TR 94/24 - Income tax: taxation amounts received by retirement village owners from incoming residents

Taxation Ruling
Income tax: taxation amounts received by retirement village owners from incoming residents

This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the ***Taxation Administration Act 1953****, is a public ruling for the purposes of that Part. Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

contents para

What this Ruling is about

1. This Ruling is about the taxation treatment under the *Income Tax Assessment Act 1936* (the Act) of lump sum payments received under the terms of various arrangements used by owners of commercial retirement villages to grant occupancy rights to village residents. This Ruling considers the following arrangements:

a) Strata title;

b) lease premium (non-assignable lease);

c) lease premium (assignable lease);

d) loan/lease;

e) loan/licence;

f) prepaid rental; and

g) redeemable preference share.

2. An explanation of these arrangements appears at paragraph 22 of this Ruling.

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

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

5. This Ruling does not consider the taxation treatment of income derived by government-approved and funded nursing homes, although

such a nursing home may be situated within a retirement village. Neither does this Ruling consider in any detail the taxation implications for village residents.

Ruling

6. Generally, where a developer constructs a retirement village and sells the individual units on a strata title basis, the trading stock provisions of the Act will apply.

7. Each of the other arrangements referred to in paragraph 1(b) to (g) of this Ruling will be treated on the basis that it is equivalent to a sale of a retirement village unit. In the context of these arrangements, the lump sum payable by an incoming resident is considered to be a gross revenue receipt and is included in the assessable income of the owner. Although the owner retains legal title to the underlying property, expenditure incurred by the owner in acquiring or developing the village is considered to be expenditure of a revenue nature. Accordingly, a deduction will be allowed for that expenditure in the year in which it is incurred. However, any expenditure attributable to the construction within a retirement village of a government-approved and funded nursing home is not considered to be part of the costs of acquiring or developing the retirement village for the purposes of this Ruling.

8. Upon rollover of a unit from one resident to another, the lump sum payable by the new resident to the village owner is included in the owner's assessable income in the year in which it is derived. In the context of these arrangements, it is considered that derivation occurs in the year in which the resident enters into possession of the unit, or the year in which the owner has done all that is necessary to enable the resident to enter into possession of the unit, whichever is the earlier. The amount payable by an owner to an outgoing resident (or their estate) is an allowable deduction in the year in which the owner incurs the obligation to make the payment.

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

10. Generally, fees are payable by residents on a regular basis (usually monthly) to the village owner in respect of management and other services (similar to body corporate fees). These fees are levied in order to meet costs of administration and accounting, and recurrent maintenance and repairs. They may be applied also to a sinking fund to meet deferred maintenance costs. It is considered that these fees

are derived by the village owner when they become due and payable by a resident, and are included in the assessable income of the owner accordingly. A deduction is allowable for expenditure incurred in providing those services in the year in which it is incurred.

11. Upon the sale of a retirement village, the whole of the proceeds will be included in the assessable income of the vendor under subsection 25(1).

12. To the extent that it is necessary to make a calculation for capital gains tax purposes, any capital gain will be reduced in accordance with subsection 160ZA(4) to the extent to which the amount is otherwise assessable.

13. In calculating the reduced cost base for ascertaining any capital loss, the amount of the consideration, incidental costs or expenditure referred to in subsection 160ZH(1) in relation to the cost base of the asset is reduced by any part that is allowed or is allowable as a deduction in any year of income: see section 160ZK. This means that any expenditure, such as the cost of acquiring or developing the retirement village, that has been allowed or is allowable as a deduction is excluded from the cost base for the purposes of calculating the reduced cost base.

14. Where a retirement village unit becomes the principal 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 unit by the resident or by the estate of the resident.

Date of effect

15. In the past, the ATO has communicated consistently to a wide range of taxpayers within the retirement village industry a certain taxation treatment that is contrary to the view of the law expressed in this Ruling (see paragraph 16 of Taxation Ruling TR 92/20). It is considered that this has contributed to taxpayers generally adopting a certain practice in lodging their tax returns.

16. In comparison to the practice previously adopted by taxpayers, this Ruling generally is less favourable. Accordingly, this Ruling applies only to years of income commencing on or after 1 July 1994. 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 paragraphs 21 and 22 of TR 92/20).

