

Revenue Rulings

Lease Provisions - General Application

Revenue Ruling DA.052

Ruling history	
Ruling no.	DA.052
Status	Current
Issued date	August 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.

Under section 7(1)(b)(ii) of the Act, duty is also payable on the surrender of a lease of the kind referred to in the above provisions.

A 'lease' is defined in section 3 of the Act to mean 'a lease of land in Victoria or an agreement for a lease of land in Victoria'. The term 'land' is defined in section 38 of the *Interpretation of Legislation Act 1984* to include buildings and other structures permanently affixed to land, land covered with water, and any estate, interest or right in or over land.

The purpose of this Ruling is to provide guidance on the operation of the lease provisions and to outline the factors the Commissioner will take into account in determining their application. The Ruling also provides a number of examples to illustrate the application of the provisions to certain common situations involving leases.

Ruling

When will the lease provisions apply?

The lease provisions are designed to apply to arrangements by which a lease of land in Victoria is used to effectively transfer rights in the underlying land and/or the economic benefits of the land, similar to a sale and purchase transaction.

Accordingly, the lease provisions can apply irrespective of the form and terms of a lease and whether it concerns land used for commercial or residential purposes in Victoria and/or is a sub-lease or concurrent lease of such land. The provisions can also apply even if the leasing arrangement arises because of statutory, planning or other restrictions on a dealing in the freehold.

Nevertheless, the provisions will only apply where consideration is paid or agreed to be paid in respect of a leasing arrangement under which the lessee, transferee, assignee or any associated person acquires valuable rights and/or benefits in relation to the underlying land. Typically, such rights and benefits may include the right to acquire, develop and sub-lease the underlying land and/or to receive the rents and profits of the land or any development on it. Where such rights and benefits are obtained under a leasing arrangement, they are considered equivalent to the rights and benefits that would be obtained by a purchaser of the land over the term of the lease. The consideration paid, or agreed to be paid, is for the acquisition of these valuable rights and is in contrast to the rent payable under the lease, which is often minimal.

For a liability to arise in respect of a leasing arrangement under which market rent is payable, consideration needs to be paid for the acquisition of rights and/or benefits in relation to the underlying land over and above the right to use and occupy the land for the term of the lease. However, for a lease under which less than market rent is payable, the right to use and occupy the land may be sufficient to subject the arrangement to duty, provided consideration is paid or agreed to be paid in respect of the arrangement. Ultimately, this will depend on the nature of the lease and the extent to which it vests economic benefits in the lessee, transferee, assignee or an associated person.

Consistent with the policy intent of the lease provisions, the liability of a transfer or assignment of a lease referred to in section 7(1)(b)(v) of the Act will be determined with reference to the application of section 7(1)(b)(va) of the Act. Generally, it would not be regarded as a transfer of dutiable property under section 7(1)(a) of the Act unless it is a transfer or assignment of a Crown leasehold estate as defined in section 3 of the Act.

What factors will the Commissioner take into account in determining the application of the lease provisions?

In determining whether a leasing arrangement is dutiable under sections 7(1)(b)(v) and (va) 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;
- b) the nature and value of the rights and benefits acquired under the leasing arrangement, including the ability of the lessee, transferee, assignee or an associated person to generate profit rental from the underlying land or otherwise receive the rents and profits of the land;
- c) the consideration paid or agreed to be paid in respect of the lease or in respect of a right to acquire the underlying land relative to the value of land;
- d) the rent payable under the lease and whether it is at a market rate; and
- e) the term of the lease and the ability of the lessee, transferee or assignee to extend, renew or continue in its possession of the land.

When will the lease provisions not apply?

As the lease provisions are designed to apply to arrangements by which a lease is used to effectively transfer valuable rights in the underlying land and/or the economic benefits of the land, they will not apply to ordinary commercial and residential leases which only require the payment of rent. For information on what types of payments may qualify as payments of rent, please see Revenue Ruling DA-050.

Generally, the lease provisions will also not apply to a transfer or assignment of an ordinary commercial lease for which nominal consideration is paid as part of a bona fide sale of a business which is conducted on the leased premises. In such circumstances, it is recognised that a nominal sum of money may be attributed to the transfer or assignment of the lease purely for the enforceability of the arrangement between the parties. Consistent with the policy underlying the lease provisions, a transfer or assignment of a lease in these circumstances would generally not be regarded as being used to effectively transfer rights in the underlying land. It should be noted however that this position may not apply where the lease includes a right to acquire the property during the term or on expiry of the lease.

