TR 2002/14 - Income tax: taxation of retirement village operators

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Australian Taxation Office

Taxation Ruling

Income tax: taxation of retirement village operators

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Preamble

*The number, subject heading,**Class of person/arrangement, Date of effect** and **Ruling** parts of this document are a 'public ruling' for the purposes of Part IVAAA of the **Taxation Administration Act 1953** and are legally binding on the Commissioner. The remainder of the document is administratively binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

*[**Note**: This is a consolidated version of this document. Refer to the Tax Office Legal Database (http://law.ato.gov.au) to check its currency and to view the details of all changes.]*

What this Ruling is about

1. This Ruling contains the Commissioner's opinion on the way in which a tax law or tax laws apply to the class of persons and class of arrangements described below.

Class of person/arrangement

2. The classes of persons to which this Ruling applies are as follows:

(a) a person who develops a retirement village;

(b) a person who develops and operates a retirement village;

(c) a person who acquires and operates a retirement village;

(d) a person who manages a retirement village; and

(e) a person who resides in a retirement village.

3. The classes of arrangements to which this Ruling applies are as follows:

(a) the development of a retirement village;

(b) the development and operation of a retirement village;

(c) the acquisition and operation of a retirement village;

(d) the management of a retirement village; and

(e) the acquisition and disposal by a resident of an interest in a retirement village dwelling.

4. This Ruling does not consider the taxation treatment of income derived by government-approved and funded nursing homes and hostel accommodation, although such facilities may be situated within a retirement village complex.

5. This Ruling does not consider the taxation treatment of operators of retirement villages where the residents do not pay entry fees, but are tenants under rental agreements. The taxation treatment of operators of these villages is no different to that of any other owner of residential rental property. Taxation Ruling TR 94/24 did not apply to these arrangements.

6. Section references are to the *Income Tax Assessment Act 1997* (the 1997 Act) unless otherwise indicated.

Previous Ruling

7. Taxation Ruling TR 94/24, which was issued on 30 June 1994, expressed our previous views on the taxation treatment of the owners of commercial retirement villages. That Ruling was withdrawn with effect from 2.00 pm Eastern Standard Time on 19 April 2000.

Ruling

Taxpayer who develops a retirement village for the purpose of selling the village

8. Where a taxpayer acquires land and develops a retirement village for the purpose of selling the entire village, the land and buildings are trading stock of the property developer and the trading stock provisions will apply.

Retirement village operator who sells strata titled units

9. Where a taxpayer develops or acquires the strata title to residential units in a retirement village for the purposes of sale, the trading stock provisions apply.

10. Where title to common areas is to pass to strata title residents, or to a body corporate owned by the residents, the cost of those

common areas should be treated as part of the cost of developing or acquiring trading stock.

11. Where common facilities will continue to be owned by the village operator after strata units are sold, the operator will have stopped holding the common facilities as trading stock immediately after separate title to them has been created on subdivision. Section 70-110 will operate to treat the village operator as having sold the common facilities, in the ordinary course of business, at their cost. This amount is assessable income, and the common facilities will not be included in closing stock at the end of the financial year. The operator will be taken to have immediately bought the common facilities for the same amount, and that amount will be treated as an outgoing of a capital nature.

12. Where a village operator:

- has an option to repurchase a strata title unit;
- does not exercise that option; and
- sells the unit to a new resident on behalf of the outgoing resident,

any fee, commission or other amount payable by the outgoing resident is assessable income of the village operator under section 6-5. If amounts known as deferred management fees (also known as 'departure fees' or 'exit fees') are also payable to the village operator by the outgoing resident, these amounts are assessable in accordance with paragraphs 39-40 below.

13. If the village operator is entitled to a fee in the nature of a commission, calculated as a percentage of the profit (if any) on the sale of the outgoing resident's undivided share of the village, the fee is derived by the operator in the year in which the operator, according to the terms of the agreement between the parties, becomes entitled to demand payment from the outgoing resident. That will usually be in the year in which settlement occurs.

14. Fees for the provision of management services (similar to body corporate levies) that are payable by residents on a regular, recurrent basis are derived by the village operator when they become due and payable, and are included in the assessable income of the operator accordingly. The village operator can deduct expenditure incurred in providing those services in the year in which it is incurred.

15. Interest expenses and other holding costs, such as rates and taxes, incurred in developing the retirement village can be deducted in the year in which the expenditure is incurred. Similarly, costs of advertising and selling units can be deducted in the year in which they are incurred.

'Purple title' arrangements

16. Under another type of arrangement, sometimes referred to as 'purple title' arrangements, residents acquire an undivided share in a retirement village as tenants-in-common and occupancy rights are obtained under separate contractual arrangements between the tenants-in-common. The taxation treatment of these arrangements is the same as for strata title arrangements.

17. Where the village operator is entitled to any fee, commission or other amount from the outgoing resident, that amount is assessable under section 6-5. If deferred management fees are also payable to the village operator by the outgoing resident, these amounts are assessable in accordance with paragraphs 39-40 below.

18. If the village operator is entitled to a fee in the nature of a commission, calculated as a percentage of the profit (if any) on the sale of the outgoing resident's undivided share of the village, the fee is derived by the operator in the year in which the operator becomes entitled to demand payment from the outgoing resident. That will usually be in the year in which settlement occurs.

Village operators who grant occupancy rights

19. Where a village operator develops or acquires a retirement village to conduct the business of granting occupancy rights to village residents, the costs of acquiring or developing the village is expenditure of a capital nature.

Deductions for capital works under Division 43

20. Where the costs of development or acquisition are capital in nature, a village operator is entitled to claim deductions for that capital expenditure to the extent allowed under Division 43.

21. Village owners who have claimed a deduction under section 8-1 (or section 51 of the *Income Tax Assessment Act 1936* (the 1936 Act)) for construction costs in accordance with the interpretation adopted in Taxation Ruling TR 94/24 are not entitled to claim deductions for the same expenditure under Division 43.

Deductions for decline in value of depreciating assets under Division 40

22. Deductions for decline in value of depreciating assets are allowable under Division 40.

Prepaid rent

23. To the extent that a village operator receives amounts that are in form rent in advance, and non-refundable, the rent is assessable in full on receipt. Where the rent is fully abatable, it is assessable over the term of the lease, in accordance with the *Arthur Murray* principle.[1]

Licence fee

24. It is likely that the label 'licence fee' in commercial retirement village arrangements is a mischaracterisation. Usually, these arrangements involve leases rather than licences and the tax treatment will depend on the proper characterisation of the particular arrangements. However, if the agreement is properly characterised as a contractual licence, any licence fee payable by an incoming resident to the village operator for the use of a village dwelling is assessable in a similar way to rent paid in advance.

Premiums received for grant of assignable or non-assignable leases

25. Whether an amount payable by an incoming resident is a lease premium is determined by the proper characterisation of the legal rights of the parties. Where at law the amount received is a lease premium, then, having regard to the nature of the business – developing or acquiring a retirement village and putting that to profit by the recurrent granting of leases – the amount received for the grant of a lease, whether it be termed a lease premium or otherwise, is on revenue account and constitutes assessable income of the operator in the year in which it is derived.[2] No deduction is allowable for the cost of the underlying asset. The capital gains tax treatment of lease premiums is discussed in paragraphs 46-48.

26. Where an amount paid by an incoming resident is properly characterised as a lease premium and included in the assessable income of the operator, the amount payable by the operator to the resident upon termination of a lease agreement is an allowable deduction in the year in which the operator becomes liable to make that payment.

27. There has been a misdescription of labels in this area. As noted above, if the amount payable is a lease premium, it is fully assessable. However, where the amount payable is described as a lease premium, a proper examination of the relevant documentation may indicate that the amount is fully repayable to the resident

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[1] See *Arthur Murray (NSW) Pty Ltd v. FC of T* (1965) 114 CLR 314.
[2] See *Kosciusko Thredbo Pty Ltd v. FC of T* (1983) 15 ATR 165; 84 ATC 4043.

(although the village operator may be entitled to set off certain fees and charges against that amount) on termination of the lease. In this situation, the amount is not payable for the grant of a lease. The amount payable by the resident is more properly characterised as a loan. It is a receipt that is capital in nature. The taxation treatment of such amounts will be the same as for amounts known as 'interest-free loans' or 'security deposits'.

Interest-free loan or security deposit

28. Where the relevant arrangement requires the resident to make a loan, the receipt and repayment of the loan are on capital account. This situation arises where:

- an amount of money (sometimes referred to in retirement village contracts as an 'interest-free loan' or 'security deposit') is paid to a retirement village operator by an incoming resident; and
- the operator has an obligation to pay the same amount to the resident upon termination of the lease.

29. Where an amount, that may be described, for example, as an 'interest-free loan' or 'security deposit', is not repayable to the outgoing resident upon termination of the lease, it is regarded as a lease premium, prepayment of rent or other fee. Similarly, where an 'interest-free loan' is not repayable unless or until another resident enters into an agreement to occupy the accommodation unit vacated by the outgoing resident, the arrangement is not properly characterised as a loan and will be regarded as a lease premium. The fact that the repayment of the 'loan' is contingent upon a new resident being found, an event that may not happen, means than an essential element of a loan – the obligation to repay – is absent. In these circumstances, the intention that reasonably can be inferred is that the resident is not entitled to repayment of the 'loan' if a new resident is not found.[3] However, because such arrangements were not dealt with specifically in draft Taxation Ruling TR 2000/D5, a village operator will be allowed to treat the receipt of the 'loan' amount from a resident and any subsequent repayment of that amount to a resident under such arrangements entered into between the issue of TR 2000/D5 and the

[3] State or Territory legislation may require village operators to repay amounts advanced by residents within a specified period after the resident vacates the property, even if a new resident is not found. In circumstances where the relevant legislation effectively overrides the terms of the agreement between the operator and the resident in this respect, the repayment would no longer be contingent upon a new resident being found.

issue of this ruling as the receipt and repayment of a loan on capital account, in accordance with this ruling.

Moneys received by company on issue of redeemable preference shares

30. Where:

- an incoming resident is required to subscribe for shares, and
- the retirement village operator has an obligation to redeem the shares for the same amount upon termination of the lease,

the amount payable by the incoming resident and the amount payable by the operator upon redemption of the shares are both on capital account. The rights attached to the preference share usually consist of the right to occupy a dwelling in the retirement village. The preference share is the instrument used to confer the occupancy rights. The share usually does not confer any other rights such as voting, dividend or capital distribution rights.

31. When the resident leaves the village and the preference share is redeemed, the outgoing resident usually is liable to pay the village operator a deferred management fee, which is set off against the amount payable to the outgoing resident by the village operator upon redemption of the shares. The deferred management fee is assessable in accordance with paragraphs 39-40.

