


TR 93/D27 - Income tax: taxation of amounts received by retirement village proprietors from incoming residents

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What this Ruling is about

1. We have been asked to clarify the taxation treatment under the *Income Tax Assessment Act 1936* (the Act) of lump sum payments received under the terms of various arrangements used by proprietors of commercial retirement villages under which occupancy rights are granted to residents. This Ruling considers the following arrangements:

- a) Strata title;
- b) lease premium (non-assignable lease);
- c) lease premium (assignable lease);
- d) loan/lease;
- e) loan/licence;
- f) prepaid rental; and
- g) redeemable preference share.

2. An explanation of these arrangements appears at paragraph 12 of this Ruling.

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3. This Ruling does not consider the application of Part IVA of the Act.

4. This Ruling considers, in general terms, the taxation consequences of each of the transactions outlined in paragraph 1. However, given that, in relation to each type of arrangement, there is no standard form of deed or agreement within the retirement village industry, the liability of any taxpayer can be determined only on the basis of the facts established in each particular case.

Ruling

5. Generally, where a developer constructs a retirement village and sells the individual units on a strata title basis, the trading stock provisions of the Act will apply. Deductions under Division 10D of Part III of the Act will be allowable in respect of the cost of community facilities constructed in conjunction with the village, provided that the expenditure qualifies as 'eligible expenditure' for the purposes of that Division. Those costs cannot be absorbed into the cost price of individual units.

6. Each of the other arrangements referred to in paragraph 1 will be treated on the basis that it is equivalent to a sale of the unit. The lump sum payable by an incoming resident is included in the assessable income of a proprietor and deductions are allowable for the costs incurred in acquiring the land and constructing the village. Deductions under Division 10D of Part III of the Act are allowable in respect of the cost of community facilities, provided that the expenditure qualifies as 'eligible expenditure' for the purposes of that Division. That expenditure cannot be taken into account in determining the proportion of construction costs attributable to individual units.

7. Upon rollover of a unit from one resident to another, the lump sum payable by the new resident to the village proprietor is included in the proprietor's assessable income in the year of income in which the agreement is entered into, and the amount payable by a proprietor to the outgoing resident (or their estate) is an allowable deduction in the year in which the proprietor is obliged to make the payment.

8. Fees payable by residents on a regular basis (usually monthly) to the village proprietor in respect of management and other services (similar to body corporate fees) are derived when they become due and

payable, and are included in the assessable income of the proprietor accordingly.

Date of effect

9. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

10. If a taxpayer has a private ruling which is inconsistent with this Ruling, then this Ruling will apply to the taxpayer only from and including the 1993-94 year of income, unless the taxpayer asks that it apply to earlier income years.

Explanations

11. Historically, retirement villages were constructed and operated by churches and charitable organizations to provide residential accommodation for retired people. Those organizations generally were exempt bodies, and no taxation consequences arose. However, in recent years there has been a significant expansion in the development of retirement villages, the majority of which have been constructed by commercial developers.

12. Generally, a developer acquires land, constructs a retirement village complex, and then recovers the cost of the development from the incoming residents. These projects are usually referred to as 'resident-funded' retirement villages. The individual dwellings, whether they be apartments, units, or villas, are either purchased or occupied under a lease or other form of agreement. Usually, to be eligible to purchase or occupy a dwelling, persons must be aged 55 years or over. Retirement villages constructed by commercial developers have been marketed in several ways:

- a) **Strata Title:** This involves the sale of dwellings in a retirement village on a strata title basis. Generally, the developer has an option to repurchase from the resident (or their personal representative), or is entitled to receive a commission upon the resale of the dwelling by the resident.