17. Likewise, if a taxpayer has a private ruling that is inconsistent with this Ruling, then this Ruling will apply to the taxpayer only in relation to years of income commencing on or after 1 July 1994, unless the taxpayer asks that it apply to earlier income years.

Explanations

18. 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.

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

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

b) **Lease premium (non-assignable lease)**: Under this arrangement, a resident is granted a long-term lease, generally for a period of 99 years, of a dwelling in the retirement village, conditional upon immediate payment to the owner of a lease premium or lease 'deposit' equal to the market value of the dwelling. Upon termination or surrender of the lease, the owner is obliged to make a payment to the resident (or personal representative) equivalent to the original premium paid by the resident, less a 'deferred management fee' which is calculated as a percentage of the lease premium for each year of occupancy. Generally, the outgoing resident shares in any capital 'gain' or 'loss'; that is, the difference between the original lease premium paid and the lease premium paid by the new resident.

c) **Lease premium (assignable lease)**: Under this arrangement, a resident is granted a long-term lease, generally for a period of 99 years, of a dwelling in the retirement village, conditional upon immediate payment to the 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 is obliged to pay the village owner the 'deferred management fee' and also a commission for services which may have rendered in connection with the assignment of the lease.

d) **Loan/lease**: Under this arrangement, a resident is granted a long-term lease, generally for a period of 99 years, of a dwelling in the retirement village, conditional upon immediate payment to the owner of an 'interest-free loan' equal to the market value of the dwelling. Upon termination or surrender of the lease, the owner is obliged to make a payment to the resident (or personal representative) equivalent to the original 'loan' given by the resident, less a 'deferred management fee', calculated as a percentage of the 'loan' for each year of occupancy. Generally, the outgoing resident shares 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.

e) **Loan/Licence**: Under this arrangement, a resident is granted a 'licence' to occupy a dwelling in the village upon immediate payment of an 'interest-free loan' 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, less a 'deferred management fee', calculated as a percentage of the 'loan' for each year of occupancy. Generally, the outgoing resident will 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.

f) **Prepaid rental:** Under this arrangement, a resident is granted a lease, generally for a period of 99 years, upon payment of rent in advance (typically stated to be for a period of 20 years), subject to a pro rata refund upon early termination of the lease. The resident generally is required also to provide an 'interest-free loan' or '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 owner, or, alternatively, to a trustee, who, under the terms of a trust deed, agrees to give to the village owner an interest-free loan to the extent of the amount received from a resident. Upon termination or surrender of the lease, the owner is obliged to refund advance rental on a pro rata basis and also make a payment to the outgoing resident equivalent to the original 'loan' or 'deposit' made by the resident. Where the 'loan' or 'deposit' is made to the trustee, upon termination of the lease, the owner is required to repay the funds obtained from the trustee and the trustee is obliged to make a payment to the outgoing resident equivalent to the amount of the 'loan' or 'deposit' originally advanced by the resident.

g) **Redeemable Preference Share**: Under this arrangement, a company which owns a retirement village issues redeemable preference shares (usually with a par value of $1.00). The articles of association confer a right to 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 equal to the market value of the dwelling. The articles also confer upon an outgoing resident shareholder a right, upon redemption of the preference share by the company and termination or surrender of the lease, to be paid an amount equivalent to the original share premium, reduced by a percentage for each year the shareholder occupies a unit in the village. In some cases, depending upon the period for which the resident is a shareholder, the payment to the outgoing resident will be no more than the par value of the share.

20. In relation to each of these arrangements other than a strata title sale and the assignable lease, the payment to the outgoing resident may be conditional upon a new resident being found, who also must make a lump sum payment (a lease premium or deposit, interest-free loan or share premium) equivalent to the market value of the dwelling at that time. The outgoing resident (or their estate) generally shares in any capital 'gain' or 'loss'; that is, the difference between the initial lump sum received from the outgoing resident and the lump sum received from the new resident. These arrangements effectively give residents an equity interest in the village units and have many features in common with a strata title sale.

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

22. With respect to each of the arrangements, it is proposed to consider what amounts a village owner should include in assessable income and what expenditure is allowable as a deduction in order to determine their income tax liability.

