



T I S H E R L I N E R & C O .

L A W Y E R S

PITFALLS WHEN PURCHASING A PROPERTY

At the outset I want to distinguish purchases of different types of property.

- A. Commercial or industrial, or
 -) In either case we need to
 -) differentiate between a
 -) completed property and a
 -) property still to be built or
 -) completed.

- B. Residential

If the property is still to be constructed or completed then we generally refer to the purchase as entering into an “**Off The Plan**” contract purchase. The phrase “purchasing off the plan” is taken to generally mean:

- (a) the purchase of a lot on an **unregistered** plan of subdivision; and
- (b) the proposed lot or unit has either not been constructed or at the minimum has not been completed.

The significance of (a) –an unregistered plan – is that the **deposit** cannot exceed 10% of the price, and it must be held in a Trust account in the joint names of the parties until it is registered. You should note that a solicitor can place it in an interest bearing trust account but an estate agent’s trust account is not acceptable.

The significance of (b) is that **settlement** is on the later of a certain number of days (usually stipulate not less than 14 days) after the later of the registration of the Plan of Subdivision and the issue of an Occupancy Permit.

There are a number of things to check in an “off the Plan” contract. The unit being purchased will usually include as part of the **Lot description** other parts such as one or two car spaces and perhaps a storage area. It is fundamental to check and ensure that the Lot that you think you are purchasing is in fact correctly described in the Contract.

The deposit will usually be placed in a **special purpose bank account**. It is important to see that the holder of the deposit receives your tax file number. Interest usually runs with the cause – that is, if the matter settles, then the Vendor receives the interest, and if the Contract is rescinded through no fault of the Purchaser (i.e. as a result of an incomplete section 32 statement), then the Purchaser receives the interest .

An important clause to look out and one which has made the “off the Plan” contract so popular is the **apportionment clause**. When the property has not been built, or completed, then you only pay **stamp duty on the value of the land and any building work already carried out** at the date of the Contract. This currently provides a substantial stamp duty saving. It is important to see that the apportionment clause, which breaks up the land value and improvements to be constructed value, is completed, so that they add up to total the purchase price.

There is protection provided by legislation (Sale of Land Act) against the vendor carrying out an amendment which **materially affects** the Lot to which the Contract relates. There is also usually a clause whereby the Vendor contracts to enter into a major domestic building contract to build and complete the property. This brings into play various **warranties**. You must watch out if the Contract is with an owner-builder as they will need a current inspection report. The Contract will also usually contain attached plans and specifications of fixtures and fittings included in the sale.

Finally check the **GST** clause. The starting point in respect to residential properties is that **there is no GST payable**. However, there are some exceptions which include:

1. The **supply of a new residence** that has not been lived in before, is a supply which is subject to the payment of GST.
2. Similarly if the development is a **renovation of a substantial nature**, then GST will be payable.

Generally residential property is sold on a **GST inclusive** basis.

The starting point in respect to commercial properties is that **there is GST payable**. However, there are exceptions including if the sale is classified as a “sale of a going concern”. This may occur if there are tenants at the property who will remain at the property after settlement and the Contract provides that the sale is a sale of a going concern. The Contract should provide that the Vendor will do all things necessary for the “Enterprise” to continue.

Obviously this is not exhaustive and it is important to check the GST clause carefully and find out whether the parties are registered for GST purposes or required to be registered for GST purposes. In the first instance the liability is upon the supplier – the Vendor – but that liability is subject to the terms of the Contract. You should check and examine whether the price for the property is **inclusive or exclusive of GST**. If it is sold on an exclusive basis, the Purchaser must be registered for GST purposes to get the GST back.

This is obviously only a brief summary of things to watch out for in an “off the Plan” Contract. I would now like to move on to the purchase of a completed property, and draw some key aspects to your attention.

You will be asked to sign a Contract of Sale and obviously will have to name a Purchaser in the Particulars of Sale. Hopefully, and usually, you will have had an opportunity to think about who should be the Purchaser. Or you may just put it in your personal name and add the words “**and/or nominee.**”

However, even where these words are included, the Duties Act 2000 and a State Revenue Office Ruling significantly limit the rights of a purchaser to nominate another person, company or trustee of a trust as the ultimate purchaser after the first purchaser has signed the Contract.

