TR 94/29 - Income tax: capital gains tax consequences of a contract for the sale of land falling through

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This ruling contains references to repealed provisions, some of which may have been rewritten. The ruling still has effect. Paragraph 32 in TR 2006/10 provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. The legislative references at the end of the ruling indicate the repealed provisions and, where applicable, the rewritten provisions.

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Taxation Ruling

Income tax: capital gains tax consequences of a contract for the sale of land falling through

other Rulings on this topic

IT 2561; TD 93/44; TD 93/45; TD 93/86; TD 93/235

contents	para
What this Ruling is about	**1**
Ruling	**4**
Cash contracts	4
Terms contracts	9
Treatment of instalment monies/damages for breach	13
Contract falling through after completion	21
Date of effect	**24**
Explanations	**25**
General	25
Nature and identification of interests involved in a sale of land	31
Disposal at completion of contract - the preferred view	39
The right to sue as an asset	56
The application of subsection 160M(7)	67

*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.*

What this Ruling is about

1. This Ruling is concerned with the capital gains tax (CGT) consequences under Part IIIA of the *Income Tax Assessment Act 1936* (ITAA) on the sale of land under a contract which for various reasons falls through and the land is returned to the vendor intact. It does not deal with cases where the land is trading stock of the vendor.

2. The Ruling looks at the position of both the vendor and purchaser and explains:

(a) when a disposal and acquisition of the land take place for CGT purposes;
(b) the effect of the contract falling through where the land is sold under a cash contract or a terms contract;
(c) the effect of the contract falling through on any instalments of principal monies retained or damages paid under the contract; and
(d) the effect of a contract falling through after completion of the contract.

3. The Ruling is concerned with the disposal of the land in its entirety. It is concerned with the disposal of the absolute freehold interest or the estate in fee simple as it is often called in legal parlance. It is not concerned with the disposal of any separate interest attaching to the land or that may be carved out or severed from the land in the process of the land being disposed of as a whole asset.

Ruling

Cash contracts

4. A change in the ownership of land, and hence a disposal and a corresponding acquisition, for the purposes of section 160M occurs at the completion of the contract under which the land is sold.

5. Completion of an ordinary contract for the sale of land normally takes place at the time of settlement. At this point in time the purchaser hands over the balance of the purchase monies and the vendor delivers the transfer or some similar instrument together with the title deeds. Generally speaking, the purchaser also obtains possession of the land at this time under a cash contract.

6. If the contract falls through before completion a change in the ownership of land will not in fact occur. Accordingly, there will be no deemed disposal or acquisition effected by subsection 160M(1). As a change in ownership has not occurred there is no disposal to which the CGT provisions can apply.

7. However, if the contract is completed, the time of disposal and acquisition is determined under the provisions of subsection 160U(3). Under these provisions, the time of disposal and acquisition is taken to be the time when the contract is made. In other words, when an actual change in ownership occurs on completion of the contract the disposal and acquisition will then relate back to the date of contract. The deeming provisions of subsection 160U(3) combine with the provisions of subsection 160Z(1) to treat a capital gain as having accrued or a capital loss as having been incurred in the year of income in which the contract was made. One needs to wait and see if completion of the contract occurs before the provisions of subsections 160U(3) and 160Z(1) can be applied. Thus, if a contract for the sale of land is entered into on 31 May 1993 and settled on 31 July 1996, any capital gain resulting from the sale would ordinarily accrue on 31 July 1996, but the combined effect of subsections 160U(3) and 160Z(1) is to bring that gain into the assessment for the year ended 30 June 1993.

8. While the obligation to declare the capital gain does not arise until the settlement of the contract, a taxpayer may be liable for the payment of interest under section 170AA in those cases where the time of making the contract and settlement of the contract span over more than one income year . However, although each case will be dealt with on its own merits, it would be expected that the discretion in subsection 170AA(11) would be exercised to remit the interest in full where requests for amendment are lodged, and where relevant, self amendments are made, within a reasonable time after the date of settlement. In most cases, we would consider a period of one month

after settlement to be reasonable for this purpose. However, we accept that there may well be circumstances where a taxpayer can establish that a longer period is reasonable. Although it is not required, a taxpayer who before settlement lodges his or her return for the income year in which the contract was made may, for convenience, at that time include in the return any net capital gain arising from the sale of the land or offset any capital loss arising from the sale of the land against a capital gain.

Terms contracts

9. Generally speaking and for the purposes of this Ruling, a terms contract is one where the purchaser is entitled to possession of the land or the receipt of rents and profits before becoming entitled to a transfer or conveyance of the land (that is, before completing the purchase by paying the balance of the purchase price and receiving the instrument of transfer and title deeds).

