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Shangri-La Hotel, Sydney
(Image courtesy of Shangri-La Hotels and Resorts)

The ANA Harbour Grand Hotel – Not just a tax case

The recent Australian Federal Court decision in *Lilyvale Hotel Pty Ltd v Commissioner of Taxation* [2008] FCA 103 not only raises some interesting issues for those in the hotel industry on tax losses, but also on "agency" relationships.

From a tax perspective, the decision has significant ramifications for potential sellers and buyers of hotels across Australia, and should be considered in any share sale transaction involving the removal or replacement of a third party operator. However, the decision also contains some thought-provoking comments on the "agency" relationship that usually exists between a hotel owner and operator under a hotel management agreement. The Agency principle is applied across most common law jurisdictions, and, therefore, this Australian decision is likely to be relevant in many other countries.

The case relates to the sale of the hotel known at the time as the ANA Harbour Grand Hotel (now the Shangri-La Hotel, Sydney), and focused on the "same business test". This test is used in the Australian tax legislation to determine the availability of carry forward tax losses which can be offset against a company's current/future year taxable income in share sale transactions, and in this instance, in circumstances where the third party operator, ANA, was terminated as part of the sale process. Justice Stone ruled that the change in the operational structure of a hotel – that is, an entity's transition from the role of owner (with a third party operator engaged to operate the hotel) to the role of owner-operator – did not satisfy the "same business test". The result was that Lilyvale was unable to carry forward its tax losses and offset them against post-sale income.

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The decision highlights the strict interpretation of the same business test used in the tax legislation and enforced by the Australian Taxation Office. The same business test requires that, in order for a company to claim prior year tax losses as an income tax deduction, the company must have carried on the same business before the "test time" as it did during the income year in which the losses are claimed as a deduction. The "test time" is the time when the continuity of ownership failed (i.e. broadly, the time when a change of ownership occurred in the company). Critically, Justice Stone's judgment requires that in order to claim the deductions, the company must carry on its business "in the same way" to show that it is in the "same business". This interpretation accords with the views of the Australian Taxation Office in its Taxation Ruling 1999/9, where the Commissioner of Taxation describes the operation of the same business test.

Lilyvale's role as hotel owner was seen as "so distant from the day-to-day activities of the hotel" – in stark contrast to the "comprehensive control of the operation and management of the hotel" exercised by the operator – that the court found no continuity between the business carried on by Lilyvale as owner and Lilyvale as owner-operator. Rather, the owner had stepped into the operator's shoes post-completion and started carrying on a business of a different nature.

The terms of the management agreement summarized in the judgment are generally in line with the provisions of the vast majority of management agreements used in the marketplace, so other agreements could be similarly interpreted.

Significantly, the agency relationship that underpins many hotel management agreements came under scrutiny by Justice Stone and her findings on this point helped form her decision. After examining the terms of the management agreement that had been in place prior to the share sale and the roles of the two parties in the running of the hotel Justice Stone dismissed the proposition that the operator had been acting as the owner's agent for the purposes of continuity of business (even though the management agreement specifically stated that this was the nature of the relationship). Her Honor did not go so far as to deny that the owner-operator relationship was one of agency for legal purposes, but she held that any agency was insufficient to attribute the activities of the operator to be those of Lilyvale in carrying on its business.

Her Honor did not specify what was, in her view, the real characterization of the relationship between owner and operator. She made it clear that an attempt to describe the relationship as one of agency would not in itself bind a Court: the Court would look to the "true character of their relationship".

The case does show an important limit to one of the industry's norms: the consequence of hotel operators in general acting as agents of hotel owners. There is also an important warning that agency cannot be created by labels – the relationship will be characterized by its true character. The assumed "agency" structure underpins key working assumptions in the industry, such as that as agent, the hotel operator is not personally liable for the debts of the business (as opposed to the hotel owner who is liable) so long as this agency relationship is made known to the outside world.

The judgment provides good reason for those hotel owners and hotel operators who regard themselves as principal and agent for all relevant legal purposes to carefully consider whether they have achieved that result and, if they have, whether the existence of agency carries with it all the consequences which were expected and intended.

We understand that Lilyvale has appealed the decision.

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HRT Newsletter Supplement – Asia Pacific Timeshare Analysis

We are pleased to share our research paper summarising the regulation of time-sharing schemes across the Asia Pacific region (see overleaf). This has been compiled by our network of Hotels, Resorts & Tourism specialists across the featured jurisdictions, and with help from Quigg Partners (www.quiggpartners.com) in relation to New Zealand, and Kim, Choi & Lim (www.kcllaw.com) in relation to South Korea. We hope you find this useful.