Other company title arrangements

32. One arrangement is where the retirement village operator owns all of the shares in the company that owns the village and particular classes of shares to which occupancy rights are attached are sold to village residents. Another arrangement is where the company that owns the village allots to village residents special class shares in the company to which occupancy rights are attached.

33. Under both arrangements, the amount payable by an incoming resident to purchase a share in the company is a receipt of capital.

34. When a resident under either of these arrangements leaves the village, the share is sold to the new resident. The outgoing resident is liable to pay the village operator a deferred management fee. The amount payable by the outgoing resident is assessable income of the operator in accordance with paragraphs 39-40.

35. In relation to the first arrangement outlined in paragraph 32, the sale of a share by the operator to the resident who first occupies an

accommodation unit in the village is the disposal of a CGT asset. Accordingly, the operator is required to work out if they have made a capital gain or loss upon the sale of the share and the time at which the event occurs.

36. In relation to the second arrangement outlined in paragraph 32, there is no CGT event upon the allotment of a share to a resident.

37. The subsequent sale of the share by the resident is the disposal of a CGT asset, but the event is disregarded if the requirements of section 118-10 of the 1997 Act are satisfied (i.e., if the dwelling in which the individual resident has an ownership interest was that person's main residence throughout the ownership period).

38. Any commission or other fees payable by an outgoing resident to the village operator upon the sale of a share to a new resident is derived by the operator under section 6-5 in the year in which the operator becomes entitled to demand payment of the fee from the outgoing resident. This will usually be in the year in which the share transfer occurs.

Deferred management fees

39. Under some occupancy agreements, deferred management fees are calculated, on a per annum basis, as a percentage of a resident's original entry price. The deferred management fee is usually subject to an upper limit (e.g., 2.5% of the original entry price for each of the first ten years that the resident occupies the village dwelling – i.e., a maximum of 25% of the original entry price). However, the village operator cannot properly demand payment of the fee until the resident ceases to reside in the accommodation unit to which the contract relates. That is a condition precedent to the making of a demand for payment. Until the condition precedent is satisfied, the fee does not mature into a recoverable debt.[4] Accordingly, the deferred management fee payable by an outgoing resident is derived by a village operator in the year in which the operator becomes entitled to demand payment of the fee from the outgoing resident.

40. Under other occupancy agreements, deferred management fees are calculated as a percentage of the entry price that is to be paid by the replacement resident. In this situation, the amount of the deferred management fee payable by an outgoing resident cannot be ascertained with certainty, nor can the village operator properly demand payment of the fee until the amount payable by the new resident has been determined. That will usually occur when a new

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[4] See *Henderson v. FC of T* (1970) 119 CLR 621, 70 ATC 4016; *FC of T v. Australian Gas Light Co & Anor* 83 ATC 4800, (1983) 15 ATR 105; and *Barratt &Ors v. FC of T* 92 ATC 4275, (1992) 23 ATR 339.

resident has entered into an agreement that grants occupancy rights of the accommodation unit vacated by the outgoing resident. If that is the case, the fee payable by the outgoing resident is derived by the village operator in the year in which the new resident enters into an occupancy agreement.

41. Where the amount payable by a new resident is properly characterised as a lease premium and the amount of the premium is included in the operator's assessable income, the deferred management fee is not included in the operator's assessable income in accordance with paragraphs 39-40. The deferred management fee is relevant only in relation to the calculation of the amount payable to the outgoing resident.

Periodic management or other fees

42. Periodic payments are usually made by residents to a village operator for the maintenance of the village and for the provision of other services. These amounts are included in the assessable income of the village operator, under section 6-5, when they become due and payable by the residents.

Recurring operating costs and sinking fund contributions

43. Residents also usually make payments to the village operator towards operating costs, either directly or into a sinking fund. Where the village owner is responsible for the outgoing, the payments made by the residents are included in the assessable income of the village operator under section 6-5 when they become due and payable by the resident. Operating expenditure that is properly characterised as a revenue expense, including holding charges, is deductible to the village owner under section 8-1 when it is incurred.

44. Where residents' contracts or State legislation regarding retirement villages require residents to pay sinking fund contributions to an independent trustee, or the village operator is required to hold residents' contributions on trust for the benefit of the village residents, these contributions are derived by the village operator when they become entitled to seek reimbursement from the independent trustee or transfer funds held on trust. Although it is necessary to examine the relevant contractual agreements or legislative framework, that entitlement usually arises when the operator has incurred the operating expenditure.

45. As neither the operator nor the residents are income beneficiaries of the trust estate, the income is assessable to the trustee under section 99A of the 1936 Act.

Capital Gains Tax consequences on grant of a long term lease

46. CGT Event F1 happens if a lessor grants a lease: section 104-110. The capital proceeds are any premium paid or payable for the grant of the lease: sub-section 116-20(2). The capital proceeds are reduced by expenditure incurred on the grant of the lease in working out whether the taxpayer has made a capital gain or loss on the grant of the lease: sub-section 104-110(3). Expenditure incurred on the grant of the lease does not include any part of the cost of the underlying asset.[5] However, expenditure can include giving property: sub-section 104-110(4). The undertaking of an obligation to pay an amount to a resident upon termination of the lease is regarded as the giving of property. Section 103-5 provides that the market value of the property is to be used in working out the amount of the payment, cost or expenditure.

47. Double taxation of the premium will be prevented by section 118-20.[6]

Election to treat long term lease as a sale

48. It is usual for the term of a lease granted to a retirement village resident to be 99 years. Non-assignable leases invariably terminate on the death of the resident. However, it is unlikely that a retirement village operator could reasonably expect that such a lease would continue for at least 50 years. Accordingly, the grant of such a lease is a CGT event F1, rather than CGT event F2.[7] However, a village owner may choose to have the grant of an assignable lease, which does not terminate on the death of the resident, treated as a CGT event F2 where, at the time of granting the lease, it is reasonable to expect that it would continue for at least 50 years and the other conditions in section 104-115 are met.

Termination of occupancy

49. Where a deposit or loan received by a village operator upon the grant of a lease is capital in nature, it follows that the repayment of that amount to an outgoing resident is also capital in nature.

50. Where a village operator, in addition to repaying the deposit or loan received by a village operator upon the grant of a lease, makes a

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[5] See the leading judgment of Hill J in *FC of T v. Krakos Investments Pty Ltd* 96 ATC 4063, at 4065; 32 ATR 7 at 10 where sub-section 160ZS(2) of the 1936 Act was considered (the provision of the 1936 Act that corresponds with subsection 104-110(3)).

[6] Rewrite of section 160ZA of the 1936 Act.

[7] Sections 104-110 and 104-115 of the 1997 Act.

payment to an outgoing resident (or to their legal personal representatives) that represents a share of any increase in the entry price payable by a new resident (that is, the difference between the entry price paid by the outgoing resident and the entry price payable by the new resident), such payments are deductible under section 8-1.

51. Refunds of unused rent in advance are also regarded as capital in nature, as are amounts paid on redemption of redeemable preference shares.

Sale of a retirement village

52. Where a village is not trading stock of the village operator, and the costs of development or acquisition are capital in nature, the proceeds from the sale of the village are also capital in nature.

53. Some prepayments such as rent in advance will not be assessable in full on receipt, but assessable over time when earned, or when the amounts can be said to have "come home". When a village is sold, the new owner may pay a lesser purchase price by undertaking to meet contingent liabilities for prepaid rent or other amounts repayable to outgoing residents in the future on termination of their leases. For capital gains tax purposes, the capital proceeds of the seller of the village and the cost base of the new owner will include an amount[8] for the liabilities assumed by the new owner for unused prepaid rent or other amounts repayable to outgoing residents. Double taxation of unused prepaid rent will be prevented by section 118-20.

54. Where the vendor of a retirement village remains contractually liable to village residents to repay unused rent in advance, or other unused prepayments, the rent is assessable income of the vendor as and when those amounts cease to be refundable or repayable.

55. However, where the contract to repay unused rent in advance is novated, the rent in advance has come home to the seller of the village on novation. The amount of unused rent in advance is included in the assessable income of the seller under section 6-5 in the year of the novation.

Capital Gains Tax on the sale of a retirement village

56. The sale of the village is a CGT event A1, under section 104-10.

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[8] Refer to sub-section 116-20(1) which specifies the inclusion in the capital proceeds of the market value of unsecured liabilities and section 116-55 which specifies a modification to the capital proceeds for assets subject to a liability by way of a security over the asset.

57. The capital proceeds from the event include the following:

- any money received for the sale (paragraph 116-20(1)(a));
- the amount of any secured liabilities assumed by the new village owner (section 116-55); and
- the market value of any other property received, such as a right in the nature of a contractual promise by the purchaser of the village to pay amounts to outgoing residents for unused rent in advance (paragraph 116-20(1)(b)).[9]

58. Taxation Ruling TR 1999/16 explains the tax treatment for a taxpayer who conducts a business with goodwill, and makes a capital gain or loss if a CGT event happens to goodwill of a business. For CGT events that happen after 11:45 am eastern standard time, 21 September 1999, the partial exemption for goodwill discussed in that Ruling has been replaced by the small business 50% reduction for active assets: see Subdivision 152-C.

59. The cost base for a village owner includes the money paid in respect of acquiring it, under sub-section 110-25(2). Purchasers of an existing retirement village business would include the amount of any assumed liabilities in the first element of the cost base, under section 112-35. However, where the new owner undertakes to meet contingent liabilities, such as the potential refund of any unexpired portion of rent in advance paid by existing residents to the outgoing owner, only amounts subsequently paid in satisfaction of that obligation would then form part of the cost base: see Taxation Ruling TR 93/15.

60. Expenditure does not form part of the second and third elements of the cost base (ie incidental costs and non-capital holding costs respectively) to the extent that a taxpayer has deducted or can deduct it. This expenditure is not at any stage included in the cost base, ensuring that no indexed component relating to it is recognised.

61. Whether deductible expenditure is excluded from the first, fourth and fifth elements of cost base depends on whether the CGT asset was acquired at or before 7:30 pm eastern standard time, 13 May 1997 (the changeover time), or whether it was acquired after the changeover time. These elements represent acquisition, improvement and title defence expenditure respectively.

62. For assets acquired at or before the changeover time, deductible expenditure may be included in the first, fourth and fifth

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[9] See also Taxation Ruling TR 93/15, which deals with similar provisions in the 1936 Act.

cost base elements. There is, however, an important exception for certain fourth element expenditure: see paragraph 64 below.