10. For CGT purposes, where a terms contract is involved a change of ownership and hence a disposal and an acquisition are taken to occur at the time when possession of the land is given to the purchaser or the purchaser becomes entitled to the receipt of rents and profits. Paragraph 160M(3)(d) deems a change in ownership to have occurred by the transaction which gave the purchaser the use and enjoyment of the land for a period at the end of which the title to the land will or may pass to the purchaser. Subsection 160U(7) makes it clear that the time of acquisition or disposal is to occur when the use and enjoyment of the land is first obtained. Use and enjoyment of the land from a practical point of view takes place at the time the purchaser gets possession of the land or the date the purchaser becomes entitled to the receipt of rents and profits. This will ordinarily occur at the time the contract is made or soon after.

11. If the contract falls through before completion, title to the land will not pass to the purchaser because the purchaser is not entitled to a conveyance or transfer of the land. Subsection 160M(4) will undo the deeming effect of the provisions of paragraph 160M(3)(d) referred to above. Under subsection 160M(4) a change in ownership is not taken to have occurred if the period for which the purchaser had the use and enjoyment of the land terminates without the title to the land passing to the purchaser. Accordingly, as a change in ownership has not occurred there is no disposal to which the CGT provisions can apply.

12. The effect of subsection 160U(7) is that any capital gains accrued or any capital losses incurred by a taxpayer will need to be returned in the year in which possession of the land was given to the purchaser or the purchaser became entitled to the receipt of rents and profits. However, on the contract falling through, subsection 160M(4)

and section 170 provide taxpayers with appropriate relief by way of amendment to their assessment.

Treatment of instalment monies/damages for breach

13. The capital gains tax treatment of instalments of monies (other than a deposit) retained by a vendor will to a large extent depend on the terms of the contract and on whether at law the forfeiture of instalments monies is regarded as penalties.

14. Generally speaking a defaulting purchaser is entitled either at law or in equity to the return of such monies. However, in some circumstances the vendor is entitled to apply such monies towards the satisfaction of damages resulting from the purchaser's breach.

15. The *Transfer of Land Acts* in some of the States, in particular Victoria and Western Australia, allow the parties to a contract to adopt the conditions set out in the Schedules to those Acts. Under Condition 6(3)(b) of Table A to the Seventh Schedule of the *Transfer of Land Act 1958* (Vic), for instance, the vendor may retain any part of the price paid under the contract pending the determination of damages for the breach of the contract by the purchaser and may apply that money in satisfaction or part satisfaction of those damages. Similar conditions may be incorporated in contracts for the sale of land.

16. The retention of instalment monies pending the determination of damages will not of itself give rise to a capital gain. However, if the vendor lawfully applies instalment monies in satisfaction of damages occasioned by the breach, or the parties settle on a specific sum for damages, the amount applied or settled on will give rise to a capital gain. Likewise, any other sum received by way of damages for breach of contract will give rise to a capital gain.

17. In the circumstances, the relevant asset for CGT purposes is constituted by either:

(a) the right of action (the 'right to sue') which vests on the vendor upon the breach of contract by the purchaser; or

(b) the notional asset created under subsection 160M(7).

In either case the cost base of the asset will be limited to the incidental costs to the vendor on the disposal of the asset.

18. The right to sue is acquired at the time of breach of the contract. Disposal of the right to sue would arise upon settlement of the action or upon issue of a court order awarding damages in favour of the vendor. Where the right to sue arises after 25 June 1992 the new provisions of subsection 160M(6) introduced by the *Taxation Laws Amendment Act (No 4) 1992* (TLAA (No 4) 1992) will apply as explained in paragraphs 65 and 66.

19. If subsection 160M(7) applies, the act, transaction or event which constitutes the disposal of an asset created by the disposal is the act, transaction or event which led the vendor to receive or entitles the vendor to receive an amount of money or other consideration. Depending on the circumstances of each case, the relevant act, transaction or event may be the breach of contract, the commencement of proceedings, the obtaining of judgment or the reaching of a settlement.

20. The views expressed in paragraphs 17-19 apply equally to damages awarded to the purchaser where the vendor has defaulted under the contract.

Contract falling through after completion

21. It is only in exceptional circumstances that a contract can fall through after completion.

22. As a general rule, once a contract has been completed, in the sense that the purchaser has paid the balance of the purchase monies and the vendor has delivered the transfer and the title deeds to the purchaser, any subsequent dealings in respect of the land will constitute a fresh disposal and acquisition. That is to say, if the parties to the original contract decide to put an end to the contract after completion there will be for CGT purposes a disposal of the land by the original purchaser and a re-acquisition of the land by the original vendor.

