the improvements are to become the lessor's property on expiration of the lease it is more likely that the covenant concerning those improvements would constitute consideration for the lease. In determining whether such a covenant constitutes consideration for the grant of a lease, the Commissioner will consider the likely value of the improvements on expiration of the lease. If the value of the improvements on expiration of the lease is negligible the covenant requiring the lessee to make the improvements would generally not be regarded as consideration for the lease. A reversion date that is in the distant future will ordinarily reduce the value of the works or improvements to the lessor and therefore the likelihood of them constituting consideration for the lease.

The Commissioner recognises that circumstances may arise in which it would be inappropriate to treat valuable covenants made by a lessee under a lease as consideration. One such case involves a bona fide security arrangement. For example, the Commissioner would not regard as consideration the provision of finance by a mortgagee in consideration of the grant of a mortgage of a leasehold estate where the mortgage occurs by way of the transfer or assignment of an unregistered lease of Victorian land or by way of the grant of a sub-lease. In each case, the financier's interest in the leasehold estate is subject to the mortgagor's right to have the leasehold estate reconveyed to it or the sub-lease terminated upon repayment of the secured moneys.

The following examples illustrate what constitutes consideration under the lease provisions. Examples 1, 2 and 3 are situations where the Commissioner would consider there to be consideration under the lease provisions. Examples 4, 5 and 6 are situations where the Commissioner would not consider there to be consideration under the lease provisions.

#### **Example 1 – Payment of premium**

ABC is the owner of a rundown inner city office building valued at approximately \$10 million. XYZ has approached ABC with a view of securing exclusive possession of the property in order to renovate the building and sub-lease the various floors. ABC agrees to grant XYZ a 99 year peppercorn lease over the building in return for XYZ paying \$10 million to a party associated to ABC. Despite the payment not being made directly to ABC, it nevertheless would constitute consideration for the grant of the lease.

#### **Example 2 – Assumption of debt liabilities**

ABC is a commercial development company which holds significant levels of debt. XYZ is interested in buying or securing a favourable long term lease over one of the retail properties owned by ABC. In consideration of ABC granting a favourable long term lease over the retail property, XYZ agrees to assume the liability under a loan facility held by ABC valued at \$5 million. Although XYZ has not made a monetary payment for the granting of the lease, the Commissioner would consider the assumption of the liability as consideration for the grant of the lease.

#### **Example 3 – Positive covenant to undertake major capital works**

ABC is under financial distress and the owner of a vacant CBD site which has received planning approval for a 20 level office and residential tower development. ABC's only major asset is the land which has been valued at \$10 million. XYZ is a developer and has agreed with ABC to construct the tower at its own cost. Under the arrangement, ABC is to grant XYZ a 199 year peppercorn lease over the land. In return, XYZ will grant to a subsidiary of ABC a sub-lease over three floors of the development upon its completion. The terms of the sub-lease are similar to the head lease

in that it is for a period of 199 years (less one day) at an annual peppercorn rental. On expiry of the lease arrangements, all the improvements which are required to be maintained by XYZ are to revert to ABC. The present value of the rent that the subsidiary of ABC will be able to generate from its sub-lease of three floors on completion of the tower has been valued at approximately \$10 million. Whilst the anticipated reversion date of the head lease is far in the future, the requirement on XYZ to maintain the building ensures that it would have more than a nominal value on expiration of the head lease. Accordingly, the covenant to fund, build and maintain the tower may be regarded as constituting consideration for the grant of the lease. In any event, the covenant by XYZ to grant a subsidiary of ABC a sub-lease over three floors of the development on its completion would be regarded as valuable consideration for the grant of the head lease.

#### **Example 4 – Sale of business**

ABC conducts a manufacturing business on premises which are leased from DEF under the terms of a standard commercial lease. The lease does not provide ABC with any rights to acquire the property in the future whether by way of transfer, option or right of first refusal. ABC enters into a business sale agreement with XYZ to transfer or assign all of the assets of the manufacturing business, including the commercial lease of the premises upon which the business is conducted. Under the business sale agreement the purchase price has been apportioned between the business assets and, to ensure the enforceability of the arrangements between the parties, nominal consideration of \$1 has been allocated to the assignment of the commercial lease of the premises. In such circumstances, the Commissioner would not consider there to have been consideration paid for the assignment of the lease as it is recognised that the nominal sum allocated to the assignment is solely for the enforceability of the arrangement.

#### **Example 5 – Positive covenant to undertake minor capital works**

ABC is the owner of a double fronted shop, with an approximate value of \$1 million. XYZ wishes to lease half the site to establish a café business. ABC agrees to grant XYZ a standard commercial lease over half the site on the condition that XYZ contributes 50% of the costs (capped to \$10,000) to construct a partition between the two shop fronts. A standard commercial lease is executed by the parties reflecting the above arrangement and the fact that the improvements are not tenant's fixtures and are the property of ABC. Given the nature and value of the improvements relative to the value of the land, the Commissioner would regard XYZ's cost contribution not to be consideration for the grant of the lease but rather a payment for and in connection with its intended use of the land.

#### **Example 6 – Arrangements where lessee may undertake works**

ABC owns a CBD site valued at approximately \$1 million. XYZ wishes to acquire the site as an outlet for its successful designer label retail business. ABC agrees to grant XYZ a 10 year standard commercial lease over the site. Under the lease, XYZ may after obtaining the consent of ABC carry out structural works, improvements and modifications to the premises. Upon the grant of the lease, XYZ seeks and obtains ABC's consent to undertake a fit out of the premises. The purpose of the fit out is to bring the premises in line with all other high end retail outlets run by XYZ and its chain of operators. The fit out is estimated to cost \$100,000 and will revert to ABC on the expiration of the lease unless XYZ decides or is directed by ABC to remove the works. It is expected that value of the fit out will be nominal on the expiration of the lease and not removed by XYZ unless directed by ABC. Given this and the fact that the grant of the lease was not made conditional on XYZ undertaking the fit out, the Commissioner would not regard the fit out as constituting consideration for the grant of the lease.

The above examples and considerations are provided as a guide only and are not an exhaustive list of the matters or factors the Commissioner may consider in determining the application of sections 7(1)(b)(v) and (va) of the Act. A taxpayer who is uncertain of the application of these provisions to their particular circumstances may apply to the Commissioner for a private ruling in accordance with the guidelines set out in Revenue Ruling GEN-009. In each case, the onus is on the taxpayer to provide the Commissioner with the necessary information to make an informed decision as to whether the grant, transfer or assignment of a lease is a dutiable transaction under Chapter 2 of the Act.

**Please note that rulings do not have the force of law. Each decision made by the State Revenue Office is made on the merits of each individual case having regard to any relevant ruling. All rulings must be read subject to Revenue Ruling GEN-001.**