PCG 2019/4 - Retirement villages: ATO compliance approach - exit allocable cost amount calculation at step 4 for certain resident liabilities under lease premium or loan/lease occupancy agreements

Retirement villages: ATO compliance approach – exit allocable cost amount calculation at step 4 for certain resident liabilities under lease premium or loan/lease occupancy agreements

Relying on this Guideline

This Practical Compliance Guideline sets out a practical administration approach to assist taxpayers in complying with relevant tax laws. Provided you follow this Guideline in good faith, the Commissioner will administer the law in accordance with this approach.

Table of Contents **Paragraph**

What this Guideline is about

1. This Guideline outlines the ATO's administrative approach to the taxation treatment of certain resident liabilities on exit of a subsidiary member of a consolidated group where that member had entered into a lease premium or participating loan/lease occupancy agreement to which Taxation Ruling TR 2002/14 *Income tax: taxation of retirement village operators* applies.

2. The resident liabilities that are the subject of this Guideline are:

- the liability to make a payment to a resident upon the termination of a *lease premium occupancy agreement* as described in paragraph 26 of TR 2002/14[1] (**lease surrender liability**)

[1] Broadly, this is a long term lease of a dwelling in the retirement village. The resident is required to make an immediate payment to the operator of an amount described as a 'lease premium' or 'lease deposit' equal to the market value of the dwelling. On 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 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.

- the liability to make a payment to an outgoing resident under a participating *loan/lease occupancy agreement* described in paragraph 50 of TR 2002/14[2] that represents a share of any increase in the entry price payable by the new resident (**increase entry price liability**).

3. In accordance with the views expressed in TR 2002/14, payments made to discharge a lease surrender liability or an increase entry price liability are deductible in the year in which the operator becomes liable to make the payment to the resident on termination of the lease.[3] These liabilities can, therefore, represent a future income tax deduction.

4. The lease surrender liability or the increase entry price liability, are amounts that would be recognised by retirement village operators under the Australian Accounting Standards and principles. Generally, retirement villages are revalued with a lease surrender liability or increase entry price liability recognised at each relevant balance date having regard to fair values and individual resident contract terms.

5. When a subsidiary member that is a retirement village operator leaves the consolidated group (**leaving entity**), the head company of the group must calculate the cost of those membership interests of the leaving entity, under the exit allocable cost amount (ACA) calculation process to work out the capital gain or loss on its disposal. As part of the exit ACA calculation, the group has regard to the leaving entity's accounting liabilities at the leaving time[4] (the step 4 amount).

6. However, the particular accounting treatment of the lease surrender liability and the increase entry price liability and the difference in the treatment of these liabilities for accounting and income tax purposes can create some uncertainty in the calculation of the step 4 exit ACA amount and specifically in the application of subsection 711-45(5) of the ITAA 1997.[5]

7. This Guideline sets out the Commissioner's approach to ensure appropriate adjustments are made at step 4 of the exit ACA calculation for the lease surrender liability or the increase entry price liability that are the subject of this Guideline.

Who this Guideline applies to

8. The head company of a tax consolidated group may rely on this Guideline if:

- a subsidiary entity owns or operates a retirement village in which residents have, prior to the subsidiary entity becoming a member of the tax consolidated group, entered into an occupancy arrangement that is either:
  - a lease premium occupancy agreement
  - a participating loan/lease occupancy agreement
- the lease surrender liability or increase entry price liability is, in accordance with the entity's accounting principles for tax cost setting, an accounting liability of the subsidiary entity just before it leaves the consolidated group

[2] Similar to the arrangement at footnote 1 of this Guideline, the loan/lease arrangement is conditional upon immediate payment to the operator of an 'interest-free' loan equal to the market value of the dwelling. On termination of the lease, the operator is obliged to repay the loan to the outgoing resident. This may be offset against any 'deferred management fees' that the outgoing resident may be required to pay to the operator. 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.

[3] Paragraph 26 (lease surrender liabilities) and paragraph 50 (increase entry price liabilities) of TR 2002/14.

[4] Subsection 711-45(1) of the *Income Tax Assessment Act 1997* (ITAA 1997) provides that the liability amount for step 4 of the exit ACA is worked out by adding up the 'accounting liability' as worked out in accordance with the leaving entity's accounting principles for tax cost setting. The accounting principles for tax cost setting is further defined in subsection 711-45(1A).

[5] All legislative references in this Guideline are to the ITAA 1997.