23. However, in some circumstances a contract may fall through after completion for reasons which will render the contract void from the beginning, that is, the contract is treated in law as never having come into existence. One example would be where the contract is set aside because of the fraud of one of the parties and the fraud is discovered after completion. In these types of cases the innocent party may rely on the fraud to have the contract of sale declared a nullity from the beginning. The position from a CGT point of view would then be that a change in the ownership of land is taken never to have occurred since the contract of sale was a nullity from the beginning. The example in Taxation Determination TD 93/44 dealing with the treatment of damages for misrepresentation covers the situation where the contract remains intact despite the misrepresentation.

Date of effect

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

Explanations

General

25. In this Ruling the neutral term 'fallen through' has been used to describe the demise of a contract. In other quarters the contract is often described as being rescinded, terminated, cancelled or having come to an end. A contract for the sale of land may fall through because of breach, frustration, repudiation, mistake, fraud or by agreement of the parties.

26. Under the laws of contract, the nature and consequences of a contract falling through are best described in the words of Dixon J in *McDonald v. Denny Lascelles Ltd* (1933) 48 CLR 457 at 476-477 where he says:

> 'When a party to a simple contract upon breach by the other contracting party of a condition of the contract elects to treat the contract as no longer binding upon him, the contract is not rescinded as from the beginning. Both parties are discharged from the further performance of the contract, but rights are not divested or discharged which have already been unconditionally acquired. Rights and obligations which arise from the partial execution of the contract and causes of action which have accrued from its breach alike continue unaffected. When a contract is rescinded because of matters which affect its formation, as in the case of fraud, the parties are to be rehabilitated and restored, so far as may be, to the position they occupied before the contract was made. But when a contract, which is not void or voidable at law, or liable to be set aside in equity, is dissolved at the election of one party because the other has not observed an essential condition or has committed a breach going to its root, the contract is determined so far as it is executory only and the party in default is liable for damages for its breach.'

27. Thus a contract induced by fraud, mistake or misrepresentation is in some circumstances treated in law as never having come into existence. Here a contract is said to be rescinded *ab initio* (as from

the beginning). All causes of action based on the existence of the contract would cease to exist. The parties would be restored to their pre-contract position. It follows that any deposit or other moneys paid under the contract would need to be returned to the purchaser: see *Johnson v. Agnew* [1980] AC 367 in Voumard, *The Sale of Land in Victoria*, 4th edition at 462.

28. In the majority of cases a contract is treated as validly made but may be brought to an end by reason of events (such as breach) which happen subsequently to its formation. Here a contract is said to be rescinded *in futuro*, that is, the parties are absolved from future performance of their obligations. Rights which have been unconditionally acquired, however, are not divested or discharged (*McDonald's* case). Only obligations required to be performed in the future will not be required to be performed. Where the purchaser is in default, the vendor is entitled to retain the deposit or to recover any deposit unpaid (*Farrant v. Leburn* [1970] WAR 179; *Dewar v. Mintoft* (1912) 2 KB 373; *Watson v. Healy Lands Ltd* [1965] NZLR 511; *Bot v. Ristevski* [1981] VR 120). In the circumstances, any deposit paid is said to be forfeited.

29. Except as indicated in paragraphs 14-16 above, the defaulting purchaser would be entitled to recover any instalment of principal monies paid irrespective of whether there is or is not an express provision for forfeiture contained in the contract. In the former case the purchaser is compelled to invoke the equitable jurisdiction of the Court to relieve against forfeiture. In the latter case a purchaser is entitled at common law to recover instalments paid (*McDonald's* case).

30. Causes of action which have accrued from the breach of contract continue unaffected (*McDonald's* case). This means that the parties can sue for any damages resulting from the breach. To the extent that either the vendor or purchaser succeeds in obtaining damages for breach those damages will be subject to capital gains tax as explained in paragraphs 16-20.

Nature and identification of interests involved in a sale of land

31. Section 160A defines the word 'asset' broadly to mean, unless a contrary intention appears, 'any form of property' and includes the subject matter of paragraphs (a) to (e) of that section.

32. Where a change has occurred in the ownership of an asset subsection 160M(1) deems the change to have effected a disposal and an acquisition of the asset. Subsections 160M(2) and 160M(3) extend the scope of 'a change in the ownership of an asset'. One effect of these provisions is that a change in the ownership of an asset may occur in circumstances where according to general law no change in

the ownership of an asset would be recognised. Apart from special cases one would, however, expect that a change in ownership of an asset for CGT purposes would in the majority of cases correspond with a change in ownership according to ordinary principles of law.

