



Economic entitlement in land – what you should know

Summary

- The Duties Act 2000 (Vic) amendment on 18 June 2019 extended the range of 'economic entitlement' transactions that attract duty.
- Under the widened provisions, an economic entitlement transaction is an arrangement that gives a party an economic interest in land, but which does not involve the transfer of a legal interest or the creation of a beneficial interest in the land. The party receiving the economic entitlement is taken or deemed to have acquired a beneficial interest in the land for duty purposes only.
- The inclusion of the amendments in the 'transfer duty' provisions means that economic entitlement issues are no longer solely a 'landholder duty' issue.
- Transactions now attracting duty involve any land valued at \$1 million or more no matter who owns it, and no matter what percentage interest is given by way of an economic entitlement.
- The provisions will apply to developers in joint venture arrangements that contract to receive an economic entitlement, often structured as a fee, from developing land owned by another entity and then selling or leasing that land on behalf of the landowner. Such arrangements are often referred to as 'Property Development Agreements', 'Project Delivery Agreements', 'Development Management Agreements' or similar.
- The provisions are not expressly limited to developers and may also potentially apply to mezzanine lenders and home builders.
- Duty is payable within 30 days of entering the arrangement that creates the economic entitlement, not on the transfer of the land. The party liable to pay the duty is the person receiving the economic entitlement, not the landowner.
- The changes contained in the new Part 4B of chapter 2 in the Duties Act are unrestricted and apply to the broadest range of transactions.
- Practitioners must identify transactions that attract duty and advise clients accordingly or recommend clients seek specialist advice.

The purpose of this alert is to raise practitioner awareness of the broadened 'economic entitlement' provisions in Part 4B of the [Duties Act 2000 \(Vic\) \(Duties Act\)](#) which took effect in June 2019.

Duty in Victoria is assessed on dutiable property (Dutiable property is defined in section 10 of the Act), typically when there is a transfer of land.

However, Part 4B of the Act also imposes duty on a person who acquires an **economic entitlement** in relation to land because they are deemed to acquire a beneficial interest in the land. No transfer of land ownership is required to trigger this duty. This is different to the pre-existing 'economic entitlements' rules relating to 'landholder duty' in the Duties Act, which also still apply.

Practitioners acting for owners, developers, contractors, financiers or other parties in connection with property development ventures need to understand the rationale and breadth of Part 4B and consider its potential application to transactions in which their retainer includes an obligation to advise on duty matters.

Situations likely to trigger an economic entitlement include joint ventures, developments agreements or financial arrangements in relation to land developments where rights normally reserved for the owner of the land are shared between the parties (such as a right to share in profits, sale proceeds or growth in value of the land).

Inherently, they are likely to be high value transactions where the assessable duty may be significant. Given the likely complexity of transactions involving Part 4B, dabbling in this area is fraught with danger and obtaining specialist duty advice is recommended.

Land covered by the 2019 amendments

In Victoria the economic entitlement provisions relate to land interests with an unencumbered value of \$1million or more. The types of land interests that may trigger the provisions include:

- freehold interest
- life estate
- crown lease
- lease that includes a right to purchase land.

The owner of these land interests is not limited to a company or unit trust like the previous requirements and includes **any owner of land**, including individuals.

It is important to note the \$1 million threshold is based on the value of the land, not the value of the economic interest.

Definition of economic entitlement

The purpose of this legislation is to make a transaction dutiable where a person effectively obtains an economic interest in land without taking a transfer of a legal interest or acquiring a beneficial interest, which would be subject to duty. The target arrangements are those that provide for rights that are economically equivalent to a beneficial interest in the land. This is achieved by deeming the person who acquires an economic interest or entitlement to have also acquired a beneficial interest in the land for duty purposes only.

A person acquires an economic entitlement if they are entitled to one or more of the following (s. 32XC (1)(b)):

- I. to participate in the income, rents or profits derived from the relevant land
- II. to participate in the capital growth of the relevant land
- III. to participate in the proceeds of sale of the relevant land
- IV. to receive any amount determined by reference to subparagraph i, ii, iii above
- V. to acquire any entitlement described in subparagraph i, ii, iii or iv above.

Of the five paragraphs listed above, paragraph IV is the one which potentially requires the most focus and attention. That provision will potentially apply to any 'fee', 'interest' or other amount that is calculated by reference to the income, profits, rents or proceeds of sale derived from the development of the land. The key point is that labelling an amount as a 'fee' or 'interest', or something else, will not avoid the economic entitlement provisions if they otherwise apply.

It is immaterial whether or not the person who acquires the economic entitlement is a party to the arrangement by which it is acquired (section 32XC(2)). This stipulation is designed to address situations where, for instance, a parent company enters the agreement for the economic entitlement but directs it to be paid to a subsidiary company.

There is also no threshold on the percentage of the economic entitlement acquired as there was prior to the amendments in 2019. Previously, under the landholder duty provisions, the economic entitlement had to relate to a more than 50 percent interest in the economic benefit from the land.

Service fees not caught

The definition of economic entitlement is very broad but the [State Revenue Office](#) have stated that the provisions do not relate to **ordinary service fees** that are calculated by reference to costs or proceeds of developments. The most obvious example would be real estate agent's fees that are linked to the sale price of the property. The [SRO website](#) states that:

'where a person providing a service in relation to land:

- is normally engaged in a full-time capacity in providing those services,
- the agreed fee/rate is within industry parameters, and
- the person is unconnected (i.e. not an associated person) to any other person who has an economic entitlement in relation to the land,

it is unnecessary for the service agreement to be disclosed to the State Revenue Office by the service provider.'

