Duties Amendment (Land Rich) Bill.

Second Reading

Ms ALISON MEGARRITY (Menai—Parliamentary Secretary) [12.43 p.m.] on behalf of Mr Craig Knowles: I move:

That this bill be now read a second time.

The land rich provisions of the Duties Act were introduced into stamp duties legislation in 1986. The provisions were introduced to deal with techniques that had developed at the time to avoid payment of transfer duty on acquisitions of interests in real estate. Instead of transferring title from owner to owner, the land was acquired by a company or trust set up primarily to hold the land, and the shares in the company or units in the trust were transferred. The owners of the company or unit holders in the trust achieved the same ability to control the use of the land as they would have if they had purchased the land directly. However, by transferring interests indirectly through the transfer of company shares or trust units, duty was reduced from up to 5.5 per cent to 0.6 per cent. Under the current land rich provisions, the following thresholds must be met before transfer duty becomes payable: first, the company or trust must have more than 80 per cent of its assets as land; secondly, of that land, the New South Wales land must be worth $1 million or more; and, thirdly, an interest of more than 50 per cent must be being acquired.

The property industry has moved on since 1986. Changing business practices have resulted in the increased use of indirect holdings in land becoming a recognised method of investment in real estate rather than direct holdings. In addition, many large investors have become more sophisticated and deals more complex, avoiding the land rich provisions in an increasing number of cases. In recent years direct ownership of large commercial properties by one entity has become rare. The values of the deals are too great, and investors are more aware of the need to diversify their risk. In this environment unit trusts have emerged as the preferred investment vehicle for indirect investment in such real estate. They enable a number of investors to pool their resources and share the benefits of high-value properties without attracting duty. Unit trusts are also more flexible than companies as there is no fixed number of shares, so new investors can be more easily accommodated. The Commonwealth Grants Commission constantly assesses the revenue-raising capacity of New South Wales and penalises the State if it determines that New South Wales has above average capacity.

Last year New South Wales grants were cut by an extra $26.2 million specifically because the Grants Commission found that we had above average capacity in transfer duty on unit trusts. That is, New South Wales is paying a penalty for revenue that it is not even raising. The cut was made by the Grants Commission because it considered Queensland, Western Australia and South Australia to be making greater efforts to collect revenue from this source and rewarded them accordingly. The New South Wales contribution to funding these rewards was $26.2 million. It is bad enough that the Commonwealth Grants Commission routinely penalises New South Wales for revenue it does raise. In this case, the State is losing more than $25 million for revenue the Commonwealth Grants Commission says we could be raising but are not.

In the 2003-04 budget the Government announced its intention to develop measures to protect the transfer duty revenue base. This bill implements that Government commitment and includes measures to bring the actual revenue-raising efforts of New South Wales into line with the Commonwealth Grants Commission's assessment of its capacity. In the preparation of this bill the Government has carefully studied the duty regimes applying in other jurisdictions to the acquisition of indirect interests in real estate. There has also been detailed consultation between Treasury and the property industry. A number of the issues raised by industry in relation to the initial proposals have been accepted by the Government and incorporated into this bill.

The measures contained in this bill will restore the integrity of the land rich provisions to ensure the equitable treatment of transactions which in substance relate to the transfer of interests in land. It should be noted that while the package included in this bill will not impact on business as severely as changes recently introduced in some other States, the impact of the changes in New South Wales will continue to be monitored. Should we identify further significant transactions and mechanisms that inappropriately escape the duty base, we will revisit the policy.

I turn now to the changes. One of the current tests that must be satisfied before transfer duty applies to the acquisition of shares in a company or units in a trust is that land must account for 80 per cent or more of the assets of the entity. Our experience has shown that this test is able to be manipulated, as the value of the other assets of the entity, particularly intangible assets like intellectual property, are difficult to verify. To reduce the scope for such manipulation, the percentage will be reduced to 60. However, following representations from Country Labor and the New South Wales Farmers Association, the Government has recognised that this change could impact adversely on the farming sector. Therefore, the Government has decided to maintain an 80 per cent land rich test for the imposition of transfer duty on the acquisition of trusts or companies whose activity is wholly or predominantly primary production. This concession will be contingent upon the land continuing to be used for primary production for at least five years after the date of acquisition.