23. Under each of the arrangements referred to in paragraph 1(b) to (g) of this Ruling, the owner receives an inflow of funds similar to that which would be generated by the sale of dwellings under a strata title arrangement. However, it has been argued on behalf of retirement village owners that the arrangements are merely a different way of funding the development of a village and that no assessable income is derived upon receipt of the initial lump sum payment from an incoming resident because it is a capital receipt.

Strata title

24. 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.

25. 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 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 Act will apply.

26. Where the owner acts as agent for the resident upon the resale of a dwelling, any commission received by the owner is assessable income under subsection 25(1) in the year in which the income is derived.

27. 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 the common property,

expenditure attributable to the common property cannot be absorbed into the cost of trading stock. Deductions will be allowable under Division 10D of Part III in respect of that expenditure, to the extent that it is 'qualifying expenditure' for the purposes of that Division.

28. Where the owner retains ownership of the common property, 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 owner when they become due and payable, and are included in the assessable income of the owner accordingly. A deduction will be allowed for expenditure incurred in providing those services, in the year in which they are incurred.

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

Lease premiums (non-assignable lease)

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

31. Upon termination or surrender of a lease, the owner is obliged to make a payment to the outgoing resident (or personal representative) equivalent to the amount of the original premium paid, less an amount known as a 'deferred management fee', which is calculated by reference to the period of occupancy (for example, an amount equal to 5% of the premium for each year of occupancy, with a minimum of 10% and a maximum of 25%). In some instances, that payment is conditional upon a new resident being found who, likewise, pays a premium for or in connection with the grant of a new lease.

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

33. For example, a resident moves into a village unit on 1 July 19X1 and pays an amount of $100,000 by way of lease premium under the terms of the lease agreement. On 30 June 19X5, the resident leaves the village and the lease is terminated. On 1 July 19X5 a new resident moves into the unit and is required to pay a lease premium of $120,000.

34. The owner is entitled to retain 5% of the lease premium for each year the outgoing resident has occupied the unit and the resident is entitled to receive 50% of the difference between the original lease premium and the lease premium payable by the new resident.
The owner will be obliged to pay to the outgoing resident (or personal representative) an amount calculated as follows:

Original lease premium	$100,000
less deferred management fee	$20,000
Amount of lease premium repayable	$80,000
add share of 'capital gain'	$10,000
Total amount payable to outgoing resident	$90,000

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

36. Similarly, it is considered that lease premiums received by owners of retirement villages are income under ordinary concepts because they are received through repetitive and recurrent transactions that are an essential ingredient of the operation of a retirement village business carried on to commercial advantage.

37. Alternatively, a lease premium received by a village owner is assessable under section 26AB. This section includes in the assessable income of a lessor a premium received for or in connection with the grant of a lease of property not intended to be used by the lessee for the purpose of gaining or producing assessable income. The word 'premium' in that section is not confined to a premium within the ordinary meaning of the word, but it extends to payments 'in the nature of' a premium paid 'for or in connection with' the grant of a lease.

38. In *Dalrymple v. FC of T* (1924) 34 CLR 283, the High Court considered paragraph 14(d) of the *Income Tax Assessment Act 1915-1918*, which included as income "... consideration in the nature of

premiums, fines or foregifts demanded and given in connection with leasehold estate ...". Knox CJ, Gavan Duffy and Starke JJ said that the object of this part of the provision was "to include in the income of a lessor all sums paid by a tenant other than the rent reserved by the lease, such as sums which are demanded on the renewal ... of a lease or on the giving of a new lease". The provision considered in that case is not materially different from section 26AB.

39. With respect to leases granted on or after 19 September 1985, the capital gains tax provisions are relevant also. Section 160ZS provides that the grant of a lease of property shall be deemed to constitute the disposal by the lessor to the lessee of an asset for a consideration equal to the premium paid or payable for the grant of the lease. This section treats a premium received upon the grant of a lease as if it was a capital sum derived from using or exploiting the capital asset held at the time the lease was granted and the premium paid. However, if a lease premium is assessable by virtue of the operation of section 160ZS, the capital gain will be reduced in accordance with subsection 160ZA(4) to the extent that it is assessable under either subsection 25(1) or section 26AB.

