Commissioner of State Revenue
State Revenue Office
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MELBOURNE VIC 3001

By email: consultation@sro.vic.gov.au

10 November 2020

Dear Mr Broderick

Draft Revenue Ruling DA.064 – Meaning of Land Development
Practical application beyond the scope of the legislative intention

The State Taxes Committee of the Law Institute of Victoria (**LIV**) refers to the Commissioner of State Revenue's (**Commissioner**) Draft Ruling DA.064 *Meaning of land development* (**Draft Ruling**) as published on the State Revenue Office website and offers its comments below as part of the public consultation process.

Executive Summary

The LIV submits that:

1. The definition of 'land development' should be interpreted in light of the original definition contained in section 32A of the 'sub-sale' provisions of Part 4A of Chapter 2 of the *Duties Act 2000* (**Duties Act**);

2. The context and purpose of Part 4A indicates that it was intended to capture value added by the 'first purchaser' or an associate of the first purchaser (or possibly a subsequent purchaser or an associate of the subsequent purchaser). It was not intended to capture value added by the vendor or by the actions of an unassociated third party;

3. A broader interpretation that includes actions carried out by the vendor or an unassociated third party would create anomalous outcomes under Part 4A;

4. The subsequent repeal of the definition in section 32A and its re-enactment in section 3(1) in largely unaltered terms as a consequence of the *State Taxation and Other Acts Amendment Act 2016* should not change that interpretation. The use of the term in section 3G can be applied consistently with an interpretation that is consistent with the suggested use in Part 4A; and

5. The Draft Ruling should clarify that the concept of enhanced value should be read to be consistent with section 22 of the Duties Act.

Background

The LIV has some concerns that the Draft Ruling has been expanded to an extent which goes beyond what was initially intended by the legislation. The activities outlined in the Draft Ruling can be triggered inadvertently by a purchaser of land who wishes to subsequently nominate a landholding entity in circumstances where the purchaser has no intention of carrying out land development.

The Draft Ruling seeks to give some clarity to the broad land development definitions set out in the *Duties Act 2000* (Vic) (**Duties Act**). However, the Draft Ruling appears to raise more questions than answers in relation to what activities constitute land development. The LIV submits that the Draft Ruling should recognise that purchasers of land may carry out due diligence activities after the day of

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sale in the contract. The LIV submits further that due diligence activities should not fall under the umbrella of 'land development' for the purpose of the Duties Act.

The Draft Ruling also highlights the uncertainty with respect to how 'land development' is interpreted under the Duties Act. Given this uncertainty, the LIV respectfully submits that this area of the Duties Act requires a complete overhaul so that a purchaser who wishes to nominate a land holding entity can do so with certainty, and without the prospect of inadvertently triggering double duty.

History of definition

The definition of 'land development' was originally included in section 32A when Part 4A was inserted by the *State Taxation Acts (General Amendment) Act 2005* into the Duties Act. On its introduction, the definition prescribed five circumstances in which land development would occur.

The definition was in identical language to that now contained in section 3(1) of the current Duties Act apart from the subsequent addition of paragraph (c) and the renumbering of subsequent paragraphs.

As a consequence of the *State Taxation and Other Acts Amendment Act 2016* the definition was moved from Part 4A to the general definitions contained in section 3(1) of the Duties Act with the addition of a new paragraph (c) which referred to requesting an amendment to a planning scheme that would affect the land.

Concern with suggested interpretation

The LIV is concerned that the Draft Ruling has unintended consequences which seeks to broaden the definition of 'land development' and, broaden its application to land transactions. In particular, contained in the conclusion in the second para under '*Ruling*' it is stated that 'it is irrelevant who carried out or intended to carry out the process or any part of the process.'

If one takes a literal interpretation this might apply. However, it is submitted that the definition has to be interpreted in the context of the sections in which it is used in Part 4A; namely sections 32I (*Transfers involving land development*) and 32P (*Options involving land development*).

It is clear from the scheme of Part 4A generally and sections 32I and 32P in particular that they are directed at capturing value which is added between the date of the contract and the date of acquiring a transfer right. It is equally clear it was not intended to capture actions that do not result in the first purchaser or a subsequent purchaser (or an associate of either) receiving additional consideration or adding to the value of the land during the relevant period.

This is reflected in, for example, section 32J(3) and (4) which exclude value which is attributable to:

1. the vendor carrying out the development as part of the contract (sec 32J(3)(a)) but not where the first purchaser or an associate was involved (sec 32J(4); and

2. land development which occurs after the subsequent purchaser acquires the transfer right (sec 32J(3)(b).

A similar analysis can be applied to a subsequent purchaser (sec 32J(5) and (6)) and to land development involving options (sec 32Q(3) to (6)).

