# Re-enacted NSW land-rich provisions of concern to small business

*By* LUIS BATALHA

*Luis Batalha is the principal of batallion legal.*

New legislation strengthens and expands anti-avoidance rules for duty on the transfer of interests in certain entities with real estate assets.

NEW LAND-RICH PROVISIONS FOR NSW represent a significant widening of the land-rich duty base. The provisions, which took effect from 14 November 2003, force taxpayers to obtain more frequently valuations of their assets and to investigate closely the asset composition of the entities in which they have interests, even minority interests.

The complete repeal and re-enactment of the provisions followed an announcement by the NSW Government in its 2003-04 Budget that it intended to protect the transfer duty revenue base. However, the changes introduced by the *Duties Amendment (Land Rich) Act 2003* (the Act) have a far greater scope than generally anticipated.

**What is land-rich duty?**

In broad terms, land-rich duty is a type of stamp duty that applies to "relevant acquisitions" of interests in land-rich private companies and private unit trust schemes. In NSW, land-rich duty is charged at rates of up to 5.5 per cent on the transfer of the shares or units on the proportion of the unencumbered value of the underlying land acquired through the acquisition. This can be contrasted to the rate of duty that usually applies to transfers of unlisted shares and units of 0.6 per cent.

**A new focus or a new head of duty?**

The changes introduced by the Act are so extensive that they potentially charge duty on many minority acquisitions of interests in trusts and companies that own interests in land. The amendments to the tracing provisions and the lowering of the thresholds are particularly concerning. Many are likely to see the new provisions as simply a revenue-raising exercise by the NSW Government and the Office of State Revenue – at great cost to taxpayers.

While first introduced as an anti-avoidance measure, the land-rich provisions now take on a new role, taxing, almost generally, dealings in land-owning unit trusts and companies. As amended, the provisions will operate in a broad range of commercial transactions resulting in an increasing need for taxpayers, especially small businesses, to undertake expensive valuations.

**The critical changes**

In summary, the new provisions make six significant changes to the existing land-rich duty model in the *Duties Act 1997* (NSW), namely:

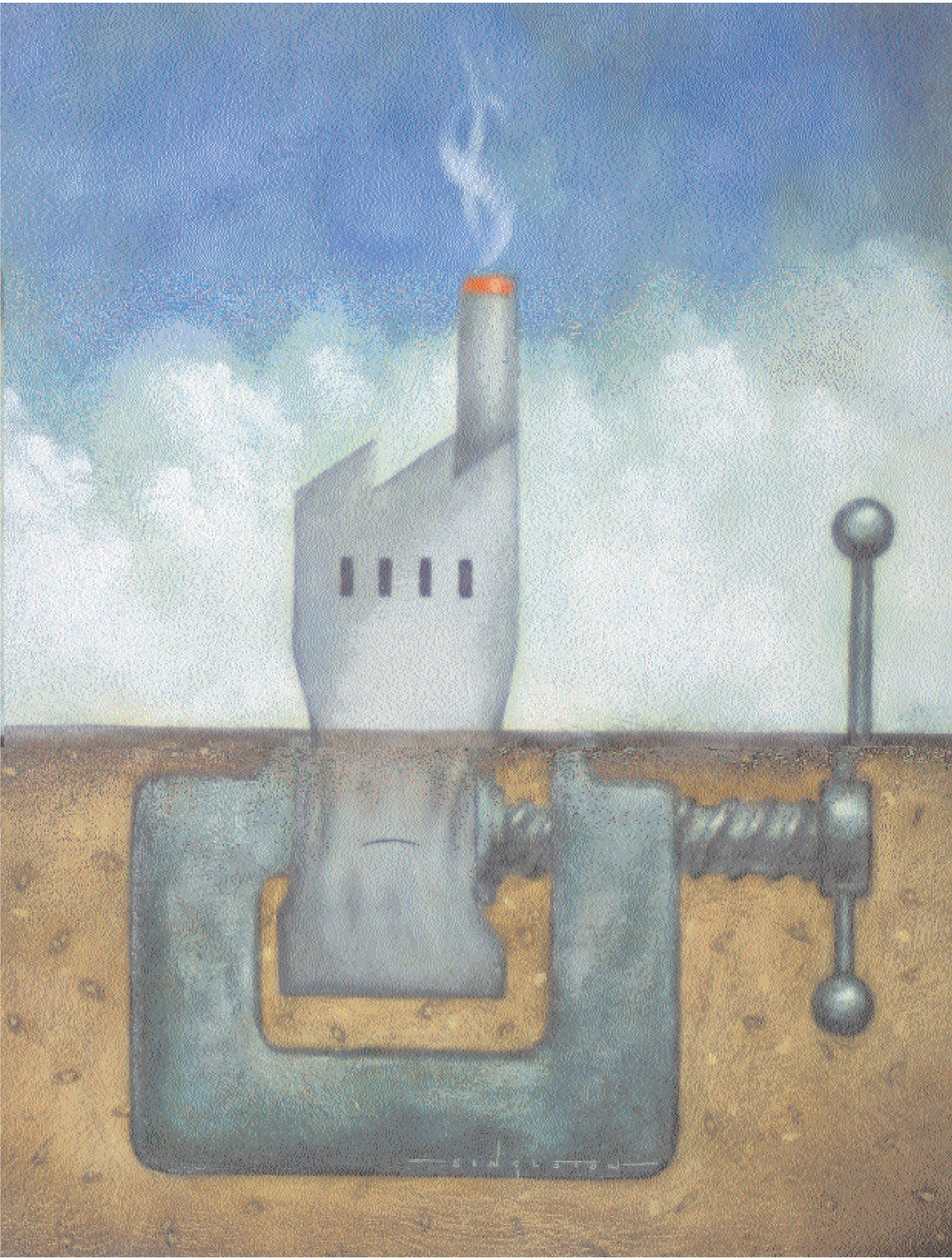
❑ wholesale unit trust schemes are now caught by the provisions;
❑ a tightening of the definition of "public unit trust scheme". Public unit trust schemes are not caught by the provisions;
❑ the threshold tests have changed from $1 million to $2 million and from 80 per cent to 60 per cent;
❑ the trigger for liability to duty has changed from "more than 50 per cent" to "50 per cent or more" for companies and wholesale unit trusts, and to "20 per cent or more" for private unit trust schemes;
❑ it is now possible to trace through subsidiaries and discretionary trusts where there is a mere 20 per cent or greater ownership chain; and
❑ a concession will be introduced for primary producers.

