

premises.²⁶ Of concern is the fact that there is no apparent time limit on how long the change of intention test continues to operate which could effectively result in an additional 7% duty liability arising many years after the initial purchase.

2.2 Land tax surcharge for absentee owners

All property in Victoria is subject to land tax, unless an exemption applies or the property's site value is below the threshold (\$250,000).²⁷ Land tax is assessed annually on the taxable (site) value of all property of an owner as at midnight on 31 December in the preceding year. However, in addition to the general rate of land tax, trustees of trusts generally pay a surcharge and absentee owners are now also liable to a surcharge.

The absentee owner surcharge was introduced into the Victorian *Land Tax Act* 2005 (**LTA**) on 1 January 2016 and currently imposes an additional surcharge of 1.5% on all non-exempt land owned by an absentee owner.²⁸

2.2.1 Who is an 'absentee owner'?

Section 3(1) of the LTA defines an absentee owner as an absentee person who is an owner of land. Absentee person in turn is defined as either:

- a) *A natural person absentee;*
- b) *An absentee corporation; or*
- c) *A trustee of an absentee trust.*

A 'natural person absentee' is defined as meaning a natural person who is not an Australian citizen or resident and –

- a) *Who does not ordinarily reside in Australia; and*
- b) *Who –*
 - i) *was absent from Australia on 31 December in the year immediately preceding the tax year; or*

²⁶ *Duties Act* 2000, s 18A.

²⁷ *Land Tax Act* 2005, Sch 1, Part 1, Table 1.4.

²⁸ see *Land Tax Act* 2005, Sch 1, Part 4, Table 4.2 and in the case of absentee trusts, Sch 1, Part 5, Table 5.2.

ii) in the year immediately preceding the tax year, was absent from Australia for a period of at least 6 months or for periods that when added together equal a period of at least 6 months.

Further, an 'absentee corporation' is defined in section 3(1) of the LTA as meaning a corporation that is incorporated outside Australia or in which an absentee person has an absentee controlling interest. According to section 3A of the LTA, an absentee person will have an 'absentee controlling interest' in a corporation if:

- a) they alone or acting together with another absentee person, can control the composition of the board of the corporation; or*
- b) they alone or acting together with another absentee person, are able to cast or control the casting of more than 50% of the maximum number of votes that might be cast at a general meeting of the corporation; or*
- c) they alone or acting together with another absentee person, hold more than 50% of the issued shares in the corporation.*

In determining whether a person has such an interest, the Commissioner will also consider the entitlements attaching to shares issued to the person including any rights or powers attached to those shares that either expand or limit the right to participate in a distribution of profits or capital.²⁹ Notwithstanding the above, a person will be taken not to hold such a controlling interest if they hold an exemption issued by the Treasurer.³⁰ According to the State Revenue Office website, 'the exemption is intended to apply to those corporations which conduct a legitimate commercial operation in Australia and whose commercial activities make a strong and positive contribution to the Victorian economy and community by engaging local labour and using local materials and services through an Australian based entity.'³¹ The Treasurer has also issued guidelines outlining the basis on which

²⁹ *Land Tax Act 2005*, s 3A(2).

³⁰ *Land Tax Act 2005*, s 3B(1).

³¹ State Revenue Office website, <http://www.sro.vic.gov.au/absentee-owner-surcharge> retrieved on 23 October 2017.

exemption decisions are to be made and these can be found and should be referred to prior to lodging any exemption application.³²

An absentee person also includes the trustee of an absentee trust which is defined in section 3(1) of the LTA as a trust under which at least one absentee beneficiary—

- a) has a beneficial interest in land subject to a fixed trust; or*
- b) is a unitholder in a unit trust scheme; or*
- c) is a specified beneficiary of a discretionary trust.*

Significantly, the definition of absentee trust is much narrower than the definition of foreign trust in the Duties Act discussed above. Whereas the definition of beneficiary under a foreign trust potentially captures all beneficiaries under a discretionary trust, the equivalent definition (of absentee trust) in the LTA is limited to specified beneficiaries only. This is necessary as it is possible that nearly all trusts have at least one foreign general beneficiary which would result in most if not all discretionary trusts being subjected to the absentee owner surcharge rate of land tax whilst there existed a foreign general beneficiary.

2.3 Vacant Residential Land Tax

The Vacant Residential Property Tax (**VRLT**) will apply in Victoria from 1 January 2018. The measure has been introduced to help address the lack of housing supply in Victoria and discourage owners from leaving homes unoccupied for extended periods. The VRLT will apply to homes in various municipal council areas in inner and middle Melbourne where those homes were unoccupied for more than six months in the preceding calendar year. This tax will impose an additional tax of 1% of the capital improved value of vacant residential land held by all property owners irrespective of whether they are an Australian or foreign owner.