Interpretation given to 'land development' under the six limbs of the Duties Act

When considering the analysis contained in the Draft Ruling in relation to the six limbs under section 3(1) of the Duties Act, the LIV sets out the following comments:

Limb (a) - Preparing a plan of subdivision of the land or taking any steps to have a plan registered under the *Subdivision Act 1988*

The LIV is concerned that some of the activities outlined focus on activities which are preliminary in nature and may not result in land development occurring. For example, a purchaser may survey land

or take steps to arrange a survey of land for the purpose of that purchaser's land acquisition, rather than for land development purposes.

Limb (b) - Applying for or obtaining a permit under the *Planning and Environment Act 1987* in relation to the use or development of the land

The LIV is concerned that a landowner may apply for many different types of permits. These types of permits may or may not constitute land development. Greater clarity is required to confirm that only a planning permit relating to land development will be subject to the legislation. If a landowner applied for a permit relating to its tenant's business, it should not be considered land development. However, it is unclear from Example 2 outlined in the draft ruling whether this would be the case.

Limb (c) - Requesting a planning authority under the *Planning and Environment Act 1987* to prepare an amendment to a planning scheme that would affect the land

When considering this limb, the LIV notes that Example 3 in the Draft Ruling uses the term 'engage with municipal council'. This term appears to include a purchaser making preliminary enquiries with Council about a planning scheme amendment. Such enquiries should be considered due diligence enquiries only, and not land development. The LIV submits that greater clarity is required about what 'engagement' means.

(d) - Applying for or obtaining a permit or approval under the *Building Act 1993* in relation to the land

The LIV's comments in relation to limb (b) above apply equally to this limb. An example of the need for greater clarity is a purchaser who is required to obtain a building approval due to a notice or order issued in respect of a property. Such a requirement should not be an activity that constitutes land development. Further, a purchaser, after signing a contract to purchase land, may also conduct a soil test for assessing the suitability for constructing a dwelling on the land.

Limb (e) - Doing anything in relation to the land for which a permit or approval referred to in paragraph (d) would be required

The LIV submits that while the Duties Act is drafted widely, this particular limb is too wide and ambiguous. Again, a distinction should be made between the definition of due diligence activities and the definition of development activities.

For example, whether engaging a surveyor to draw a plan and/or to obtain a cultural heritage management plan required by a cultural heritage planning overlay in anticipation of obtaining a planning permit is considered "land development" must be clear.

Further Analysis of the Examples Set out in the Draft Ruling

Examples 1 and 5

Example 1 and Example 5 in the Draft Ruling are examples where the ***vendor*** has applied for the permit and the permit is granted pre-completion. Presumably if the contract is subject to a condition that the subdivision be completed or the permit be granted, the price would reflect that and the exception in section 32J(3)(a) may apply. Nevertheless, there may be situations where a vendor has taken some step which is not specifically paid for by the sale consideration. For instance, at the date of sale, the vendor may have carried out an extension which was not subject to a building permit. As a consequence of the purchaser's enquiries or requisitions, the vendor may then apply for a building permit in order to comply with the terms of sale. This is not subject to any additional consideration and therefore section 32J(3) would not apply.

The LIV submits that the sub-sale provisions were never intended to capture 'land development' carried out by the vendor under the terms of sale and the definition should be interpreted consistently with that intention.

Further, rules of statutory interpretation dictate that the same approach must be applied to **all paragraphs** within the definition of 'land development'. If it is 'irrelevant who carried out or intended to carry out the process or any part of the process' for the purposes of paras (a) and (d), then the same must apply to the other paragraphs. However, as Example 4 below would show, this would lead to non-sensical results.

Example 4

If the same reasoning is applied to para (c) of the definition of 'land development', it would mean that if any independent third party (including the local Council) prepared a Precinct Structure Plan which might affect the relevant land, then this would mean that sec 32I would apply.

Example 4 contains a statement that 'a submission made to the PSP Panel is considered to be a request under limb (c)'. The LIV questions what this is intended to convey. If the reasoning used in Examples 1 and 5 is applied, it would be irrelevant whether a request was made by the purchaser or by any third party and whether or not that request relates to the specific land.

If this interpretation applies, then land development would be taken to occur despite the PSP being prepared by somebody totally unrelated to either the vendor or purchaser and regardless of whether it may add value or even detract from the value of the subject land. As stated in the Draft Ruling a PSP can apply to the whole of a municipal district, or even multiple municipal districts. The LIV notes that a PSP process may carry on for a significant period.

