The Law Society
of New South Wales

170 Phillip Street, Sydney NSW 2000
Australia; DX 362 Sydney
Tel (02) 9926 0333 Fax (02) 9231 5809
ACN 000 000 699 ABN 98 696 304 966
www.lawsociety.com.au

Our ref: JC:ljb: 1292969

28 May 2009

Mr Anthony Johnston
Commissioner of State Revenue
Office of State Revenue
Lang Centre Corner of Hunter &
Marsden Streets
PARRAMATTA NSW 2150

Dear Anthony

State Revenue Legislation Amendment Bill 2009

I am writing to you at the request of the Law Society members of the Law Society/Office of State Revenue Liaison Committee (Committee).

The Committee welcomes the opportunity to review and comment upon the exposure draft of the State Revenue Legislation Amendment Bill 2009 (Bill). The Committee's comments on the proposed changes to the Duties Act 1997 (NSW) to be effected by the Bill are set out below.

General Comments

Although the Committee appreciates its inclusion in the review process, there is a general view amongst its representatives that the time within which they are required to provide comment is insufficient to enable them to consider the Bill thoroughly and in a manner which is likely to provide proper assistance to the Office of State Revenue (OSR).

Principal Concern

The Committee's principal concern is the proposed introduction of complex general anti-avoidance provisions in the new Chapter 11A. Provisions of this kind raise difficult questions of statutory construction which are unique to the particular legislation of which they form part. Unless sufficient time is spent considering the potential consequences of such provisions before they become law, it is conceivable that unintended consequences will emerge which could adversely affect ordinary commercial transactions. This is particularly relevant in the context of the Government's current reform programme, since the Committee is unable at this stage to review or comment upon the interaction between the new landholder provisions (which are not yet available) and Chapter 11A.

To enable proper consideration of the implications of Chapter 11A, the Committee requests the Government to consider deferring the introduction of those provisions by removing them from the Bill, to be reintroduced at a later time, if considered appropriate, with an appropriate commencement date (say 1 January 2010). This will not impede the commencement of the remaining provisions of the Bill as presently proposed, and would allow a reasonable period for the OSR and the Government to consult comprehensively with the Law Society; the Taxation Institute of Australia, industry representative bodies and other interested persons. Deferring the introduction of such provisions will also provide the Law Society with an opportunity to roll out a much-needed programme of education to its members.

Despite the above, in light of the tight timeframe you have set for the review process, the Committee has set out below at section 5 its members' initial observations and suggestions.

1 Creation of life estates and estates in remainder in land

On the grant or creation of a life estate in land, a remainder interest also arises as a consequence. In a case where the remainder interest would be held by the person granting or creating the life interest, is it intended that not only is duty payable on the grant or creation of the life estate in land but also on the remainder interest that is created as a consequence of the granting or creation of the life interest? That is, in those circumstances do the provisions create a liability based on the full market value of the property in which life and remainder interests are created?

The Committee submits that where a fee simple owner grants a life interest in favour of a third party and as a consequence obtains the remainder interest, the creation of the remainder interest should not be chargeable with duty. Likewise when a remainder interest is granted or created by an owner of fee simple and the life interest remains with that owner, duty should not be chargeable on the creation of the life interest.

The proposed provisions do not deal with the complexity and expense of attending to stamping of these proposed dutiable transactions. The valuation of life or remainder interests is potentially problematic. To determine the dutiable value of a life or remainder interest, the underlying land must first be valued by a qualified valuer. In addition, an actuary must prepare a report as to the value of the life interest or remainder interest taking into account the specific circumstances of the life of the person upon which the life interest is conditioned. A potentially wide range of valuations is possible. There are a small number of valuers who prepare such valuations and the expense of their work can be substantial. We understand that the OSR at one time published a valuation table setting out a percentage of the underlying land value that they would accept as representing the value of a life interest. The OSR no longer publicly provides such information. Would the OSR be prepared to republish such a table?

2 Apportionment of business assets

The proposed provisions dealing with apportionment of business assets (proposed s 28) are somewhat ambiguous. Section 28 refers to goods supplied or services provided 'by the business to customers in NSW'. This phrase could be interpreted as requiring either that:

(a) the goods are supplied or services performed in NSW; or

(b) the customer is resident in NSW.

The intended meaning should be clarified and be reflected unequivocally in the statutory language. The Committee suggests the insertion of the words 'who are resident' after the word 'customers' in each case.

In practice it is difficult for taxpayers to ascribe a location to customers who might carry on business Australia-wide. The Committee suggests the drafting of an interpretation provision which would define the location of customers by reference to the location of the office or premises of the customer from which the order originates.

The transitional provision for transfers of business assets should be amended to make it clear that it does not apply to a transfer of dutiable property that takes place pursuant to an agreement for transfer that was first executed, or that occurred, before 1 July 2009.

