Capping the SRO's sweet tooth


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CAPPING THE SRO'S SWEET TOOTH

The consequences of the State Revenue Office's liking for fixtures and its liberal interpretation of the definition of chattels have been coming before the Supreme Court regularly. By Russell Cocks
ANYONE COMING INTO CONTACT WITH

the State Revenue Office (SRO) in recent years will have noticed that it appears to be a far more voracious beast than in days gone by. Not satisfied with the feast provided by the 1990s real estate boom, it now seeks to pick over the bones, as represented by the accoutrements associated with real estate transactions. The consequences of this feeding frenzy have been coming before the Supreme Court fairly regularly since 2000 and the first half of 2004 has seen a veritable plethora, with three cases being decided by the Court of Appeal and another two by single judges.

A few basic principles relating to the imposition of duty are:
- duty is payable on transfers of real estate;
- real estate, by the doctrine of fixtures, includes fixtures attached to the land;
- chattels are not attached and therefore are not fixtures;
- the Stamps Act adds the value of chattels for the purposes of duty, although primary production chattels are excluded;
- a sale of a business is not dutiable. The sale of a business will usually include the sale of plant and equipment (chattels and fixtures) used in the business and the goodwill arising from the business; and
- goodwill may include a licence to operate a business.

CASES

CHATTELS

Australian Rice Holdings Pty Ltd v SRO (Waterwheel) (see appeal right)

Harper J decided that “chattels” could include non-physical assets and that the value of water rights sold separately, but contemporaneously, with real estate was dutiable.

Uniqema Pty Ltd v SRO (Uniqema) (see appeal right)

Embodied by the wide definition given to chattels in Waterwheel, the SRO argued that goodwill, being the value of a business operated by a vendor of real estate, was a chattel and therefore dutiable when the land and business was sold.

However, Pagone J decided that “chattels” does not extend to non-physical assets and that goodwill cannot therefore be a chattel.

While acknowledging that the goodwill of a business conducted by a vendor might “attach” to the land and increase the value of the land for duty purposes, Pagone J concluded that that would not always be the case.

If the business might be conducted in virtually any location then the goodwill attaches to the business, rather than the land, and is not dutiable.

The case related to the sale of a chemical factory and associated goodwill by separate contracts between one vendor and one purchaser. Pagone J concluded that the land was not central to the operation of the business and that the business might be conducted anywhere, thus goodwill attached to the business rather than the land and was not dutiable.

Morvic P/L v SRO (Morvic) (no appeal)

Pagone J decided that the sale of a motel and the separate sale of the goodwill by the same vendor to the same purchaser resulted in the goodwill being assessable on the basis that the sale of the land of itself entitled the purchaser to conduct the business conducted on the land and that the value of the land therefore included the value of the business.

Contrary to the situation in Uniqema, in this case the location of the business was absolutely central to the operation of the business.

The SRO had argued that the goodwill associated with the business was a chattel and therefore dutiable, but Pagone J confirmed his earlier view that chattels must have a physical presence.

The SRO also argued that the goodwill of the business was “site goodwill”, having its exclusive source in the land. The judge upheld the assessment without accepting this argument as a general proposition and indicated that a different result might have followed if a different entity conducted the business and/or the business was sold to a different entity.

The SRO’s victory in the Waterwheel case proved to be somewhat pyrrhic, as shortly after the decision the government announced that water rights would no longer be dutiable. Moreover, Waterwheel was appealed.
Australian Rice Holdings Pty Ltd v SRO: (Waterwheel appeal)
The issue was whether the value of the land sold was to be increased for duty purposes by the addition of the value of the water licences. The Court of Appeal accepted the appellant's primary argument that, assuming that the water licences were indeed chattels, then they were primary production chattels and therefore exempt from duty. It was not necessary for the Court to decide whether the licences were chattels at all.
However, that question was squarely before the Court of Appeal in:
SRO v Uniqema: (Uniqema appeal)
The SRO sought to overturn Pagone J's view that goodwill was not a chattel and to promote a wider definition, as had been adopted by Harper J in Waterwheel, and not specifically rejected in the Waterwheel appeal. However, the Court of Appeal firmly rejected this proposition and confirmed Pagone J's view that chattels are tangible assets and do not include intangibles, such as licences and goodwill.

