

## **REVENUE RULING NO. SD 027**

### **NOVATIONS, SUBSALES AND REFUNDS IN RESPECT OF CONTRACT FOR SALE OF LAND**

#### **PREAMBLE**

A novation is a substitution of a "new" contract for an "old" contract in consideration of the discharge of the "old" contract. It is, of necessity, tripartite. In the case of the sale of land, it involves the original vendor, the original purchaser and a substituted purchaser.

In the usual case, the terms of the contracts are the same. Usually, the only change is the substitution of the purchaser or the addition of a further purchaser. Following the novation, the liabilities, obligations

and interests of all the parties under the "old" contract are determined.

Novation at the very least involves two instruments, the original contract and the substituted contract. It may also involve an intervening agreement setting out the agreement of the parties to enter into the substituted contract and cancel the original contract and this agreement itself may constitute the substituted contract. Ad valorem duty is payable on both the original and substituted contracts pursuant to

section 41 of the Stamp Duties Act, 1920.

A refund of duty paid in respect of the original contract can be applied for under section 41(7) of the Act, provided the application is made in, or to the effect of, the prescribed form (that is, Form "I", Regulation 24 of the Stamp Duties Regulations, 1934) and provided it is made within 12 months of the cancellation of the original contract.

However, a refund is not automatic as section 41 (7)(c) states that the refund provisions will not apply if the Chief Commissioner "is of the

opinion that a subsequent sale of the property is a transaction within the meaning of a subsale".

#### **RULING**

##### **Subsales - Relevant Factors**

In forming an opinion as to whether or not the substituted contract is within the meaning of a subsale, the Chief Commissioner looks primarily at the intention of, and the benefit passing to, the original purchaser as a result of the cancellation of the original contract. The following factors are considered to be relevant:

- (1) Whether or not a benefit passes from the substituted purchaser to the original purchaser in the nature of the benefit which ordinarily passes to a vendor pursuant to a sale. A sum of money passing from a substituted purchaser to the original purchaser would obviously suggest that there was, in fact, more than one sale. However, the benefit may be more intangible than this. For example, a developer may "onsell" a vacant lot to an institutional investor at the same price, or even a lower price than the price at which he bought it, but may agree with the institutional investor, by way of a separate agreement but as part of the one package, that he develop the site and erect income-earning buildings on it. Such a sale to the institutional investor, if it took the form of only the one sale by way of a novation from the original vendor, would be regarded as a subsale from the developer even though there was, on the face of it, no profit passing to the developer from the institutional investor pursuant to that subsale.
- (2) If the only benefit passing to the original purchaser is the benefit of being released from his obligations under the original contract, this would not, of itself, be sufficient to characterise the substituted contract as a subsale from him to the substituted purchaser. For example, if an original purchaser found himself unable to raise the finance necessary to complete an intended purchase, but located an alternative purchaser and persuaded the vendor to accept this substituted purchaser by way of novation of the contract, the Chief Commissioner would not view this as a subsale.
- (3) On the other hand, the inclusion of a novation clause in the original contract, whereby the original purchaser could require the vendor to accept a substituted purchaser by way of novation, would tend to suggest that the original purchaser intended to sub-sell the property. Accordingly, the Chief Commissioner would be inclined to regard the substituted contract as a subsale.

#### **Examples of Instances where a Refund would not be Granted**

A refund of duty would not be made where the original purchaser:

- (1) is a holding company but, at the time of the original purchase, no decision had been made about which of a number of subsidiaries would be the ultimate purchaser;
- (2) subsequently decides that, for tax purposes, it is desirable that the property be acquired in the name of a company, trust or partnership; or
- (3) intended to bring in a member of the family as a co-purchaser but, at the time of exchange, had not decided who (of a number of family members) was to be joined in the purchase.

In each case, the substituted purchaser's entitlement under the novation arises as a result of an intention formed by the original purchaser

subsequent to the original purchase. The Chief Commissioner would view the novation as being in the nature of a subsale, regardless of any passage of benefit.

These examples are not intended to be exhaustive and each application for a refund will be considered on its merits.

#### **Four Cases where Refunds would be Granted**

There are at least four circumstances in which contracts for the sale of land are novated and the Chief Commissioner would not consider that a subsale occurs. These are:

(1) Where the novation takes place at the initiative of the vendor.

This goes to the facts and will not necessarily be apparent from the documents involved.