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- b) **Lease premium (non-assignable lease):** Under this arrangement, a resident is granted a long-term lease, generally for a period of 99 years, of a dwelling in the retirement village, conditional upon immediate payment to the proprietor of a lease premium equal to the market value of the dwelling. Upon termination or surrender of the lease, the lessor is obliged to make a payment to the resident (or personal representative) equivalent to the original premium paid by the resident, less a 'deferred management fee' which is calculated as a percentage of the lease premium for each year of occupancy. That amount is deducted from or set off against the amount of the lease premium. Generally, the outgoing resident shares in any 'capital gain or loss'; that is, the difference between the original lease premium paid and the lease premium paid by the new resident.
- c) **Lease premium (assignable lease):** Under this arrangement, a resident is granted a long-term lease, generally for a period of 99 years, of a dwelling in the retirement village, conditional upon immediate payment to the proprietor of a lease premium equal to the market value of the dwelling. The terms of the lease enable the resident (or personal representative) to assign the lease to someone over 55 years of age and who is approved by the proprietor of the village. Upon assignment of the lease, the new resident pays to the outgoing resident an amount equivalent to the market value of the dwelling at the time of the assignment. At the same time, the outgoing resident is obliged to pay the village proprietor the 'deferred management fee' and also a commission for services which may have rendered in connection with the assignment of the lease.
- d) **Loan/lease:** Under this arrangement, a resident is granted a long-term lease, generally for a period of 99 years, of a dwelling in the retirement village, conditional upon immediate payment to the proprietor of an 'interest-free loan' equal to the market value of the dwelling. Upon termination or surrender of the lease, the lessor is obliged to make a payment to the resident (or personal representative) equivalent to the original 'loan' given by the resident. The outgoing resident is required to pay a 'deferred management fee', calculated as a percentage of the 'loan' for each year of occupancy. Usually, that amount is deducted from or set off against the amount of the loan.

Generally, the outgoing resident shares in any 'capital gain or loss'; that is, the difference between the 'loan' originally made by the outgoing resident and the 'loan' given by the new resident.

- e) **Loan/Licence:** Under this arrangement, a resident is granted a 'licence' to occupy a dwelling in the village upon immediate payment of an 'interest-free loan' or 'deposit' equal to the market value of the dwelling. Upon termination of the 'licence' the proprietor is obliged to make a payment to the resident (or personal representative) equivalent to the original 'loan' given by the resident. The outgoing resident is required to pay a 'deferred management fee', calculated as a percentage of the 'loan' for each year of occupancy. Usually, that amount is deducted from or set off against the amount of the loan or deposit. Similarly with the lease arrangements, the outgoing resident shares in any capital gain or loss.
- f) **Prepaid rental:** Under this arrangement, a resident is granted a lease, generally for a period of 99 years, upon payment of rent in advance (typically stated to be for a period of 20 years), subject to a pro rata refund upon early termination of the lease. The resident generally is required also to provide an 'interest-free loan' or 'deposit'. The total of the two amounts payable usually is equivalent to the market value of the dwelling. Payment of the loan or deposit may be made directly to the proprietor, or, alternatively, to a trustee, who, under the terms of a trust deed, agrees to give to the village proprietor an interest-free loan to the extent of the amount received from a resident. Upon termination or surrender of the lease, the proprietor is obliged to refund advance rental on a pro rata basis and also make a payment to the outgoing resident equivalent to the original loan or deposit made by the resident. Where the loan or deposit is made to the trustee, upon termination of the lease, the proprietor is required to repay the loan obtained from the trustee and the trustee is obliged to make a payment to the outgoing resident equivalent to the amount of the loan or deposit originally advanced by the resident.
- g) **Redeemable Preference Share:** Under this arrangement, a company which owns a retirement village issues redeemable preference shares (usually with a par value of \$1.00). The articles of association confer a right to be

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granted a lease of a dwelling in the village, conditional upon payment of a share premium equal to the market value of the dwelling. The premium is paid into the share premium account of the company. The articles also confer a right to redemption of the premium upon termination or surrender of the lease. The outgoing resident is required to pay the 'deferred management fee' which is deducted from or set off against the amount of the share premium. Generally, there is also a sharing in the 'capital gain or loss'; that is, the difference between the share premium originally paid by the outgoing resident and the share premium paid by the new resident.

13. In relation to each of these arrangements other than a strata title sale, the payment to the outgoing resident may be conditional upon a new occupant being found, who makes a lump sum payment specified as a lease premium, share premium, or interest-free 'loan' which is equivalent to the market value of the dwelling at that time. The outgoing resident (or their estate) generally shares in any 'capital gain or loss'; that is, the difference between the initial lump sum received from the outgoing resident and the lump sum received from the new resident, which effectively gives a resident an equity interest in the unit they occupy. These arrangements have many features in common with a strata title sale.

14. The proprietor of the village usually derives income also from a management fee for providing maintenance and other services to the residents. Those fees are payable by residents on a regular, recurrent basis (usually monthly) and are similar to fees levied by a body corporate.

15. With respect to each of the arrangements other than a strata title sale, the question has been raised as to what amounts a village proprietor should include in assessable income and what costs can be claimed as allowable deductions in order to determine their income tax liability.