63. For assets acquired after the changeover time, deductible expenditure is at first included in the first, fourth and fifth elements. However, just before the relevant CGT event happens, the deductible expenditure is excluded from the cost base. The initial inclusion in and later exclusion from the cost base allows for the recognition of any indexed component to 30 September 1999.

64. The later exclusion from cost base outlined in paragraph 63 above applies to land or a building acquired at or before the changeover time for deductible expenditure forming part of the fourth element that is incurred after 30 June 1999.

65. The reduced cost base will not include any amount allowed (or allowable) as a deduction: sub-section 110-55(4). Accordingly, where a deduction has been allowed for the cost of development or acquisition of a village in accordance with Taxation Ruling TR 94/24, those amounts will not be included in the reduced cost base.[10]

66. Similarly, any amounts allowed under Division 43 for capital expenditure will also be excluded from the reduced cost base.

Transitional issues

67. A village operator may seek to amend assessments for prior years or recast accounts consistently with this Ruling. They will be able to do so, in any manner chosen, subject to any limitation on amendment contained in section 170 of the 1936 Act. However, there may be situations where a taxpayer has complied with Taxation Ruling TR 94/24 and does not seek to amend assessments for prior years.

68. A village operator may have complied with Taxation Ruling TR 94/24 and returned rent in advance as assessable income when paid by an incoming resident, notwithstanding the rent is fully abatable, and properly assessable following the principle in *Arthur Murray*. On the view expressed in this ruling, rent is included in assessable income as it comes home. In these circumstances a village operator is potentially taxable twice on the same income.

69. This treatment would produce an undesirable result, especially where it is no longer possible for assessments in prior years to be amended to exclude the rent in advance.

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[10] See paragraph 13 of TR 94/24, where the same position was adopted in respect of the operation of section 160ZK of the 1936 Act.

70. Accordingly, where a village operator has followed Taxation Ruling TR 94/24 and returned rent in advance as assessable income when paid by an incoming resident, notwithstanding the rent is fully abatable, and properly assessable following the principle in *Arthur Murray*, the rent will not be assessed a second time when the rent might be said to have "come home" in a period after this ruling comes into effect.

71. A similar treatment will be afforded to deferred management fees to prevent double taxation. This means that where a village operator has followed Taxation Ruling TR 94/24 and the full amount of the payment received from the incoming resident has been included in the assessable income of the village operator, then the deferred management fees will not be included in the assessable income of the operator in accordance with paragraphs 39-40 of this Ruling.

72. When a retirement village owner, who has claimed the development costs of a village in accordance with Taxation Ruling TR 94/24, sells that village, the sale proceeds are assessable under section 6-5: see paragraph 11 of TR 94/24. The sale of the village is also a CGT event. In calculating a capital gain, the vendor must include an amount in the capital proceeds to take into account liabilities assumed by the purchaser of the village.[11]

73. However, any capital gain is reduced in accordance with section 118-20 to the extent to which the amount is included in assessable income. To avoid double taxation, it is accepted that the inclusion of the gain on the granting of the initial leases under Taxation Ruling TR 94/24 and the gain included under the CGT provisions upon sale of the retirement village arise from the same event for the purposes of section 118-20. Similarly, it is accepted for the purposes of sub-section 160ZA(4) of the 1936 Act that both these amounts result from the disposal of the village.

Extent to which Taxation Ruling TR 94/24 may continue to be relied upon

74. Taxation Ruling TR 94/24 will continue to apply to arrangements of the type covered in that Ruling begun to be carried out before its withdrawal (section 14ZAAL *Taxation Administration Act 1953*).[12] Accordingly, owners of retirement villages who began

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[11] See paragraph 160ZD(1)(c) of the 1936 Act and sub-section 116-20(1) of the 1997 Act which specify the inclusion of the market value of unsecured liabilities and sub-section 160S(2) of the 1936 Act and section 116-55 of the 1997 Act which specify the inclusion of the amount of secured liabilities assumed.

[12] This does not include arrangements involving rights to occupy, partly funded by residents (see subparagraph 84(c) below). This type of arrangement was not covered by TR 94/24.

an arrangement to develop or acquire a retirement village before 19 April 2000 can apply TR 94/24 to that arrangement.

75. If a retirement village is developed by a partnership, the partners rather than the partnership are the owners of the village. Therefore, only those partners who began an arrangement before 19 April 2000 can apply TR 94/24. A partner has begun an arrangement only when an application for investment in a new partnership has been received or an interest in an existing partnership has been acquired. Partners whose applications for investment are received or who acquire an interest in a partnership after the withdrawal of TR 94/24 cannot rely on that Ruling.

76. Where investors invest in a trust to develop or acquire a retirement village, the trustee must have begun the arrangement prior to the withdrawal of TR 94/24 to apply that Ruling to the arrangement.

77. For the purposes of former section 14ZAAL and section 358-20 of Schedule 1 to the *Taxation Administration Act 1953*, each of the following is a separate 'arrangement':

(a) **Construction or acquisition of a village; grant of first occupancy rights; sale of village:** A village owner who comes within the terms of Taxation Ruling TR 94/24, and began an arrangement to build or acquire a retirement village prior to the date of withdrawal of Taxation Ruling TR 94/24, may continue to rely on the ruling after the date of its withdrawal in respect of claiming deductions for planned construction costs or costs of acquisition. This is subject to the proviso that lump sums payable by the first residents are included in assessable income, and that the gross proceeds on sale of the village are also included in assessable income in the year of sale;

(b) **Construction by stages:** The development or construction of a retirement village in stages on one parcel of land is one arrangement. A village owner, who comes within the terms of Taxation Ruling TR 94/24 and began an arrangement to develop a retirement village in stages prior to the date of withdrawal of Taxation Ruling TR 94/24, may continue to rely on the ruling after the date of its withdrawal in respect of claiming deductions for construction costs when incurred. This is subject to the proviso that lump sums payable by the first residents of each stage are included in assessable income, and that the gross proceeds on sale of the village are also included in assessable income in the year of sale;

(c) **Subsequent rollover of occupancy:** A village operator who comes within the terms of Taxation Ruling TR 94/24 may continue to rely on the ruling after the date of its withdrawal in respect of rollover of occupancy, described in paragraph 8 of TR 94/24, where the new occupancy arrangement was entered into prior to the ruling's withdrawal. For rollovers where the new occupancy arrangement was entered into after the withdrawal of TR 94/24, receipts from the incoming resident, and payments to the outgoing resident, will be treated in accordance with the principles outlined in this ruling.

78. The arrangements described in paragraph 77 of this Ruling will also be treated as separate arrangements for the purposes of withdrawal of private rulings made before 1 January 2006. To the extent that this public ruling is inconsistent with a private ruling, the Commissioner will be taken to have withdrawn the private ruling so far as there is any inconsistency and withdrawal is allowed: see former sections 14ZAU and 14ZAW of the *Taxation Administration Act 1953* and section 357-75 of Schedule 1 to the *Taxation Administration Act 1953*.[13]

Capital Gains Tax main residence exemption

79. Where a retirement village dwelling becomes the main residence of a resident under any of the arrangements discussed in this Ruling, there will be no capital gains tax implications upon the subsequent disposal of the dwelling by the resident or by the estate of the resident. This is because the resident has an 'ownership interest' in the residential unit for the purposes of section 118-130 of the 1997 Act and, consequently, any CGT event in relation to that interest is disregarded under section 118-100 of the 1997 Act.

[13] Under the former subsections 14ZAU(2) and (4) of the *Taxation Administration Act 1953*, the Commissioner could withdraw a private ruling if the arrangement to which it relates had not begun to be carried out, except to the extent it related to a year of income that had commenced or ended. The Commissioner, however, cannot withdraw a private ruling issued after 1 January 2006. Instead he can issue a revised private ruling if a private ruling was previously made and neither the scheme to which the earlier ruling relates, nor the income year has begun. (subsection 359-55(1) of Schedule 1 to the *Taxation Administration Act 1953*).

Date of effect

80. This Ruling applies to arrangements begun after 2.00 pm EST on 19 April 2000. 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 that date. See also paragraph 29 regarding the application of this Ruling to arrangements where there is no certain obligation to repay 'loan' amounts.

Note: The Addendum to this Ruling that issued on 1 November 2006 applies on and from 1 January 2006.

Explanations

Background

81. Historically, retirement villages were constructed and operated by churches and charitable organisations to provide residential accommodation for retired people. Those organisations 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.

82. 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. The operator provides various degrees of services to the residents of these retirement villages which often include different levels of community facilities. Some retirement villages are situated in complexes which include nursing home facilities and/or hostel accommodation.

83. Retirement villages constructed by commercial developers have been marketed in several ways. New arrangements are being devised to meet the demands of a growing industry.

84. There are three broad types of occupancy arrangements for retirement villages:

(a) **Strata title arrangements.** Residents buy the dwellings outright, and the village operator manages the village and often provides other services to the residents;

(b) **Rights to occupy, fully funded by residents.** Legal title to the village stays with the village operator. The owner recoups the full development cost of the village from the initial occupants. Residents pay an amount equivalent to the market value or at least the cost of the dwelling on taking up residence. At the end of the occupancy, residents or their estates often share in any capital appreciation or depreciation of their dwelling, and usually are required to pay deferred management fees. In addition, residents pay regular maintenance fees and usually also sinking fund contributions. Some arrangements provide for a payment by a resident that is less than the market value of the dwelling ('discount leases') and the resident is liable to pay an increased deferred management fee upon termination of the right to occupy;

(c) **Rights to occupy, partly funded by residents.** Legal ownership of the village remains with the owner/operator of the village. The owner does not recoup all of the development costs of the village from the initial occupants. Residents pay less than market value of the dwelling on taking up residence and may pay a periodic rental (usually subsidised with rent assistance from the Commonwealth) as well as regular maintenance fees, sinking fund contributions and deferred management fees. This type of arrangement was not covered by Taxation Ruling TR 94/24.

85. In arrangements other than strata title villages, a variety of occupancy rights may be granted. These include a non-transferable 99 year lease, assignable lease, lifetime lease, loan agreement, loan/licence, preference share and other similar arrangements. Under all of these arrangements residents usually pay a lump sum on entry and are entitled to some form of payment at the end of the occupancy (usually after a new tenant is found). Residents may also be liable to pay regular maintenance fees (monthly, fortnightly or other), sinking fund contributions for periodic maintenance and improvements, and deferred management fees.

Description of some existing arrangements

86. **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. The developer may also be entitled to a deferred management fee. The village operator acts as the manager

of the body corporate in relation to the community facilities and may also provide other services to the residents.

87. **'Purple Title':** Under this arrangement, a resident acquires an undivided share in a retirement village as a tenant-in-common. The resident does not acquire a particular dwelling in the village, but obtains the right to occupy a dwelling under contractual arrangements between the tenants-in-common. Generally, when the resident's undivided share is sold to a new resident, the operator is entitled to a share of the profit (if any) on the sale. The operator may also be entitled to a deferred management fee.