However, on any view of the word "subsale" it must mean, in a novation situation, a sale (or notional sale) from the original purchaser to a substituted purchaser. This view is reinforced by the wording of section 42(3), which addresses itself specifically to the liability of subsale instruments to duty.

Where the novation takes place at the initiative of the vendor and the original purchaser withdraws at the request of the vendor, the Chief Commissioner would not regard the substituted contract as amounting to a sale from the original purchaser to a substituted purchaser.

(2) Where the novation takes place in order to remedy the inadequacies of a pre-incorporation contract.

This case is well settled and the Chief Commissioner's view is that there is no subsale where a contract is entered into by a promoter on behalf of a named company to be formed and that contract is novated following incorporation, so that the promoter is released from the original contract and the new company is bound by the substituted contract.

Even this result is limited to these specific circumstances and, for example, a novation in favour of a shelf company which was itself in existence when the original contract was entered into and which was subsequently purchased by the promoter will not come within this category. The Chief Commissioner's view is that a novation, in these circumstances, amounts to a subsale from the promoter to the shelf company.

Novation is not the only way of dealing with a pre-incorporation contract, for stamp duty purposes. For example, if the pre-incorporation contract is not novated but the name of the intended company is specified in the contract and (following incorporation) the transfer showing the company as the transferee is executed by the transferor and completion takes place, the Chief Commissioner (following the view of Dixon J.

in **Vickery v Woods** (1951) 85 CLR 336) accepts that the transfer in such circumstances is "in conformity with" the contract for the purposes of section 41(4)(a) and will charge only one amount of ad valorem duty in respect of the transaction. This alternative approach may well become more common than in the past as section 81 of the Companies (NSW) Code now allows companies to ratify pre-incorporation contracts and thereafter enforce them against the other contracting party - something which previously could only be done after a novation.

Where a novation agreement (or transfer) is tendered for stamping in any of the above circumstances, the lodging party should also furnish a statutory declaration indicating whether the company was in existence at the date of exchange of the original contract (i.e. the date of incorporation) and whether the named company has undergone a change of name at any time before novation or transfer in its favour.

- (3) Where the novation takes place to correct a failure of the original contract to accurately reflect the intentions of the parties.

An example of this would be where X purchases a new home at auction **with the intention of purchasing it on behalf of himself and his wife** and, in the heat of the moment following the auction, gives the auctioneer his name alone as the purchaser.

If there is a subsequent novation and substituted contract with X and his wife as joint purchasers, the Chief Commissioner's view is that there is no subsale.

In this case, joint provision of the original purchase moneys is a strong, though not decisive, indicator of intention.

- (4) Where the novation takes place to comply with government requirements.

An example of this would be where X, a foreign person or corporation, purchases a property subject to Foreign Investment Review Board approval and this approval is subsequently obtained, but subject to X joining in an Australian person or corporation as a joint venturer in the purchase of the property. In such circumstances, if the original contract were novated so that X and an Australian third party were substituted as co-purchasers, the Chief Commissioner's view is that there is no subsale.

### **Partial Subsalses**

While the Act does not contemplate a partial subsale, the Chief Commissioner in applying section 41(7) will be prepared to grant a proportionate refund in appropriate circumstances. For example, if the original contract is novated so that the substituted contract shows the original purchaser together with a third party as co-purchasers of the property in equal shares, the Chief Commissioner will not regard this as a subsale of the half share which ultimately passes to the original

purchaser and, provided duty is paid on both contracts, will allow a refund of half the duty paid on the original cancelled contract, even if he forms a view that the half share passing to the third party passes by way of a subsale.

#### **Time for Payment of Duty on the Substituted Contract**

It should be noted that there is no provision in the Act for duty which may have been paid on the original contract to be applied towards the liability for duty of the substituted contract. Consequently, if there is a novation it is not sufficient to lodge the substituted contract together with an application for refund of the duty in respect of the original contract in the expectation that the duty paid on the original contract can be "switched over" to the substituted contract. In such circumstances, duty should be paid on the substituted contract, as with any other instrument, within two months of its first execution. Otherwise, in the event that a refund of duty is not granted, time may well have passed and a fine may have accrued in relation to the substituted contract.

A. D. CLYNE,  
Chief Commissioner of Stamp Duties.  
11 July, 1986

Last Updated: 20-Sep-2001