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29 October 2019

Mr Tim Pallas MP  
Treasurer of Victoria  
Level 4, 1 Treasury Place  
EAST MELBOURNE VIC 3002

Dear Treasurer,

## **Economic Entitlement Provisions Impact on Retirement Villages**

### **Background**

The *Taxation Acts Amendment Act 2019* made changes to the economic entitlement provisions of the *Duties Act 2000*.

The amendments are said to correct the law following a decision of the Victorian Supreme Court. In reality, the changes go much further. In *BPG Caulfield Village Pty Ltd v Commissioner of State Revenue [2016] VSC 172*, Justice Croft said repeatedly that, if the construction the Commissioner argued for in that case was adopted, it would lead to a new head of revenue being created.

Since the announcement of the proposed changes in the State Budget, the Property Council has advocated to the State Revenue Office (**SRO**) on its members' behalf and raised a number of instances where the economic entitlement provisions result in inconsistencies and unintended consequences.

For the retirement living sector two unintended consequences have arisen.

1. Lease villages in Victoria have historically always been exempt from duty given there is no transfer of land rights, however the economic entitlement provisions compromise this historic exemption.
2. In the case of freehold villages, duty is currently payable by the purchaser of the freehold title against the freehold price. The economic entitlement provisions now also give rise to a new head of duty for village operators as deferred management fees are captured by the provisions.

The SRO guidance outlining the Commissioner's view regarding the operation of retirement living arrangement provisions does not adequately provide certainty for taxpayers negotiating

their arrangements as it does not have legislative force leading to uncertainty for both operators and potential new residents.

The uncertainty created by the capturing of retirement arrangements under economic entitlement flows against the Government's priority to provide greater certainty and clarity for senior Victorians making the move into retirement living. This letter sets out issues relating to the impact of the economic entitlement provisions on retirement villages in Victoria.

## **How is Retirement Living captured by the change?**

### **Lease Villages**

Most retirement villages in Victoria are operated under a lease model.

Under a lease model:

- (a) the landowner is the retirement village owner and operator;
- (b) the land in a retirement village is usually contained in one parcel of land; although, at times, there may be a number of titles if the land has been acquired over time;
- (c) the landowner grants a lifetime lease or licence to a resident to occupy a unit in the village, and this right is defined as a residence right under the *Retirement Villages Act 1986 (Act)*;
- (d) the resident pays an ongoing contribution for the right to reside in the unit; and
- (e) when the resident leaves the unit and vacates the village, the resident is repaid part of that ongoing contribution – called a refundable ongoing contribution under the Act – less various fees, including a deferred fee.

In many retirement villages the resident also receives a share in any capital growth in the value of the residence right, namely the difference in the amount of the ongoing contribution paid by the resident and the ongoing contribution payable by the next incoming resident acquiring a residence right to occupy that unit (**Capital Growth**).

The grant of the lifetime lease to a unit is currently not a dutiable transaction under the *Duties Act 2000* due to the exception set out in section 7(3AA) of the Duties Act which states:

*"Despite subsection (1), the granting, 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 is not a dutiable transaction."*

The exception outlined in section 7(3AA) is at odds with section 32XC of the Duties Act. Under those provisions the grant of the lease with the right to share in the Capital Growth is likely to be an acquisition of an economic entitlement as:

- (a) A lease is granted to a resident (being an "arrangement");
- (b) The granting of the lease entitles the resident to participate in the Capital Growth of the relevant land upon the expiration or termination of the lease of the unit; and

- (c) The threshold test as set out in section 32XC(1)(A) is likely to be met as the relevant land will be the parcel upon which the retirement village as a whole (or at least many units) is located, not the individual unit. Further, in some villages the threshold test is likely to be met based on the value of the land upon which the individual unit is located.

### **Freehold Villages**

Many retirement villages in Victoria are operated under a freehold title model where the resident owns the title to the land and unit and receives services from the operator.

