

Episode 48

Duty calls: Navigating transfer duty on options

Intro

This is Risk on Air by Lawcover. Our topic today – duty calls: navigating transfer duty on options.

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- Julian:** Welcome to Risk on Air. I'm Julian Morrow and our topic today is navigating transfer duty on options and the call that we've made about duty is to leading Australian tax barrister, Andrew Rider, who edits Australian Stamp Duties Law and is also a member of the liaison committee between the Tax Institute and the New South Wales Office of State Revenue. Andrew, thanks very much for answering our call to talk about duties on options for Risk on Air.
- Andrew:** Pleasure Julian, happy to be here.
- Julian:** Now, one of the big reasons for this discussion is changes to the New South Wales Duties Act of 1997 that were made back in May of 2022. And that's got major implications for what were previously regarded as tried and tested transaction structures. We'll come to those amendments shortly, but let's get some terminology right first Andrew. Could you give us a basic rundown of what an option to purchase is and, in particular, the difference between a put option and a call option?
- Andrew:** Yeah, so properly drafted, an option is an irrevocable offer. Typically, well for call options, it's an option for someone to buy. A put option is where the prospective purchaser gives the vendor the option of putting the property to them in the event the call options not exercised.
- Julian:** Right, and what's the difference between an option and a right of first refusal?
- Andrew:** Good question. As I say, an option's an irrevocable offer. A first right of refusal is something less than that. I guess if you've got an option, the parties are absolutely bound, whereas they're not necessarily bound to proceed unless the first right of refusal is exercised. But don't quote me on that. It's a fine distinction.
- Julian:** And I suppose one of the things that emerges from some of the commentary is that the title that you put at the top of the document doesn't necessarily determine what the substance of the document is.

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Andrew: Yeah, well, that's absolutely right. I mean, I do often get asked the question you just put to me what's the difference between a first right of refusal and an option? And regardless of the label that you put on a document, it may well be through careless drafting that something somebody purports to be an option may well be a first right of refusal, but, more concerningly, vice versa. And if it is this latter case, well then you've got to start talking about duty on the grant of what, in substance, may well be an option.

Julian: Another term in this sort of universe is a conditional contract and how that's different from an option. Could you speak to that a little and also what the duty consequences of that distinction are?

Andrew: Yeah, so obviously a conditional contract is the parties are bound to proceed subject to the satisfaction of a condition, and the key difference between a conditional contract and the grant of an option is a conditional contract is dutiable upfront within three months. If you're going to transact in relation to land, it's going to be on the higher of what you've agreed to pay for the land or what its market value is. With an option, a grant of a call option, it's also dutiable, but it's only dutiable to the extent if it's arm's length parties the option fee or generally other things that go towards consideration or if it's non-arm's length parties, it's the value of the option.

Julian: So, what were these amendments in May 2022, and why has it got everyone talking now?

Andrew: Yeah, well, it's interesting, they're actually termed change of beneficial ownership. So it's not the most obvious thing you'd think of with a new head of duty called change of beneficial ownership. There is definitions of what a change of beneficial ownership is and it does include, from memory, the creation of dutiable property and extinguishment of dutiable property, termination, that sort of thing. The call option over land in New South Wales is a species of dutiable property and so therefore, the creation of it, it was going to tax the grant of a call option to purchase land for the first time in New South Wales. So, again, not the most obvious terminology you'd think that would apply to options. But not long after the law was changed, the Commissioner brought out a couple of practice notes, not the one that came out recently, we'll talk about that maybe later, but earlier ones I think certainly made it very clear to the profession that the Commissioner would regard this new head of duty as taxing the grant of call options for the first time.

Julian: Yeah, so there was the New South Wales State Commissioner's practice note, firstly on changes in beneficial ownership - so that was directly addressing the terminology in the legislation. But there is a new one now that came out in December 2024, practice note 37, which outlines common transactions involving options to purchase land which the Commissioner says now are liable to duty. You mentioned consideration before, Andrew. How do you work out the consideration for an option?

Andrew: Well, that's a really good question and first of all, I would commend to all practitioners, whether they deal with options regularly or whether or not they receive instructions for the first time, they really do need to read Commissioner's Practice Note CPN 037 and acquaint themselves with the Commissioner's views about the various dutiable aspects of options.