If there is any likelihood that the first purchaser in a Contract will want to complete the purchase by substituting another person or entity, **it is imperative that you get legal advice before the Contract is signed. Otherwise, the nomination may be deemed to be a sub-sale and double the amount of stamp duty will be payable on the transaction.** Here are some of the steps that should be taken – and the list is not exhaustive:

(1) **Agent pursuant to a written authority.**

A written authority must exist **before** the Contract is signed for the first Purchaser to act as agent and should be dated – unless the second Purchaser is a spouse.

(2) **Pre-incorporation purchase and “shelf companies”.**

Before the Contract is signed, the first Purchaser must **actually instruct** a solicitor or accountant to incorporate a company or purchase a shelf company. The Company can then be incorporated after the date that the Contract is signed, but it is important that notes of that conversation be kept – by both you and the professional instructed as there must be **evidence** of

such instructions to **substantiate** the position. A written instruction is the safest.

(3) Purchase on behalf of a Trust not yet formed.

While the first Purchaser may act in anticipation of incorporation of an intended company, where a Trust is to be nominated as the ultimate purchaser, **the trust must be established in writing before** the first purchaser signs the Contract.

(4) Partnerships/ Syndicates/ Joint Ventures

A partner must have the **prior written authority of the other partners** unless there is a written partnership agreement with specific terms regarding the actual purchase.

(5) Fractional Interests

A very recent development has occurred where a contract specifies more than one purchaser. There is a presumption that they **purchase on an equal basis**. A Transfer reflecting a **change in a purchaser's interest** in a Contract may be dutiable, unless there is **rebuttable evidence**. For example, A & B purchase a property, subsequently the Transfer says A purchases as to 70% and B purchases as to 30%. Unless you can produce **evidence** to show different contributions of deposit and of the balance of purchase monies from that intended at the outset, then there is a risk of additional stamp duty being required

There are other matters to consider when you consider who will be the Purchaser, whether at the outset or by subsequent nomination. A big consideration is **Land Tax**. Does the chosen Purchaser own other property in Victoria? Land Tax in Victoria is on an aggregating scale – the more property you own, not only the greater the Land tax sum, but the **rate of tax escalates** upwards. So you need to think carefully about the entity which will be purchasing the property.

If you propose to put the property into a Trust, which is a Trust that doesn't hold other property, it is my view that you should **avoid using the same Trustee as trustee for several Trusts**. Section 52 of the Land Tax Act 1958 assesses liability for land tax on a trustee as if he were beneficially entitled to such land, except where he is the owner of different lands in severalty in trust for different beneficial owners. Despite that proviso, the practice of the SRO has been to assess a trustee for land tax where the trustee is a trustee of several trusts. The difficulties of overcoming that problem were seen in a case in 1999 when two blocks of land were consolidated into one title in Stonnington Place Toorak, in the

case of Commissioner of State Revenue v. Famajohn Nominees Pty Ltd. Those two blocks were not held "for different beneficial owners" and Land tax was assessed.

I now want to quickly draw your attention to the new Victorian "**land rich**" provisions which came into force from 13 May 2004. When the "land rich" provisions were first introduced in 1987, the intention was to close a loophole whereby conveyancing stamp duty was avoided through the use of company shares and unit trusts to effect transfers of high value real property. Instead of a direct sale of land between parties, land was purchased in the name of a company or trust, and **all the shares or units were purchased to effect a change of ownership of land**. This resulted in a considerable stamp duty saving.

For example, consider a company whose only asset is a large parcel of land worth \$5.0m. Assume also the company has no liabilities. A transfer of that land itself for a consideration of \$5m would be chargeable with stamp duty of \$275,000 (based on the current rate of 5.5%)

Prior to the introduction of **the land rich provisions**, if all the shares in the company were transferred to the purchaser, rather than the land itself, the transfer of shares would be chargeable with duty of \$3,000 (based on the **lower rate of marketable securities duty** of 0.06%). That is a significant saving.