Under a freehold village model:

- (a) the village land is subdivided into separate parcels of land, each with its own certificate of title;
- (b) the resident is the owner of their unit and the operator owns communal facilities, with an owners corporation the owner of the common property;
- (c) the resident purchases the title to the unit upon entry to the village and enters into a services agreement with the operator for the provision of services to the resident, and payment of certain fees to the operator upon the resale of the unit; and
- (d) when the resident sells the unit and vacates the village, the resident receives the new purchase price from the new purchaser resident less various fees, including a deferred fee which is payable to the operator.

Under section 32XC of the Duties Act, the entry into the services agreement or other agreement by the operator is likely to be an acquisition of an economic entitlement as:

- (a) A services agreement is entered into with the operator which sets out certain fees due to the operator upon resale (being an "arrangement");
- (b) The entry into the agreement entitles the operator to payment of a deferred fee, so as to participate in the proceeds of sale of the unit upon resale; and
- (c) The threshold test as set out in section 32XC(1)(A) will be met where the relevant unit has an unencumbered market value of more than \$1,000,000.

### **Case Study: Impact on Residents**

#### **Lease Village – Doncaster**

The village land is located on one parcel of land with one certificate of title. The village land has an unencumbered value that exceeds \$1 million. The resident is granted a long-term lease of the unit and pays an ingoing contribution of \$639,000 for the right to reside in the unit under a Residence and Management Contract. Upon the re-letting of the unit, the resident is entitled to repayment of a proportion of the ingoing contribution and is entitled to 100 per cent of the Capital Growth, less various fees. In particular a deferred fee of 5 per cent of the value of the residence right upon re-letting (**Resale Lease Price**) plus 5 per cent per year of occupancy of the Resale Lease Price for a maximum of 5 years, is deducted from the amount due to the resident.

The resident occupies the apartment for 3 years and upon re-letting of the apartment the Resale Lease Price is \$695,000. The Resident is entitled to 80 per cent of the Resale Lease Price (100 per cent less deferred fees of 5 per cent plus 5 per cent per annum for 3 years), less other costs for refurbishment fees.

Under section 32XC of the Duties Act, the resident is likely to be a person who acquires an economic entitlement as the resident is entitled to share in the Capital Growth of the value of the residence right upon the reletting of the unit.

Under the Residence and Management Contract, the resident is entitled to a minimum of 70 per cent of the Resale Lease Price, and a maximum of 95 per cent of the Resale Lease Price depending upon the years of occupancy in the apartment. On the basis of the examples set out on the SRO website, the resident will be deemed to have acquired an interest in the land upon entering into the Residence and Management Contract, and the highest deeming rate will be 95 per cent (the maximum amount of the Resale Lease Price the resident may be entitled to depending upon the years of occupancy). Duty on this amount would be \$38,410 (duty on \$639,000 which is 95 per cent of the ingoing contribution as at the date of the Residence and Management Contract).

### **Lease Village – Cranbourne**

As for the case studies set out above, the resident is granted a long-term lease of the unit. The ingoing contribution is \$530,000, and the deferred fee is 3 per cent of the ingoing contribution per annum for each year of occupancy plus 4 per cent of the Resale Lease Price, and the resident is entitled to 50 per cent of the Capital Growth.

The resident occupies the unit for 6 years and upon re-letting, the Resale Lease Price is \$625,000. The resident receives 50 per cent of the Capital Growth.

On the basis of the examples set out on the SRO website, the resident will be deemed to have acquired an interest in the land upon entering into the Residence and Management Contract, and the rate will be the percentage interest in the Capital Growth. Duty on this amount would be \$9,600 (duty on \$265,000 which is 50 per cent of the ingoing contribution as at the date of the Residence and Management Contract).

### **Lease Village – Canterbury**

Like case study number 1 above, the village land is located on one parcel of land with one certificate of title and has a value that exceeds \$1 million. The resident is granted a long-term lease of the unit and pays an ingoing contribution of \$970,000 for the residence right under a Residence and Management Contract. Upon the re-letting of the unit, the resident is entitled to repayment of a proportion of the ingoing contribution and is entitled to 100 per cent of the Capital Growth, less various fees. A deferred fee of 3 per cent of the Resale Lease Price per year of occupancy to a maximum of 30 per cent is deducted from the amount due to the resident.