As part of that Commissioner's Practice Note, the Commissioner does give his opinion on what constitutes consideration, what the High Court tells us, quite helpfully or maybe not, in terms of what is consideration from the famous Dick Smith case from the early 2000s. What's consideration? Anything that moves a transaction.

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The Commissioner gives examples, I think in the Commissioner's practice note, of things like non-refundable amounts, perhaps glibly described as security deposits. And again coming back to what you said, it doesn't matter what label you put on something. If the substance of whatever's occurring does really have the character of moving the transaction or being a reason why the parties have transacted, then chances are it is going to be consideration, particularly where it's an amount of money that's changing hands for whatever reason.

Julian: So the obvious thing is going to be the stated option fee, but you can't finish your consideration of consideration there. You mentioned non-refundable security deposits. What about reimbursements for legal fees?

Andrew: Yeah, so that's the big one. It may not be a big amount of duty, but it certainly caught a lot of people unawares. That was actually brought to the public's attention, or practitioner's attention, in the Commissioner's earlier practice note on change of beneficial ownership and I think it caught a lot of people by surprise. The Commissioner said well, look, if the person that's been granted the option is going to pay the legal fees of the person granting the option, I think if it was more than \$1,000, well, that's all part of the consideration. Even if it's a nominal option fee, say \$10, you're still going to have to pay duty on \$10 plus whatever the amount of the reimbursed legal fees were.

Julian: And also things like value of in-kind works.

Andrew: Yeah, absolutely. Yep, so they're dutiful as well. So, yes, you do have to, I think, step back, take a deep breath and confront the reality that if anything is offered by the grantee to the grantor that moves the transaction again coming back to what the High Court told us, then chances are the Commissioner is going to take the position that it's consideration. It's an interesting thing the way that these options get stamped - the grant of an option itself gets stamped on what's called EDR, which is a system that doesn't go directly to the Commissioner. It gets checked by the Commissioner after the event, sometimes years after the event. So, because of the risk that practitioners who are registered for EDR and stamping documents on behalf of the Commissioner, bear if they don't get it right, I can't emphasize enough when it comes to any amounts, regardless of how they're characterised under the call option or the giving of in-kind works or that sort of thing, please go to the Commissioner's practice note CPN 037, and read the section carefully on what consideration is.

Julian: And you mentioned also whether or not it's an arm's length transaction is going to be critical at a practical level.

Andrew: Yeah, absolutely, because the Commissioner really importantly says in his Commissioner's practice note CPN 037, if the parties are acting at arm's length, then he'll generally accept that what the amount of money, particularly for the option fee, is an arm's length amount and he will, I guess, be happy enough that that's the dutiable amount. Bearing in mind, with options, like any dutiable transaction, duty is on the higher of the consideration or the unencumbered value. So, as I say, for arm's length transactions, he will accept that the parties, obviously, through their negotiations have agreed an option fee and anything else that goes towards consideration, and he won't go any further. He'll just look at those things and that will be the dutiable amount.

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The obverse situation which I think concerned a lot of practitioners generally when this new tax was introduced in 2022, was whether or not you'd have to get a valuation of the option in each and every case.

Now, again helpfully, in the Commissioner's practice note, he says it's only in situations where the parties are not acting at arm's length, or if they're related, that he will require evidence of valuation. That in itself is actually quite an onerous obligation to put on taxpayers, not least of which because the Commissioner expects valuations, when they're performed, to be done by people who have actually got a track record in valuing those particular types of things and, I think, as a practical matter, if you've ever got to get a valuation of an option, I think the number of valuers who are actually qualified to do that, whether in Sydney or elsewhere, is pretty thin on the ground and it's going to be expensive.

Julian: And so that's a valuation when you're putting together the option contract.

Andrew: Yes.

Julian: How long is that valuation good for?