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

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

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

43. In *Federal Commissioner of Taxation v. St Hubert's Island Pty Ltd* (1978) 8 ATR 452, 472; 78 ATC 4104, 4121, it was held that land, in appropriate circumstances, may be trading stock. However, it is not considered that this decision supports the proposition that a taxpayer who acquires or develops for the purpose of leasing residential units in the village can treat those leases as trading stock. The leases in question do not fit the definition "anything ... acquired ... for purposes of manufacture, sale or exchange". Owners of retirement villages derive income not from trading in leases, but from recurrent

exploitation of the underlying property by means of leasing and re-leasing.

44. If the individual leases were regarded as trading stock, it is considered that the cost of acquiring each lease as a separate item of trading stock would include only expenditure incurred by the lessor in relation to the grant of the lease. Consequently, the calculation of taxable income would not result in a correct reflex of the income of a village owner.

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

46. However, a lease premium is received in consideration of the grant of a lease by the owner to an incoming resident. Accordingly, upon granting the lease, it is considered that the owner has done all that is required to derive the amount of the premium. *Arthur Murray* has no application in those circumstances.

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

48. In the context of this arrangement, the lump sum payable by an incoming resident is considered to be a gross revenue receipt and is included in the assessable income of an owner in the year in which it is derived. It is considered that derivation occurs in the year in which the resident enters into possession of the unit, or the owner has done all that is necessary to enable the resident to enter into possession of the unit, whichever is the earlier.

49. Expenditure incurred by a village owner in acquiring or developing the village is considered to be expenditure of a revenue nature. Accordingly, a deduction will be allowed for that expenditure in the year in which it is incurred.

50. On the basis that the expenditure incurred in acquiring or developing a retirement village is considered to be of a revenue nature, it is not 'qualifying expenditure' for the purposes of Division 10D of the Act.

51. In addition, holding costs such as interest, rates and taxes, advertising and marketing costs, generally will be allowable deductions in the year in which they are incurred.

52. Upon rollover of a unit from one resident to another, the lump sum payable by the new resident to the village owner is included in the owner's assessable income in the year in which it is derived. The amount payable by a village owner to an outgoing resident (or their estate) is an allowable deduction in the year in which the owner incurs the obligation to make the payment.

53. Fees for the provision of management and other services (similar to body corporate fees) generally are payable by residents on a regular (usually monthly) basis. Such fees are derived as and when they become due and payable, and are included in the assessable income of the owner accordingly. A deduction will be allowed for expenditure incurred in providing those services.

Lease premiums (assignable lease)

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

55. A lease can be assigned by an outgoing resident (or personal representative) to an incoming resident. In consideration for the assignment of the lease, the new resident is required to pay a lump sum to the outgoing resident equivalent to the present market value of the dwelling at the time the agreement to assign is entered into. Consequently, the outgoing resident receives the benefit of any increase in the 'capital value' of the dwelling. The outgoing resident is obliged to pay a 'deferred management fee' to the owner, calculated by reference to the period of occupancy, and may be required also to pay a commission fee to the owner for services rendered in arranging for a new resident to take an assignment of the lease.

56. The assignment of the lease will be regarded as a disposal of the resident's interest in the village unit and, provided the unit is the principal residence of the outgoing resident, no capital gains tax implications will arise for the outgoing resident upon assignment of the lease.

57. The discussion in respect of non-assignable leases is relevant also in relation to assignable leases. Similarly, it is considered that the initial lease premium received by the owner is fully assessable, primarily under subsection 25(1), and that the expenditure incurred in acquiring or developing the retirement village is an allowable deduction in the year in which it is incurred.

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

59. Management fees generally are payable on a regular (usually monthly) basis by residents for the provision of management and other services. Such fees are derived when they become due and payable and are included in the owner's assessable income accordingly. A deduction will be allowed for expenditure incurred in providing those services.

Loan/lease

60. Under this arrangement, the resident is required to make an interest-free 'loan' to the owner of an amount equivalent to the market value of the dwelling, in consideration for the grant of a long-term lease. Upon termination or surrender of the lease, generally the owner is obliged to make a payment to the outgoing resident (or personal representative) equal to the amount of the original 'loan', less a 'deferred management fee', calculated by reference to the period of occupancy. 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.