33. As the expression 'any form of property' is central to the definition of 'asset' it is appropriate to ask what the scope of the expression is. In *McCaughey v. Commr of Stamp Duties* (1945) 46 SR (NSW) 192 at 201 Jordan CJ said:

> 'The word "property" is used in different senses. It may denote either objects of proprietary rights, such as pieces of land, domesticated animals, and machines; or the proprietary rights themselves ... In common parlance it is usually employed in the former sense, but in the language of jurisprudence in the latter ... Property, in the sense of proprietary rights, may exist in relation to physical objects, or to intangible things such as debts or patent rights. Each separate piece of property consists of a bundle of proprietary rights relating to a particular object, including rights of administration and rights of enjoyment, the totality of which may be vested in a single person, or may be divided amongst a number of persons, as for example when they are shared by several who together own them all, jointly or in common. It is common also in English law to find the rights of administration divorced from the rights of enjoyment, the former being vested in an executor or administrator who holds in *autre droit* or in a trustee who holds in trust, and the latter being vested in beneficiaries. Where such a division exists, the personal representative or trustee is, for most purposes, treated as the absolute owner by a court of common law engaged in enforcing common law rights, whilst, in the contemplation of a court of equity, the beneficiaries are regarded as entitled to the beneficial rights and to the enjoyment of so much of them as is for the time being available.'

34. The capital gains tax provisions in the use of the term 'asset' adopt both senses of the word 'property' to which Jordan CJ referred and also specifically recognise various forms of proprietary rights. For instance: the definition of 'land' in subsection 160K(1) is expressed to include (paragraph (a)) 'a legal or equitable estate or interest in land'; paragraph 160M(3)(b) recognises interests or rights in or over property, at law or in equity, as assets; and subsection 160P(8) deems land and any building or other improvement to be a single asset except as provided by the section.

35. Because of its very nature, property in land consists of a bundle of proprietary rights both at law and in equity. This is not to say that when the land is in the hands of the vendor the vendor holds the various rights in the bundle separately. On the contrary, the vendor

has the whole right of property in the land and not separate and distinct interests. It is generally recognised that new proprietary rights can be created, carved out, or severed from the object, the land, itself. The CGT provisions recognise that each proprietary right in the bundle may constitute a separate asset and when in turn disposed of would be subject to CGT. But it does not mean that on every occasion where there is a change in the constitution of the object itself there is a disposal or part disposal of the object.

36. Where the purpose of a transaction is to dispose of one of the new proprietary rights created, carved out or severed from the bundle, the CGT provisions will apply to that proprietary right as a separate asset. Examples of these include easements, profits à prendre and leases (see Taxation Ruling IT 2561 and Taxation Determination TD 93/235). The ruling in Taxation Determination TD 93/86 is distinguishable from the present Ruling on the basis that the former concerns the treatment of contractual rights where no underlying asset is involved.

37. However, the subject of this Ruling is the disposal of the land as a whole. The principal question that arises in this context is - at what point in time is it regarded that a change in the ownership of land, and hence a disposal, has occurred in respect of land sold under a contract of sale?

38. From the case law and the literature of learned authors on the subject emerge three different views which can be summarised as follows:

- disposal occurs at date of contract;
- disposal occurs at completion/settlement of contract; or
- disposal occurs at time of registration.

Our preferred view in the context of the CGT legislation and with respect to cash contracts is that a change of ownership and hence a disposal occurs at the completion of the contract. However, for the purposes of the CGT provisions the time of disposal and acquisition is determined under the provisions of subsection 160U(3). The subsection does not deem a disposal to occur on the making of the contract. Rather, it provides that where there is a change of ownership, disposal is to be taken to have occurred on the making of the contract. In other words, the disposal when it occurs relates back to the time the contract was made (see Case 24/94, 94 ATC 239; Case 9451, 28 ATR 1108). As explained in paragraphs 9-12 above, terms contracts are separately dealt with under the CGT legislation.

Disposal at completion of contract - the preferred view

39. Completion of an ordinary contract for the sale of land takes place at the time of settlement. At this time the purchaser hands over the balance of the purchase money and the vendor delivers the transfer or some similar instrument together with the title deeds. Generally speaking, the purchaser also obtains possession of the land at this time.

40. On settlement the purchaser is, therefore, in relation to land under the Torrens system placed in a position to acquire the protection of the Land Transfer Acts by registering the transfer. In relation to land not under the Torrens system, the purchaser obtains absolute ownership.

41. The opposing view that disposal takes place at the time of contract concentrates on the nature of the equitable interest which emerges under a contract for the sale of land. The case law on the matter express varying opinions as to the existence, nature and effect of that interest. The cases show a divergence of opinion as to when the equitable interest, in whatever form, actually passes to the purchaser. There is support for the view that the equitable interest does not pass until completion of the contract as well as for the view that the equitable interest passes at the time of the contract. We have also noted that equitable interests are recognised as assets for CGT purposes just as much as legal interests and the objects themselves.