Each of these changes is explained in more detail below.

**Wholesale unit trust schemes now caught by the provisions**

Prior to the amendments, the land-rich

ILLUSTRATION:CAMERON SINGLETON



provisions applied to "private corporations", which included only private companies and private unit trust schemes. However, the Act extends the application of the provisions to wholesale unit trust schemes.

To this end, the Act replaces the use of *private corporation* with the broader concept of *landholder* which is defined to include private companies, private unit trust schemes and wholesale unit trust schemes.

Broadly, a "wholesale unit trust scheme" is a unit trust scheme in which not less than 80 per cent of the units are held by investors who are trustees of certain funds or trusts and in which each such investor holds less than 50 per cent of the units, or a unit trust scheme which it is anticipated will become a wholesale unit trust scheme within 12 months.

**The land-rich test has become $2 million and 60 per cent**

As noted above, two changes have been made to the test for determining whether a landholder is "land-rich". In a win for taxpayers (possibly as a result of submissions made by professional bodies), the unencumbered value of the landholder's NSW land holdings has increased from its current $1,000,000 to $2,000,000. As originally drafted, the Office of State Revenue had intended that the threshold remain the same as the value it was set at in 1987 – that is, $1,000,000. If the threshold had remained at its 16-year-old level and the other proposed changes been made, then this would have greatly increased the compliance burden for taxpayers, but generated only a small amount of duty.

However, in one of a series of wins for the Office of State Revenue, the proportion of the total land holdings of a landholder to the unencumbered value of all its property is reduced from 80 per cent to 60 per cent.

The reduction to 60 per cent represents a critical change to the land-rich provisions and one that should cause concern to small business operators. The reduction to just 60 per cent is likely to mean that many small businesses are now caught by the provisions. As a result of the changes, it won't simply be those trying to avoid transfer duty that will be caught by the provisions but rather any business that has significant land assets. Accordingly, many small businesses, particularly if they are underperforming, are likely to have as their most valuable asset the land or buildings where their business is carried on. As a result of the changes, share and unit transfers in small businesses may be exposed to land-rich duty as opposed to marketable security duty.

Further, while submissions were made by the professional bodies to exclude from the definition of "land", interests in the nature of fixtures, the Office of State Revenue did not accept these submissions.

"… it won't simply be those trying to avoid transfer duty that will be caught by the provisions but rather any business that has significant land assets."

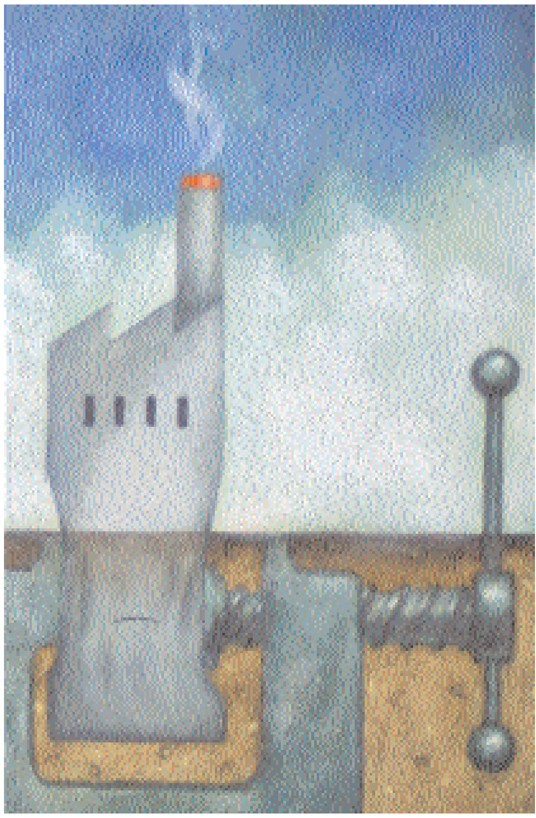
**From more than 50 per cent to 50 per cent or more**

In a significant win for the Office of State Revenue, the Act has replaced the current liability trigger for land-rich duty of an acquisition of a *majority interest*, that is, greater than 50 per cent, with the requirement for the acquisition of a *significant interest* in a landholder.