Prior to the recent amendments the land rich provisions operated to impose duty on a relevant acquisition of a **majority** interest made by a person in such a corporation or trust which met certain requirements. They were the land threshold test and the land ratio test. The land threshold test required the unencumbered value of the property to be **not less than \$1m**, and the land ratio test required that the value of all the corporation's land be **at least 80%** of the corporation's or trust's property.

The threshold test has now been broadened – instead of 80% it is **now 60%**. Also whereas the acquisition test for a private company was previously triggered by the acquisition of an interest of more than 50%, now a liability for duty is triggered by the **acquisition of an interest of 50%** or more. And for a private unit trust, the acquisition test has expanded significantly to an interest of **20%** or more. A land rich duty liability can also arise if, even though a person has not acquired any units or shares, the person acquires "**control**" over a land rich landholder. Control means if a person acquires "the capacity to determine or influence the outcome or decisions about the landholder's financial and operating policies". Because these provisions can apply on a very broad basis, the **Commissioner has a discretion** to treat the acquisition as exempt if he determines that to impose duty would not be "**just and reasonable.**"

An example of constructive ownership is where there are linked entities – the landholder is deemed to hold land even if it is held in other entities. For example:

Company A - holds 45% of

Company B - which holds 45% of

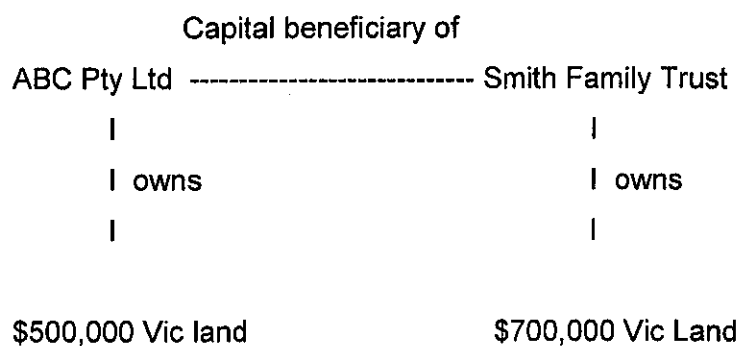
Company C - which holds land worth \$10m.

Under the new constructive ownership provisions Company A would be entitled (on a notional winding up of the companies) to more than 20% of the land from the limited entity – in fact it is 20.25% of the value of Company C's land (ie \$2,025,000) would be included in the value of Company A's land holdings.

Another example is constructive ownership through discretionary trusts. Normally a beneficiary of a discretionary trust has **no present entitlement** to any trust property. But for the purposes of the constructive ownership provisions, a beneficiary is a person or member of a class, which by the terms of the discretionary trust, the capital of the trust may be applied. If the landholder is a capital beneficiary, the constructive ownership provisions deem the landholder to own or be entitled to the trust property.

Any property that is subject of a discretionary trust is taken to be the subject of any other discretionary trust if the other trust is a capital beneficiary of the first trust.

For example:



In this example ABC Pty Ltd is deemed entitled to \$700,000 of land from the Smith Family trust. Thus ABC's land holdings are \$1.2m (and has assets of over \$1 million dollars) and it is therefore a rich landholder to which the provisions apply.

There are other provisions in this new Act which bring in earlier acquisitions within the previous three years.

It is said that this new legislation not only broadens the number of situations than before, but also make the land rich duty not just an anti avoidance measure but a new head of duty.

The final aspect that I would like to cover (briefly) is **aggregation**. If you purchase several properties within 12 months, even if on separate contracts, be aware that the State Revenue can (and will) treat the individual sales on a total aggregated basis and you will pay stamp duty at a higher rate. This is known as aggregation under Section 24 of the Duties Act 2000. The way to overcome this is to demonstrate that each property was genuinely available for separate sale to the general public at the relevant date of the Contract – whether the purchase was made for development or investment purposes. Thus if you buy twelve flats or ten blocks of land, and have twelve contracts, it is likely that the stamp duty will be aggregated, because you were not able to buy just, say one flat or block, but had to buy all of them – the purchase is all substantially one arrangement.

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