42. Support for the preferred view may be got from the following passages from the joint judgment of Deane and Dawson JJ in *Stern v. McArthur* (1988) 165 CLR 489 which discuss the nature of the equitable interest. At 521-523 they say:

> 'It has been said in a variety of ways that a vendor under a valid contract for the sale of land holds the land as trustee for the purchaser. He is, however, a trustee only in a qualified sense and the qualifications are such as to rob the proposition of much of its significance or, for some purposes, its validity. The vendor must make title before there can be any alteration in the equitable ownership of the land, although the alteration may then relate back to the date of contract. Even so the vendor retains a substantial interest in the property until the whole of the purchase money is paid. He is entitled, subject to the contract, to possession and to the rents and profits in addition to a lien on the land as security for any amount outstanding. Any right to equitable ownership on the part of the purchaser is contingent only, being subject to the payment of the purchase money and being said to exist only so long as the contract remains specifically enforceable at his suit.

> As Deane J pointed out in *Kern Corporation Ltd v. Walter Reid Trading Pty Ltd* (1987) 163 CLR 164 at p. 191, it is not really possible with accuracy to go further than to say that the purchaser acquires an equitable interest in the land sold and to that extent the beneficial interest of the vendor in the land is diminished. The extent of the purchaser's interest is to be measured by the protection which equity will afford to the purchaser.
>
> To put the matter in this way is to say little more than that the equitable interest of a purchaser under a contract for the sale of land is that which equity recognizes and protects: *Hewett v. Court* (1983) 149 CLR 639 at pp. 665-666, per Deane J. The relationship of trustee and beneficial owner will certainly be in existence when the purchase money specified in the contract has been paid, title has been made or accepted and the purchaser is entitled to a conveyance or transfer. At that point the purchaser is entitled in equity to the land and the vendor is a bare trustee: *McWilliam v. McWilliams Wines Pty. Ltd*. (1964) 114 CLR 656 at p. 660, per McTiernan and Taylor JJ. Otherwise there is no unanimity upon when the relationship of trustee and beneficial owner arises: *Chang v. Registrar of Titles* (1976) 137 CLR 177 at p. 184, per Mason J. But that does not mean that before that time has arrived the purchaser may not be entitled to a lesser equitable interest than ownership.'

43. Another way of looking at the problem is to concentrate on the nature of the asset that is being disposed of rather than the individual rights comprising it or arising under the contract. In *Zim Properties Ltd v. Proctor* (1984*)* 58 TC 371 Warner J saw no difficulty in accepting that not every right to a payment is an asset within the meaning of that term in the United Kingdom capital gains tax legislation. The most obvious example, he says, of one that is not is the right of a seller of property to payment of its price - the relevant asset, then, is the property itself. The new subsection 160MA(2) introduced by the TLAA (No 4) 1992 recognises that it is the land that is the relevant asset being disposed of and not the various rights created under the contract of sale. Land is property known to the common law. The asset to be disposed of is therefore legal property not an equitable property. Looked at in the language of jurisprudence, it is the fee simple, the legal estate, the freehold interest.

44. The nature of the property to be disposed of may be tested by asking the question - what is the nature of the asset in the vendor's hands? The vendor is the legal owner of the land; it has the whole right of property in the land but has no separate equitable estate in it, for its equitable estate is absorbed in the legal estate. There is no severance of the legal and equitable interests in the land whilst the

land is in the hands of the vendor - see Gibbs CJ in *DKLR Holding Co (No 2) Pty Ltd v. Commissioner of Stamp Duties (NSW)* 82 ATC 4125 at 4131-4132; (1982) 12 ATR 874 at 880.

45. Aickin J in the same case (82 ATC at 4145; 12 ATR at 895) put the proposition this way:

> 'If one person has both the legal estate and the entire beneficial interest in the land he holds an entire and unqualified legal interest and not two separate interests, one legal and the other equitable ... he is the absolute owner of an estate in fee simple in the land.'

Brennan J expressed similar views.

46. In *Commissioners of Inland Revenue v. Angus* 23 QBD 579, the Court of Appeal had to consider the question whether an agreement for the sale of property and the goodwill of the business carried on there conveyed or transferred a legal or equitable interest and hence was subject to ad valorem duty. Lord Esher MR, when discussing the nature of the property under the agreement said at 590:

> 'When the property to be conveyed is a property known to the common law, then the conveyance, if there be one, will be a legal conveyance; and when the property to be conveyed is an equitable property or interest, then the conveyance, if there be one, will be an equitable conveyance ... Now the property which was to be conveyed in the present case is a legal property.'