SITE GOODWILL
As an alternative, the SRO argued that the goodwill arising from a business conducted on the land by a vendor of that land will be "site goodwill" which enhances the value of the land for duty purposes.
The Court of Appeal rejected this as a general proposition, holding that goodwill is a separate and distinct asset of a business, separate from the other assets of the business, such as the real estate. As such, it will normally "attach to" and give value to the business, rather than the associated real estate.
Exceptions to this general proposition may exist where the location of the real estate is integral to the operation of the business, such as in the case of a "corner store or hotel", but these are exceptions to the general rule. The Court of Appeal did not say that the value of the land in these exceptional cases will always be increased by the value of the goodwill, but it did appear more prepared to consider that this might be the case.
The SRO had taken a wide view of "site goodwill" in the period between Morvic and the Uniqema appeal and had issued many assessments calling to duty goodwill sold in association with a real estate transaction, whether that transaction involved a single vendor and a single purchaser or whether it involved "related parties". However, this approach did not find favour in the recent case of:

Palace Hotel (Hawthorn) Pty Ltd v SRO:
The taxpayer was the proprietor of the business conducted on the land (under a lease) and then acquired the freehold under a deed of compromise relating to proceedings involving the tenant and the freehold owner. The SRO sought to add the value of the business to the dutiable value of the real estate, arguing that the value of the real estate was "enhanced by the goodwill of the licensed hotel business which is conducted on the premises".
This argument was rejected. Harper J stated: "[It] is therefore perhaps confusing to speak of goodwill that has its source, or part of its source, in the land, as enhancing the value of the land" and "that it is unhelpful to speak of goodwill, which of its nature is (a) indivisible and (b) inseparable from a business, as being 'annexed' to land where the owner of the business may have no greater interest in the land than that of a tenant".
The final nail in the goodwill coffin may have been delivered by:

Primeline (Glendale Hostel) Pty Ltd v SRO:
Harper J specifically awaited delivery of the Court of Appeal judgments before handing down this judgment. The case involved the sale of real estate by a single vendor to a single purchaser and the contemporaneous sale by the vendor to that purchaser of a business conducted on the land by the vendor.
Harper J held that the value of goodwill and licences sold under the separate sale of business contract was not to be included in the dutiable value of land on which the business was conducted.

Harper J also challenged the view taken by Pagone J in Morvic. He concluded that as goodwill is a separate and distinct proprietary right, it never forms part of the value of other assets of the business.
While the goodwill of a business may enhance the value of the land, that is different to concluding that the value of land includes the value of the goodwill of the business conducted on the land. Goodwill, as personal property, is not dutiable. It is not a "chattel", nor is its value added to the value of the land on which the business is conducted. And this is so whether the land and business is sold by the same vendor to the same purchaser or a combination of vendors to a combination of purchasers.
With respect, this is precisely the argument that lawyers advanced to the SRO when legislation was proposed to specifically bring goodwill to duty back in the early 1990s. The proposal was abandoned, but the SRO seems to have spent the past decade endeavouring to recant from that position.
Hopefully, the issue is now truly "dead and buried".
Revenue Ruling DRO29, effective from 1 August 2004, relates to assessment under the Duties Act and confirms that the SRO now accepts that goodwill is not dutiable.
However, the SRO has not gone totally vegetarian. DRO29 goes on to suggest "that the presence of a business may enhance the value of the land".
The SRO has abandoned the "site goodwill" argument and has adopted the "valuation" argument. To this end the ruling requires the party lodging the documents for assessment to provide a valuation by a "certified practising valuer" where the transaction (land and business) involves a consideration of more than $1 million or where the consideration for the real estate is low in view of the capital improved value. Valuation requirements also apply where there has been a transfer of the business in the previous 12 months, or it is proposed to transfer the business in the subsequent 12 months.
It may well be that these precautions are merely designed to ensure that "mixed" transactions apply appropriate values to the dutiable and non-dutiable portions of the transaction.
and that, provided that a reasonable apportionment is made, the “valuation argument” may have little effect.