Andrew: Okay, so well. Yeah, it's a good question. It may depend upon where the underlying property is located. Commissioner's got a whole lot of revenue rulings about all of this. The one about the age for want of better words of the valuation comes from Revenue Ruling DUT 12. I think we're now up to version four. It doesn't specifically talk about options but it does talk about land and it makes a distinction between land in a metropolitan area in New South Wales and land outside a metropolitan area. If you can extrapolate that and say, well then an option over land in a metropolitan area, he generally wants valuations to be no more than three months old. Conversely, and again this is extrapolating what he says about direct dealings in land, if it's outside a metropolitan area, he will often accept it if it's up to 12 months old, providing there haven't been any changes in zoning or other material changes which might uplift, for example, the value of the option or that sort of thing.

Julian: Yeah, and I think in practice note 37, it does say that 12 month period if the exercise of the option happens within 12 months.

Andrew: Yeah, so just on that point. So there's a difference between when you commission a valuation and how old it can be by the time you've got to give it to the Commissioner, as opposed to the requirement that if your option is exercised more than 12 months after you've granted, then the Commissioner, when the option is exercised, will want a valuation of the underlying land, the subject of the agreement that comes into effect when the option is actually exercised. Now again, it's something I think many practitioners are aware of, but not everyone - it's not a new requirement. The Commissioner put this into his revenue ruling DUT 12 (version, it was probably version three when he did it, it's now version four) several years ago.

But that sort of segues into why now transacting by way of options is actually a pretty expensive from a duty point of view, way to proceed down a particular path. And that's because with a conditional contract you lock in the dutiable value at the date of exchange. Presumably, if it's arm's length the Commissioner will accept the purchase price is equal to the value of the land.

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Where you've got an option, and typically the reason that you grant an option is because the prospective purchaser of the land wants something to happen to the land, like, for example, a subdivision, approval or rezoning or that sort of thing. So, by the time those trigger events happen, which is typically more than 12 months after the option was granted, they cause a substantial uplift in the value of the land, which means the contract which comes into being on the exercise of the option many years after it's granted, the value of the underlying land is normally substantially more than what it was had you copped the duty up front on a conditional contract years before.

Julian: So, the practice note came out in December 2024. The new laws had been in operation for the best part of two years by then. Have parties been getting stung with duties that they weren't expecting and occurring more often than they were expecting in the transaction process and calculated on higher amounts?

Andrew: Yeah, look, absolutely. I know I get a lot of people come to me (always after the event) when they're upset with either they had an EDR audit and the Commissioner alleged that more duty was payable than not. Or, for example, where an options on foot but it hasn't been exercised yet and, for example, the parties wanted to modify, for example, the option by extending its term by paying option extension fees. Now that was a big issue for a long time about, well what was the effect of the payment or the agreement to pay an option extension fee? Did it mean it crystallized a liability within three months of the agreement to pay the fee, which meant you had to up-stamp the original option, or did it have some other duty effect?

Now, thankfully, in the Commissioner's practice note and I keep plugging this so that people will remember it - CPN037. What he says, the Commissioner says very clearly about option extension fees - the way they manifest themselves in terms of the duty outcome is you add the option extension fees to the, for example, purchase price under the contract when it's exercised, so it grosses up the consideration side of the dutiable value of the contract. Now, the only exception to that is, although the Commissioner's practice note doesn't say as much, if those option extension fees were, for example, credited towards the purchase price, it seems, based on what the Commissioner said in an earlier practice note that it may be that you don't need to actually gross up the purchase price if, for example, the call option fees, or any option fee for that matter is actually credited towards the purchase price.

Julian: So you're in a situation where, under the change of beneficial ownership rules, now there'll be duty on the grant of the option. What happens if the option is not exercised?

Andrew: Yeah. So if it's not exercised, bad luck you don't get your money back. But actually, even if it's exercised, you don't get a credit for the duty you paid on the grant. But, concerningly, the Commissioner identifies something which is right technically – and I think it's something prudent practitioners may have already known but perhaps it was in the back of their minds - if you've got an option on foot and the parties want to get out of it, so rather than letting it lapse through the effluxion of time, they take proactive steps to actually enter into, say, a deed of termination or rescission, unbelievably, that's actually a dutiable transaction. It's another element of the definition of change of beneficial ownership, extinguishment of dutiable property. Coming back again to the fact that a call option to purchase land in New South Wales is and of itself a type of dutiable property. So when parties terminate it, again, if they're at arm's length and there's consideration, then I guess the person who granted the option is going to be liable because they're getting back something that they gave and they're being paid I guess. The mind boggles, the mind really boggles.