16. Under each of the arrangements, the proprietor receives an inflow of funds similar to that which would be generated by the sale of dwellings under a strata title arrangement. However, it has been argued on behalf of retirement village proprietors that no assessable income is derived upon receipt of the initial lump sum payment from an incoming resident because it is a capital receipt.

a) Strata Title

17. Strata title transactions involve the sale of dwellings within a retirement village complex. The proprietor generally retains ownership of the common property of the village, and either has an option to repurchase individual dwellings from proprietors or their personal representatives for subsequent resale, or is entitled to receive a commission where they arrange for the resale of a dwelling on behalf of a resident owner or their personal representative. Commission fees generally are secured by a charge over the property.

18. Generally, where the proprietor of a retirement village constructs a retirement village and sells the individual units on a strata title basis, the proprietor will be required to account for the sale of those units under the trading stock provisions of the *Income Tax Assessment Act 1936* (the Act).

19. Fees for the provision of management services (similar to body corporate levies) generally are payable by residents on a regular, recurrent basis. Those fees are derived by the village proprietor when they become due and payable, and are included in the assessable income of the proprietor accordingly.

20. Where the proprietor of the village repurchases a unit from an outgoing resident and sells to another retiree, the trading stock provisions of the Act will apply. Where the proprietor acts as agent for the resident upon the resale of a dwelling, any commission received by the proprietor is assessable income under subsection 25(1) of the Act in the year in which the income is derived.

21. Interest expenses and other holding costs, such as rates and taxes, incurred in developing the retirement village generally are allowable as deductions in the year in which the expenditure is incurred. Similarly, costs of advertising and selling units generally are deductible in full in the year in which they are incurred.

22. Deductions under Division 10D of Part III of the Act are allowable in respect of the cost of community facilities constructed in conjunction with the village, provided that the expenditure qualifies as 'eligible expenditure' for the purposes of that Division. Those costs cannot be absorbed into the cost price of individual units.

b) Lease premiums (non-assignable lease)

23. Under this arrangement, the resident is required to pay an amount called a lease premium, equivalent to the market value of the dwelling, in consideration for the grant of a long-term lease. Apart from the premium, no separate rent (with the exception of a nominal

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or peppercorn rent payable only if demanded) or other consideration for occupancy rights is payable.

24. Upon termination or surrender of a lease, the proprietor grants a new lease to the incoming resident. The proprietor is obliged to make a payment to the outgoing resident (or personal representative) equivalent to the amount of the original premium paid, less an amount known as a 'deferred management fee', which is calculated by reference to the period of occupancy (typically, an amount equal to 2.5% of the premium for each year of occupancy, with a minimum of 10% and a maximum of 25%). In some instances, that payment is conditional upon a new resident being found who, likewise, pays a premium for or in connection with the grant of a new lease.

25. The outgoing resident generally shares in any 'capital gain or loss'; that is, the difference between the lease premium paid by the outgoing resident and the lease premium paid by the new resident.

26. Although a premium received as consideration for the grant of a lease ordinarily might be characterized as a capital receipt, it was held in *Kosciusko Thredbo Pty Ltd v. FC of T* 84 ATC 4043; 15 ATR 165, that a lease premium may be assessable as income under ordinary concepts where the business of the taxpayer includes the receipt of lease premiums. In that case, Rogers J said that lease premiums received through repetitive and recurrent transactions that were an essential ingredient of the operation of a business to commercial advantage were assessable income under subsection 25(1). The sub-letting of apartment blocks in a ski resort by the appellant, and the consequent receipt of lease premiums, was no more than a different method of exploiting the resort facilities - a means of conducting the business.

27. On the authority of *Kosciusko Thredbo*, it is considered that lease premiums received by proprietors of retirement villages are income under ordinary concepts because the business of retirement village proprietors includes the receipt of lease premiums.

28. Alternatively, a lease premium received by a village proprietor is included in assessable income under section 26AB of the Act. That section assesses premiums received for or in connection with the grant of a lease of property not intended to be used by the grantee for the purpose of gaining or producing assessable income. The word 'premium' in that section is not confined to a premium within the ordinary meaning of the word, but it extends to payments 'in the nature of a premium paid 'for or in connection with' the grant of a lease.

29. In *Dalrymple v. FC of T* (1924) 34 CLR 283, the High Court considered paragraph 14(d) of the *Income Tax Assessment Act 1915-1918*, which included as income "... consideration in the nature of premiums, fines or foregifts demanded and given in connection with leasehold estate ...". Knox CJ, Gavan Duffy and Starke JJ said that the object of this part of the clause was "to include in the income of a lessor all sums paid by a tenant other than the rent reserved by the lease, such as sums which are demanded on the renewal ... of a lease or on the giving of a new lease". The provision considered in that case is not materially different from section 26AB.