It is submitted that it cannot be the intention of the legislation that anybody making a nomination under a contract where the relevant land happens to be within an area subject to a PSP should be unexpectedly subject to double duty. Although normal conveyancing enquiries should alert a purchaser to the existence of a PSP, those searches may not have been completed before the nomination was made. It would not seem to be relevant whether that PSP was underway before the date of the contract or whether it was initiated after the date of contract. The exceptions in sections 32J(3)(a) or (5)(a) would not apply as the consideration under the contract would not include any allowance for the PSP.

Consequently, the LIV submits that the definition must be read down consistently so as to apply only in circumstances where: (1) there is value added to the subject land between the date of contract and the date of nomination, and (2) that value is added by the first purchaser or an associate of the first purchaser (or in the case of a subsequent purchaser, by the subsequent purchaser or an associate). This is consistent with the structure of sections 32I and 32P and the scheme of the exceptions contained in sec 32J(3) to (8) and sec 32Q(3) to (8).

<u>Application to section 3G</u>

The LIV submits that the interpretation favoured is consistent with the use of the term 'land development' in section 3G.

If the vendor or some other third party has undertaken 'land development' for the purposes of using the land as residential land, this should not result in the purchaser incurring additional duty under section 28A unless either:

1. the actions have resulted in the land becoming residential land under paragraph (a); or

2. the purchaser intends to develop the land in accordance with the activities carried out by the vendor or third party, in which case it would fall within paragraph (c).

If this broad interpretation applies, it would result in a foreign purchaser incurring additional duty if:

1. The vendor had at some stage previously taken steps to develop the land as residential (such as preparing a plan of subdivision) where the concept was subsequently abandoned as economically unfeasible or due to failure to meet sufficient pre-sales. The land is then

subsequently sold as commercial property (other than commercial residential) where the purchaser intends to continue that usage;

2. The vendor had at some stage taken steps to develop the land as residential but subsequently changed their intentions and resubmitted plans to develop the land as commercial (but not residential commercial). The land is sold subject to the later plans, permits or approvals.

3. A previous owner had at some stage taken steps to develop the land (such as obtaining a planning permit) but the concept was subsequently abandoned due to market conditions or the insolvency of the previous owner. The land is sold as commercial property (other than commercial residential) subject to existing tenancies.

It is noted that a broad interpretation in the context of section 3G means land could be residential if ***any person*** has applied ***at any time*** for anything that may be land development (even if that action was 50 years ago).

It is therefore submitted that the term must be read down and the approach favoured by the LIV serves both the legislative purpose and protects the revenue whilst avoiding non-sensical outcomes.

Example 6

In relation to Example 6 the LIV cannot see how engaging a firm to provide professional building advice and prepare reports as initial steps *before* applying for a building permit could enhance the value of the land so that para (d) may apply. Whilst such an engagement might 'lead to' the enhancement of the value of the land, it is submitted that this is too remote.

Paragraph (f) should be interpreted as applying only to something that ***directly*** leads to an enhancement of the land value. Something that is merely a step in a process which *might* ultimately lead to an enhancement in the value of the land is too remote.

Example 8

The LIV does not support including changes to the legal title in respect of the land as items within the parameters of paragraph (f).

It is submitted that it is incorrect to state that 'activities that do not change the physical characteristics of land may still amount to land development and these include the removal of a covenant on title or a removal from the Heritage Register'. The wording of paragraph (f) is focused on physical changes to the land. The removal of a covenant should not amount to 'developing or changing the land'. The land as a matter of fact is not developed by removing the covenant, nor is the land changed. The land remains the fee simple estate, albeit no longer subject to the covenant.

By analogy, it may be concluded that a discharge of a mortgage or the removal of a caveat, would be 'land development'. It is submitted that it is not possible to draw a distinction between removing a covenant or removing a caveat or mortgage.

The LIV is also concerned that the test for the words "enhancement of its value" under paragraph (f) of the definition of land development is not clarified. Whilst there are examples of physical changes to the land and non-physical changes to the land, there is no clear position given on what extent these examples come within the ambit of 'enhanced value'. Rather, it has been left open for interpretation whether physical or non-physical changes to the land or the land's legal description or legal registration will be subject to double duty where there is only a mere nominal value increase.

The LIV submits that the ordinary application of section 22 of the Duties Act should be applied to determine whether in the open market, free from encumbrances, the land would, in fact achieve a higher land valuation in addition to the contract price, evidenced by the taxpayer through valuation evidence.

Conclusion

The LIV believes that for the reasons set out above, there needs to be further consultation with the legal profession and other stakeholders before this Draft Ruling is finalised and therefore welcomes the opportunity to provide further comment or meet with the Commissioner to discuss its concerns in further detail.

Your sincerely,

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