61. For example, a resident moves into a village unit on 1 July 19X1 and provides a 'loan' of $100,000 under the terms of the lease agreement. On 30 June 19X5, the resident leaves the village and the lease is terminated. On 1 July 19X5 a new resident moves into the unit and is required to provide a loan of $150,000.

62. The owner is entitled to retain 5% of the loan for each year the outgoing resident has occupied the unit and the resident is entitled to receive 50% of the difference between the original 'loan' and the amount of the 'loan' provided by the new resident. The owner will be obliged to pay to the outgoing resident (or personal representative) an amount calculated as follows:

Original 'loan'	$100,000

less deferred management fee	$20,000
Amount of 'loan' repayable	$80,000
add share of 'capital gain'	$25,000
Total amount payable to outgoing resident	$105,000

63. It has been argued on behalf of village owners that, where the initial payment is referred to in the agreement as a loan, the legal form of the agreement must be respected and that, accordingly, the payment should be treated as a capital receipt and not regarded as assessable income for taxation purposes. However, it is necessary to examine the loan arrangement to determine the true character of the payment.

64. In some of the loan/lease arrangements that have been examined, it appears that there is either no obligation to pay to the outgoing resident an amount equal to the original 'loan', or the obligation to pay that amount is heavily qualified. The amount payable generally is calculated by deducting the deferred management fee and also taking account of the resident's share in the capital 'gain' or 'loss'. Generally, the repayment is conditional upon the owner being able to find a new resident who, in turn, is required to provide a 'loan' (based on the then current market value of the dwelling) as consideration for the grant of a new lease. In some instances, the payment to the outgoing resident is calculated as a percentage of the lump sum amount received from the new resident. For example, if 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 .

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

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

66. 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".

67. In circumstances where the whole of the amount is not unconditionally repayable, or the amount and timing of any ultimate repayment are variable according to events which are neither fixed or determinable as to future time, some of the essential features of a loan are absent. It is clear that the real nature of the payment by the

resident is that of consideration for granting occupancy rights and is, in substance, no different from the lease premium arrangement.

68. Some 'loan' agreements provide for repayment of the full amount of the 'loan' and also provide for the amount to be repaid within a specified period (typically six months) after termination of the period of occupancy. Rather than calculating the amount payable to the outgoing resident by deducting the deferred management fee, the initial lump sum amount is repayable in full. Nevertheless, the owner is entitled to a deferred management fee calculated as a percentage of the initial lump sum for each year of occupancy. It has been argued that, where the agreement provides that the loan is fully repayable and the time for repayment is fixed or can be determined, the lump sum payment is a genuine loan and, therefore, is a capital receipt.

69. Nevertheless, the fact that the relevant agreements refer to the payments as loans does not determine their real effect: see *Inland Revenue Commissioners v. Wesleyan and General Assurance Society* [1948] 1 All ER 555; 30 TC 11.

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

71. Considering the transaction in its commercial context, it is simply a different legal form used to exploit the retirement village units on a regular and recurrent basis and is no different, in substance, from the lease premium arrangements. The initial lump sum amount payable by the resident, although specified as a 'loan' in the agreement between the parties, is the consideration passing from the resident to the owner for the grant of occupancy rights. The legal relationship created between the parties is one of lessor and lessee. It is, in effect, the disposal of a long-term leasehold interest in a retirement village unit.

72. Irrespective of the way in which this arrangement is structured, each transaction is regarded as the equivalent of a sale. Consequently, as discussed earlier in this Ruling, the lump sum payments are included in the assessable income of the retirement village owner, primarily under subsection 25(1), in the year in which they are derived. In the context of this arrangement, it is considered that derivation occurs in the year in which the resident enters into possession of the unit, or the owner has done all that is necessary to

enable the resident to enter into possession of the unit, whichever is the earlier.

73. Expenditure incurred by the village owner in acquiring or developing the retirement village is considered to be expenditure of a revenue nature. Accordingly, a deduction will be allowed for that expenditure in the year in which it is incurred.

74. Upon rollover of a unit from one resident to another, the lump sum payable by the new resident to the village owner is included in the owner's assessable income in the year in which it is derived. The amount payable by a village owner to an outgoing resident (or their estate) is an allowable deduction in the year in which the owner incurs the obligation to make the payment.

75. Fees payable by residents for the provision of management and other services are derived when they become due and payable and are included in the owner's assessable income accordingly. A deduction will be allowed for expenditure incurred in providing those services.