The SRO also acknowledged that assessments made against taxpayers on the basis of the “site goodwill” argument were incorrect and acknowledged a liability to refund such assessments.

**FIXTURES**

Improvements attached to land which may be classified as “fixtures” have always been regarded as part of the land and enhancing the value of the land for duty purposes. However, this is not the case unless the improvements satisfy two fundamental requirements relating to:

- the degree of annexation to the land; and
- the object of annexation.

In Unigema, Pagone J had concluded that certain substantial improvements on part of the land sold were not fixtures as they had been annexed to the land with the intention that they might be removed. Further, he concluded that even if they were fixtures, they were tenant's fixtures and as s281(2) of the Landlord and Tenant Act gave the tenant the right to remove those fixtures, the value of the fixtures should not be included in the value of the land for duty purposes.

On appeal (Unigema appeal), these outcomes were confirmed and reference made to Vopak Terminals Aust Pty Ltd v SRO* (Vopak), where the Court of Appeal had found that tenant's fixtures should not be regarded as adding to the value of land for duty purposes.

That case also found against the SRO in respect of other improvements (apart from the tenant's fixtures) attached to the land. These were substantial storage tanks which certainly satisfied both the degree of annexation and object of annexation tests. However, the owner of the land had sold the “fixtures” to a third party and the Court of Appeal held that the value of those fixtures was not to be taken into account for duty purposes as those fixtures were subject to the third party’s equitable interest.

From these decisions it may be concluded that improvements affixed to land will not enhance the value of the land for duty purposes if:

- they are not sufficiently affixed to the land; or
- if the intention is that they may be removed; or
- if they are affixed by a tenant; or
- if they are owned by a third party.

The SRO did not take these losses well. While the cases related to duty liability under the Stamps Act, it may be expected that the carefully reasoned judgments of the Court of Appeal would impact on the interpretation of similar issues that will inevitably arise under the Duties Act.

The response was therefore the legal equivalent of the king-hit – change the law.

**STATE TAXATION ACTS (TAX REFORM) ACT 2004**

While not seeking to discard the long-established requirement that fixtures be supported by both degree of annexation and intention to annex, the State Taxation Acts (Tax Reform) Act 2004 (the Act) addresses the two bases on which these cases excluded the value of third party or tenant’s fixtures from duty by providing (in s55 and 6) that the value of real estate does include the value of pre-existing equitable interests and tenant’s fixtures.

Thus a purchaser may be required to pay duty on an acquisition based on the enhanced value of the property and then stand by and watch a third party or tenant remove substantial fixtures which produced that enhanced value.

**BUSINESS GOODS**

The Act (s22B) also introduces a new concept of “business goods” under the heading of “Interdependent sale of land and business goods”.

This would appear to be designed to supplement the aggregation provisions of the Act (s24) and directed at including for duty goods (such as plant and equipment) used in a business which is contemporaneously sold with real estate. Thus, while goodwill and licences may be quarantined, tangible goods associated with the business may fall for duty.

The section only applies if there is a separate “land transferee” and “goods transferee” and is expressed in a negative way, so it may be necessary to await judicial interpretation of this, and the aggregation provisions generally, before being sure of the extent of liability.

**TAX AVOIDANCE SCHEMES**

The SRO has found it necessary to specifically include within the Duties Act provisions directed against alleged schemes. However, the extremely wide language of the provisions is of concern, particularly as it includes a penalty for “a person who is employed or concerned in the preparation of an instrument or the provision of any advice” relating to dutiable transactions, which clearly includes legal advisers.

Tax avoidance is defined to include reduction or postponement in liability. Notional this could include advice to a client as innocuous as advice that a terms contract, rather than a cash contract, will postpone duty.

The Act also seeks to “tighten up” land rich company provisions and introduces specific tax avoidance provisions in relation to those provisions.

It also creates a duty liability for acquisitions of land use entitlements. This is designed to cast the duty net over that small number of transactions relating to company share flats.

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5. [2004] VSCA 82.