Contingent Consideration

This Commissioner's practice describes how the Commissioner will assess transactions which include future payments that depend on whether certain events occur (*contingent consideration*).

Background

Dutiable value

The duty payable on a transaction is calculated using the dutiable value of the transaction. The dutiable value is usually the greater of either the consideration for the transaction or the unencumbered value of the relevant property.

Contingent consideration

Contingent consideration is not payable at the time of the transaction but may become payable at a future time depending on events that occur after the transaction.

If a maximum amount is payable, this will be taken as the ascertainable consideration for the purposes of determining the dutiable value of the transaction. If no maximum amount is payable, the consideration will not be ascertainable.

The following are examples of ascertainable contingent consideration.

- A developer buys a parcel of land and agrees to pay an additional $150,000 if the land is rezoned as residential within 18 months after the settlement date.
- A property manager buys another property management business and agrees to pay an extra $100,000 if at least 90 per cent of clients are retained for at least 12 months after the sale.
- The purchase price for a business sale agreement includes one per cent of revenue in the two years after settlement, to a maximum of $20,000.
- A mining tenement sale agreement includes a payment of $500,000 if certain geological targets are met on the tenements.
- A mining tenement sale agreement includes a net smelter royalty of one per cent, capped at $1 million, if the tenement reaches production.

The following are examples of transactions that include contingent consideration that is not ascertainable.

- A land sale agreement provides that if the land is sold again within three years the purchaser must pay 20 per cent of the price increase to the vendor.
- The consideration for a business sale agreement includes one per cent of total revenue received by the business within 12 months after settlement.
- The sale of a mining tenement includes a royalty of $2 per tonne of iron ore extracted from the tenement.

Reassessment if contingent consideration is not paid

If an agreement to transfer dutiable property includes contingent consideration, a taxpayer can apply for a reassessment within five years after the agreement is made if:

- the contingent consideration (or part of the contingent consideration) has not been paid
- the event that would have triggered the contingent payment did not happen, or did not happen within the time specified for the happening of the event in an instrument effecting or evidencing the agreement and
- the event cannot happen in the future, or the time specified for the happening of the event in an instrument effecting or evidencing the agreement has passed or expired.[1]

The agreement will be reassessed in accordance with the consideration not including the contingent consideration that was not paid.

Commissioner's Practice

Dutiable and non-dutiable property

1. When assessing a transaction which includes contingent consideration, the Commissioner will first determine whether all the property in the transaction is dutiable property.

2. If the transaction includes non-dutiable property, the transaction can't be assessed on the consideration unless there is an allocation of consideration between dutiable and non-dutiable property.

3. If there is a clear link between a component of the consideration and a particular item of dutiable property, the Commissioner will assess based on that consideration being allocated to that property, even if it is not explicit in the agreement. This will generally be when the contingent event relates to the performance of a particular item of property.

Example 1

The consideration for a business sale agreement is $500,000 in cash plus an extra $50,000 if one major client is retained for at least 12 months after settlement.

The agreement assigns $70,000 of the consideration to stock in trade, which is not dutiable property, and $430,000 to the business name, intellectual property, ongoing contracts and client lists and goodwill, all of which are Western Australian business assets. The $50,000 contingent payment is not allocated to a specific item of property in the agreement.

Even though the agreement does not specify that the $50,000 contingent payment relates to a specific item of property, the Commissioner will consider it relates to the business assets, as the payment will depend on the performance of those assets, and is not related to the stock in trade.

The consideration relating to dutiable property will be $430,000 plus $50,000. The Commissioner would assess on a dutiable value of $480,000 unless the unencumbered value of the business assets is more than $480,000.

[1] This may be because the agreement required the event to occur within a specific time period.

Assessing transactions

4. The Commissioner will generally assess the transaction on the total consideration if:

   4.1 the consideration for a transaction includes a contingent payment and

   4.2 all of the relevant property is dutiable and

   4.3 all of the consideration is ascertainable.

5. If all conditions in paragraph 4 are met, the Commissioner may require a valuation of the relevant property where the parties to the transaction are related or are not acting on an arm's length basis, or in any other circumstances where the Commissioner is satisfied it may not be appropriate to assess on the consideration.

Assessing where the contingent consideration is not ascertainable

6. The Commissioner will determine whether the unencumbered value of the dutiable property is greater than the ascertainable consideration before issuing an assessment if the consideration for a transaction includes a contingent payment that is not ascertainable.

7. The Commissioner will assess on the value of the dutiable property if it is greater than the ascertainable consideration. If not, the Commissioner will assess on the value or amount of the ascertainable consideration.