88. **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 operator of an amount described as a 'lease premium' or lease 'deposit' equal to the market value of the dwelling. Upon termination of the lease, the operator is obliged to make a payment to the outgoing resident (or personal representative) equivalent to the entry price paid by the new resident. The outgoing resident may be required to pay a deferred management fee. The operator is entitled to offset the amount of the deferred management fee payable by the resident against the amount the operator is required to pay to the outgoing resident.

89. **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 owner 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 owner 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 may be obliged to pay the village operator a 'deferred management fee' and also a commission for services which may have been rendered in connection with the assignment of the lease.

90. **Loan/lease (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 operator of an 'interest-free loan' equal to the market value of the dwelling. Upon termination of the lease, the operator is obliged to repay the loan to the outgoing resident (or personal representative) and the outgoing resident may be required to pay a 'deferred management fee' to the operator. The deferred management fee is offset against the amount repayable to the outgoing resident.

91. Leases will be either 'participating leases' or 'non-participating leases'. A resident who enters into a participating lease shares in any capital 'gain' or 'loss'; that is, the difference between the 'loan' originally provided by the resident and the replacement 'loan' given by the new resident. A non-participating lease is one where the resident does not share in the capital 'gain' or 'loss' upon termination of the lease.

92. **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' equal to the market value of the dwelling. Upon termination of the 'licence', the owner is obliged to make a payment to the resident (or personal representative) equivalent to the original 'loan' given by the resident and the outgoing resident may be required to pay a 'deferred management fee'. The deferred management fee is offset against the amount of the loan repayable to the outgoing resident. The outgoing resident may also share in any capital 'gain' or 'loss'; that is, the difference between the 'loan' originally provided by the outgoing resident and the replacement 'loan' given by the new resident.

93. **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 'lease 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 operator, or, alternatively, to a trustee, who, under the terms of a trust deed, agrees to give to the village operator an interest-free loan to the extent of the amount received from a resident. Upon termination of the lease, the operator is obliged to refund advance rental on a pro rata basis and also repay 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 operator is required to repay the funds obtained from the trustee and the trustee is obliged to repay the 'loan' or 'deposit' originally advanced by the resident.

94. **Redeemable Preference Share:** Under this arrangement, a company, which owns a retirement village, issues redeemable preference shares to new residents. The articles of association confer a right to a resident shareholder to be granted a long-term lease (for 50 years or more) or a 'licence' of a dwelling in the village, conditional upon payment of a share premium, or the issue price of the shares, equal to the market value of the dwelling. The articles also confer upon an outgoing resident shareholder a right, upon termination of the lease, to redemption of the preference share by the company and to be paid an amount equivalent to the original share premium or

issue price. The outgoing resident may be obliged to pay deferred management fees. The deferred management fee is offset against the amount payable to the outgoing resident. There are similar arrangements that use a unit trust structure. The treatment of these arrangements is similar to that applied to redeemable preference share arrangements.

95. In relation to some of these arrangements, the outgoing resident (or their estate) may be entitled to a share in any capital 'gain' or 'loss' (that is, the difference between the initial entry price paid by the outgoing resident and the entry price payable by the new resident). These arrangements effectively give residents an equity interest in the village units and have many features in common with a strata title sale.

96. Deferred management fees may be calculated as a set percentage, for each year of occupancy, of a resident's original entry price or the entry price paid by a new resident, often limited to a maximum amount (e.g., 25% of the original entry price). The deferred management fee may also be the greater of a set percentage per year of occupancy of either the original entry price paid by the outgoing resident or the entry price payable by the new resident.

97. The operator of the village usually derives income in the form of 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. State retirement villages legislation may regulate some of these payments.

Taxation treatment of the arrangements

Strata title

98. Strata title transactions involve the sale of dwellings within a retirement village complex. The owner generally has an option to repurchase individual dwellings from residents or their personal representatives for subsequent resale, or is entitled to receive a commission if they arrange for the resale of a dwelling on behalf of an outgoing resident or their personal representative. Commission fees generally are secured by a charge over the property.

99. The tax treatment for strata title operators is essentially the same as that under Taxation Ruling TR 94/24. Where a developer constructs a retirement village and sells the individual units on a strata title basis, the owner will be required to account for the sale of those units under the trading stock provisions of the 1997 Act. Similarly, where the owner of the village repurchases a unit from an outgoing resident and sells it to another retiree, the unit will be treated as the

trading stock of the owner and the trading stock provisions of the 1997 Act will apply.

100. Where the village owner acts as agent for the resident upon the resale of a dwelling, any commission received by the owner is included in assessable income under section 6-5 in the year in which the income is derived. Deferred management fees are assessable in accordance with paragraphs 39-40 above.

101. Generally, the owner will dispose of the common property of the village, including what are known as community facilities, to, for example, a body corporate comprising the residents of the village. In that situation, the common property will be treated as a separate item of trading stock and the trading stock provisions will apply. However, if the owner retains ownership of part of the common property, expenditure attributable to that property cannot be absorbed into the cost of trading stock. Deductions will be allowable under Division 43 in respect of that expenditure, to the extent that it satisfies the requirements of that Division.

'Purple Title'

102. The tax treatment for operators of 'purple title' villages is similar to that of strata title operators. Under these arrangements, a developer constructs a retirement village and residents acquire the village as tenants-in-common, each owner having an undivided share in the village. Consequently, legal title to the village transfers from the developer to the residents. The developer will be required to account for the sale of the village under the trading stock provisions of the 1997 Act.

103. Where the operator is entitled to a share of the profit on sale, when an outgoing resident sells their undivided share of the village, the amount payable to the operator is assessable in the year in which settlement occurs. Until settlement, no debt is owed to the village operator: see *Gasparin v. FC of T.*[14] Deferred management fees are assessable in accordance with paragraphs 39-40 above.

Village operators who grant occupancy rights: characterisation of development and construction costs, or costs of acquisition

104. A village operator who incurs costs in developing, constructing or acquiring a retirement village for the purpose of carrying on a retirement village business and grants occupancy rights

[14] 94 ATC 4280; (1994) 28 ATR 130.

to village residents, acquires a profit yielding subject. The outgoings are clearly capital or capital in nature.

105. In *Sun Newspapers Ltd v. FC of T*,[15] Dixon J said:

> The distinction between expenditure and outgoings on revenue account and on capital account corresponds with the distinction between the business entity structure or organisation set up or established for the earning of profit and the process by which such an organisation operates to obtain regular returns by means of regular outlay, the difference between the outlay and returns representing profit or loss.[16]

106. This was described as the difference between the profit yielding subject and the process of operating it.[17] In determining the true character of the expenditure, three matters must be considered:

> … (1) the character of the advantage sought, and in this its lasting qualities may play a part, (2) the manner in which it is to be used, relied upon or enjoyed and in this and under the former head recurrence may play its part and (3) the means adopted to obtain it; that is by providing a periodical reward or outlay to cover its use or enjoyment for periods commensurate with the payment or by making a final provision or payment so as to secure future use or enjoyment.[18]

107. A retirement village constructed for operating a business over time will bring in receipts or profits over the period it is held. Profits come from granting of occupancy rights to the real estate, which is at all times owned by the village operator. A significant advantage will be obtained by the operator on the grant of the first long-term leases or licences, as well as long-term benefits. Payments will be made by new residents on the grant of new leases, which may be expected to exceed payments to outgoing residents or their estates. Deferred management fees may also be offset against amounts payable to outgoing residents.

108. In the case of villages which are not fully resident-funded, because the entry price is significantly less than cost recovery, the long-term benefits represent a greater part of the benefits derived from the expenditures.

109. It is clear that the cost of land, development and construction costs result in a profit yielding subject, notwithstanding that major benefits will also be obtained within the first few years. Accordingly the expenditure should be treated as capital in nature.

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[15] (1938) 61 CLR 337.
[16] 61 CLR at 359.
[17] 61 CLR at 360.
[18] 61 CLR at 363.

110. In the case of the purchase of an existing village, the operator will only acquire long-term benefits, which will be realised on the termination of existing leases, when new leases (for higher entry prices) may be granted. The purchase price is clearly of a capital nature.

Characterisation of receipts on the grant of occupancy rights: form of retirement village arrangements

111. It is usually necessary for a prospective resident to enter into a number of agreements which are essential or integral to one another. Invariably, exclusive possession of a retirement village dwelling is dependent on payment of the full entry price, irrespective of the several forms that may take. The agreements do not give a resident absolute ownership equivalent to fee simple, although contractual guarantees and statutory safeguards ensure they have a proprietary interest in the dwelling they occupy. They do give a resident secure long-term tenancy rights, but residents can be forced to vacate if unable to care for themselves. Residents are usually unable to assign their rights, or their assignment is strictly controlled.

112. Arrangements can vary from village to village, and even from resident to resident within a village. However all arrangements can be broken down into the following rights and obligations:

113. From the residents' point of view:

- residents are obliged to enter into all of the necessary agreements;
- before taking possession, residents are required to pay the full entry price, however calculated;
- residents acquire secure long-term tenancy rights, subject to conditions and restrictions;
- residents will have the right to use common areas and facilities;
- residents are obliged to contribute to budgeted village operating costs, and sometimes to a sinking fund established by the operator;
- at a defined time after termination of a tenancy, the resident (or their estate) will be entitled to a payment from the village operator, and/or a trustee, based on the entry price paid by that resident or the entry price paid by the new resident. Residents also often share in any capital gain or loss; that is, the difference between the entry price paid by the outgoing resident and the entry price paid by the new resident. They also usually have

an obligation to pay deferred management fees based on the actual period of occupancy.

114. From the village operator's point of view:

- the operator has the right to receive the entry price (including any amounts passed through a trustee);
- the operator has the right to receive contributions from residents to meet the costs of running the village;
- at a defined time after termination of a tenancy, the operator is obliged to make a payment to the outgoing resident (in some circumstances the payment to an outgoing resident may be contingent upon a new resident entering into an agreement and having paid the entry price for the right to occupy the dwelling);
- from the amount payable to an outgoing resident, the operator may be entitled to retain or offset amounts often described as 'deferred management fees';
- the operator and the outgoing resident may share any increase or decrease in the value of the long-term tenancy right;
- the operator has responsibility for maintaining and running the village.

115. In form, the long-term occupancy rights granted to village residents constitute a lease agreement. A lease confers on a tenant an interest in the land and the right to exclude all persons from the property that is the subject of the lease. A tenant may even exclude the landlord, usually subject to the right to enter and view the state of repair.