His Lordship concluded that the agreement did not convey the legal property despite the fact that the agreement was one of which a Court of Equity would instantly decree specific performance. At 591 His Lordship considers what the doctrine of specific performance is and says:

> 'If the instrument is a "conveyance" in itself, why do you want a decree for specific performance? If the instrument has conveyed the property to the purchaser, he does not require specific performance of an agreement with reference to his own property which has been already conveyed to him.'

47. Similar points of view as to the nature of an asset and the intervention of equity were expressed by the Privy Council in *Livingston v. Commissioner of Stamp Duties (Q)* (1960) 107 CLR 411. Their Lordships had to consider the nature of the interest held in the assets of an unadministered estate. Viscount Radcliffe in delivering the opinion of their Lordships put the problem and the response at 422 as follows:

> 'Where, it is asked, is the beneficial interest in those assets during the period of administration? It is not, *ex hypothesi*, in the executor: where else can it be but in the residuary legatee?

> This dilemma is founded on a fallacy, for it assumes mistakenly that for all purposes and at every moment of time the law requires the separate existence of two different kinds of estate or interest in property, the legal and the equitable. There is no need to make this assumption. When the whole right of property is in a person, as it is in an executor, there is no need to distinguish between the legal and equitable interest in that property, any more than there is for the property of a full beneficial owner. What matters is that the Court will control the executor in the use of his rights over assets that come to him in that capacity; but it will do it by the enforcement of remedies which do not involve the admission or recognition of equitable rights of property in those assets. Equity in fact calls into existence and protects equitable rights and interests in property only where their recognition has been found to be required in order to give effect to its doctrines.'

48. The same thing can be said about a contract for the sale of land. The nature of the property to be conveyed is legal property. The contract does not convey the legal property. The very fact that the assistance of equity may be called upon is an express recognition that the ownership in the legal property has not passed under the contract. A contract of sale anticipates and looks forward to a conveyance of the land. Equity acts *in personam* and compels the vendor to do whatever is necessary to be done to transfer the property to the purchaser. But equity will only intervene if it is called upon to do so in order to recognise the existence of equitable rights and interests and to protect them.

49. If a contract for the sale of land is completed the ownership in the legal property passes at that time, when the purchaser has the title deeds and transfer in his or her control and he or she has paid the balance of moneys to the vendor. If one of the parties breaches the contract before completion, the innocent party may call the assistance of equity to have the contract specifically performed. If equity decrees specific performance the contract will be completed and the property passes accordingly. But by its decree equity does not affect the property itself. It does not decree that the legal property has passed to the purchaser.

50. To borrow the words of Viscount Radcliffe in the *Livingston* case 'the dilemma is founded on a fallacy that for all purposes and at every moment of time the law requires the separate existence of two different kinds of estate or interest in property, the legal and the equitable'. The vendor has an entire and unqualified legal interest. It is that interest which he intends to sell under a contract of sale.

51. When the *Livingston* case was before the High Court of Australia, Dixon CJ said that an equitable interest is not ownership;

but it is proprietary. A person acquiring such an interest can nonetheless dispose of it and for CGT purposes the interest will then be considered as a separate asset. The nature of the purchaser's interest under a contract for the sale of land and the consequences upon disposal were recently considered by the Full Supreme Court of Western Australia in *Mt Newman Mining Co Pty Ltd v Commissioner of State Taxation (WA)* 94 ATC 4141; 27 ATR 518.

52. But what we are presently concerned with is the position of a vendor under a contract of sale who wishes to sell the entire interest in the land and the consequences that flow from this.

53. Further support for the view that a disposal does not occur until the contract is completed may be got from the decisions of the High Court in *Commissioner of Taxes (Q) v. Camphin* (1937) 57 CLR 127; *Currey v. Federal Building Society* (1929) 42 CLR 421 and the decision of McGarvie J of the Supreme Court of Victoria in *Benwerrin Developments Pty Ltd v. FC of T* 81 ATC 4524; (1981) 12 ATR 335.

54. Adopting the view that a change of ownership with respect to the sale of land occurs at the date of completion of the contract will mean that problems concerning the re-acquisition of the land by the vendor when the contract falls through before completion will not arise. That is to say, if the land was a pre-CGT asset it retains that status. There is no disposal and reacquisition involved on the part of the vendor.

55. Further, adopting the preferred view will mean that section 160ZF will have no role to play where the contract falls through before completion. Accordingly, the anomalies that would flow from the provisions of that section if the date of contract view was adopted are avoided.