76. On the basis that transactions requiring a resident to provide an 'interest-free loan' to an owner will be treated as equivalent to a sale, there will be no taxation implications for a resident in respect of the value of any benefit received by the resident as a result of providing that 'loan'.

Loan/license

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

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

79. The payment of an amount equal to the market value of the dwelling to secure the right of exclusive possession of the dwelling for

the period during which the resident occupies that dwelling leads to the conclusion that what is being granted to the resident is in the nature of a lease and not a licence.

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

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

82. Having regard to the nature of the transaction, it is considered that residents in retirement villages are granted exclusive possession of the dwellings they occupy and that there is a tenancy agreement between the village owner and each resident of the village. It is not accepted that the mutual intention of the parties to these 'licence' agreements is to create a mere contractual licence.

83. For the reasons discussed earlier in this Ruling, it is considered that the initial lump sum payment made by a resident cannot be characterised as a loan, and must be treated for tax purposes as the equivalent of the proceeds of a sale of the unit. The lump sum payable by the resident is considered to be a gross revenue receipt and is included in the assessable income of the retirement village owner in the year in which it is derived. In the context of this arrangement, it is considered that derivation occurs in the year in which the resident enters into possession of the unit, or the owner has done all that is necessary to enable the resident to enter into possession of the unit, whichever is the earlier.

84. As explained also earlier in this Ruling, expenditure incurred in acquiring or developing the retirement village is considered to be of a revenue nature and, accordingly, a deduction will be allowed for that expenditure in the year in which it is incurred.

85. Upon rollover of a unit from one resident to another, the lump sum payable by the new resident to the village owner is included in the owner's assessable income in the year in which it is derived. The amount payable by a village owner to an outgoing resident (or

their estate) is an allowable deduction in the year in which the owner incurs the obligation to make the payment.

86. Fees payable by residents for the provision of management and other services are derived when they become due and payable and are included in the owner's assessable income accordingly. A deduction will be allowed for expenditure incurred in providing those services.

87. On the basis that transactions requiring a resident to provide an 'interest-free loan' to an owner will be treated as equivalent to a sale, there will be no taxation implications in respect of the value of any benefit received by a resident as a result of providing that 'loan'.

Prepaid rental

88. Under this arrangement, the village owner leases a unit to a resident on the basis that the resident pays an amount which, it is argued, is prepayment of rent by the resident and not a premium for or in connection with the grant of the lease. Usually, it is also a condition of the lease agreement that, in addition to the prepaid rent, the resident also provides an amount which is specified as either a 'loan' or a 'deposit'. Generally, the total of the loan or deposit and prepaid rent payable by an incoming resident is equivalent to the market value of the dwelling. In that respect, it is not dissimilar to the lease and licence arrangements discussed earlier in this Ruling.

89. The term of the lease generally is expressed to be "for a term of 99 years, if the lessee shall so long live" and the prepaid rent usually is expressed to be for a period of 20 years, subject to a condition that upon termination or surrender of the lease the owner is obliged to repay, on a pro rata basis, the amount of rent attributable to the unexpired portion of the period to which it relates.

90. It has been argued that the 'loan' component is a capital receipt and that the prepaid rent should be assessed in accordance with the principle established in the *Arthur Murray* case and, accordingly, the whole of the amount of prepaid rent should not be treated as assessable income in the year of receipt, but, rather, should be brought to account on an annual basis over the term of the lease.

91. It is not accepted that, generally, this arrangement is, in substance, a prepayment of rent.

92. It has been argued that *Frazier v. Commissioner of Stamp Duties (NSW)* (1985) 17 ATR 64; 85 ATC 4735 provides authority for the proposition that rent paid in advance as a lump sum for the grant of a lease is rent and not a premium. On the facts of that case, the lump sum was fixed by reference to the cost of the unit and by taking current rentals into account, and, consequently, Lee J accepted that the

amount paid in advance as rent under a 20 year lease could be regarded as commercially realistic.