116. Some of the arrangements under which occupancy rights are granted to village residents are described as a licence (a mere right to occupy that, without more, confers no interest in the land and no right to exclude all persons from the land).[19] However, the occupancy rights granted to retirement village residents that are the subject of this Ruling are not usually the grant of a mere right to occupy and so the label ascribed by the parties to the contractual relationship is not correct in these cases.

117. Where an amount, described as pre-paid rent, is genuinely for the use of the premises by a resident, for taxation purposes it represents the payment of rent in advance and should be accounted for accordingly.

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[19] Peter Butt, *Land Law*, 2nd ed, Law Book Co, Sydney, 1988, p.220.

118. Where a payment by a resident, described as an 'interest free loan', 'security deposit' or 'lease premium', is fully repayable at the end of the occupancy, it is in form a 'loan'. It is unlikely to be held to be in form a premium: see *FC of T v. Krakos Investments Pty Ltd* [20]. However, to the extent that any amounts can be deducted from or offset against the amount repayable, to cover deferred management fees, those amounts are derived in accordance with paragraphs 39-40.

119. Lease agreements sometimes describe the entry price in a way that does not correspond with the form of the arrangement. For example, where the entry price is described as a 'lease premium', but the agreement provides that the amount of the entry price will be repaid to the resident on termination of the lease, the proper characterisation of the entry price is that it is a loan in form and not a lease premium.

120. Where an amount received by an operator from a resident is properly characterised as a loan, it is expected that the amount received would be reflected in the operator's accounting records accordingly.

121. Where an entry price is described as an 'interest-free loan' or a 'security deposit', but the operator is obliged to make a payment to the outgoing resident calculated by reference to the new resident's entry price, the proper characterisation of the entry price is that it is a lease premium and not a loan, because it cannot be regarded as other than a payment that is required to be made in consideration for the granting of the lease. The taxation treatment of entry prices is determined by the legal form of the particular arrangement rather than the name used to describe it (see also paragraphs 133-134).

Prepaid rent

122. The question of whether an amount described as rent in advance paid by a resident of a retirement village should be regarded as rent rather than as a premium was considered by the Supreme Court of NSW in *Frazier v. Commissioner of Stamp Duties (NSW).*[21] An amount of about $31,000 was said to be rent in advance for 20 years. However, there was no indication of its relationship to any weekly or periodic amount of rent. The resident was told by her solicitor that the sum was to cover rent for 20 years, and that a portion would be

[20] 96 ATC 4063, at 4075; 32 ATR 7 at 21.
[21] (1985) 85 ATC 4735; 17 ATR 64. *Frazier* was cited with approval by Hill J in the leading judgment of the Full Federal Court decision in *FC of T v. Cooling* 90 ATC 4472, at 4485. See also McHugh JA, in *Commissioner of Stamp Duties (NSW) v JV (Crows Nest) Pty Ltd* 86 ATC 4740, at 4747; 17 ATR at 1094.

refundable in certain events.[22] The resident also had to pay regular maintenance charges, which were agreed to be rent.[23]

123. In determining the amount payable in advance, the retirement village owner's real estate agent fixed the term for the amount by reference to the cost of the building, taking into account current rental values, the value to the village owner of rent in advance, and the security of tenure being granted under the lease. However these matters were seen as not pointing, one way or the other, to whether the amount was 'rent' or 'premium'.[24]

124. Lee J said the question was to be determined by deciding whether the sum "is a payment required as a consideration for the granting of the lease or whether it is a payment for the use and enjoyment by the lessee of the land".[25]

125. The Court considered that the matter was not to be controlled by the way in which the parties described the payments.[26] The fact that the lease document granted a lease for 20 years "upon payment by the lessee (resident)… of the rent in advance as a lump sum… for the grant of this lease", pointed to the payment being made "as a consideration for the grant of the lease" and therefore a premium. However, the Court said the whole circumstances must be looked at to determine as a fact whether the amount was paid as a consideration for the granting of the lease or whether it was a payment intended as rent for the use of the premises.[27]

126. The Court placed great significance on the provisions for abatement in the case of destruction or damage by fire, flood etc., when the premises become unfit for occupation, or on early termination of the lease, such as on the death of the resident, when compensation was to be paid for the rent in advance for the unexpired term of the lease. The inference drawn was a clear intention by the parties that the amount paid was referable to the actual use and occupation of the premises by the resident, and therefore 'rent'.[28] The fact that the amount was paid in a lump sum, and was not quantified by reference to any periodical payment, did not affect this conclusion.[29]

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[22] 85 ATC at 4739; 17 ATR at 69.
[23] 85 ATC at 4736; 17 ATR at 65.
[24] 85 ATC at 4739; 17 ATR at 69.
[25] 85 ATC at 4738; 17 ATR at 68. See Also *Ex parte Lathouras; Re Vendardos* [1964-5] NSWR 254, at 257, where amounts described as 'premium' were held to be part of the payment for the use of the land, and therefore rent.
[26] 85 ATC at 4737; 17 ATR at 67.
[27] 85 ATC at 4740; 17 ATR at 70.
[28] 85 ATC at 4740; 17 ATR at 70.
[29] 85 ATC at 4742; 17 ATR at 72.

127. In *Case B51,* 70 ATC 253, the taxpayer received three years rent in advance, but without provision for any abatement. The Taxation Board of Review held that the amount was in fact rent, but that it had "come home" to the taxpayer and was assessable in full in the year of receipt.[30]

128. Retirement village leases should generally be regarded as arm's length transactions. Residents are protected in their dealings with village operators by State legislation and a code of practice, and are expected and encouraged to obtain independent legal advice before entering into leases. The money the residents spend on their accommodation is clearly based on what the market will bear.

129. Where:

- a resident is prepared to make a lump sum payment in exchange for the right to occupy a village dwelling for a fixed term;
- the resident is entitled to receive a pro-rata refund for the unexpired portion of the lease on termination; and
- the intention of the parties to the lease is that the lump sum payment in advance is for the use and enjoyment by the resident of a village dwelling for the fixed term,

the amount payable should be accounted for as a payment of rent in advance. This may be the case, notwithstanding that the rent may be calculated as a percentage of the market value of the property.

130. The rent should be brought to account over the period for which the payment is made, in accordance with the *Arthur Murray* principle.[31] This was the approach adopted by the Taxation Board of Review in *Case B47,* 70 ATC 236.

Characterisation of receipts on the grant of occupancy rights: licence fee

131. The difference between a lease and a licence was described above at paragraph 116. The retirement village occupancy arrangements dealt with in this Ruling give legal rights and obligations in the nature of a lease. However, if there is an arrangement under which a resident obtains no more than a mere licence to occupy a village dwelling, and the resident is required to pay a licence fee in return for the use of the retirement village dwelling, the fee is regarded as rent, or in the nature of rent, and is

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[30] 70 ATC at 254; Case 113 15 CTBR (NS) 736 at 738.
[31] *Arthur Murray (NSW) Pty Ltd v FC of T* (1965) 114 CLR 314.

included in the village operator's assessable income as rent in advance as per paragraph 23.

Characterisation of receipts on the grant of occupancy rights: premiums received for grant of leases

132. A premium received for the grant of a lease of a dwelling in a retirement village is a revenue receipt.[32]

133. Whether an amount is a premium or not is a question of fact, and will not be determined by the description ascribed to it by the parties: *Frazier's* case (see paragraph 122 above). Similarly, in *Radaich v. Smith*[33] McTiernan J said: "the parties cannot by the mere words of their contract turn it into something else. Their relationship is determined by the law and not by the label they choose to put on it".[34]

134. Where a payment by a resident is fully repayable at the end of the occupancy, it is unlikely to be held to be in form a premium: see *FC of T v. Krakos Investments Pty Ltd*.[35] In these circumstances, the agreement would more properly be characterised as a loan agreement (refer to paragraphs 136-138). If this is the case, the taxation treatment described in paragraph 28 would apply.

Characterisation of receipts on the grant of occupancy rights: interest free loan or security deposit

135. Under some arrangements, the resident is required to make an interest-free 'loan' to the operator in consideration for the grant of a long-term lease. The amount of a loan may be as high as the equivalent to the market value of the dwelling. Upon termination of the lease, the operator is obliged to make a payment to the outgoing resident (or personal representative) equal to the amount of the original 'loan' and the resident is required to pay a 'deferred management fee', calculated by reference to the period of occupancy. The deferred management fee is deducted from or offset against the amount of the loan repayable to the outgoing resident. The outgoing resident may share in any capital 'gain' or 'loss'; that is, the difference between the amount of the 'loan' originally made by the outgoing resident and the replacement 'loan' provided by the new resident.

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[32] See *Kosciusko Thredbo Pty Ltd v. FC of T* 84 ATC 4043, at 4052; 15 ATR 165 at 175.
[33] (1959) 101 CLR 209.
[34] Ibid, at 214, adopting the words of Denning LJ in *Facchini v. Bryson* (1952) 1 TLR 1386. See also Taylor J at 219 and Windeyer J at 222.
[35] 96 ATC 4063, at 4075; 32 ATR 7 at 21.

136. For example, a resident moves into a village unit on 1 July 2000 and provides a 'loan' of $100,000 under the terms of the lease agreement. On 30 June 2005, the resident leaves the village and the lease is terminated. On 1 July 2005, a new resident moves into the unit and is required to provide a loan of $150,000.

137. The outgoing resident is required to pay deferred management fees equal to 5% of the original loan of $100,000 for each year the resident has occupied the unit (subject to an upper limit of 25% of the original 'loan') and is also entitled to receive 50% of the difference between the original 'loan' and the amount of the 'loan' provided by the new resident. The operator will be obliged to pay to the outgoing resident (or personal representative) a net amount calculated as follows:

Repayment of original 'loan'	$100,000
Less deferred management fee	25,000
	75,000
Add resident's share of 'capital gain'	25,000
Net amount payable to outgoing resident	$100,000

138. In form, this arrangement is a loan and the taxation treatment in paragraph 28 would apply. As discussed in paragraph 134 above, even if the entry price is described, in such arrangements, as a 'lease premium', it is in form a loan.

139. A receipt of a loan or deposit will be regarded as capital in nature.[36] Where deferred management fees are payable by a resident and are subsequently offset against the amount repayable to the resident upon termination of the lease, the deferred fees are assessable in accordance with paragraphs 39-40.

140. In some instances, where the entry price is described in the arrangement as an 'interest-free loan', the payment to the outgoing resident is calculated as a percentage of the lump sum amount payable by a new resident. For example, if an outgoing resident has occupied a village unit for a period in excess of three years, the outgoing resident is entitled to receive 80% of the loan advanced by the new resident. Therefore, the amount received by the outgoing resident could be greater or less than the original loan. Consequently, on signing the occupancy agreement, the village operator is not obliged to repay the original 'loan' amount, but is only required to make a payment of a yet to be determined amount on the termination of the lease.

