

FINI VILLAGES

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FINI VILLAGES

27 February, 2006

AS 28/2/06

The Manager
Taxation of Financial Arrangements
The Treasury
Langton Crescent
PARKES ACT 2600

By Facsimile: 02 6263 4466

Dear Sir

Submission re Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2006

We refer to the exposure draft legislation released in relation to the Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2006 (the "Draft Bill").

We write to express our concern that the proposed legislation may have an unintended negative consequence on the income tax treatment of retirement village operations. Of particular concern is that the proposed legislation may be sought to apply to the payment of "deferred management fees" to retirement village operators, as well as to the pre-sale of retirement village units during village development.

We note that this issue is of great concern not only to us, but to many retirement village industry members who we have spoken to.

1. The Issue

"Deferred management fees", sometimes structured as "deferred facilities fees", are fees that are payable by a retirement village resident to a retirement village operator at the time the resident leaves the retirement village. The deferred fee structures that exist in most retirement villages enable retirement village operators to offer competitively priced accommodation to seniors that might not otherwise be able to afford such a standard of accommodation.

These fees are usually calculated either on a per annum basis, as a percentage of the resident's entry price or resale price (eg. 2.5% p.a.), or as a percentage of the increase in the value of the resident's accommodation (eg. 50% of the difference between the resale price and the entry price). We note that these fees are therefore generally subject to significant uncertainty in respect of both the amount of the fees and timing of payment of the fees.

ASSOCIATED VILLAGES
HARBORSIDE VILLAGE
THE PINES
LAKESIDE VILLAS
TIMBERSIDE VILLAS
PARKLAND VILLAS
PARKLAND VILLAS
PARKLAND VILLAS

- MINDARIE
- ELLENBROOK
- BIBRA LAKE
- WOODVALE
- BOORAGOOH
- MANDURAH
- WOODLANDS

7 HONIARA WAY, MINDARIE, 6030
21 PONTE VECCHIO BOULEVARD, ELLENBROOK, 6069
14 LEWINGTON GARDENS, BIBRA LAKE, 6163
10 TIMBERCREST RISE, WOODVALE, 6026
510 MARMION STREET, BOORAGOOH, 6184
2 HUNGERFORD AVENUE, MANDURAH, 6210
82 LIEBE STREET, WOODLANDS, 6018

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We are concerned that the Draft Bill if enacted, as is, would result in some or all deferred management fees being considered "derived" or "earned" (despite uncertainties in respect of their amount and timing) for income tax purposes on an accruals basis, and therefore tax would be payable often many years earlier than the fees can actually be collected.

For example, at Fini Villages' "Parkland Villas Booragoon", opened in 1986 with 100 villas developed into the early 1990's, over 30 of the villas are still occupied by their original residents. A 20+ year delay between when retirement village financial arrangements are entered into, and when fees are actually collected, is therefore not unusual.

In addition, we are concerned that the Draft Bill would capture the pre-sale of units during the initial development of retirement villages. Pre-sales are often entered into significantly before construction is complete and settlement occurs. This Draft Bill would conflict with *Gasparin's case* which found that income of the sale of property is properly derived when settlement occurs.

2. Existing Taxation Treatment

Significant time and effort have been expended in the past by both the Australian Taxation Office and the retirement village industry in establishing the basis upon which retirement village operators currently determine their income tax position. This result of these efforts was the issue of TR 2002/14, which comprehensively sets out the way in which retirement village operator transactions are to be treated for income tax purposes.

The treatment of deferred management fees is specifically dealt with in paragraphs 39-41 of this taxation ruling. As we would suggest is appropriate, the ruling provides that, in general, deferred management fees are derived when a retirement village operator becomes entitled to demand payment of the fee.

3. Draft Bill Policy Objectives

The stated objective of the Draft Bill (per Section 230-10(a)) is to "minimise the extent to which the tax treatment of...your financial arrangements distorts...your trading, financial and investment decisions...".

The deferred management fee structures that exist in most retirement villages have not been established on the basis of taxation considerations. As noted above, they exist so as to enable retirement village operators to offer competitively priced accommodation to seniors. Accordingly, the deferral of the fees is done to accommodate seniors requirements, rather than any preference of retirement village operators to defer fees in order to defer taxation liabilities.

In fact, rather than improving the situation we would suggest that the Draft Bill would distort retirement village operators' decisions by making it uneconomic to incorporate deferred management fees into their villages' financial arrangements.

The Draft Bill may also distort decisions in respect of pre-sales. Pre-sales are used to manage development risk, and the taxation of estimated development income prior to settlements may diminish the value of this risk management tool to retirement village operators.

4. Potential Impact on the Retirement Villages Industry

Most retirement village operators rely upon deferred management fees to:

- make their retirement villages economically viable; and
- justify the ongoing management time and effort required to operate their retirement villages.

They also use pre-sales to manage their development risks, which therefore assist in decisions to proceed with new retirement village developments.

Should the concerns expressed in this letter not be resolved, the basis upon which much of the retirement village industry currently operates would likely no longer be viable.

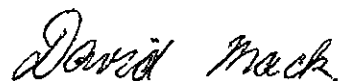
Therefore, on the basis that:

1. There is already an established and detailed basis for the taxation of retirement village operators in the form of TR 2002/14;
2. The objectives of the proposed legislation do not appear to be consistent with the potential impact of the Draft Bill on retirement village operators; and
3. Given the potential impacts of the Draft Bill on the retirement village industry, there are good policy reasons for excluding retirement villages from the purview of the proposed Division 230,

we request that the Draft Bill be amended to address our concerns. The Draft Bill might be amended to specifically exclude retirement village development and operation transactions from the definition of "financial arrangements".

We look forward to your receiving your response to this submission. Should you have any questions in relation to this submission, please do not hesitate to contact Tim Mack (08 9385 3210).

Yours sincerely



David Mack
Director
Fini Villages Pty Ltd