30. With respect to leases granted on or after 19 September 1985, the capital gains tax provisions are relevant also. Section 160ZS provides that the grant of a lease of property shall be deemed to constitute the disposal by the lessor to the lessee of an asset for a consideration equal to the premium paid or payable for the grant of the lease. However, by the operation of subsection 160L(8), section 160ZS does not apply to leases created between 19 September 1985 and 23 May 1986 over land acquired by a taxpayer before 20 September 1985. Although a lease premium may be assessable under 160ZS, subsection 160ZA(4) operates to reduce the otherwise assessable capital gain to the extent that it is assessable under either subsection 25(1) or section 26AB.

31. It has been argued that leases granted to residents should be regarded as trading stock and that development costs form part of the cost price of the lease. That argument is not accepted.

32. Subsection 6(1) of the Act defines "trading stock" to include "anything produced, manufactured, acquired or purchased for purposes of manufacture, sale or exchange ...".

33. In other jurisdictions, it has been held that certain leases are capable of constituting trading stock. However, those cases concerned leases of mineral rights (*Minerals Limited v. Minister of National Revenue* 55 DTC 492), oil leases (*Great West Exploration Limited v. Minister of National Revenue* 57 DTC 444) and property leases (*Arndale Properties Ltd v. Coates (Inspector of Taxes)* [1984] 1 WLR 1328), and were concerned with the question whether a taxpayer who acquired and disposed of leases in the ordinary course of business could treat those leases as trading stock.

34. In *Federal Commissioner of Taxation v. St Huberts Island Pty Ltd* (1978) 8 ATR 452, 472; 78 ATC 4104, 4121, it was held that land, in appropriate circumstances, may be trading stock. However, it is not considered that this decision supports the proposition that a developer who acquires land for the purpose of constructing and

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leasing residential units can treat those leases as trading stock. The leases in question do not fit the definition "anything ... acquired ... for purposes of manufacture, sale or exchange". Proprietors of retirement villages derive income not from trading in leases, but from recurrent exploitation of the underlying property by means of leasing and re-leasing.

35. A further argument made on behalf of village proprietors is that lease premiums are not assessable upon receipt on the basis that the premium is paid in consideration of the right of residence over the balance of the resident's life, and that until the lessor provides that consideration the premium has not been derived. This argument relies upon the authority of the High Court decision in *Arthur Murray (NSW) Pty Ltd v. FC of T* (1965) 114 CLR 314; 9 AITR 673; 14 ATD 98.

36. However, putting aside the question whether *Arthur Murray* can apply in a case where the income in question is derived from the grant of a lease rather than the provision of future services, the relevant lease premiums generally are specified in the leases to be "in consideration of the grant of the lease to the lessee by the lessor". Accordingly, upon granting the lease, the lessor has done all that is required to derive the amount of the premium. *Arthur Murray* has no application in those circumstances.

37. An alternative argument put forward is that a deduction is available for the diminution in value of the real estate upon the granting of a long-term lease to a retiree. The decision in *Jennings Industries Ltd v. FC of T* (1984) 15 ATR 577; 84 ATC 4288 is relied on to support this argument. However, that decision does not support the proposition that a notional deduction is allowable for the development costs incurred by the proprietor of a retirement village who retains ownership of the property and exploits the village facilities by granting occupancy rights on a regular and recurrent basis.

38. A further argument put on behalf of the retirement village industry is that, if the capital gains tax provisions of the Act apply, the proprietor is entitled to elect, under section 160ZSA, to treat the grant of a long-term lease as a disposal of the freehold interest in the property for a consideration equal to the greater of the market value or any premium paid for the grant of the lease. However, it is not considered reasonable to expect such a lease to continue for at least 50 years. Industry sources estimate that the average period of occupancy in retirement villages is no more than 12 years. Accordingly, a lease would not qualify as an eligible long-term lease within the terms of subsection 160ZSA(3) of the Act.

39. The question arises as to what deductions are available to a proprietor upon the grant of a lease of a unit. Although the proprietor retains legal title to the underlying property, given the method by which the village proprietor conducts business operations for profit, the transaction, in substance and intent, is the equivalent of a sale of the unit.

40. On the basis that the lease premiums are in the nature of income earned from the recurrent and repetitive exploitation of the units, a proportion of the cost of constructing the retirement village units (including the land component) is an allowable deduction relating to that income.