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[36] See e.g. *Australian National Hotels Ltd v. FC of T* 88 ATC 4627, at 4633; 19 ATR 1575 at 1581-82.

141. A standard definition of 'loan' is found in *Chitty on Contracts*,[37] 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".

142. 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". See also the judgment of Sackville and Lehane JJ in *FC of T v. Radilo Enterprises Pty Ltd* where their Honours said that "A loan involves an obligation on the borrower to repay the sum borrowed."[38] They then refer to Dr Pannam's description of a loan of money and cite further authority for the proposition that the obligation to repay the principal sum is an essential feature of a loan transaction.[39]

143. In circumstances where the principal amount is not repayable (whether or not there is provision for the payment of interest), an essential feature of a loan is absent. Accordingly, these amounts are paid in relation to contractual arrangements that do not require a repayment of the principal and are not properly characterised as loans. These arrangements are more properly characterised as the payment of a lease premium because they are payments made as consideration for the grant of a lease. Such payments are assessable income of the village operator in the year in which the occupancy agreement is entered into. The amount payable to the outgoing resident upon termination of the occupancy agreement is an allowable deduction to the village operator in the year in which the operator is obliged to make the payment to the outgoing resident under the terms of the occupancy agreement.

Characterisation of receipts on the grant of occupancy rights: moneys received by company on issue of redeemable preference shares

144. Under this type of arrangement, an incoming resident purchases a redeemable preference share in a company which owns a retirement village. However, the resident is required to pay an issue price or purchase price equivalent to the market value of the dwelling

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[37] 25th Ed., (1986) Sweet & Maxwell, 541.
[38] 97 ATC 4151 at 4161; (1997) 34 ATR 635 at 646.
[39] An alternative view is that it is not necessary for the actual amount of the 'loan' to be repayable for the transaction to constitute a loan. Having regard to the context of the arrangements considered in this Ruling, it is considered that the alternative view is not the correct view of the law.

to be occupied. Under the old corporations law, a resident was required to pay a share premium equivalent to the market value of the dwelling. Usually, there are several different classes of shares. A shareholder is entitled to the grant of a lease or 'licence' of a particular type of 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.

145. Upon termination of the lease, the preference share is either redeemed or sold to a new resident on the outgoing resident's behalf. Upon redemption, the company is liable to pay the outgoing resident (or personal representative) an amount equivalent to the original issue price and the resident is required to pay a deferred management fee calculated by reference to the period of occupancy (usually a percentage of the issue price of the share for each year the resident occupies the village dwelling, up to a maximum of 25%). The deferred management fee is deducted from or offset against the amount payable to the resident upon redemption of the preference share. The resident also may share in the 'capital gain or loss'; that is, the difference between the original issue price or share premium paid by the outgoing resident and the issue price or share premium paid by the new resident.

146. Moneys received by way of premiums on shares issued by a company are regarded as capital receipts: see, for example, *Lowry v. Consolidated African Selection Trust Ltd* (1940) AC 648. Similarly, the amount paid by the company to redeem the resident's share is a payment of capital. Where deferred management fees are offset against the amount payable to an outgoing resident on redemption of the shares, the deferred fees are assessable in accordance with paragraphs 39-40.

Deferred management or other fees

147. There is a question about the time at which deferred management fees are derived by village operators, who generally derive income on an accruals basis.

148. For taxpayers who operate on an accruals basis of accounting, "income will ordinarily be derived when a debt comes into existence, irrespective of when the debt is paid or becomes payable": see *BHP Petroleum (Bass Strait) Pty Ltd v. Commissioner of Taxation*[40] per Kenny J, and the cases cited therein.

149. Usually the calculation of the deferred management fee is based on the initial years of residency. For example, the fee may be

[40] 2002 ATC 4142; (2002) 49 ATR 145

calculated as a percentage (e.g., 2.5%) of the entry price paid by a resident (e.g., $100,000) for each year that the resident remains in the accommodation unit. The fee is usually payable only for a specified number of years (e.g., 10 years). This means that, in this example, the maximum deferred management fee payable by the outgoing resident is 25% of the entry price paid ($25,000). (If the resident occupies a unit for a period of five years, the deferred management fee in this example would be $12,500. If the resident occupies a unit for a period of ten or more years, the fee would be $25,000, irrespective of the number of years the resident continues to reside in the unit.)

150. It can be argued that at the end of each year of occupancy (or part thereof), an amount has become due to the operator. However, under the contractual arrangements, the resident is not obliged to pay the deferred management fee until the occupancy agreement is terminated. Accordingly, the village operator has no present right to demand payment of the fee until the occupancy agreement comes to an end.

151. There are also arrangements in the industry where the deferred management fee is calculated as a percentage of the entry price that will be paid by a new resident. Similarly, the operator does not have any right to demand payment of the fee until the occupancy agreement comes to an end. Furthermore, because the fee is based on an amount that will not be known until some time in the future, the amount of the fee cannot be presently ascertained (although a reasonable estimate can be made, based on the current market value of the unit, at the end of each year of occupancy (or part thereof)).

152. Whether a deferred management fee is calculated by reference to the entry price paid by the resident or is calculated by reference to the entry price to be paid by a new resident, the better view of the law appears to be that no debt comes into existence (and, therefore, the fee is not derived for taxation purposes) until the occupancy agreement comes to an end and the village operator becomes entitled to demand payment of the fee from the outgoing resident. However, the relevant time at which derivation occurs can be established only by reference to the specific contractual arrangements between the parties, and may also be subject to the operation of any State legislation that regulates such arrangements.

Sale of a retirement village

Treatment of rent in advance, or other prepayments, which new village owner undertakes to pay to outgoing residents

153. Some prepayments such as rent in advance will not be assessable in full on receipt, but assessable over time when earned, or when the amounts can be said to have "come home". When a village

is sold, the new owner may pay a lesser purchase price by undertaking to meet contingent liabilities for prepaid rent or other amounts repayable to outgoing residents in the future on termination of their leases.

154. Where the vendor of a retirement village remains contractually liable to village residents to repay unused rent in advance, or other unused prepayments, the rent is assessable income of the vendor as and when those amounts cease to be refundable or repayable.

155. However, where the contract to repay unused rent in advance is novated, the rent in advance might be said to have come home to the seller of the village on novation. The seller is assessable on that rent, under section 6-5, in the year of the novation.

156. The liability of the seller of a retirement village to refund the prepaid rent is governed by the law of landlord and tenant. The seller, as original lessor, is a party to a contract, constituted by the lease, between itself and the resident as original lessee.

157. The existence of privity of contract means that both the original lessor and the original lessee remain liable for the performance of their respective covenants in the lease even after they have assigned their respective interests in the land. This means that not only may the original lessor enforce all the covenants in the lease to be performed by the lessee while the original lessee retains the lease but also that the original lessee remains liable on those covenants even after he or she has assigned the lease to a third party.

158. By the same token, the original lessor remains liable on the lessor's covenants in the lease notwithstanding any disposal by the original lessor of their reversion.[41] Thus under the ordinary law of landlord and tenant the original lessor would remain liable to refund any unused portion of the prepaid rent to an existing resident (or their estate) upon the resident vacating their dwelling or dying, even though the original lessor had disposed of the reversion.

159. The liability of the original lessor could only be extinguished by an agreement with the original lessee. Presumably a novation would have to be entered into between the original lessor, the original lessee and the purchaser under which the original lessee released the original lessor from their liability to refund unused rent in advance upon the purchaser undertaking to take over this liability.

160. There would, of course, be no privity of contract between the purchaser and the lessee (whether the original lessee or an assignee from the original lessee) although there is privity of estate. Where

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[41] *Stuart v. Joy* [1904] 1 KB 362 referred to by *Megarry and Wade-Law of Real Property*, Stevens & Sons, 1957, at 654.

there is only privity of estate the purchaser of the reversion is only liable in respect of lessor's covenants which "run with the land", i.e., covenants which "touch and concern the land" or, put slightly differently, "have reference to the subject matter of the lease". It was held in *Re Hunter's Lease* [1942] Ch 124 that a covenant by a lessor to pay the tenant £500 at the end of the lease unless a new lease was granted was not a covenant which ran with the land so as to enable the lessee to sue the assignee of the reversion for the amount on termination of the lease without a new lease being granted.

161. It is our view that a covenant by a lessor to refund to the lessee unused rent in advance upon early termination of the lease is not a covenant which runs with the land so as to be enforceable by the original lessee against a purchaser of the reversion. The original lessee's rights would be against the original lessor only. It should be noted that in some States legislation may make the new village owner liable to residents for existing obligations of the outgoing owner (the original lessor).

162. If the purchaser of the reversion was liable under such a covenant**,** this would not mean that the original lessor would not also be liable. The original lessee in such circumstances would have the ability to recover against either the original lessor or the purchaser of the reversion although the original lessee would not be able to recover more than once. If the purchaser were required to pay, they would have a right of indemnity against the original lessor.

163. Unless the original lessor were to require the purchaser of the reversion to indemnify them against any payment they were required to make to the original lessee by way of refund of unused rent in advance, the original lessor would have no right of indemnity against the purchaser (and this is the case whether or not the purchaser was also liable under the covenant by virtue of it being one which ran with the land).

164. If the original lessor wished to make the purchaser liable for the refunding of the unused rent in advance, it would be necessary for the original lessor, the residents and the purchaser to enter into a novation agreement or to have the purchaser indemnify the seller (original lessor) against all claims made on it by residents. In the absence of novation, the original lessor would remain liable to the residents to make the refunds if and when required to do so, even though it had a right of indemnity against the purchaser. In these circumstances, it could not be said that the original lessor was in a position where it had done everything necessary to earn the rent paid in advance and therefore had derived the same. It would remain liable to refund the unused portion of any such payment and the right of indemnity against the purchaser does not change this situation.

Sinking Funds: residents' contributions for village maintenance

165. Under non-strata title occupancy arrangements residents usually contribute to the cost of maintaining the village. Generally, such contributions are paid directly to the village operator as periodic fees. The operator may refer to such fees as sinking fund contributions.

166. Whether these contributions are reflected in a Sinking Fund Account in the village operator's books or placed in a separate bank account of the operator, the contributions are income of the operator and are assessable when they become due and payable by the resident. The contributions are able to be used by the operator at any time for the purpose of maintaining the operator's property.