Further, and something to be mindful of, the State Revenue Office has advised that as details of this new tax were only released in May 2017, homes will be treated as having been occupied from 1 January to 30 April

³²<http://www.gazette.vic.gov.au/gazette/Gazettes2015/GG2015G033.pdf#page=28> from gazette page 1802.

2017 (a period of 4 months) thus requiring properties to be occupied for a further two months between 1 May and 31 December 2017 in order to meet the six-month occupancy test.

4. BEWARE DUTIABLE LEASES

Although there have been no recent changes to the lease provisions in Victoria, the Commissioner has in recent times considered these arrangements more closely and taken a more aggressive approach to imposing duty on leases where valuable fixtures are involved.

Under section 7(1)(b)(v) and (va) of the Duties Act, the granting or assignment of a lease may give rise to a liability to duty on the value of the land the subject of the lease.

The Commissioner has stated that the intention of these provisions is to capture those leasing arrangements whereby a lease is used to effectively transfer valuable rights in the underlying land and/or the economic benefits of the land. This is because, under these arrangements, the lessee acquires rights and benefits effectively equivalent to those obtained when a person acquires the land directly.

Section 7(1)(b)(v) of the Duties Act provides that duty is charged on:

- v) the granting of a lease for which any consideration other than **rent reserved** is paid or agreed to be paid, either 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, license, contract, scheme or arrangement by which the lessee, or an associated person of the lessee,*

obtains any right or interest in the land that is the subject of the lease other than the leasehold estate.

Section 7(1)(b)(va) of the Duties Act provides that duty is charged on:

- va) the transfer or assignment of a lease for which any consideration is paid or agreed to be paid, either in respect of the transfer or assignment 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, license, contract, scheme or arrangement by which the lessee, or an associated person of the lessee, obtains any right or interest in the land that is the subject of the lease other than the leasehold estate.*

'Rent reserved' in relation to a lease is defined in section 3(1) of the Duties Act as meaning the rent paid or payable during the term of the lease and amounts paid or payable for the right to use the land under the lease. Examples of rent reserved are set out in the Act under this definition and include rates, charges, taxes, maintenance, utilities, legal costs required to be paid by the lessee on behalf of the lessor in relation to the grant of the lease, insurance premiums, marketing costs and car park contributions.

The Commissioner looks at leases lodged for assessment very closely in terms of forming a view as to whether the lease is a dutiable lease. As he explains in Revenue Ruling DA.053, the factors he will consider include:

- 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.*

Having regard to the Commissioner's guidance above, there are several key areas to be mindful of when negotiating and drafting leases. The Commissioner often regards very long term leases with minimal rent as prima facie liable to duty. Similarly, where a premium has been paid for the granting of the lease, the lease is likely to be dutiable particularly where that premium appears to reflect the market value of the land the subject of the lease.

It is less clear however, where the lessee is required to undertake improvements on the land prior to the lease being granted. The Commissioner will often look to the value or cost of these improvements and whether the lessee was obligated to make the improvements or merely permitted to do so. This is a fine line as the Commissioner will often conclude that there was an obligation to make the improvements if not making them would have rendered the entire lease arrangement ineffective or otherwise of little value to the parties.

The Commissioner will also have regard to related transactions involving sale of associated assets as he is often mindful to aggregate transactions that artificially separate transfers of fixed assets and associated leases. In this respect, it is important to consider the existence and value of any fixtures on the relevant leased land. Section 22A states that the value of any tenant's fixtures on land are to be included in the value of that land. However, they are not to be included if they are not being sold or transferred to the purchaser. Arguably, in the case of a lease transfer, the tenant's fixtures (being property of the current lessee) are likely to be

also transferred to the transferee of the lease. But there are arguments that can be made both ways.

The correct treatment of leases and fixtures also often arises in the Landholder Acquisition provisions in Chapter 3 of the Duties Act. In Revenue Ruling DA.055, the Commissioner has indicated that if a person makes a relevant acquisition in a landholder whose Victorian landholdings comprise:

- a) only leasehold estates that are not dutiable property, no duty will be payable as the acquisition of the interest is exempt under section 89D(a) of the Duties Act;*
- b) leasehold estates (none of which are dutiable property) and freehold land, duty will be payable with reference to the value of the freehold land only as the concession in section 89E of the Duties Act will apply to exclude the non-dutiable leasehold estates from the duty calculation; and*
- c) leasehold estates (some or all of which are dutiable property) and/or freehold land, duty will be payable with reference to the value of all the landholder's landholdings that would be dutiable on a transfer under Chapter 2 of the Duties Act (both leasehold and freehold estates).*

The Commissioner generally takes the above approach to the imposition of duty on leases indirectly acquired or transferred under the landholder provisions in Chapter 3. However, again, where valuable fixtures are involved, he is likely to form the view that those leases are dutiable leases which include the value of the fixtures thereon. Depending on the nature of the transaction involved, there are arguments that can be made to exclude the value of these fixtures in reliance of section 154A of the *Property Law Act 1958*.

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