41. Deductions generally are available under Division 10D of Part III of the Act for capital costs incurred in constructing community facilities, provided that the expenditure qualifies as 'eligible expenditure' for the purposes of that Division.

42. In addition, holding costs such as interest, marketing costs, administration costs, and expenses incurred in preparing leases generally will be allowable deductions in the year of income in which they are incurred.

43. Upon rollover of a unit from one resident to another, the lump sum payable by the new resident to the village proprietor is included in the proprietor's assessable income in the year of income in which the agreement is entered into, and the amount payable by a proprietor to the outgoing resident (or their estate) is an allowable deduction in the year in which the proprietor is obliged to make the payment.

44. Fees for the provision of management services (similar to body corporate fees) generally are payable by residents on a regular, recurrent basis. Such fees are derived as and when they become due and payable, and are included in the assessable income of the proprietor accordingly.

c) Lease premiums (assignable lease)

45. Under this arrangement, the resident is required to pay a lease premium, equivalent to the market value of the dwelling, in consideration for the grant of a long-term lease. Apart from the premium, no separate rent (with the exception of a nominal or peppercorn rent payable only if demanded) or other consideration for occupancy rights is payable.

46. The lease can be assigned by the outgoing resident (or personal representative) to an incoming resident. Upon assignment of the lease,

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the new resident is required to pay a lump sum to the outgoing resident equivalent to the present market value of the dwelling at the time the agreement to assign is entered into. Consequently, the outgoing resident receives the benefit of any increase in the 'capital value' of the dwelling. The outgoing resident is obliged to pay a 'deferred management fee' to the proprietor, calculated by reference to the period of occupancy, and may be required also to pay a commission fee to the proprietor for services rendered in procuring a new resident to take an assignment of the lease.

47. The discussion in respect of non-assignable leases is relevant also in relation to assignable leases. Similarly, it is considered that the initial lease premium received by the proprietor is fully assessable under either subsection 25(1), section 26AB or section 160ZS of the Act. On the same basis as explained in paragraphs 39-40, a proportion of the cost of acquiring the land and constructing the village is an allowable deduction.

48. Upon rollover of a unit from one resident to another, the amount of the deferred management fee and any commission fee payable by the outgoing resident to the proprietor is included in the proprietor's assessable income in the year in which it becomes due and payable.

49. Fees payable by residents for the provision of day-to-day management services are derived when they become due and payable and are included in the proprietor's assessable income accordingly.

d) Loan/lease arrangement

50. Under this arrangement, the resident is required to make an interest-free 'loan' to the proprietor of an amount equivalent to the market value of the dwelling, in consideration for the grant of a long-term lease. Upon termination or surrender of the lease, the proprietor is obliged to make a payment to the outgoing resident (or personal representative) equal to the original loan amount. The outgoing resident is required to pay the proprietor a 'deferred management fee', calculated by reference to the period of occupancy. That amount either is deducted from or set off against the amount of the loan. In some instances, the outgoing resident shares in any 'capital gain or loss'; that is, the difference between the amount of the 'loan' originally made by the outgoing resident and the 'loan' provided by the new resident.

51. It has been argued on behalf of village proprietors that the initial payment made by each resident is, both in form and in substance, a loan, and, therefore, it is a capital receipt and is not included in

assessable income. However, it is necessary to examine the loan arrangement to determine the true character of the payment.

52. In some of the loan/lease arrangements that have been examined, it appears that there is either no obligation to pay to the outgoing resident an amount equal to the original 'loan', or the obligation to pay that amount is heavily qualified. The amount payable generally is calculated by deducting the deferred management fee and also taking account of the resident's share in the capital 'gain' or 'loss'. Generally, the repayment is conditional upon the proprietor being able to find a new resident who, in turn, is required to make a lump sum payment specified as a 'loan' (based on the then current market value of the dwelling) as consideration for the grant of a new lease. In some instances, the payment to the outgoing resident is calculated as a percentage of the lump sum amount received from the new resident. For example, if a resident has occupied a village unit for a period in excess of three years, he or she is entitled to receive 80% of the loan advanced by the new resident, less the deferred management fee.

53. A standard definition of 'loan' is found in *Chitty on Contracts* 25th Ed., (1986) Sweet & Maxwell, 541, which defines a loan as:

... a contract whereby one person lends or agrees to lend a sum of money to another, in consideration of a promise express or implied to repay that sum on demand, or at a fixed or determinable future time, or conditionally upon an event which is bound to happen, with or without interest.

