


# ***IT 2400 - Income tax : conversion of perpetual lease into freehold title and sale of land within 12 months of conversion - operation of section 26AAA***

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TAXATION RULING NO. IT 2400

INCOME TAX : CONVERSION OF PERPETUAL LEASE INTO  
FREEHOLD TITLE AND SALE OF LAND WITHIN 12 MONTHS OF  
CONVERSION - OPERATION OF SECTION 26AAA

F.O.I. EMBARGO: May be released

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I 1210886	PROFITS ON SALE OF PROPERTY PURCHASE OF PROPERTY PERPETUAL LEASE	26AAA

PREAMBLE

Section 26AAA of the Income Tax Assessment Act requires that the assessable income of a taxpayer shall include any profit arising from the sale of property or an interest in property where the property or interest was purchased within 12 months of the date of sale.

2. The operation of section 26AAA in situations where farming land which had been held for many years under a perpetual lease from the Crown is converted into freehold title and sold within 12 months of the date of conversion has been considered in this Office.

3. The circumstances in the situations considered followed much the same pattern. Farming land had been held under perpetual lease for many years. The lease had been granted under State Crown Lands legislation. A business of primary production had been carried on by the lessee and his family and residential dwellings had been built on the land. After years of conduct of the business the lessee wished to retire and sell the property. The conversion from perpetual lease to freehold was undertaken in order that sale of the property may be more readily effected.

4. The nature of perpetual leases may be gleaned from this extract from the Law of Real Property in New South Wales by Helmore (Helmore) - Second Edition, page 34.

"In the latter half of the 19th century, the practice of making straight-out unconditional grants of land was abandoned by the Crown in favour of a policy designed to systematise the settlement of people on the land, with reasonably sized, but limited, holdings. Crown Lands legislation which, in a masterpiece of understatement, may be described as voluminous, has produced a wide and varied assortment of tenures ranging from mere occupation licences through the whole gamut of leases for years, and so-called

perpetual leases, to the comparatively few straight-out grants in fee. Many of these interests are subject to special obligations and conditions and particularly to restrictions on the right of alienation. Some of them, like purchases and perpetual leases under the Crown Lands Act, result in the immediate or eventual issue to the holder of a Crown grant, but the denial of a right to alienation without the consent of the Minister for Lands frequently continues to attach even after the grant has issued. When a grant issues, the land automatically comes under the Real Property Act and transactions are implemented by the forms of instruments prescribed under that Act."

5. The reference to "so-called perpetual leases" may be explained by the following extract from Helmore at page 70:-

"A 'perpetual lease' is a contradiction of terms, and the conditions to which these tenures are subject are in no way inconsistent with the incidence of a fee simple upon condition, the right of forfeiture for non payment of a rent or breach of condition being equivalent to the right of re-entry on a breach of condition subsequent. Moreover the words of limitation used in the Deeds of Crown, viz. 'to the grantee his heirs and assigns forever', are peculiarly appropriate for a fee simple."

6. What emerges from the terms under which perpetual leases are granted is that, notwithstanding the legal relationship of lessor and lessee created by a perpetual lease, for almost all practical purposes they are the equivalent of a grant in fee simple.

7. With the passage of time the various State statutory provisions relating to perpetual leases have been modified. So far as is relevant to this Ruling a perpetual lessee is now able to acquire fee simple in the land the subject of the perpetual lease. The restriction on alienation provisions can also be removed. In New South Wales, for instance, a perpetual lessee can become the owner of the land by payment of a lump sum equal to the capital value at the date of acquisition of the lease. The restriction on alienation can be removed by payment of a further lump sum equal to 5% of the current unimproved capital value. In South Australia the amount payable to convert a perpetual lease to freehold, together with the associated costs, is approximately 5% of the current market value of the land.

8. It is possible under the various State laws for a perpetual lessee to dispose of the perpetual lease either wholly or by way of sub-division. Approval of the Minister is necessary. Perpetual lessees who convert to freehold claim that, even with the Minister's approval, it is difficult to find a willing purchaser of a property held under perpetual lease as any subsequent disposition will also require the Minister's approval. It has also been said that it is easier to sell large rural properties if they are split and sold in portions to neighbouring property owners. It is easier to do this if the land is held under freehold title. It is generally the case

that the value of properties held on perpetual lease is only marginally less than if the property was held under freehold.

RULING 9. Section 26AAA operates where there has been a purchase and sale of property within 12 months. The basic question for decision is whether the conversion of a perpetual lease into freehold title is a purchase within the meaning of section 26AAA.

10. While it is recognised that a perpetual lease is not a grant of land in fee simple the fact remains that a perpetual lease has almost all the advantages of a grant in fee simple. The value of the reversion to the Crown is very slight. In Helmore, under the heading of "By Merger" at page 106, it is stated that "merger may occur when the owner of a reversion releases it, i.e. conveys or transfers it, to the owner of the leasehold". This is what occurs when a perpetual lease is converted into a freehold title - the Crown releases the fee simple in the land to the perpetual lessee. In the light of this understanding it requires a straining of the ordinary meaning of words to say that the statutory procedure for conversion of a perpetual lease into freehold title involves a purchase and sale of property.

11. Paragraph 26AAA(1)(f) extends the ordinary meaning of purchase and sale to include the transfer of property from one person to another in exchange for other property or without consideration. The release of the fee simple by the Crown to a perpetual lessee does not involve the exchange of property, i.e. it does not involve the transfer of the freehold title in exchange for the perpetual lease. There is not any consideration given for the perpetual lessee's interest in the perpetual lease. Nor can it be said that the conversion involves a transfer of property without consideration - as illustrated in paragraph 7 above the perpetual lessee is required to make certain payment for the fee simple.

12. Against the background of the nature of a perpetual lease the conversion of a perpetual lease to freehold title by payment of the relevant statutory amount is seen to be more in the nature of a removal of impediment to a legal title rather than a purchase of property. It may be said to be similar to the removal of a condition which may exist in the case of a fee simple upon condition.

13. In the result it is accepted that the conversion of a perpetual lease into freehold title does not involve a purchase of property within the meaning of section 26AAA.

COMMISSIONER OF TAXATION  
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