The right to sue as an asset

56. The right to sue is often the term used to describe the cause of action or the right of action that arises in favour of the innocent party where a contract is breached by the other party to the contract. The issues that arise in this context is whether the right to sue arising under a contract for the sale of land is an asset for CGT purposes. If it is an asset when is it acquired, when is it disposed and what is the consideration for its acquisition and disposal?

57. There is some judicial support for the view that the right to sue is an asset for CGT purposes. In *Hepples v. FC of T* 91 ATC 4808; (1991) 22 ATR 465 McHugh J appears to recognise that the right to sue bears the character of a proprietary right once it is vested in the grantee. At 4840 His Honour says:

> 'When a person creates a right in another person to sue him or her, the grantor does not dispose of any asset of his or her own. The personal right to sue is never vested in the grantor, even momentarily. It is only when the right to sue is vested in the grantee, and not before, that it bears the character of a proprietary right.'

58. Rich J in *Loxton v. Moir* (1914) 18 CLR 360 at 379 on a similar point said:

> 'The phrase "chose in action" is used in different senses, but its primary sense is that of a right enforceable by an action. It may also be used to describe the right of action itself, when considered as part of the property of the person entitled to sue. A right to sue for a sum of money is a chose in action, and it is a proprietary right.'

59. There is also the English authority of *Zim Properties Ltd v. Proctor* (1984) 58 TC 371 supporting the view that a right to bring an action to seek to enforce a claim, which the case for the sake of convenience described as a right to sue, was an asset under the United Kingdom capital gains tax legislation.

60. In this Ruling we are looking at the right that the innocent party has against the other party to a contract for the sale of land for damages suffered as a result of the contract coming to an end by reason of breach of the contract or for some other reason.

61. When is the right to sue acquired? The general rule where a breach of contract is involved is that the cause of action (the right to sue) arises at the time of the breach (see *The Millstream Pty Ltd v. Schultz* (1980) 1 NSWLR 547; *Johnson v. Agnew* and *Zim Properties* above).

62. What is the cost base of the right to sue? It is obvious from the remarks of McHugh J in *Hepples* that the right to sue does not result from a disposal of that right from the grantor to the grantee. The right to sue vests on the grantee by operation of law. In this sense a change of ownership and hence an acquisition occurs by the method envisaged in paragraph 160M(2)(c). The provisions of subsection 160ZH(9) do not apply to attribute a market value as a cost base to the right to sue.

63. The type of costs that can be included in the cost base of the right to sue in terms of subsection 160ZH(1) are any incidental costs incurred in obtaining legal advice concerning the merits of the right of action and the costs of prosecuting the taxpayer's right of action to finality. These will be considered to be incidental costs to the taxpayer of the disposal of the asset pursuant to paragraph 160ZH(1)(e).

64. It is regarded that the right to sue is disposed of when it is satisfied either by settlement or upon the issue of a court order awarding damages. The disposal occurs by way of satisfaction or surrender as mentioned in paragraph 160M(3)(b). The amount settled on or the amount ordered to be paid by the court represents the consideration on disposal.

65. To the extent that the amendments relating to capital gains tax contained in Division 6 of the TLAA (No 4) 1992 apply to the right to sue they do not alter the position described above. The new provisions will operate in the following manner in relation to the person creating the asset:

- The purchaser will be the person who creates the asset (the right to sue) in another person (the vendor) where the purchaser is in breach of the contract (new subsection 160M(6)). As was said by McHugh J in *Hepples* case the right to sue is vested in the grantee, i.e., the vendor in the particular situation.
- The purchaser will be taken to acquire the asset and to commence to own it immediately before the time of vesting, i.e., the time of breach (new paragraph 160M(6A)(a) and subparagraph 160U(6)(b)(ii)).
- The purchaser will be taken to have subsequently disposed of the asset to the vendor (new paragraph 160M(6A)(b)) at the time when the asset vests in the vendor (new subparagraph 160U(6)(b)(iii)).
- The purchaser will have included in the cost base of the asset only expenditure incidental to the disposal of the asset (new paragraph 160M(6A)(c)). Generally speaking, having regard to the nature of the asset and its date of acquisition and disposal by the purchaser the cost base of the asset will be nil.
- As the purchaser is not likely to receive any consideration for vesting the right to sue on the vendor at the time of breach the consideration on disposal by the purchaser will also be nil (new paragraph 160M(6A)(d)).
- Accordingly, there will be no capital gain or loss arising to the purchaser from the creation of the right to sue and its vesting on the vendor.