In broad terms, a significant interest is an entitlement, in the event of a distribution of all of the property of the landholder to:

❑ 20 per cent or more of the property in the case of a private unit trust scheme; or

❑ 50 per cent or more of the property in the case of a wholesale unit trust scheme or private company.



The adoption of the new "50 per cent or more" trigger for wholesale unit trust schemes and private companies is narrower than that found in other Australian jurisdictions, including Queensland. In addition, the replacement of the existing majority interest test for private unit trusts with a "20 per cent or more" test will lead to a significant increase in valuation and other compliance costs for taxpayers. Moreover, taxpayers may find it difficult, if not impossible, to gather the information necessary to determine the asset composition of the entities in which they hold a mere 20 per cent interest. Finally, apart from a general opposition to trusts because of their traditional use as tax minimisation vehicles, it is unclear why from a policy perspective the narrower approach has been taken.

**Tighter definition of 'public unit trust scheme'**

Public unit trust schemes are not caught by the land-rich duty net. Accordingly, the definition of a "public unit trust scheme" is important. Before the amendments, the definition of "public unit trust scheme" included listed trusts and schemes in which:

❑ units in the scheme have been issued to the public;

❑ 50 or more persons are beneficially entitled to units in the scheme; and

❑ more than 20 persons are beneficially entitled to at least 75 per cent of the total units in the scheme.

The Act tightens significantly the definition by requiring that 300 rather than 50 or more persons be beneficially entitled to units in the trust, and that none of those persons (individually or together with associated persons) be entitled to more than 20 per cent of the units in the trust. Originally, the NSW Office of State Revenue had proposed to increase the number of persons to 500, but after submissions from various industry bodies the number was reduced to 300.

**Tracing through subsidiaries and discretionary trusts**

Before the re-enactment of the land-rich provisions, the constructive ownership of land and other property could be traced through a *subsidiary* of a private corporation or through a discretionary trust. These provisions, in so far as they apply to subsidiaries, are replaced with provisions that enable the ownership trail to be traced through *linked entities*. Broadly, an entity will be linked to another entity where, among other things, one entity is entitled to receive not less than 20 per cent of the unencumbered value of the property of the other entity if the other entity were to be wound up. As a threshold, 20 per cent is fairly low and is likely to result in a heavy compliance burden for taxpayers.

**Concession for primary producers**

The Act provides that if a landholder is a primary producer (as defined in the Dictionary to the *Duties Act*) when a relevant acquisition is made and the landholder's land holdings in all places comprise less than 80 per cent of the unencumbered value of all its property, no duty is payable on the acquisition. However, duty will be payable if the landholder ceases to be a primary producer at any time within five years after the relevant acquisition is made.

**Other amendments**

In addition to the main changes discussed above, the Act also introduced the following changes:

❑ In calculating the unencumbered value of a landholder's property, the current duplication of discretions vested in the Chief Commissioner of State Revenue is removed.

❑ The Act provides for the effect of uncompleted agreements for the disposal or acquisition of property other than land. (Previously, the provisions only dealt with uncompleted agreements relating to transfers of land.)

❑ A general definition of the meaning of "acquisition" is given with specific examples being provided. (This is in contrast to the earlier provision which defined exclusively the term "acquisition". The proposed new section is similar to s.162 of the Queensland *Duties Act*.)

❑ The new s.114(1)(a)(iii) is narrowed to cover only arrangements "between the acquirers". Arguably, in contrast to the earlier position, this means that arrangements with a non-acquirer third party are outside the scope of the section.

❑ Some further information concerning acquisitions is now required to be included in acquisition statements lodged with the Chief Commissioner.

❑ The exception for an acquisition comprising a transaction that is not liable for transfer duty under the general provisions of the *Duties Act* has been removed.

❑ The provision for the phasing-in of duty (s.122) was repealed and has not been replaced.

❑ The current s.107(2)(b) has been amended to provide that money on deposit "with any person" is not to be counted. Previously, only money on deposit with a bank was excluded.

**Conclusion**

To some extent the new land-rich provisions for NSW follow the existing Queensland and Western Australian models. However, in other respects the provisions represent a significant tightening of the provisions and thus a revenue-raising exercise for the NSW Government and the Office of State Revenue. While the narrower provisions of Queensland and Western Australia may work well in those States, it is difficult to see why NSW should adopt them. NSW ought to recognise itself as the Australian economy with most commercial activity and, accordingly, not hamper that activity by imposing a tax in a way that reaches beyond its intended realm. Provisions that were originally intended as an anti-avoidance measure should not be given a life of their own to the point where they will burden one of the most important sectors of our economy – namely, small business. ❑