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Julian: And you've mentioned this already, but if you've paid the duty for the option and there is an exercise, you're not going to get a credit.

Andrew: No, unfortunately. So, again, that's another reason why transacting in relation to land using options as opposed to conditional contracts – and disclaimer here I'm not advocating any particular position I'm just here to, I guess, forewarn people that a conditional contract has a certain type of dutiable outcome. Options - if you track through all the dutiable steps, including the fact that if it's exercised more than 12 months afterwards, you're having to get a valuation, invariably going to be paying on a lot higher land value at the time of the exercise of the option than the land value was if you'd say contracted by way of a conditional agreement. The thing about it is so you pay duty on the grant of the option, you don't get a credit for it when you exercise it, but worse, when you exercise it you've then got to pay on the higher of the consideration, which can include the option fee if it's not credited and any option extension fees if they're not credited, or the value of the land.

But I think in practice, invariably most people will end up paying on the value of the land and, bearing in mind it's not inexpensive to have to get a valuation and the adequacy or otherwise of valuations is a prime area of dispute with Revenue New South Wales. If for example, the valuer hasn't been instructed properly or they don't have a track record in valuing a particular type of property the subject to the option. So, for example, if it's over industrial property or commercial property and the valuer's resume doesn't show a track record there the Commissioner can say *Well, who's this person to opine on the value of the industrial or commercial land? Go back, we don't like your valuation - not accepting it - go back and get another one from somebody who is qualified.*

Julian: Now, as if that wasn't complicated enough, Andrew. What's 'call option assignment duty'?

Andrew: Oh... well, I'm glad you asked. It's not new, but the fact is it has basically got zero recognition in the profession I would have thought. The duty's actually been with us for about 20 years and it is a very pernicious and disastrous type of duty, if it ever applies. It's an interesting type of duty as well - what I'll do is I'll walk you through a case study to explain how it works, that's probably the easiest way to do it.

So, imagine, I've been granted a call option and I've granted a put option over the owner of the land. Okay, so we've got a put and call - one of the prerequisites for call option assignment duty to ever apply is there must be a put and call option over the same land. So, just say, Julian, you come along to me one day and you say: *Listen, that call option, I like the look of that land. I reckon I can make a bit of money out of that. Would you sell me your call option?* I say: *Yeah, sure.* You say: *I'll give you a million dollars for it.* Oh, happy days, Julian, happy days.

Julian: We're in very hypothetical scenarios now, Andrew.

Andrew: So, the thing about it is, you're giving me a million dollars satisfies the second and third parts of the equation in that I've divested myself of my option rights to you, and I've done so for valuable consideration.

Just pausing there for a minute. It's called call option assignment duty, but it's not merely an assignment, in this example, from me to you. It's any way that I can confer, and I use that word very generically, my rights in the call option to you. Again, the prerequisites are it's got to have a put and call around the same land and secondly, when you confer your option rights on somebody else, then they've got to give you valuable consideration.

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What's valuable consideration? It's not defined in the Duties Act. It's never been considered, as far as I'm aware, by any court or a tribunal. But I think instinctively, if you've got to ask ever in relation to a transaction, is this for valuable consideration? You've probably already answered your own question, which is yes, it probably is. But in any event - so let me explain how this pernicious duty works. Unusually for stamp duty, I'm the person in this example giving away the rights and, as we all know, generally with stamp duty it's the person that acquires something or has transferred something or is granted something. They're traditionally the person that's got to pay duty, but with call option assignment duty, the duty's on me, the person that's got to pay duty, but with call option assignment duty, the duty's on me, the person that's giving away the rights, not who's acquiring the rights. They also have to pay duty in their own special way, but it's different. It's not call option assignment duty, but I have to pay it. So that's an unexpected thing in that it's falling on a party who you normally wouldn't associate with having to pay duty. The pernicious thing about it is as well my liability to duty, as somebody who sold or assigned my call option rights to you for a million dollars, when I work out my duty liability, as with all types of duties, there are two sides to the dutiable value equation - what's the consideration and what's the dutiable value? So, on the consideration side, this is my liability to you, whatever you've paid me for me to confer my rights on you, what I would have normally paid had I held the option to purchase the land under the call option, if I'd exercised it. So that's one side of it.