167. In some cases, the residents' contracts or State legislation require residents to pay sinking fund contributions directly into a trust fund established for that purpose, and the contracts or legislation specify that the funds may only be used for the purpose of maintaining the village. In these circumstances, contributions are considered to be income of the operator only when the operator has incurred operating expenditure and becomes entitled to seek reimbursement of that expenditure from the trustee. They are not income of the trustee as they are contributions of capital to the trust. Amounts received by the operator from the trustee are assessable when the operator has incurred relevant expenditure and becomes entitled to seek reimbursement of that expenditure from the trustee. As there is no beneficiary presently entitled to the income of the trust estate, the trustee is assessed and is liable to pay tax on the net income of the trust estate under section 99A of the 1936 Act.

168. The taxation treatment described in paragraph 167 would also apply where the contributions are paid directly to the village operator in accordance with the residents' contracts and then transferred by the operator to an independent trustee.

Examples

Transitional issues

Example 1

169. A person acquires an option, for valuable consideration, over land prior to 19 April 2000, for the purpose of conducting a feasibility study on developing a retirement village on the land.

170. The feasibility study is conducted after 19 April 2000. The outcome of the feasibility study is positive, the taxpayer develops a plan that enables finance to be obtained, exercises the option and constructs a retirement village on the land. The arrangement to

develop a retirement village does not commence until the taxpayer exercises the option and, therefore, the taxpayer is not permitted to rely on Taxation Ruling TR 94/24.

Example 2

171. A person acquires an option over land prior to 19 April 2000, with the definite intention of developing a retirement village on the land. The option was necessary to secure the site while finance was arranged. The option had been acquired and plans to commence an arrangement of the type covered by TR 94/24 had been developed as the basis for making an application for finance prior to 19 April. Finance was approved after 19 April, after which the taxpayer exercised the option, and proceeded to obtain council approval and construct a retirement village on the land. Provided the taxpayer is able to produce sufficient evidence to support the facts, an arrangement would have commenced prior to 19 April and the taxpayer would be able to rely on TR 94/24. Similarly, if an option is acquired for the purpose of obtaining council approval for a proposed development and the application for approval is lodged with the council prior to 19 April 2000, an arrangement would have commenced prior to that date and the taxpayer would be able to rely on TR 94/24, even if council approval is not given until after that date.

Example 3

172. A taxpayer was engaged in negotiations for a number of months to acquire an existing retirement village, but contracts were not exchanged prior to 2:00pm on 19 April 2000. Because the contract was not signed, the arrangement did not begin before the withdrawal of TR 94/24.

Example 4

173. A taxpayer exchanged on a contract to acquire land for the purpose of developing a retirement village prior to 19 April 2000. Settlement occurs after 19 April and a village is subsequently constructed on the land.

174. As the exchange of contracts occurred prior to the withdrawal of Taxation Ruling TR 94/24, and provided the taxpayer can provide sufficient evidence to demonstrate the intention to develop the village in accordance with Taxation Ruling TR 94/24, the arrangement has commenced prior to 19 April and the taxpayer can rely on TR 94/24.

Transitional issues for syndicates

Example 5

175. A promoter exchanged on a contract before 19 April 2000 to purchase land with the intention of issuing an information memorandum to attract investors to invest in a syndicate. None of the investors' applications were received before 19 April. All investors' applications were received prior to 30 June 2000.

176. The syndicate is not required to comply with the Managed Investment Act and title to the village is held in the names of the individual investors as tenants-in-common. The investors are in partnership as they are carrying on business together.

177. It is the investors who must have begun an arrangement, not the promoter, before the withdrawal of Taxation Ruling TR 94/24. Until the promoter receives an investor's application, the investor has not begun the arrangement. Because applications from investors were not received by the promoter until after 19 April, they cannot apply Taxation Ruling TR 94/24 to their arrangement.

Example 6

178. A promoter exchanged on a contract before 19 April 2000 to purchase land and issued a prospectus to attract investors to invest in a Managed Investment Scheme (MIS). None of the investors' applications were received before 19 April.

179. The syndicate is required to comply with the Managed Investment Act. Accordingly the single responsible entity (SRE) for the MIS is required to hold the village on trust for the scheme members resulting in the creation of an active trust. However, no trust comes into existence until the first investor subscribes.

180. Where the investors are investing through a trust, the relevant taxpayer to claim deductions under TR 94/24 is the trustee. The trustee cannot rely on TR 94/24 because the trust did not come into existence prior to 19 April and, therefore, an arrangement did not begin prior to that date. Any losses in relation to the development or acquisition of a retirement village are retained in the trust to be offset against future income derived by the trustee.

Example 7

181. A promoter exchanged on a contract before 19 April 2000 to purchase land and issued a prospectus to attract investors to invest in a Managed Investment Scheme (MIS). One investor subscribes prior to 19 April.

182. The syndicate is required to comply with the Managed Investment Act. Accordingly the single responsible entity (SRE) for the MIS is required to hold the village on trust for the scheme members resulting in the creation of an active trust.

183. Where the investors are investing through a trust, the relevant taxpayer to claim deductions under TR 94/24 is the trustee. In this example, the trustee can rely on TR 94/24 because the trust did come into existence prior to 19 April and, therefore, an arrangement began prior to that date.

Example 8

184. A promoter exchanged on a contract before 19 April 2000 to purchase land with the intention of forming a partnership. The promoter received applications from 12 investors before 19 April. Applications from another eight investors were received after 19 April.

185. Only the 12 investors whose applications were received prior to 19 April can apply Taxation Ruling TR 94/24. The eight investors whose applications were received after 19 April did not begin an arrangement before the withdrawal of TR 94/24 and cannot rely on that Ruling.

186. In this situation, it will be necessary to keep separate accounts for tax purposes for the investors who wish to rely on TR 94/24.

Example 9

187. A promoter exchanged on a contract before 19 April 2000 to purchase land with the intention of attracting 20 investors to invest in a partnership. The minimum subscription required was 15 interests in the partnership. The promoter received applications for 16 interests before 19 April. After 19 April the promoter subscribed for the other four interests under a pre-existing obligation contained in the information memorandum.

188. The 16 investors whose applications were received before 19 April can apply Taxation Ruling TR 94/24 to their arrangements. Because the promoter had a pre-existing obligation to take up the interests that had not been subscribed for, the promoter would be entitled to the benefit of Taxation Ruling TR 94/24 even though the subscriptions were taken up after 19 April.

Example 10

189. A promoter exchanged on a contract before 19 April 2000 to purchase land with the intention of attracting 20 investors to invest in

a partnership. The minimum subscription required was 15 interests in the partnership. The promoter received applications for 16 interests before 19 April. The promoter was under no contractual obligation to take up any unsubscribed interests. Nevertheless, after 19 April the promoter subscribed for the remaining four interests.

190. The 16 investors whose applications were received before 19 April can apply Taxation Ruling TR 94/24 to their arrangements. However, the promoter would not be entitled to the benefit of Taxation Ruling TR 94/24 because the promoter did not take up the remaining interests until after 19 April.

Example 11

191. A promoter exchanged on a contract before 19 April 2000 to purchase land with the intention of attracting investors to invest in a syndicate. The promoter received applications from several investors before 19 April on the basis that their money would be returned if the minimum subscription was not reached.

192. On the basis that the minimum subscription is reached, the investors who subscribed before 19 April are considered to have begun an arrangement before 19 April. Therefore, they can rely on Taxation Ruling TR 94/24.

193. In this situation, it will be necessary to keep separate accounts for tax purposes for the investors who wish to rely on Taxation Ruling TR 94/24.

Transitional issues for staged developments

Example 12

194. A taxpayer settled on a contract for land prior to 19 April 2000, for the purpose of developing a retirement village in stages, and entered into a contract with builders before 19 April to construct the first stage.

195. The project plans, development applications, financing and project viability proceeded on the basis that further stages of the village would be completed, albeit consecutively over some years as demand requires. Alternatively, the village owner decides some years after the establishment of the village to expand the village by building new blocks of units, for which new development applications are required, on the existing land. Contracts for construction of the later stages are entered into after 19 April 2000.

196. In both cases, all stages of the village are part of the one arrangement that began prior to 19 April 2000. Accordingly, the

village owner can rely on TR 94/24 in respect of all stages of the village.

Example 13

197. Prior to 19 April 2000, the taxpayer acquires an option, for valuable consideration, over land adjacent to the taxpayer's existing village. The option was acquired for the purpose of conducting a feasibility study on developing additional stages of the existing village and to secure finance for development costs. The feasibility study is conducted after 19 April 2000 and the outcome is positive. The taxpayer obtains finance, exercises the option after 19 April 2000, and constructs additional stages on that land.

198. The arrangement to develop a retirement village does not commence until the taxpayer exercises the option and, therefore, the taxpayer cannot rely on Taxation Ruling TR 94/24.

Example 14

199. A taxpayer that owns an existing village at 19 April 2000 acquires adjacent land after that date with the intention of expanding the existing village.

200. The planned expansion is a separate arrangement from the existing village. Accordingly, the taxpayer has not begun that separate arrangement before 19 April and cannot apply TR 94/24 to that arrangement.

Deferred management or other fees

Example 15

201. In return for the payment of an entry price in the form of a loan of $100,000 from an incoming resident, a retirement village operator grants a 99-year lease for an accommodation unit in the village to the resident. Under the terms of the agreement, upon ceasing to occupy the village unit, the operator is required to repay the loan and the resident is obliged to pay to the operator a deferred management fee of $2,500 (i.e., 2.5% of $100,000) for each year (or part thereof) (up to a maximum of 25% of the loan amount) that the resident occupies the dwelling.

202. After 15 years, the resident ceases to occupy the village unit to which the contract relates. The outgoing resident's outstanding debt of $25,000 is offset against the $100,000 that the operator owes to the resident, resulting in a net payment of $75,000 by the operator to the resident.

203. The deferred management fee is assessable income of the village operator in the year in which the resident ceases to occupy the village unit. This is when the fee that has accrued during the term of the resident's occupancy matures into a recoverable debt and the village operator becomes entitled to demand payment of the fee.

204. The receipt of the loan by the operator is a capital receipt and the subsequent repayment of the loan is a capital payment. The fact that the deferred management fee can be offset against the loan amount repayable does not change the character of the loan.

Example 16

205. Assume the same circumstances as in Example 12A, except that the deferred management fee is calculated at 22.5% of the entry price that will be paid by a new resident (7.5% for the first year of occupancy or part thereof and 2.5% for each of the next six years (or part thereof)).

206. The deferred management fee is assessable income of the village operator in the year in which the resident ceases to occupy the village unit and the new entry price is determined. This is when the fee that has accrued during the term of the resident's occupancy matures into a recoverable debt and the village operator becomes entitled to demand payment of the fee.

