

# Property Law Update

Winter 2008

## GST and forfeited deposits

*FCT –v– Reliance Carpet Co Pty Limited* is of interest to people selling properties because it was the first GST case heard in the High Court and involved the forfeiture of a deposit.

### Facts

The purchaser of a property failed to settle in time and the sale contract was rescinded and the deposit forfeited to the vendor. The purchaser's accountant requested a tax invoice for the forfeited deposit. The vendor declined to provide a tax invoice on the basis that the deposit was retained as damages in part satisfaction of the vendor's loss and was not consideration for a taxable supply. The vendor was assessed for GST on the forfeited deposit, and objected to the assessment.

### High Court of Australia Decision

The High Court unanimously affirmed the ATO's decision that the forfeiture of a deposit, as rendered under a standard land contract, is consideration for a supply for the purposes of the *GST Act*.

### Practical Consequences – Should vendors require a deposit of 11%?

Is it necessary, in contracts for sale of real estate entered into by vendors registered (or required to be registered) in the course or furtherance of an enterprise, to require the purchaser to pay more than a ten per cent deposit to cover the potential GST imposition on the vendor if there is a forfeiture of the deposit?

As only a small percentage of sales are made by vendors registered for GST purposes in the course or furtherance of an enterprise and as an even smaller percentage of those sales fail to proceed to completion, it is problematic whether the contract of sale should contain any gross up or increased deposit mechanism. There may be a place for an 11% deposit in commercial contracts. But great care and our advice should be sought if a gross up is proposed – for example in Queensland if a deposit is more than 10% the contract will be

deemed an instalment contract giving the purchaser additional rights and making termination of the contract by the vendor more difficult.

It may be preferable for vendors to either absorb the GST (on the deposit) as a cost of business or, alternatively, increase the sale price by an amount to cover the contingency.

The case also has implications for other kinds of forfeited deposits which may potentially be subject to GST like:

- fees for the late cancellation of accommodation or travel bookings
- deposits on contracts for provision of goods and services generally
- deposits of sale of furniture and other household goods
- deposits on sales of businesses

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# Electronic conveyancing

## Victoria

Victoria, at a cost of \$30M, has developed a web-based electronic conveyancing system for:

- lodgment and registration at the Land Titles Office; and
- financial settlement.

The two parts of the system can operate independently but are designed to occur simultaneously. Title is to pass about the same time that the purchase money is transferred electronically.

Current subscribers to the system in Victoria include some of the smaller financial institutions and Bendigo Bank—this means that the financial banking system is available to the subscribers to conduct financial settlements.

The system operates where the subscribers act as agents for their clients.

Their role is to:

- identify the client as the vendor/purchaser/mortgagee or mortgagor;
- certify their client's identity and that they have authorised the transaction;
- authorise and "sign" the documents for the transaction.

The Victorian system presently operates as a pilot. There are very few transactions because the small number of participants means it is unlikely that there will be authorised subscribers for all parties to the transaction. Each party will need to have an authorised subscriber.

The system relies on each of the subscribers being insured. It is unlikely that the conveyancers will be able to obtain the same insurance from commercial insurers as Victoria's lawyers enjoy. Victorian lawyers are presently being advised by their compulsory insurer that they may not be insured for those parts of the transaction where there has been risk shifting from the risks presently involved in the paper-based system. This is a matter still being negotiated.

The major and the other banks are not presently participating with the Victorian system because they want a national consistent system.

## Australia-wide

The national approach, National Electronic Conveyancing System (NECS), has been to look at what might be the requirements for a national system and to see if the Victorian system fits within those requirements.

The Victorian system could be used by being licensed to other jurisdictions. Queensland has indicated that the Victorian system can be adapted to suit Queensland at a cost of approximately \$400,000. This will result in a federated system of similar, but not identical, systems. However, a national model to be built from the ground up is likely to cost in the order of \$60M - \$100M.

## New Zealand

Prior to 1 May 2007 New Zealand used a paper-based system under the *Land Transfer Act* to register documents dealing with land. This meant that upon buying a property the purchaser and any bank or finance company would have to wait up to 15 working days to be legally registered on the title. At present New Zealand has two systems for registration of documents, the paper based system and the new electronic system. By 1 July 2008 only the electronic system will be available.

After 1 May 2007 Landonline introduced the gradual withdrawal of paper-based lodgements with the move to 100% electronic lodgement. Compulsory e-dealing started with mortgage discharges on 1 May 2007 and was expanded to include transfers on 1 August 2007. On 28 April 2008 a further Landonline release meant that 81.9% of documents registered under the paper-based system will now be e-capable instruments. These e-capable instruments became compulsory e-dealing transactions on 28 April 2008 although Land Information New Zealand have allowed a two month teething process for people to get used to the changes.

Brookfields lawyers having used this system for just under a year have welcomed the opportunity to complete more transactions by way of e-dealing as Landonline offers its users a quicker turnaround time for registration. Under Landonline registration of e-dealing is instant. The system has been embraced by banks, finance companies and the public in general, as it offers many features including:

1. New owners are immediately registered on the title, and
2. Mortgages, discharge of mortgages, notices of claims and the like are dealt with immediately.

The above features mean that one of the biggest benefits of Landonline for the public is that a property can change hands a number of times in quick succession without delay in the registration process.

For lawyers this means that dealings are no longer checked by the registry and the actual processing is carried out by them with increased cost to the client partially offset by lower registration charges.