The Government acknowledges the important contribution small businesses make in New South Wales. It recognises that many genuine small businesses are operated through companies and trusts, and it is not the Government's intention, in reducing the percentage of land in the land rich test, to capture these businesses. For this reason the Government proposes to double the threshold for the value of New South Wales land in the land rich test from $1 million to $2 million. By doubling the value of New South Wales land required to meet the land rich threshold of $2 million, many purchasers of small businesses in New South Wales will now be eligible for a new concession potentially worth tens of thousands of dollars.

Last week a purchaser of a company or trust purchasing a fruit and vegetable shop for $2.35 million, including land worth $1.9 million, would have paid $92,690 stamp duty. From today, the same small business purchaser will pay only $14,100 duty on the shares or units in the entity operating the fruit and vegetable shop, a saving of $78,590. Changes included in the bill will also help a small business person purchasing a company or trust operating a coffee shop for $1.35 million, including land worth $1.1 million; the total saving will amount to $14,358. The next change introduced by the bill is to the "majority interest" test. Currently the land rich provisions apply only where an interest of greater than 50 per cent is acquired. Investor practices have changed since the majority interest provision was introduced. The objective of many major investors in unit trusts now is to acquire a sufficient holding to influence rather than control ownership. These investors typically acquire no more than 50 per cent of the units of a trust.

With regard to private unit trusts, the bill proposes to reduce the interest test to 20 per cent or more, an outcome that will ensure that acquisition of an indirect interest in land is consistent with the tax treatment of a transfer of a direct interest without imposing the significant compliance and administrative costs that would be associated if all acquisitions were taxed. The Government recognises that many households have funds invested in unit trusts. Accordingly the bill provides for concessional treatment for public unit trusts. Acquisition of units in a public unit trust that is land rich will not be subject to transfer duty. The definition of public unit trust in the bill includes trusts listed on the Australian Stock Exchange, other international exchanges and other trusts with at least 300 unit holders.

The definition of a "public unit trust" in this bill is more stringent than the current definition in the Duties Act, which provides the same concession to trusts with more than 50 unit holders. Experience has shown that this threshold is capable of being manipulated by essentially private trusts to satisfy the definition. Wholesale trusts form an important part of the funds management industry. In particular, they have an important role to play in pooling the resources of individual superannuation funds and large public unit trusts to enable investments in significant property projects. Several jurisdictions provide some form of concession for such wholesale trusts. This bill provides that a unit holder in a wholesale trust that is land rich will not be liable for transfer duty unless the unit holder acquires 50 per cent or more of the trust. This concession is the same as the concession provided in Western Australia, and similar to the concession available in Queensland.

This concession, combined with the concession for public unit trusts will provide scope for superannuation funds and public unit trusts to make significant investments of retirement savings without attracting transfer duty. While acquisitions of less than a 50 per cent interest in a unit trust are taxed in most jurisdictions and are proposed to be taxed in New South Wales, no jurisdiction taxes acquisitions of less than a 50 per cent interest in companies. Because New South Wales has only taxed acquisitions of more than 50 per cent, the practice has emerged over the past 20 years where, in order to avoid transfer duty, most acquisitions of land rich companies are of no more than 50 per cent of the shares. In recognition of that practice the bill proposes that acquisitions of 50 per cent or more in land rich companies will now be dutiable.

The following changes will apply equally to companies and unit trusts. The land rich provisions currently allow a holding to be traced through subsidiaries. This limitation has been exploited by acquiring an interest in a subsidiary to circumvent the tracing rule. It is acknowledged by industry that action to halt avoidance in this area is necessary and appropriate. Therefore, the tracing rule is therefore being tightened by this bill, which will allow tracing through holdings in other entities down to a 20 per cent interest. The bill also includes a number of improvements to the provisions by adopting the Queensland definition of "acquisition" to ensure that any method of acquiring an interest in land is brought within the provision. I table a summary of the bill for the assistance of honourable members and I commend the bill to the House.