54. In *Re Securitibank Ltd (No. 2)* [1978] 2 NZLR 136 at 167, Richardson J stated that "... the essence of a loan of money is the payment of a sum on condition that at some future time an equivalent amount will be repaid".

55. In circumstances where the whole of the amount is not unconditionally repayable, or the amount and timing of any ultimate repayment are variable according to events which are neither fixed or determinable as to future time, some of the essential features of a loan are absent. It is clear that the real nature of the payment by the resident is that of consideration for granting occupancy rights and is, in substance, no different from the lease premium arrangement.

56. Some 'loan' agreements provide for repayment of the full amount of the 'loan' and also provide for the amount to be repaid within a specified period (typically six months) after termination of the period of occupancy. Rather than calculating the amount payable to the outgoing resident by deducting the deferred management fee, the initial lump sum amount is repayable in full. Nevertheless, the

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proprietor is entitled to a deferred management fee calculated as a percentage of the initial lump sum for each year of occupancy. However, it has been argued that, where the agreement provides that the loan is fully repayable and the time for repayment is fixed or can be determined, the lump sum payment is a genuine loan and, therefore, is a capital receipt.

57. Although the form of the agreement may comply with the strict definition of the term 'loan', the fact that the relevant agreements refer to the payments as loans does not determine their real effect: see *Inland Revenue Commissioners v. Wesleyan and General Assurance Society* [1948] 1 All ER 555; 30 TC 11.

58. The real nature of the transaction must be examined carefully to determine the appropriate tax accounting treatment. As Hill J said in *FC of T v. Cooling* (1990) 21 ATR 13; 90 ATC 4472, in determining the legal effect of a contract between parties, regard can be had to the whole factual matrix of which the contract forms part. He went on to say that regard can be had to the whole context in which an agreement is made to determine the character of a receipt: see also *McLennan v. FC of T* (1989) 20 ATR 1771 at 1777; 90 ATC 4047 at 4052.

59. Considering the transaction in its commercial context, it is simply a different legal form used to exploit the retirement village units on a regular and recurrent basis and is no different, in substance, from the lease premium arrangements. The initial lump sum amount payable by the resident, although specified as a 'loan' in the agreement between the parties, is the consideration passing from the resident to the proprietor for the grant of occupancy rights.

60. The transaction is regarded as the equivalent of a sale of a village unit. Consequently, the amount of the 'loan' is included in the assessable income of the retirement village proprietor, and, as explained in paragraphs 39-40, a proportion of the costs of acquiring the land and constructing the retirement village is an allowable deduction in respect of that income.

61. Upon rollover of a unit from one resident to another, the lump sum payable by the new resident to the village proprietor is included in the proprietor's assessable income in the year of income in which the agreement is entered into, and the amount payable by a proprietor to the outgoing resident (or their estate) is an allowable deduction in the year in which the proprietor is obliged to make the payment.

62. Fees payable by residents for the provision of day-to-day management services are derived when they become due and payable and are included in the proprietor's assessable income accordingly.

e) Loan/licence arrangement

63. Under this arrangement, similar to the loan/lease arrangement, the resident is required to make a 'loan' to the proprietor of an amount equal to the market value of the dwelling. However, in this situation, the 'loan' is said to be advanced in consideration for the grant of a 'licence' to occupy a dwelling in the retirement village complex. As in the loan/lease arrangement, the loan is interest-free and is repayable upon termination of the 'licence', less a 'deferred management fee' calculated by reference to the period of occupancy, according to a formula specified in the agreement. Alternatively, the loan may be repayable in full, although the outgoing resident is still liable to pay the 'deferred management fee' calculated by reference to the period of occupancy.

64. It has been argued that the interest being granted to the resident under these arrangements is a mere licence. That argument is not accepted. Although the agreement is described as a licence, the nature of the occupancy has to be determined by law and not by the label attached to it by the parties to the agreement: *Addiscombe Garden Estates v. Crabbe* [1958] 1 QB 513.

65. The payment of an amount equal to the market value of the dwelling to secure the right of exclusive possession of the dwelling for the period during which the resident occupies that dwelling leads to the conclusion that what is being granted to the resident is in the nature of a lease and not a licence.

66. The primary difference between a lease and a contractual licence is that a lease confers an interest in the land, whereas a licence confers only a personal interest. The significance of this distinction is that the rights created between the parties to the contract are merely personal rights which bind only the parties to the contract. Consequently, if residents of a retirement village have no more than a contractual licence to occupy a unit and the proprietor subsequently sells the village, the residents do not have any rights which are enforceable against the new proprietor.