> *Example 2*
>
> A mining company agrees to buy two early stage exploration licences. The consideration for the agreement is:
>
> - $50,000 in cash
> - $500,000 in cash if an economic mineral deposit is identified in the tenements and
> - one per cent of all revenue from mineral production on the tenement if a mine is developed.
>
> The first two components of the consideration are ascertainable, while the third component is not. The ascertainable portion of the consideration is $550,000.
>
> Provided the Commissioner is satisfied the value of the exploration licences is no more than $550,000, the transaction will be assessed on $550,000.

8. The Commissioner may accept a valuation of the unascertainable consideration to determine the unencumbered value of dutiable property if satisfied the parties to the transaction are genuinely acting at arm's length.

> *Example 3*
>
> The consideration for a business sale agreement is $500,000 in cash plus one per cent of revenue earned from existing clients of the business in the 12 months after settlement. All the property in the agreement is dutiable property.
>
> The purchaser lodges the transaction for assessment, with a submission from a financial analyst that based on previous performance of the business, the further amount payable is likely to be around $50,000. This suggests the unencumbered value of the business assets is $550,000.
>
> If the Commissioner accepts the submission, the transaction will be assessed on a dutiable value of $550,000.

9. The Commissioner will require a valuation if the consideration does not provide a useful guide to the value of the property, or if the parties to the transaction are not acting at arm's length.

Multiple components of consideration relating to a single variable

10. The consideration for a transaction may contain components calculated based on a variable arising from events after the transaction. Examples include a contingent payment calculated based on an increase in value, and an amount of sales or production of minerals from a mining tenement. These components are contingent consideration.

11. The Commissioner will consider whether multiple components of consideration relating to the same variable are genuinely separate items of consideration or are effectively a change in how a single component is calculated.

12. Multiple components will be treated as a single component when they relate to the same variable with a different calculation based on the range of that variable.

> *Example 4*
>
> The consideration for a business sale agreement consists of:
>
> - $100,000 in cash
> - two per cent of revenue received in the 12 months after the transaction up to revenue of $1 million and
> - one per cent of revenue received in the 12 months after the transaction for revenue above $1 million
>
> If each component is viewed in isolation, then the second component is capped at $20,000 and the third component is not ascertainable. When viewed together, the second and third components relate to the same variable (revenue in the 12 months after the transaction) and change the rate at which the consideration is calculated. The Commissioner will treat these as a single component of consideration that is not ascertainable.
>
> The Commissioner will determine the ascertainable component of the consideration to be $100,000, then decide whether to assess on the consideration for the transaction or determine the unencumbered value of the dutiable property.

Reassessments

13. The Commissioner will generally reassess an agreement to transfer dutiable property based on the amount of consideration actually paid, even if the unencumbered value of the dutiable property was higher than the consideration excluding the contingent consideration that was not paid, if:

    13.1 the agreement includes contingent consideration

    13.2 that contingent consideration was not paid, and cannot become payable in the future and

    13.3 the taxpayer applies for a reassessment of duty.

Example 5

The consideration for a business sale agreement is $500,000 in cash plus $100,000 if certain business targets are met in the 12 months following settlement. The agreement is lodged with RevenueWA and assessed on a dutiable value of $600,000.

After the 12 months have passed the taxpayer applies for a reassessment as the targets were not met and the extra $100,000 was not paid. While the value of the dutiable property is likely to have been above $500,000 at the time of the agreement, the agreement will be reassessed on a dutiable value of $500,000, being the amount of consideration actually paid.

14. The Commissioner will reassess an agreement on the unencumbered value of the dutiable property if the Commissioner believes the consideration for the agreement, including the contingent portion, was not negotiated at arm's length, and the unencumbered value of the dutiable property under the agreement is higher than the consideration excluding the contingent consideration.

Example 6

A prospector owns 100 per cent of a company, and agrees to sell an exploration licence to that company for the following consideration:

- immediate payment of $100 and
- further payment of $500,000 if the tenement commences production within three months following the agreement.

Due to the relationship between the parties the Commissioner obtains a valuation of the tenement, which is $150,000. The agreement is assessed on a dutiable value of $500,100.

Three months later the prospector applies for a reassessment as the contingent consideration was not paid. The Commissioner reassesses the transaction on a dutiable value of $150,000, being the value of the tenement at the time of the agreement, rather than $100 which is the consideration actually paid.

Date of Effect

This Commissioner's practice takes effect from 19 September 2022.

Chris McMahon
COMMISSIONER OF STATE REVENUE
19 September 2022

Document History

Commissioner's Practice	Issued	Dates of effect	
		From	To
DA 53.0	19 September 2022	19 September 2022	Current