66. In relation to the person in whom the right to sue is vested on its creation (the vendor in the particular situation referred to above) the new provisions will operate in the following manner:

- The vendor will be taken to have acquired the right to sue from the purchaser who created it, and to commence to own it (new paragraph 160M(6B)(a)).
- The vendor is taken to acquire the asset at the time it vests in him or her (new subparagraph 160U(6)(b)(i)). The right to sue vests on the vendor at the time of breach as indicated above.
- As the vendor does not give any consideration on the acquisition of the asset the cost base of the right to sue is limited to incidental costs of disposal as explained in paragraph 63 above.
- The right to sue is disposed of when it is satisfied either by settlement or upon the issue of a court order for damages as explained in paragraph 64 above. The amount settled on or the amount ordered to be paid by the court represents the consideration on disposal.

The application of subsection 160M(7)

67. The changes made to subsection 160M(7) by the TLAA (No 4) 1992 will mean that the new subsection will have a residual application where the other CGT provisions, including the new provisions dealing with the creation of incorporeal assets (subsection 160M(6)), have not applied to a transaction. While both new subsections 160M(6) and 160M(7) will be subject to the provisions of Part IIIA, subsection 160M(6) will apply in precedence to subsection 160M(7). This will mean that subsection 160M(7) will only apply where the receipt of an amount of money or other consideration is not in respect of the disposal of an asset or the creation of an incorporeal asset. In view of the nature of the right to sue it is most likely that the issue concerning the treatment of damages received for breach of contract will be determined under either the general provisions or the new provisions of subsection 160M(6) as outlined in this Ruling.

68. Apart from the residual application of the new subsection 160M(7) and a number of minor technical amendments made by the TLAA (No 4) 1992 to clarify the operation of the subsection, the new subsection will generally apply as it did before the subsection was amended.

69. However, the following points need to be made as to the operation of the subsection in the context of the subject matter of this Ruling:

(a) The new provisions will apply in relation to an act, transaction or event which takes place after 25 June 1992. The subsection applies where an act or transaction has

taken place in relation to an asset (an actual asset) or an event affecting an actual asset has occurred and the person who owned the actual asset at the time of the act, transaction or event has received, or is entitled to receive, an amount of money or other consideration by reason of the act, transaction or event.

(b) The actual asset which is affected by an event or in relation to which an act or transaction has taken place is the right to sue or alternatively the land itself. In the majority of cases, however, the right to sue will fall for consideration under either paragraph 160M(3)(b) or subsection 160M(6) and there will be little scope for applying subsection 160M(7).

(c) As from 25 June 1992 the actual asset must be owned by the person entitled to damages. Before that date, at least on the authority of Dawson, Toohey, Gaudron and McHugh JJ in *Hepples* case, the actual asset does not have to be owned by the taxpayer. Of course, where the actual asset is the right to sue, the actual asset will always be owned by the party entitled to damages. Where the actual asset is the land itself and the defaulting party is the purchaser the actual asset will also be that of the taxpayer. Where the actual asset is the land and the vendor is the defaulting party the provisions of the new subsection 160M(7) cannot apply to the purchaser.

70. The subsection is concerned with the creation and disposal of a notional asset. The act, transaction or event triggers the disposal of the notional asset which is itself created by the disposal.

71. The cost base of the notional asset will be incidental costs similar to those mentioned in paragraph 63 above.

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subject references
- capital gains
- assets
- damages
- disposal
- acquisition
- breach of contract
- cash contracts
- cause of action
- change of ownership
- choses in action
- completion
- contracts
- contracts falling through
- equitable interest
- instalment monies
- purchaser
- rescission
- right of action
- right to sue
- sale of land
- settlement
- terms contract
- time of acquisition
- time of disposal
- vendor

legislative references
- ITAA 160A
- ITAA 160ZH(1)
- ITAA 160ZH(1)(e)
- ITAA 160ZH(9)
- ITAA 160K(1)
- ITAA 160M
- ITAA 160M(1)
- ITAA 160M(2)
- ITAA 160M(2)(c)
- ITAA 160M(3)
- ITAA 160M(3)(b)
- ITAA 160M(3)(d)
- ITAA 160M(4)
- ITAA 160M(6)
- ITAA 160M(6A)(a)
- ITAA 160M(6A)(b)
- ITAA 160M(6A)(c)
- ITAA 160M(6A)(d)
- ITAA 160M(6B)(a)
- ITAA 160M(7)
- ITAA 160MA(2)
- ITAA 160P(8)
- ITAA 160U
- ITAA 160U(3)
- ITAA 160U(6)(b)(i)
- ITAA 160U(6)(b)(ii)
- ITAA 160U(6)(b)(iii)
- ITAA 160U(7)
- ITAA 160Z(1)
- ITAA 160ZF
- ITAA 160ZH
- ITAA 170
- ITAA 170AA
- ITAA 170AA(11)
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