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

94. However, generally in relation to this arrangement, the prepaid rent is not commercially realistic and the total of the prepaid 'rent' and the 'loan' or 'deposit' paid is equivalent to the market value of the unit. In this regard, the prepaid rental arrangement is not dissimilar to the lease and 'licence' arrangements discussed earlier in this Ruling. Accordingly, the total of the amounts payable by residents is regarded as a revenue receipt and is included in the assessable income of the retirement village owner in the year in which it is derived. In the context of this arrangement, it is considered that derivation occurs in the year in which the resident enters into possession of the unit, or the owner has done all that is necessary to enable the resident to enter into possession of the unit, whichever is the earlier.

95. As explained earlier in this Ruling, expenditure incurred by the owner in acquiring or developing the retirement village is considered to be expenditure of a revenue nature and, accordingly, a deduction will be allowed for that expenditure in the year in which it is incurred.

96. Upon rollover of a unit from one resident to another, the total of the amounts payable by the new resident to the village owner is included in the owner's assessable income in the year in which it is derived. In the context of this arrangement, it is considered that derivation occurs in the year in which the resident enters into possession of the unit, or the owner has done all that is necessary to enable the resident to enter into possession of the unit, whichever is the earlier. The amount payable by an owner to an outgoing resident (or their estate) is an allowable deduction in the year in which the owner incurs the obligation to make the payment.

Redeemable preference share

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

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

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

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

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

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

103. The view that the receipt of the 'share premiums' is not a capital receipt is supported by the fact that the shares generally do not confer any voting rights, nor do they confer any right to a dividend or share in the profits of the company, nor any entitlement to a distribution on the winding up of the company. Consequently, a share does not constitute what is known as a congeries of rights in the shareholder against the company. The only valuable right conferred on a shareholder is the right to occupy a village unit under the terms of a lease agreement. The company does not issue shares at a premium for the purpose of raising venture capital, but to facilitate the provision of occupancy rights to shareholders for the purpose of making a profit or gain. The occupancy rights given by the articles are conditional upon the payment of the share premium.

104. Consequently, the transaction is regarded as equivalent to the sale of an individual unit, and the amount of the 'share premium' is included in the company's assessable income in the year in which it is derived. In the context of this arrangement, it is considered that derivation occurs in the year in which the resident enters into possession of the unit, or the company has done all that is necessary to enable the resident to enter into possession of the unit, whichever is the earlier.

105. As explained earlier in this Ruling, expenditure incurred by the owner in acquiring or developing the retirement village is considered to be expenditure of a revenue nature and, accordingly, a deduction for that expenditure will be allowed in the year in which it is incurred.

106. Upon rollover of a unit from one resident to another, the lump sum payable by the new resident to the company as a 'share premium' is included in the company's assessable income in the year of income in which it is derived. In the context of this arrangement, it is considered that derivation occurs in the year in which the resident enters into possession of the unit, or the company has done all that is necessary to enable the resident to enter into possession of the unit, whichever is the earlier. The amount payable by the company to an outgoing resident (or their estate) is an allowable deduction in the year in which the company incurs the obligation to make the payment.

107. Fees payable by residents for the provision of management and other services are derived when they become due and payable and are included in the company's assessable income accordingly. A deduction will be allowed for expenditure incurred in providing those services.

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

legislative references
- ITAA 6(1)
- ITAA 25(1)
- ITAA 26AB
- ITAA 51(1)
- ITAA Pt III Div 10D
- ITAA 160ZA(4)
- ITAA 160ZH(1)
- ITAA 160ZK
- ITAA 160ZS
- ITAA 160ZSA
- ITAA Pt IVA

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- Arthur Murray (NSW) Pty Ltd v. FC of T (1965) 114 CLR 314; 9 AITR 673; 14 ATD 98
- Cooling; FC of T v. (1990) 21 ATR 13; 90 ATC 4472
- Dalrymple v. FC of T (1924) 34 CLR 283
- Frazier v. Commissioner of Stamp Duties (NSW) (1985) 17 ATR 64; 85 ATC 4735
- Great West Exploration Limited v. Minister of National Revenue 57 DTC 444
- Kosciusko Thredbo Pty Ltd v. FC of T (1983) 15 ATR 165; 44 ATC 4043
- Lowry v. Consolidated African Selection Trust Ltd [1940] AC 648
- McLennan v. FC of T (1989) 20 ATR 1771; 90 ATC 4047
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- Case B47 70 ATC 236
- Case B51 70 ATC 253