Example 17

207. A resident (the first resident) obtains a lease of an accommodation unit in a retirement village in return for what purports to be a loan of $100,000. Upon termination of the lease agreement, the operator is obligated to pay to the outgoing resident an amount equivalent to 80% of the replacement 'loan' paid by a new resident to acquire the right to occupy the accommodation unit. The new resident provides a 'loan' of $150,000 and the operator is required to pay an amount of $120,000 to the first resident.

208. The agreement does not require the operator to repay the amount of the 'loan' provided by the first resident. The payment made by the first resident is more properly characterised as a lease premium and is included in the operator's assessable income in the year in which it becomes payable. The amount payable by the operator to the first resident upon termination of the lease is an allowable deduction in the year in which the operator becomes liable to make the payment. In this example, no separate deferred management fee is payable by the outgoing resident and, therefore, no additional amount is included in the assessable income of the operator.

Example 18

209. A resident obtains a lease of an accommodation unit in a retirement village and pays a 'security bond' of $100,000. The 'security bond' is fully repayable upon termination of the lease and the resident is liable to pay a deferred management fee up to a maximum of 33% of the 'security bond' – 12% for the first year of occupancy (or part thereof), 11% for the second year (or part thereof) and 10% for the third year (or part thereof). The lease is terminated after ten years, when the resident leaves the village.

210. The deferred management fee of $33,000 is assessable income of the village operator in the year in which the resident ceases to occupy the village unit. This is when the fee that has accrued during the term of the resident's occupancy matures into a recoverable debt and the village operator becomes entitled to demand payment of the fee.

Example 19

211. A resident obtains a lease of a retirement village dwelling and pays a 'security bond' of $100,000 on 1 May 2002. The 'security bond' is fully repayable upon termination of the lease. The resident agrees to pay an additional amount of $25,000 (25% of the 'security bond' payable upon entry into the lease). This amount is prepayment of the deferred management fee. There is no provision for abatement of the deferred management fee. No further fee is payable by the resident upon termination of the lease.

212. The resident becomes liable to pay the deferred management fee upon entry into the lease and there is no condition precedent to the making of a demand for payment by the village operator. Accordingly, the operator derives the full amount of the prepaid deferred management fee of $25,000 in the 2002 income year.

Example 20

213. A resident enters into what is known as a 'discount lease'. The resident is required to pay a 'security bond' of $70,000. That amount is calculated as 70% of the standard amount payable under such an arrangement ($100,000). The 'security bond' is fully repayable when the lease is terminated and the resident is required to pay a deferred management fee to the operator. In this situation, the fee is calculated as 25% of the discounted 'security bond' for the first year of occupancy (or part thereof) and 25% for the second year (or part thereof). The lease is terminated after five years, when the resident leaves the village.

214. The deferred management fee of $35,000 is assessable income of the village operator in the year in which the resident ceases to occupy the village unit. This is when the fee that has accrued during the term of the resident's occupancy matures into a recoverable debt and the village operator becomes entitled to demand payment of the fee.

Example 21

215. In February 2001, a retiree purchases a strata title accommodation unit in a retirement village. The retirement village is managed by a village management company. Several years after purchasing the unit, the resident/owner enters into an agreement to sell the unit to another person who intends to reside in the unit. The management agreement provides that the village manager will act as agent of the resident/owner for the sale of the unit and that, upon settlement of the sale of the unit, the owner/resident must pay to the manager a 'deferred facilities fee' equal to 5% of the sale price of the unit. The sale price of the unit is $300,000 and settlement occurs in February 2008.

216. The village manager becomes entitled to demand payment of the fee immediately upon settlement. That is when a debt comes into existence. Accordingly, the amount of $15,000 is assessable income of the village manager in the 2008 income year.

Sinking funds

Example 22

217. Moneys regularly contributed by residents towards a sinking fund are reflected in a Sinking Fund Account in the village operator's books, but no separate money account is kept, and the fund mingles with the rest of the village operator's funds. Contributions are assessable income of the village operator when they become due and payable by the residents.

Example 23

218. Moneys regularly contributed by residents towards a sinking fund are reflected in a Sinking Fund Account in the village operator's books. A separate money account is kept, so that the fund does not mingle with the rest of the village operator's funds. However, there is no restriction on withdrawal of funds from the account. Contributions are assessable income of the village operator when they become due and payable by the residents.

Example 24

219. Moneys regularly contributed by residents towards a sinking fund are paid to the village operator. The village operator pays the funds to an independent trustee. The contracts with residents and/or State legislation and/or the trust deed restrict withdrawal of funds from the account until required for sinking fund purposes. Moneys are paid from the fund to the operator upon production of receipts for expenditure incurred. There are no income beneficiaries.

220. Contributions are assessable income of the village operator when the operator incurs relevant expenditure and becomes entitled to seek reimbursement of that expenditure from the trustee. Payments by the village operator to the trustee are not deductible because they are payments of capital into a trust fund. The village operator is a mere conduit for transmission of funds from the residents to the independent trustee. Amounts received by the trustee from the operator are not assessable income because they represent a contribution of capital to the trust fund.

221. Income that is earned by the fund is not income to which anyone is presently entitled and is assessable income of the trustee under section 99A of the 1936 Act. Income retained in the trust fund represents an accretion to the corpus of the fund.

Example 25

222. Residents pay moneys directly into a sinking fund established by the village operator. The trustee of the fund is independent of the operator. Where the residents have an obligation to make payments directly to the trustee, the payments are not included in the assessable income of the village operator in the year in which contributions become due and payable by the residents. As in the previous example, the operator derives assessable income in the year in which relevant expenditure is incurred and the operator becomes entitled to seek reimbursement of that expenditure from the trustee.

223. Income that is earned by the fund is not income to which anyone is presently entitled and is assessable income of the trustee under section 99A of the 1936 Act. Income retained in the trust fund represents an accretion to the corpus of the fund.

Example 26

224. The Retirement Villages Act (Qld) requires the village operator to establish a 'maintenance reserve fund'. The Act states that the operator holds amounts standing to the credit of the fund on trust solely for the benefit of residents in a trust account. Residents are solely responsible for contributing to the fund. The legislation restricts the use of those funds by the operator to maintenance of the operator's village.

225. Amounts paid into the fund by residents do not constitute assessable income of the operator. They are payments of capital into the fund. The operator derives assessable income in the year in which relevant expenditure is incurred and the operator becomes entitled to seek reimbursement of that expenditure from the fund.

226. Income that is earned by the fund is not income to which anyone is presently entitled and is assessable income of the trustee under section 99A of the 1936 Act. Income retained in the trust fund represents an accretion to the corpus of the fund.

Appendix 1 – Compliance approach for operators of South Australian retirement villages

This Appendix sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow the advice in this appendix in good faith and consistently with the ruling section, the Commissioner will administer the law in accordance with this approach.

227. In accordance with paragraph 26 of this Ruling, where an amount paid by an incoming resident is properly characterised under the relevant arrangement as a lease premium and included in the assessable income of the retirement village operator, the amount payable by the retirement village operator to the resident upon termination of a lease agreement is an allowable deduction in the year in which the retirement village operator becomes liable to make the payment.

228. By contrast, in accordance with paragraph 28 of this Ruling, where the relevant arrangement requires the incoming resident to make a loan, the receipt and repayment of the loan are on the capital account of the retirement village operator. As a result, the receipt of the loan amount is not included in the assessable income of the retirement village operator and the repayment of the loan by the retirement village operator is not an allowable deduction.

229. The difference between loan and lease premium arrangements is outlined in paragraph 29 of this Ruling. For a contract to be characterised as a loan, there needs to be the essential element of a loan present, that is, the obligation to repay. A repayment that is contingent upon a new resident being found, an event that may not happen, means that such an obligation to repay is absent.

230. However, footnote 3 in paragraph 29 of this Ruling makes it clear that provisions of State or Territory legislation may require retirement village operators to repay amounts within a specified period after the resident vacates the property, even if a new resident is not found. In this respect, the repayment would no longer be contingent upon a new resident being found.

231. Subsection 27(2) of the *Retirement Villages Act 2016 (South Australia)*[42] (the Act) is one such provision. Relevantly, it states that, if a residence contract[43] provides for the payment of an exit entitlement[44], the exit entitlement can be recovered as a debt from the operator when a period of 18 months has elapsed since the resident ceased to reside in the retirement village provided that other conditions have not occurred first.

Residence contracts entered into prior to 1 January 2018

232. Where:

- a residence contract is entered into prior to 1 January 2018 and an amount paid by a resident[45] is properly characterised as a lease premium (and included in the assessable income of the operator)
- the operator becomes obliged to pay an exit entitlement to that resident after 1 January 2018, and
- the operator claims a deduction for the exit entitlement in the year in which the payment is due,

the Commissioner will not apply compliance resources to consider the deductibility of that exit entitlement.

Residence contracts entered into on or after 1 January 2018

233. Where a residence contract is entered into on or after 1 January 2018, in light of subsection 27(2) of the Act, the repayment obligation requirement in paragraph 29 of this ruling is satisfied. As a result, the contract is considered to be a loan contract as there is a non-contingent obligation for the repayment of an amount.

234. This is so notwithstanding the absence of a similar requirement to that of subsection 27(2) of the Act in the residence contract.

235. Consequently, where a residence contract is entered into on or after 1 January 2018, both the receipt of ingoing contribution and repayment of the exit entitlement are on the capital account of the operator. As a result, the receipt of the ingoing contribution is not included in the assessable income of the operator and the repayment of the exit entitlement by the operator is not an allowable deduction.

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[42] The *Retirement Villages Act 2016 (South Australia)* provides a regulatory framework for the operation of retirement villages in South Australia and comes into operation on 1 January 2018.
[43] As defined in subsection 4(1) of the Act.
[44] As defined in subsection 4(1) of the Act.
[45] As defined in subsection 4(1) of the Act.

236. Paragraphs 233 to 235 of this Ruling will only apply if subsection 27(2) of the Act has not been repealed at the time the residence contract was entered into.

237. However, if subsection 27(2) of the Act had not been repealed at the time the residence contract was entered into but is subsequently repealed while the residence contract remains on foot, paragraphs 233 to 235 of this Ruling will apply.

Detailed contents list

238. Below is a detailed contents list for this Ruling:

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Previous draft:
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Related rulings/determinations
TR 92/1; TR 93/15; TR 94/24; TR 97/16; TR 1999/16

Subject references:

- interest-free loan
- security deposit
- lease
- lease premium
- licence
- prepaid rental
- redeemable preference share
- retirement village
- share premium
- strata title

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- ITAA 1997 104-110(4)
- ITAA 1997 104-115
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- Radaich v. Smith (1959) 101 CLR 209
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