What I'm paid, plus the purchase price under the contract, that's the consideration side. And here's the sting in the tail: the other side of the equation is the dutiable value of the underlying land, the subject the option. Even though I never exercise the option, I have to pay duty - and I imagine in practice this will be probably most of the time when this call option assignment duty applies, when I have to pay duty because I conferred my option rights on you, invariably I'm going to end up paying duty on what the value of the underlying land was. But there's a really bad sting in the tail for you because you, so keen to deal with me to get my option rights, you agreed (and your solicitor didn't pick this up) that you would pick up any stamp duty arising from my conferral of my option rights on you. So, while I remain technically liable to pay the duty, you have actually by contract undertaken to pay my duty. You probably didn't even know there was this type of duty, but invariably you've then got to pay duty on my conferral of the call option rights to you, picking up my liability by contract - so you're paying the same duties if you'd actually bought the land and in addition to that you've also got to pay the normal duty that applies to anyone who acquires call option rights. It's a different regime and it goes back to the normal rules about higher of unencumbered value and consideration and that sort of thing. Have I completely confused you? Because if I have, you're not Robinson Crusoe. Okay, but any discussion, to be honest, of duty on options cannot be complete without discussing call option assignment duty. Even though it's been with us for 20 years. As I say, it would literally have zero recognition in the profession.

Julian: Well, it certainly put me off the transaction.

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Andrew: But I think and to be honest, I think maybe that was the Commissioner's idea all along with imposing duty on option related transactions. I think the Commissioner, and I think it's probably no secret, is trying to guide people towards contracting upfront by way of, say, the conditional agreement - he gets his duty upfront within three months, albeit the interesting thing is he actually ends up getting less duty out of the whole scheme of things because using options, as I say, invariably you're going to end up paying on the value of the - when you exercise it - on the uplifted value of the land a few years down the track.

Julian: You mentioned before the scenario of simultaneous put and call arrangements. How often does that happen and what are the risks that the Commissioner flags about that sort of situation?

Andrew: Okay. Well, they're relatively common, or they used to be relatively common, when options were the property developer's friend - no longer the property developer's friend, and that's because previously we've been discussing they weren't liable to duty when they were granted. Put and calls were typically put in place because to some extent they in substance sort of replicate like a conditional contract, the parties are sort of locked in in a similar way. The implications of a put and call arrangement - there's two of them - we've just discussed one of them, and that is the potential liability of any dealings in the call option, the liability of the person that's conferring the rights to call option assignment duty. We've already talked about that. But at the absolute outset, the issue is whether or not the Commissioner may choose to apply the general anti-avoidance provision. And so the Commissioner does opine in his Commissioner's practice note 037, two scenarios one where he says it will apply, one where he says it won't apply in terms of the general anti-avoidance provision.

Just stepping back though, as to, well, how's the Commissioner even going to become aware that the thing actually proceeded by way of a, say, a contract had an antecedent put and call option arrangement behind it. And the reason is because - every practitioner should know this - the Purchaser Declaration, now there was a question that says *Did this transaction arise from a put or call option arrangement?* Tick, yes. *If so, please provide us with all the documentation.*

So, what happens to the unfortunate parties and practitioners? Nobody thought of the anti-avoidance provision at the time, they thought this put and call was a great thing. It was going to defer the payment of duty, which, of course, deferment of payment of duty is within the definition of tax avoidance. And so they lodged their contract years after the put and call was entered into, and they answer yes, it arose from a put and call - and the Commissioner looks through it and says *Hmm, okay. Can't really see any commercial rationale for why you did it this way. I mean the relevant counterfactual, which is sort of the language of anti-avoidance, seems to me you probably would have reasonably been expected to go by way of a conditional agreement or contract. If you had that means you actually should have paid me duty years before, and so I'm now going to issue you with a anti-avoidance assessment backdated to when the put and call was entered into.* I'm saying that the reasonable counterfactual is it would have been a conditional agreement. Obviously, then I look at the dutiful value, at what it was back then. But the sting in the tail is, if it's years after the event, 25% minimum penalty tax and the interest which is around 14% per annum, it fluctuates every couple of months. Anyway, it will be a killer because it's relating back to a liability that arose many, many years before.