3 Trustees

3.1 Proposed amendment to section 54 (1)

Item 12 of Schedule 1 deletes the trustee of a complying superannuation fund from the definition of special trustee. In effect, the availability of the concession for the transfer of dutiable property consequent upon a change of trustee will be conditioned upon the Chief Commissioner being satisfied that the incoming trustee is not and cannot become a member of the relevant superannuation fund.

In the case of a SMSF the trustees of which are natural persons it is not possible to satisfy the restriction in s54 (3). The fund members would be compelled to appoint as trustee a corporation of which they are directors, thereby causing them to incur ongoing expense and administration. The appointment as trustee of a SMSF of any person other than the fund members or a corporation of which they are directors would cause the SMSF to be in breach of section 17A of the SIS Act. The consequences for breaching section 17A are severe and can amount to a penalty of half of the value of the fund.

The Committee recommends that if the OSR wishes to recast the concession available under s54 (3) to a trustee of a complying superannuation fund, it should do so in a way which does not deny that concession to a complying superannuation fund the members of which are trustees.

3.2 Proposed section 54A (4)

This amendment provides for nominal duty for a transfer of property from a sub-custodian to a custodian of a responsible entity. The Committee suggests the extension of this concession to a transfer from a custodian to a sub–custodian of a responsible entity.

4 Mortgage duty provisions

4.1 Enforceability

The proposed changes to section 211 (consequences of non-payment of duty) are harsh and unfair on lenders, particularly in combination with the proposed abolition of section 218, which currently permits stamping in anticipation of future advances. It is submitted that the current provision should be maintained. That is, a security should be enforceable to the extent to which duty has been paid on advances.

Reasons why the proposed change is harsh include:

(a) In practice there are many situations in which a fluctuating facility (which might be denominated in a foreign currency or which may be a daily fluctuating overdraft account) is difficult to monitor accurately. A small oversight by a lender or borrower in stamping the full amount of the fluctuating facility would have the disproportionately harsh consequence that the lender could not enforce the security at all;

(b) The calculation of duty depends upon the accuracy and veracity of the multi-jurisdictional mortgage statements prepared usually by the borrower. It would be very difficult and burdensome in practice for the lender to have to attempt to verify the asset values proposed by the borrower. The lender should not be penalised for inaccuracies of the borrower in this regard;

(c) Many securities are 'all money' securities which could pick up a large number of different types of facilities provided by a bank to its customer at branches located around the country or even overseas. Again a simple administrative error or oversight in respect of including a small facility in one branch might lead the bank not to be able to enforce a security for other facilities.

The proposed repeal of section 218 prevents a lender from being able to stamp in advance for the full amount of facilities (in anticipation of the full draw down of all facilities granted to a customer) as a safeguard against understamping through oversight.

A limited NSW mortgage (that is, a mortgage under which the amount recoverable is limited to a specified sum by reference to which duty is imposed) will become liable to mortgage duty if an advance or further advance is made that is secured by a mortgage package (proposed s 213, omission of ss 217A, 217). In addition the removal of the NSW limit and Australian limit concepts (proposed omission of s 217A) will either result in mortgage duty becoming payable on total worldwide advances or parties will be required to carry out significant work at additional expense to determine the value of foreign secured property.

The transitional provisions insofar as they relate to a pre 1 July 2009 limited mortgage are particularly problematic. Such a security will become chargeable with further duty if a further advance is made which results in a total of secured advances in excess of the limit on the amount recoverable, being the amount by reference to which duty was imposed and paid. This will significantly alter the basis on which many commercial lending transactions were implemented and create potentially significant and unexpected costs to commercial parties at a time of enormous difficulty within lending markets. The Committee strongly submits that the transitional provisions be amended to ensure that no further duty is imposed on post 30 June 2009 advances secured on a limited security executed prior to 1 July 2009, except in accordance with the provisions of the Act as they stood prior to that date.

4.2 Stamping before advances made

The proposed abolition of section 218 together with the requirement to recalculate duty each time a collateral security is added to a mortgage package will greatly increase the compliance cost for lenders and borrowers.

That is, every time there is either:

(a) an increase in the total amount actually outstanding under all facilities granted to a customer; or

(b) a new collateral security taken;

there will be a requirement to prepare and lodge a fresh multi-jurisdictional mortgage statement and if necessary to pay additional duty. Yet in situations where the total duty payable has fallen, no refund will be due.

Under the present law, it is possible for a lender to stamp in anticipation of future advances up-front once and for all, to minimise compliance costs. The current section 218(2) (b) contains a sufficient protection against situations where a taxpayer might seek to stamp in anticipation of advances when the NSW dutiable proportion was low. The current section 218 should be retained.

4.3 Additional comments

The first part of proposed section 218D (1) should read:

> If the total of the amount of ad valorem duty chargeable under this Act in respect of the amount secured by a mortgage package ...

5 New Chapter 11A

5.1 Section 284C

Chapter 11A should only apply to schemes which are 'artificial, blatant or contrived'. The words 'and to render those schemes liable to duty' should be added to the end of section 284C to make it clear that there is a link between what is deterred and what is rendered dutiable, in both cases being schemes which are artificial, blatant or contrived. This will then more clearly act as the governing principle.