Exemptions, concessions and exclusions

The Act sets out numerous exemptions, concessions and exclusions from the application of the lease provisions. These include –

- a) Section 7(3AA) which excludes from the operation of the Act the grant, transfer, assignment or surrender of a lease creating or giving rise to a residency right in a retirement village within the meaning of the *Retirement Villages Act 1986*.
- b) Section 7(3AAB) which excludes from the application of the lease provisions a lease granted as a result of the exercise of an option for a further term where the option was provided for by a lease which was granted before 21 November 2008 and the lease required the payment of consideration for the exercise of the option.
- c) Sections 32Y, 38B, 41B, 50B, 57G(2) and 58(3) which ensure that all the existing exemptions and concessions applicable to dutiable transactions under Chapter 2 of the Act apply in respect of the lease provisions.
- d) Section 49 which exempts from duty the grant, transfer, assignment or surrender of a lease for a site, or a site and a caravan, in a caravan park registered in accordance with the regulations made under section 515 of the *Residential Tenancies Act 1997*, provided a caravan is located or to be located on the site and is used or intended to be used as the principal place of residence of the lessee or intended lessee, and
- e) Section 57 which exempts from duty the transfer of land to a lessee, transferee or assignee or the enlargement of a term into fee simple under section 153 of the *Property Law Act 1958*, provided duty was paid under the lease provisions in respect of the grant, transfer or assignment of a lease over the land.

When is duty payable?

Duty is payable within 3 months of the occurrence of a dutiable transaction in respect of dutiable property.^{FN1} A dutiable transaction in respect of a lease occurs upon its grant, transfer, assignment or surrender. Under the Act, a dutiable transaction in respect of a lease is chargeable with duty on the greater of the amount of the consideration paid or agreed to be paid and the unencumbered value of the land that is subject to the lease.

The grant, transfer or assignment of a lease for which consideration has been paid or agreed to be paid in respect of a right or option to acquire the underlying land is dutiable at the time of grant, transfer or

^{FN1} The *State Taxation Acts Further Amendment Act 2011* amended the *Duties Act 2000* to provide that the period for payment of duty for dutiable transactions and relevant acquisitions occurring on or after 1 April 2012 is within 30 days after the liability to pay the duty arises.

assignment irrespective of whether such right or option has been exercised at that time. However, where additional consideration equivalent to the full unencumbered value of the land is required to be paid upon or following the exercise of the right or option, the Commissioner will generally only require the lessee, transferee or assignee to pay the duty liability if and when the right or option to acquire the land has been exercised. In such circumstances, it is considered that the lessee, transferee or assignee has not acquired valuable rights in the land equivalent to ownership and will only do so upon the exercise of the right or option and payment of the full purchase price of the land. If a lessee, transferee or assignee elects to pay duty in accordance with this concession, interest at the market rate only may be payable under the arrangement.

In all other cases (where additional consideration less than the full unencumbered value of the land is payable on the exercise of the right or option), duty will be payable at the time of the grant, transfer or assignment of the lease on the greater of the consideration paid or the unencumbered value of the land. Where full duty has been paid on a lease, any subsequent transfer of land to the relevant lessee, transferee or assignee would not be separately chargeable with duty.

Examples on the application of the lease provisions

The following examples illustrate the application of the lease provisions to certain common situations involving leases. Examples 1, 2 and 3 are situations where the Commissioner would regard the lease provisions as being applicable. Examples 4, 5 and 6 are situations where the Commissioner would regard the lease provisions as not being applicable. Examples 7 and 8 illustrate the application of exemptions under the Act and examples 9 and 10 consider the timing of when duty is payable.

Example 1 – Grant of long term lease

ABC is the owner of prime CBD real estate including an office tower, which is run down and in need of refurbishment. XYZ, a development company, wishes to acquire the property, refurbish the office tower and lease out the various floors. Instead of acquiring the freehold, which has an estimated market value of \$10 million, XYZ takes a long term lease of the property from ABC in consideration of the payment of a premium of \$10 million and at an annual rent of \$10. Under this arrangement, XYZ has acquired the right to develop the property and receive all the rents and profits from the land and its development for the duration of the lease. As consideration equivalent to the value of the property was paid to ABC for the lease, the grant of the lease to XYZ would attract duty on the basis of a value of \$10 million.

Example 2 – Transfer of sub-lease over alpine ski resort apartment

ABC is the lessee under a lease of land at Mount Hotham upon which a ski resort, including ten residential apartments, is located. ABC operates the ski resort and has entered into ten sub-leases of the

property, comprising the residential apartments, to various sub-lessees, including X, who acquired his lease prior to the commencement of the lease provisions.

The sub-lessees do not acquire shares in ABC, so the arrangement is not a land use entitlement. Y wishes to acquire an apartment in Mount Hotham for use as a holiday home and pays

X the sum of \$500,000 for a transfer of X's sub-lease, which has 30 years to run with no obligation to pay rent other than to make contributions in respect of certain taxes, charges and maintenance expenses associated with the property. The transfer of the sub-lease from X to Y is dutiable under the lease provisions as it effectively vests ownership of the apartment in Y for the next 30 years.

Example 3 – Grant of concurrent lease

ABC is the lessor and XYZ is the lessee under a standard commercial lease under which only market rent is payable. The term of the lease is ten years coupled with nine options for XYZ to renew for a further ten years. As such, the lease could potentially run for 100 years. ABC grants a concurrent lease to DEF under which DEF effectively stands in the shoes of the lessor, ABC. The consideration in respect of the grant of the concurrent lease is \$10 million, which reflects the net present value of the income stream from the property in perpetuity. The grant of the concurrent lease would be dutiable under the lease provisions as it effects a sale and purchase of the economic benefits (i.e. the right to receive all the rents and profits) of the land in perpetuity between ABC and DEF.