Julian: And the Commissioner says it's not going to be in all circumstances. There can be genuine commercial purposes for a put and call arrangement, but any simultaneous put and call arrangements, Chief Commissioner says, will be examined closely through the anti-avoidance perspective.

Andrew: Will be and are in practice.

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Julian: We've mentioned, obviously, the importance of going to that CPN 037. It notes that it needs to be read in conjunction with the other practice note that you mentioned earlier the change in beneficial ownership one. There's also a little flag at the end of CPN 037 that says that that practice note doesn't deal with the duty implications of transactions that involve options that have been granted. What's that getting at, Andrew?

Andrew: Yeah. So that's sort of the counter side of the example that I just gave you about call option assignment duty and that is, we talked about my unusual liability, the person conferring the rights. Now, as I said in that example, you would have always been liable to duty based on the relevant regime to do with you acquiring those call option rights. The Commissioner's practice note, I think is talking about your liability to duty. It's different to the way call option assignment duty is calculated. So, the normal case is coming back to what I said before - a call option to purchase land in New South Wales is and of itself a type of dutiable property. As we know, a dutiable transaction in the normal course includes, say, a transfer, which includes an assignment. So in the example where I conferred my rights on you, say we did it by way of a transfer, you would have been liable to duty, and you are, based on what you paid me, which is a million dollars, or what the value of the option was. But because we were transacting at arm's length, the Commissioner would generally accept you've got to pay transfer duty on a million dollars. Remember the way that I worked out my liability was completely different under call option assignment duty.

So I think it's just a flag to say look, don't forget, in addition to what the practice note is really about in terms of working out the duty on the grant of an option, once an option's been granted and if it's dealt with by way of, say, a sale or assignment to a third party for valuable consideration, that other person has to pay their own lot of duty, which is separate to what I talked about in terms of call option assignment duty. The other thing as well is, in the case of a call option that's been granted and it's acquired by someone else for valuable consideration, you don't need a put option for you to be liable to duty - it is and of itself just liable to duty anyway. So there isn't that precondition of also requiring a put option - that's not needed.

Julian: Well, I for one am convinced that this is an area that practitioners need to take great care in. Just to finish up, Andrew, what practical advice would you give to solicitors who are dealing with this new regime or examples of the traps that solicitors could well fall into in this area?

Andrew: I think probably, while crunching numbers is probably not every lawyers cup of tea or strength, I think if a client ever comes to you and says *Well look, I'm interested in a block of land and maybe we should do it by way of put and call...*, I think probably you should try and model what the numbers are in terms of... all right, well if we went by a conditional contract, the duty would be X. If we go down the option route, the duty would be Y on the grant of the option and then it would be Z on the exercise of the option, bearing in mind you're probably going to be paying on a much higher land value down the track when the option's exercised and say to the client well, *what would you prefer to do?* Would you rather cop a smaller amount of duty upfront or kick a whole lot of a higher amount of duty down the road, bearing in mind the Commissioner may think it's anti-avoidance anyway and backdate the assessment so that you should have paid within three months, and so you earn yourself a whole lot of penalty tax and interest in addition to the duty that you would have paid anyway within three months. So yeah, I think calculations simulating what the likely duty scenarios are - I think any prudent advisor has to do that now.

Julian: Much better to be modelling those scenarios upfront than frantically calling Andrew Rider when it's all come a cropper years later.

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Andrew: Absolutely.

Julian: Well, Andrew, thank you so much for doing your duty on Risk on Air today and navigating us through the transfer duty on options.

Andrew: Thank you, Julian.

Julian: Thanks for listening to Risk on Air by Lawcover and to stay up to date, join us for the next episode on current risks in legal practice.

Resources:

[Commissioner's practice note CPN 037](#)