It is important to note that service fees which are not 'ordinary' may be treated as an economic entitlement as explained above. For example, a developer who is entitled to be paid a 'Development Service Fee' based on a large percentage of the proceeds of sale of new residential apartments will have an economic entitlement. The guidance provided by the State Revenue Office above is meant to apply to common and industry standard fees which typically involve a relatively low percentage.

Common examples

Some common examples of an economic entitlement in relation to land are set out below.

Example One

- A landowner and developer enter a joint venture agreement to develop land, previously used for farming, into residential lots for sale.
- The land value is \$11 million, excluding GST.
- It stays in the name of the landowner while the developer obtains the necessary approvals and undertakes all required works.
- The developer arranges for the sale of the residential lots on behalf of the landowner, achieving total sale proceeds of \$66 million, including GST at 10 percent.
- The sale proceeds belong to the landowner as the owner and vendor of the residential lots.

- The landowner is liable for GST of \$6 million, with the net proceeds being \$60 million.
- The agreement specifies that the landowner will retain from the net sale proceeds \$11.3 million, which is \$300,000 more than the pre-development land value.
- The developer is entitled to a fee equal to balance of the net sale proceeds, which is \$48,700,000 plus GST.

The developer may have acquired an economic entitlement, being the fee calculated by reference to the proceeds of sale of the land. If so, the developer will be taken to have acquired a beneficial interest in the land and will be liable for duty, based on the value of the land on the date when the joint venture agreement was entered.

Example Two

- A landowner owns land worth \$5 million on which it is developing a new apartment complex.
- The landowner needs some short-term finance to complete the project and applies to a non-bank lender.
- The non-bank lender agrees to loan the required monies on the basis it will receive interest calculated as a percentage of the profits when the new apartments are sold.

The non-bank lender may have received an economic entitlement, being the right to receive interest calculated by reference to the profits from the development of the land. If so, it will be liable for duty based on the percentage interest it is deemed to have acquired based on the value of the land as at the date the loan agreement is entered, which may include the partially completed apartments.

Example Three

- A landowner owns two residential lots worth \$1.5 million (\$750,000 each).
- The landowner has entered a joint venture with a home builder.
- The two lots will both be sold to separate buyers as a part of 'house and land packages'.
- The purchasers will pay the price for the combined house and land to the landowner on settlement, estimated to be \$2 million each.
- The landowner will pay a portion of the proceeds from the sale to the home builder.

The home builder may have received an economic entitlement, being the right to receive or participate in the proceeds from the sale of the improved lots.

The value of the two lots may be aggregated when determining the duty payable by the home builder, pushing the combined value above the \$1 million threshold at which the economic entitlement provisions apply.

If so, duty will be calculated based on the percentage interest acquired on the date when the agreement with the landowner was entered. If no percentage was specified, the home builder will be deemed to have acquired a 100 percent interest, and would need to satisfy the Commissioner a lower percentage should apply.

As the value of the land is between \$1 million and \$2 million, duty will be calculated on a phased-in basis.

We note that the above examples are intended to illustrate circumstances when a transfer duty liability may be triggered under the economic entitlement provisions. As always, it is necessary to consider all the facts, circumstances and transaction documents relating to a particular transaction to determine if duty does apply. If in doubt, clients should be made aware of the risks and encouraged to seek specialist advice.

When is duty payable?

A dutiable transaction occurs when the economic entitlement is **acquired**, not when the entitlement is realised. The duty is payable within **30 days** from acquiring the economic entitlement, that is, when the contract is signed not when the relevant property is sold. This is a significant change in mindset when compared to payment time for other transfer duty.

In example one above the entitlement is acquired when the **joint venture agreement is signed**, giving the developer the right to 81 percent of the proceeds of sale. The duty is payable within **30 days** from signing the agreement, not when the property is sold, which can be many months later.

How is duty calculated?

These transactions are treated by the SRO as "complex transactions" for the purpose of assessing duty. The duty payable is based on the value of the land at the time the economic entitlement was acquired, not when the land is ultimately sold and the payment is made.

Where the entitlement is expressed as a percentage, the dutiable value is calculated based on the percentage entitlement multiplied by the value of the land. Duty is then calculated based on this dutiable value by applying the prevailing transfer duty rate.

As a concession, duty is phased in at a lower rate where the value of the land is between \$1 million and \$2 million. The formula to calculate the concessional duty payable is:

$[(A - \$1,000,000) / \$1,000,000] \times B$

Where A is the unencumbered value of the land and B is amount of duty that would otherwise be payable on the acquisition of the economic entitlement.

If the arrangements are more complex than just an economic entitlement calculated based on a percentage interest, or don't refer to a percentage, then the party acquiring the economic entitlement is deemed to acquire a 100 percent beneficial interest in the property and duty is calculated on the full value. The Commissioner has the discretion to determine the percentage interest is less than 100 percent if the Commissioner considers that is appropriate in the circumstances.

Economic entitlements and private landholder duty

The economic entitlements provisions in Part 4B of Chapter 2 relating to transfer duty discussed above are separate to the pre-existing economic entitlement provisions relating to landholder duty. Economic entitlement provisions still apply to landholder duty but are outside the scope of this alert. More information about them can be found in Part 2 Division 2, and in particular s81, of the Duties Act.

Risk management - what you should do

·Appreciate you need at least a basic understanding of when a deemed beneficial interest is likely to occur so clients can be alerted to the issues and referred for expert advice.

- Read Part 4B Chapter 2 in the [Duties Act](#).
- Read the information on the SRO website about:
- new [economic entitlement](#) provisions in relation to land, particularly the examples provided
- the [private landholder](#) duty regime.
- Update your checklists and precedents to alert you to consider the economic entitlement issue and advise your clients as early as possible.
- Do not dabble in complex duty matters and seek instructions to engage specialist expert advisers for the client where prudent to do so.