67. Although the English courts appear to have accepted the proposition that the grant of exclusive possession is not inconsistent with the creation of a mere licence, in Australia it has been held that a legal right to exclusive possession gives the occupant a proprietary interest in the land as opposed to a mere personal right: see *Radaich v. Smith* (1959) 101 CLR 209.

68. Having regard to the nature of the transaction, it is considered that residents in retirement villages are granted exclusive possession

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of the dwellings they occupy and that there is a tenancy agreement between the village proprietor and each resident of the village. It is not accepted that the mutual intention of the parties to these 'licence' agreements is to create a mere contractual licence.

69. For the reasons discussed earlier in this Ruling, it is considered that the initial lump sum payment made by a resident cannot be characterized as a loan, and must be treated for tax purposes as the equivalent of the proceeds of a sale of the unit. That is, the lump sum amount is a revenue receipt and is included in the assessable income of the retirement village proprietor. As explained in paragraphs 39-40, a proportion of the cost of acquiring the land and constructing the retirement village is an allowable deduction in relation to that income.

70. Upon rollover of a unit from one resident to another, the lump sum payable by the new resident to the village proprietor is included in the proprietor's assessable income in the year of income in which the agreement is entered into, and the amount payable by a proprietor to the outgoing resident (or their estate) is an allowable deduction in the year in which the proprietor is obliged to make the payment.

71. Fees payable by residents for the provision of day-to-day management services are derived when they become due and payable and are included in the proprietor's assessable income accordingly.

f) Prepaid rental arrangements

72. Under this arrangement, the village proprietor leases a unit to a resident on the basis that the resident pays an amount which, it is argued, is prepayment of rent by the resident and not a premium for or in connection with the grant of the lease. Usually, it is also a condition of the lease agreement that, in addition to the prepaid rent, the resident also provides an amount which is specified as either a 'loan' or a 'deposit'. Generally, the total of the loan/deposit and prepaid rent payable by an incoming resident is equivalent to the market value of the dwelling. The term of the lease generally is expressed to be "for a term of 99 years, if the lessee shall so long live" and the prepaid rent will be expressed to be in respect of a period of 20 years, subject to a condition that upon termination or surrender of the lease the proprietor is obliged to repay, on a pro rata basis, the amount of rent attributable to the unexpired portion of the period to which it relates.

73. It has been argued that the 'loan' component is a capital receipt and that the prepaid rent should be assessed in accordance with the principle established in the *Arthur Murray* case and, accordingly, the whole of the amount of prepaid rent should not be treated as

assessable income in the year of receipt, but, rather, should be brought to account on an annual basis over the term of the lease.

74. It is not accepted that in all situations this transaction is, in substance, a prepayment of rent.

75. It has been argued that *Frazier v. Commissioner of Stamp Duties (NSW)* (1985) 17 ATR 64; 85 ATC 4735 provides authority for the proposition that rent paid in advance as a lump sum for the grant of a lease is rent and not a premium for the purposes of the *Stamp Duties Act 1920* (NSW). On the facts of that case, the lump sum, which was fixed by reference to the cost of the unit and by taking current rentals into account, Lee J accepted that the amount paid in advance as rent under a 20 year lease could be regarded as commercially realistic.

76. In the light of the decision in *Frazier*, it appears that, in a situation where the prepaid rental is commercially realistic, having regard to the term to which it relates, and there is provision for a full refund of rental for the unexpired period, the *Arthur Murray* principle will apply: cf *Case B47 70* ATC 236 and *Case B51 70* ATC 253. It will be necessary to consider each case on its own merits.

77. Where the incoming resident is required to make a payment by way of 'loan' or 'deposit' in addition to the prepaid rental, that amount is regarded as assessable under subsection 25(1) or section 26AB, but the costs of acquiring the land and constructing the retirement village are not allowable deductions, except to the extent allowed by Division 10D of part III of the Act.

78. However, where the prepaid rent is not considered to be commercially realistic and the total of the prepaid 'rent' and the 'loan' or 'deposit' paid is equivalent to the market value of the unit, the transaction is regarded as equivalent to a sale. Accordingly, the lump sum amounts received from residents are included in the assessable income of the retirement village proprietor. As explained in paragraphs 39-40, a proportion of the cost of acquiring the land and constructing the retirement village is an allowable deduction in relation to that income.

g) Company title arrangements

79. Under this arrangement, an incoming resident purchases, at par value (generally \$1.00), a redeemable preference share in a company which owns a retirement village. However, the resident is required to pay a share premium equivalent to the market value of the dwelling to be occupied. Usually, there are several different classes of shares. A shareholder is entitled to the grant of a lease of a particular type of

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dwelling in the retirement village to which their class of share relates. The rights and privileges attaching to the shares are personal to the shareholder and cannot be assigned or transferred.