5.2 Section 284D

In the proposed section 284D (2) it should be made clear that the test of whether there is any 'duty avoided' should be objectively determined. The words 'as determined by the Chief Commissioner' should be deleted. Compare the proposed section to section 434(1) Duties Act 2001 (QLD); section 270 Duties Act 2007 (WA); section 177C Income Tax Assessment Act 1936 (Cth).

Section 284D (3) is unclear in its intended operation. On one view it could result in duty being imposed on a person who is not party to the transaction or instrument which is the subject of assessment. Duty should only be able to be assessed under Chapter 11A against a liable party and, we submit, only if that party was aware of the scheme being entered into or carried out.

5.3 Section 284E

Subsection 284E (1) serves no purpose other than to create uncertainty as to whether the application of the Chapter is wholly discretionary. Subsection (2) then claws back the discretion somewhat but in our view subsection (1) should be removed.

The Committee is greatly concerned that in the proposed section 284E (2) the determination of the sole or dominant purpose is a matter of the Chief Commissioner's opinion. This clearly departs from the model adopted by Part IVA of the Income Tax Assessment Act 1936 and of the corresponding general anti-avoidance provisions in the Queensland and Western Australia Duties Acts. In those other legislative provisions, the corresponding definitions of tax avoidance scheme depend on an objective determination of the sole or dominant purpose. The definition of a tax avoidance scheme does not depend on the opinion of the Commissioner. (See section 433(1) Duties Act 2001 (QLD); section 268(2) Duties Act 2008 (WA); and section 177D and 177A (5) Income Tax Assessment Act 1936 (Cth).)

The difficulty is that the current drafting raises the uncertainty as to whether a court can review these tests on the merits, or whether a review would be limited to administrative law grounds. The large number of income tax cases on the Part IVA provisions demonstrates that the objective tests in those provisions have worked more than adequately to protect the revenue.

It follows that section 284G should be redrafted along the following lines:

> "Where duty has been avoided by a taxpayer under a tax avoidance scheme, the Chief Commissioner may make an assessment etc."

The reference in subsection 284E (2) to postponing a liability causes a significant issue of interpretation. For example, under section 284G, the Commissioner can assess a liability for duty based on his determination "as to the duty avoided". It is unclear how this is intended to apply to duty postponed (if at all)? What happens when the postponed duty liability eventually arises? Is that then assessed in addition to the duty under Chapter 11A? The obvious solution is to remove the reference to the postponement of duty or provide special treatment for it under the assessment provisions.

Subsections 284E (4) and (5) should be deleted, or at least confined to refer to other stamp duties. These clauses otherwise substantially undermine the main theme of sole or dominant purposes.

5.4 Section 284G

Provisions should be added to the Chapter putting constraints on the Commissioner determining that there is a tax avoidance scheme if he has previously made an assessment in relation to a document or transaction. For example, if there has been full material disclosure (in the absence of fraud etc) and the Commissioner has previously made an assessment then the usual reassessment rules should apply.

5.5 Section 284I

Section 284I should be deleted because of the very difficult jurisprudence it brings from the federal cases.

5.6 Transitional provisions

The first part of the transitional provision is unclear. We suggest that proposed clause (1) (b) be amended to refer to a step in the scheme being carried out after the commencement of the Chapter. Compare clause 24 of Schedule 3 Duties Act 2008 (WA).

5.7 General

The Committee considers that Chapter 11A should not apply where the duty is "avoided" as a result of the taxpayer qualifying for an exemption or concession. In this regard you should compare section 433(3) of the Duties Act 2001 (QLD).The Committee suggests that a specific advance ruling provision be inserted to allow taxpayers to obtain certainty as to whether Chapter 11A would apply to a proposed transaction, along the lines of section 269 Duties Act 2008 (WA).

Based on the Committee's understanding that the discretions conferred on the Chief Commissioner under Chapter 11A it will not be delegated, it is suggested that the word 'personally' be inserted wherever appropriate to qualify references to a decision, opinion or determination.

In addition, the Committee seeks further assurance that, over time, the Chief Commissioner does not extend the use of the proposed chapter 11A to schemes which are not clearly artificial, blatant or contrived. That is, the Committee is concerned that in the future the Commissioner may seek to apply the chapter to small aspects of commercial transactions involving the drafting of documents or timing of steps in a transaction.

Conclusion

Thank you once again for the opportunity to comment on the Bill.

The Committee urges a reconsideration of the introduction of the new Chapter 11A provisions with the balance of the Bill as set out above.

The extremely short time allowed for consideration of these complex provisions is plainly inadequate to allow the Committee's state revenue law specialists to consider the potential consequences of such legislation in order to avoid unintended consequences.

If you have any queries in relation to this submission, please contact Ms Liza Booth, Executive Member, OSR/Law Society Liaison Committee on (02) 9926 0202 or by email to ljb@lawsocnsw.asn.au .

Yours sincerely

Joseph Catanzariti
President