- the payment made to discharge the lease surrender liability or the increase entry price liability by the leaving entity would be deductible under section 8-1[6], and
- there has been an increase in the value of the lease surrender liability or increase entry price liability after the joining time and that change has been taken through the entity's profit and loss account for accounting purposes.

Date of effect

9. This Guideline applies both before and after its date of issue.

ATO compliance approach

10. Where this Guideline applies, the Commissioner accepts the change in value of the lease surrender liability or increase entry price liability are amounts that are taken into account for income tax purposes at a later time than under accounting principles for the purposes of applying subsection 711-45(5). This is notwithstanding that only the change in value of the lease surrender liability has been taken through the entity's profit and loss account whereas the entire lease surrender amount is deductible for income tax purposes when discharged. As for a participating loan/lease occupancy agreement, the increase entry price liability and the discharge amount in respect of it are taken into account for both accounting and income tax purposes. The Commissioner accepts that both the lease surrender liability and the increase entry price liability are liabilities to which subsection 711-45(5) applies.[7]

Examples

Example 1 – lease surrender liability

11. *Company A is incorporated with $100,000 equity and develops an independent living unit for $100,000.*

12. *A resident commences occupying the unit under a lease premium occupancy agreement and pays a lease premium of $100,000 to Company A.*

13. *Under the agreement between Company A and the resident, the resident is entitled to 100% of the increase in the entry price payable by a new resident for the unit upon exit. Company A recognises, for accounting purposes, a lease surrender liability owing to the resident for $100,000. The receipt of the lease premium, and the corresponding recognition of the lease surrender liability, are not reflected in Company A's profit and loss account.*

14. *Company A is acquired by a tax consolidated group for $100,000.*

15. *At the end of year one, Company A recognises an increase in the value of the unit of $50,000. The lease surrender liability is also increased by $50,000 to $150,000. The change in the lease surrender liability is reflected in Company A's profit and loss account.*

16. *The tax consolidated group sells its interests in Company A for $100,000.*

17. *The cost bases for the membership interests in Company A are calculated in accordance with Division 711. For the purposes of the exit ACA calculation, the Commissioner will accept the change in the future deductible lease surrender liability as an*

[6] The payment would be deductible under section 8-1 in accordance with the views in TR 2002/14.
[7] Note that subsections 711-45(8) and (10) are engaged as a result of the application of subsection 711-45(5).

amount taken into account for income tax purposes at a later time than under accounting principles when applying subsection 711-45(5).[8]

Example 2 – increase entry price liability

18. *Company A is established with $100,000 equity and develops an independent living unit for $100,000.*

19. *A resident commences occupying the unit under a loan/lease occupancy agreement and provides a loan of $100,000 to Company A.*

20. *Under the agreement between Company A and the resident, the resident is entitled to 100% of the increase in the entry price payable by a new resident for the unit upon exit. Company A recognises a loan liability to the resident for $100,000.*

21. *Company A is acquired by a tax consolidated group for $100,000. There was no increase entry price liability recognised at the joining time in accordance with its accounting principles for tax cost setting.*

22. *At the end of year one, Company A recognises an increase in value of the unit of $50,000. Company A recognises a future deductible unrealised increase entry price liability to the resident of $50,000. The change in the increase entry price liability is reflected in Company A's profit and loss account.*

23. *The tax consolidated group sells its interests in Company A for $100,000.*

24. *The cost bases for the membership interests in Company A are calculated in accordance with Division 711. For the purposes of the exit ACA, the Commissioner will accept the unrealised increase entry price liability is an amount taken into account for income tax purposes at a later time than under accounting principles, in applying subsection 711-45(5).*[9]

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[8] Note that, in this example, subsections 711-45(8) and (10) are engaged as a result of the application of subsection 711-45(5).

[9] Note that, in this example, subsections 711-45(8) and (10) are engaged as a result of the application of subsection 711-45(5).

References

Previous draft:

Previously released in draft format as PCG 2019/D1

ATOlaw topic(s)	Income tax ~~ Consolidation ~~ Identification of assets and liabilities ~~ Other
Legislative references	ITAA 1997 ITAA 1997 8–1 ITAA 1997 Div 711 ITAA 1997 711-45(1) ITAA 1997 711-45(1A) ITAA 1997 711-45(5) ITAA 1997 711-45(8) ITAA 1997 711-45(10)
Related Rulings/Determinations	TR 2002/14
ATO references	1-DRREN5D
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