Hunt & Hunt's Murray McCutcheon has been appointed by the Law Council of Australia to represent the Australian legal profession on the National Project Team of the National Electronic Conveyancing System. Murray is hosting the National Project Team in the Melbourne office on 29 July 2008.

The National Project Team is made up of eight stakeholder representatives representing the banks, non-bank lenders, mortgage processors, information brokers, State land registries, State revenue offices, licensed conveyancers and the legal practitioners across Australia. The purpose of the National Project Team is to drive the implementation of national electronic conveyancing – specifically looking at what might be the requirements for a national system and to adapt the current web-based Victorian system to fit within the requirements of a national system as much as possible.

# The Victorian government launches energy efficient laws for home alterations and in line with national standards

In order to combat climate change and global warming, the Victorian Government has announced five star standards for home renovations and relocations. These changes came into effect on 1 May 2008. The changes have brought Victoria in line with national standards in the Building Code of Australia.

## Background

Since June 2005, new homes in Victoria must achieve a five star energy rating for the building fabric, water efficient taps and fittings, plus either a rainwater tank for toilet flushing, or a solar hot water system. Now renovations and relocated homes will be subject to similar requirements.

## What are the new requirements?

The requirements for alterations or relocated homes are not as extensive

as those prescribed for new homes and only apply to renovation work that requires a building permit. Therefore simple renovation work is excluded. The requirements only apply to the thermal performance of a home and do not require a solar hot water system or rainwater tank for toilet flushing. Essentially that means homeowners only need to ensure that they comply with a five star building fabric.

## When do the new requirements apply to renovations or alterations?

If the type of renovation work undertaken exceeds 50 per cent of the original volume of the building (including any alterations carried out in the previous three years) the existing building must be brought up to the same standard as new construction. The new

regulations also apply to any extension greater than 25 per cent of floor area of the existing building or 1,000 square meters (whichever is the lesser). There are circumstances where the building surveyor has discretion to allow partial compliance. Relevant factors include where the compliance would be overly onerous, technically impractical or would not provide a level of benefit proportionate with cost.

## Practical implications

Before building, renovating or relocating your home it is important to speak to your local council, developer or building surveyor to see whether the works must comply with the five star energy efficiency standard and if so, how this affects your plans.

## Property insurance – the position in New South Wales on sale of real estate

In New South Wales a vendor carries the risk of loss or damage to property and the risk does not pass to a purchaser until the sale is completed, or the purchaser's earlier occupation of the property. The practical effect is that when purchasing property a purchaser is under no obligation to insure the property until completion or possession. The vendor should continue its insurance until completion.

But a purchaser can rescind a contract if the property is "substantially damaged" after the making of the contract and before the risk passes to the purchaser. Substantial damage means damage that makes the property materially different from that which the purchaser contracted to buy.

A purchaser may claim a reduction in the purchase price if the property is damaged after the making of the contract and before the risk passes to the purchaser, unless the damage is caused by the negligence of the purchaser. If

the purchaser's claim for reduction is not resolved prior to completion, the purchaser has a right to claim an amount from the vendor after completion as a debt.

## Contracting out

### 1. Dwelling Houses

It is not possible to contract out of, remove, or vary a purchaser's statutory rights about the passing of risk for a place of residence.

### 2. Commercial/Other Property

A vendor can contract out of the provisions in the Act when the property sold is commercial property, to ensure the risk passes on exchange to the purchaser. This means a purchaser needs to arrange for its own insurance upon exchange of contracts. In the absence of any contracting out clause, the risk remains with the vendor until completion and the vendor should maintain insurance until completion.



## Business owners and buyers – your lease deal may limit your ability to sell your business

In most leases the tenant has the right to assign the lease with the landlord's consent. The landlord may impose conditions for its consent. It is common for one of these conditions to be that the parties show the landlord that the proposed new tenant is respectable and financially sound with experience in and a good reputation for conducting the business permitted under the lease, or words to a similar effect.

Usually landlords would have a look at the proposed new tenant's business experience. If the proposed new tenant puts up the necessary bank guarantee/directors' guarantee, has some relevant experience and the previous tenant is not released from the lease obligations, landlords would usually consent to the lease assignment.

The tenant owned a large restaurant in Manly. With 18 months (and two three year options) left to run on the lease the tenant attempted to sell its business. The shareholders of the purchaser company had considerable business experience but

no experience in managing or operating a restaurant business. The landlord refused its consent to the assignment of the lease on the basis that the experience and retailing skills of the shareholders of the purchaser (proposed new tenant) were less than that of the current tenant.

The lease was for a retail shop under the NSW legislation. *The Retail Leases Act 1994 (NSW)* provides that a landlord can withhold its consent to an assignment if the proposed assignee has financial resources or retailing skills that are inferior to those of the current tenant. The Queensland *Retail Shop Leases Act 1994* does not contain a similar provision but the Victorian *Retail Leases Act* provides a landlord can refuse consent if the landlord considers the assignee doesn't have sufficient "business experience to meet the obligations of the lease".

The NSW Supreme Court held that the landlord was legally justified to withhold its consent on the basis that the purchaser's retailing skills were

inferior to those of the tenant. The Court concluded that there was no requirement for the businesses of the tenant and purchaser to be identical but they should be sufficiently similar to permit ready comparison of the retailing skills involved.

This in turn stifled attempts by the tenant to sell the business. This case sounds a warning to tenants and prospective business purchasers that transfer of a lease to a business purchaser is not an automatic process.



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