80. Upon termination or surrender of the lease, the preference share is redeemed. Upon redemption, the company is liable to pay the outgoing resident (or personal representative) an amount equivalent to the original premium, less a percentage of that amount for each year the resident has occupied the particular dwelling (the 'deferred management fee'). The resident also may share in the 'capital gain or loss'; that is, the difference between the original share premium paid by the outgoing resident and the share premium paid by the new resident.

81. It has been argued by the retirement village industry that there is no derivation of assessable income as the amount of the premium is in the nature of capital, and does not represent a profit.

82. As a general proposition, moneys received by way of premiums on shares issued by a company are capital receipts: see, for example, *Lowry v. Consolidated African Selection Trust Ltd* (1940) AC 648.

83. Nevertheless, having regard to the substance of the transaction, share premiums received in circumstances outlined above are considered to have the character of income.

84. The business being carried on by the company is the leasing of retirement village dwellings. That business is undertaken by means of issuing and redeeming shares in the company, on a repetitive and recurrent basis, at a premium that equates with the current market value of the dwellings. The company is conducting a commercial enterprise in a systematic and regular way with a view to profit: see *Kosciusko Thredbo*. Consequently, it is considered that the premiums are assessable under subsection 25(1) of the Act as proceeds of a business carried on by the company which owns the retirement village.

85. Alternatively, the share premiums are assessable under section 26AB of the Act. The amount paid by an incoming resident upon the allotment of a share which carries rights to the grant of a lease, is consideration in the nature of a premium paid for or in connection with the grant of a lease.

86. The view that the receipt of share premiums is not a capital receipt is supported by the fact that the shares do not confer any voting rights, nor do they confer any right to a dividend or share in the profits of the company, nor any entitlement to a distribution on the winding

up of the company. Consequently, a share does not constitute what is known as a congeries of rights in the shareholder against the company. The only valuable right conferred on a shareholder is the right to occupy a village unit under the terms of a lease agreement. The company does not issue shares at a premium for the purpose of raising venture capital, but to facilitate the provision of occupancy rights to shareholders for the purpose of making a profit or gain. The occupancy rights given by the articles are conditional upon the payment of the share premium.

87. The transaction is regarded as equivalent to the sale of an individual unit, and the amount of the share premium is included in the company's assessable income in the year in which the agreement is entered into. As explained in paragraphs 39-40, a proportion of the cost of acquiring the land and constructing the retirement village is an allowable deduction. Deductions will be allowable also under Division 10D of Part III of the Act for capital costs incurred in constructing community facilities, provided that the expenditure qualifies as 'eligible expenditure' for the purposes of that Division.

88. Upon rollover of a unit from one resident to another, the lump sum payable by the new resident to the company as a share premium is included in the company's assessable income in the year of income in which the agreement is entered into, and the amount payable by the company to an outgoing resident (or their estate) is an allowable deduction in the year in which the company is obliged to make the payment.

89. Fees payable by residents for the provision of day-to-day management services are derived when they become due and payable and are included in the company's assessable income accordingly.

90. With respect to some of the arrangements that have been examined involving the issue of redeemable preference shares to prospective residents, it is considered that, as a matter of law, the shares in question are not redeemable preference shares.

91. Subsection 192(1) of the *Corporations Act 1990* provides that a company having a share capital may, if authorized by its articles, issue preference shares that are, or at the option of the company are to be, liable to be redeemed. The term 'preference share' is not defined, but carries the ordinary meaning that it vests rights in the holder in priority or preference to other shareholders, particularly in respect of dividends and return of capital upon winding-up of the company.

92. Section 200 of the *Corporations Act* provides that the memorandum or articles of the company must set out the

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... rights of the holders of those shares with respect to repayment of capital, participation in surplus assets and profits, cumulative or other non-cumulative dividends, voting, and priority of payment of capital and dividend in relation to other shares or other classes of preference shares.

93. In other words, an essential feature of a preference share is that rights of preference or priority attach to such a share. However, in the articles of association of some retirement village companies that have been examined, no rights of priority or preference upon winding-up attach to the redeemable preference shares.

94. The absence of any of the standard features of a capital subscription indicates that the articles merely incorporate an agreement to secure occupancy, rather than a means of raising capital. This reinforces the view that the true nature of the transaction is equivalent to the sale of the unit.

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