Example 4 – Grant of lease for consideration in addition to rent reserved

ABC is the owner of land in the CBD with a market value of \$5 million which has been refurbished for use as a pub. ABC has advertised the premises as available for lease and has been inundated with offers. One such offer is from XYZ which has offered a premium of \$100,000 to secure a lease over the property in addition to the payment of market rent. Having accepted XYZ's offer, ABC grants XYZ a standard commercial lease for a period of seven years with two options for further terms of seven years. Under the lease, XYZ does not obtain any rights or benefits in relation to the underlying land other than the right to use and occupy the land. Ordinarily, the grant of a lease for consideration other than rent reserved would be dutiable under the lease provisions. However, consistent with the policy underlying the lease provisions, the grant of the lease in this example will not be chargeable with duty. Despite consideration being paid, XYZ has not obtained valuable rights or benefits in relation to the land other than the right to exclusive possession. When regard is had to the transaction as a whole including the consideration paid relative to the market value of the land, it is apparent that XYZ has paid the premium to secure the right to use and occupy the premises over the term of the lease. In such circumstances, the Commissioner would regard the premium as a payment for the use of the land.

Example 5 – Transfer of lease on 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, consideration of \$1 has been allocated to the assignment of the commercial lease of the premises. As only nominal consideration has been paid in respect of a lease which does not provide the lessee with any valuable rights and benefits in relation to the land other than the right to use and occupy the land at a market rate of rental, the assignment of the lease from ABC to XYZ would not be dutiable under the lease provisions.

Example 6 - Surrender of old lease and grant of new lease

ABC owns a shopping centre and has granted a lease of one of its shops to XYZ. Other than the rent reserved, XYZ has not paid or agreed to pay any consideration in respect of the grant of the lease. Due to the expansion of another tenant, ABC requests XYZ to relocate to a new shop within the centre. To induce XYZ to move, ABC agrees to pay XYZ \$10,000 in relocation expenses. Having accepted the relocation, XYZ surrenders the lease over the old shop and accepts a grant of a lease over the new shop in respect of which it does not pay or agree to pay any consideration other than the rent reserved. The surrender of the old lease is not dutiable as no consideration other than rent reserved was paid or agreed to be paid in respect of its grant to XYZ. Similarly, the grant of the new lease to XYZ is not liable to duty. In such circumstances, the Commissioner would not regard the payment to XYZ of \$10,000 in relocation expenses as consideration in respect of the grant of the new lease.

Example 7 – Sale and transfer of lease between spouses

Mr X owns an alpine ski resort apartment under a long term lease which does not require the payment of rent. The market value of the apartment is \$500,000. Mr X transfers the lease over the apartment to his wife in return for the payment of \$500,000. Provided no other person takes or is entitled to take an interest in the property under the transfer of the lease to Mrs X, it is exempt from duty under section 43 of the Act as it is a transfer of dutiable property between spouses.

Example 8 – Grant of lease on sale of a caravan park site

ABC owns land on which it operates a registered caravan park. ABC grants a lease of one of the caravans and caravan sites to X in consideration of the

payment of a premium. X occupies the caravan and the caravan site as his principal place of residence. The grant of the lease to X is exempt from duty as X occupies the site as his principal place of residence.

Example 9 - Lease with an option to purchase land for consideration equivalent to full market value during or on expiry of lease

ABC is the lessor of land valued at \$5 million. XYZ wishes to establish and conduct a manufacturing business on the premises. This will require XYZ to expend a considerable sum on plant and equipment so XYZ agrees, in addition to rent reserved, to pay consideration by way of a premium of \$5,000 to ABC for an option to purchase the premises at the conclusion of the lease in five years time. Upon exercise of the option XYZ is required to pay to ABC consideration equivalent to the full market value of the land when the option is exercised. In these circumstances, the Commissioner will allow XYZ to defer payment of duty until the option to purchase is exercised. If the duty (including any applicable interest) is paid on the lease when the option to purchase is exercised, the subsequent transfer of land from ABC to XYZ will not be separately chargeable with duty.

Example 10 - Lease with a right to acquire land for less than market value during or on expiry of lease

ABC leases land with a market value of \$1.5 million to XYZ. On the grant of the lease, XYZ paid ABC consideration of \$1 million for the right to acquire the land during the term of the lease or upon expiry of the lease. On the exercise of the right to acquire the land XYZ is only obligated to pay the balance of the unencumbered value of the land, being \$500,000. In these circumstances, duty is payable at the time the lease is granted on the greater of the consideration paid or agreed to be paid and the unencumbered value of the land, being \$1.5 million.

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 the lease provisions. 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, assignment or surrender 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.



August 2010

Commissioner of State Revenue