The resident occupies the unit for 3 years and upon re-letting the Resale Lease Price is \$1,070,000. The resident receives 91 per cent of the Resale Lease Price (100 per cent less deferred fees of 3 per cent per annum for 3 years) less other costs for refurbishment and fees.

Under the Residence and Management Contract, the resident is entitled to a minimum of 70 per cent of the Resale Lease Price and a maximum of 97 per cent of the Resale Lease Price depending upon the years of occupancy in the apartment. On the basis of the examples set out on the SRO website, the resident will be deemed to have acquired an interest in the land upon entering into the Residence and Management Contract, and the highest deeming rate will be 97 per cent (the maximum amount of the Resale Lease Price the resident may be entitled to depending upon the years of occupancy). Duty on this amount would be \$51,254 (duty on \$940,900 which is 97 per cent of the ingoing contribution as at the date of the Residence and Management Contract).

### Case Study: Impact on Operators

#### **Strata title Village - Kew**

The village apartments are each located on a separate parcel of land. The resident acquires the freehold title to the land upon payment of the ingoing contribution as the purchase price. The resident pays a purchase price of \$1,150,000. Upon the resale of the apartment, under the terms of the services agreement entered into with the operator, the operator is entitled to a deferred payment, being 8.65 per cent of the purchase price for the unit paid by the next resident (**Resale Price**) plus 3.65 per cent of the Resale Price per year of occupancy for a maximum of 7 years (minimum 8.65 per cent and maximum 34.2 per cent).

Under section 32XC of the Duties Act the operator is likely to be a person who acquires an economic entitlement as the operator is entitled to share in the proceeds of the Resale Price and the ingoing contribution for the unit exceeds \$1 million. Based on the examples set out on the SRO website, the operator will be deemed to have acquired an interest in the land upon entering into the services agreement and the rate will be the maximum deferred fee payable to the operator. Duty on this amount would be \$18,650 (duty on \$393,300 which is 34.2 per cent of the purchase price paid by the resident upon entry).

#### **Landowner and Operator - different entities**

Many villages owned and operated by religious organisations are structured with the village land owned by a corporate trust entity and the operator as a separate legal entity created to provide retirement living and aged care services to residents. In these villages, the village land is located on one parcel of land with one certificate of title. The resident is granted a long-term lease of the unit by the corporate trust landowner and pays an ingoing contribution to the operator for the right to reside in the unit under a Residence and Management Contract. The operator provides services to the resident and operates the village. Upon the re-letting of the unit the operator is entitled to payment of a deferred fee, being a percentage of the Resale Lease Price.

As the operator is not the landowner, the operator is likely under section 32X of the Duties Act to be a person who acquires an economic entitlement as the operator is entitled to share in the Capital Growth or the proceeds of sale, and as the land usually comprises the whole village or at least a number of units, the threshold value of more than \$1 million will be reached.

#### **Next Steps**

We submit that it is an unintended consequence of the recent amendments to the Duties Act that Retirement Villages are captured.

Given the threshold measures set out in section 32XC are satisfied by the retirement village model, a legal obligation to pay duty arises under the economic entitlements provisions. In leasehold villages this is inconsistent with section 7 (3AA) which provides that any leasehold interest acquired in retirement village land should be exempt from duty and we submit that this should extend to economic entitlement provisions.


In relation to strata title villages, we submit that these measures are inconsistent with the ownership and operational model for these villages where the resident acquires the freehold interest in the unit and the operator is paid a deferred fee as a contribution to the overall development and maintenance of the village.

We propose that an exclusion mirroring the exclusion outlined in section 7 (3AA) should be set out in the Duties Act to specifically exclude any rights granted in relation to land within a retirement village from the economic entitlement provisions:

*"Despite subsection (1), the granting, transfer, assignment or surrender of a lease creating or giving rise to a residence right, or the participation in the profit or proceeds of sale of a residence right, in a retirement village within the meaning of the Retirement Villages Act 1986 does not create an economic entitlement."*

If you require further information or clarification, please contact Emily Young, Senior Communications and Policy Advisor, on 0447 020 329 or [eyoung@propertycouncil.com.au](mailto:eyoung@propertycouncil.com.au).

Yours sincerely,



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