Please contact either Robert Williams, Partner on +61 2 8922 5676 or robert.williams@bakernet.com or David Jacobs, Partner on +61 2 8922 5336 or david.jacobs@bakernet.com if you have any queries, or would like any further information on any particular jurisdiction. Also, email addresses for contributors for each jurisdiction are included in the body of the paper should you wish to contact them directly.

Asia Pacific Timeshare Analysis

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The information in this document is a high level comparative guide to the regulation of timesharing schemes within the jurisdictions featured and is correct at 7 August 2008.

It is not a comprehensive statement of the applicable law in any jurisdiction, and should not be relied upon as being definitive. In most jurisdictions, general consumer protection law will apply to timesharing schemes. Readers are strongly encouraged to seek specific advice in any relevant legal jurisdiction as applicable laws and regimes, and the availability of exemptions, will vary depending on the structure and features of the relevant timesharing scheme.

In addition, this document does not address any cross border or extra-territorial laws that may apply. For example, the promotion of interests in an Indonesian scheme to Australian consumers may be required to comply with Australian laws applying to timesharing schemes.

Jurisdiction & Contact	Are timeshare sales in this jurisdiction regulated as a security or financial instrument?	If not regulated as a security, are timeshare sales in this jurisdiction regulated in any other way?	In this jurisdiction is there any mandatory cooling-off/ rescission period during which timeshare consumers can abort or cancel their purchase of timeshare interests?
<p>Australia</p> <p>robert.williams@bakernet.com</p>	<p>Yes: timesharing schemes are heavily regulated in Australia as sales of securities/financial products. Operators of timeshare schemes have to produce a product disclosure statement (similar to a prospectus), and a trustee of a timeshare scheme must hold an Australian Financial Services Licence.</p>	<p>Not applicable.</p>	<p>Yes: if the operator is a member of the recognised Australian industry body ATHOC, a cooling off period of 7 days applies. Otherwise a cooling off period of not less than 14 days applies.</p>
<p>China</p> <p>rico.chan@bakernet.com</p> <p>ricky.viu@bakernet.com</p>	<p>No.</p>	<p>Yes: there is no specific legal regime governing timesharing schemes. However, codes of conduct have been adopted by some companies engaged in the timeshare business, although such codes are voluntary in nature and are not legally binding or enforceable by or against the signing parties.</p>	<p>No: the concept of a cooling off or rescission period is not present in the legal regime in China.</p>
<p>Hong Kong</p> <p>rico.chan@bakernet.com</p> <p>ricky.viu@bakernet.com</p>	<p>Yes: whilst there are currently no timesharing products relating to properties in Hong Kong, timesharing schemes can fall within the definition of collective investment schemes under the Securities and Futures Ordinance in HK. This carries elaborate compliance and disclosure requirements.</p>	<p>No.</p>	<p>No: the concept of a cooling off or rescission period is not usual under Hong Kong laws.</p>
<p>Indonesia</p> <p>duane.i.gingerich@bakernet.com</p> <p>susanti.suhendro@bakernet.com</p>	<p>No.</p>	<p>No.</p>	<p>No.</p>
<p>Japan</p> <p>Fumio.Koma@bakernet.com</p> <p>Kei.Matsumoto@bakernet.com</p>	<p>No.</p>	<p>No.</p>	<p>No: in general, there is no mandatory cooling off or rescission period specifically for timeshare sales. Cooling off periods under the Real Estate Business Act (8 days) or Consumer Contract Act (6 months) may be applicable though we do not think they will apply to timeshare sales in the ordinary course.</p>

Jurisdiction & Contact	Are timeshare sales in this jurisdiction regulated as a security or financial instrument?	If not regulated as a security, are timeshare sales in this jurisdiction regulated in any other way?	In this jurisdiction is there any mandatory cooling-off/ rescission period during which timeshare consumers can abort or cancel their purchase of timeshare interests?
<p>Malaysia</p> <p>Abdul.Aziz.Munir@bakernet.com Hsian.siong.yong@bakernet.com</p>	<p>No: timesharing schemes are not currently a 'security' under the <i>Capital Markets and Services Act, 2007</i> (CMSA), although a disclosure and approval regime does apply to timesharing schemes under the Malaysian Companies Act, 1965 (MCA), with the result that timeshare is subject to a regime similar to that applying to share issues.</p>	<p>Yes: sales of interests in timesharing schemes are regulated by the MCA. Issuers have to produce a prospectus, and the scheme must be governed by a trust deed approved by the Companies Commission of Malaysia (CCM).</p>	<p>Yes: under the policy guidelines issued by the CCM, a cooling off period of at least 10 days after the date on which the purchaser lodges an application with the developer/operator or its agent must be provided.</p>
<p>New Zealand*</p> <p>JohnHorner@quiggpartners.com MattYates@quiggpartners.com</p>	<p>Yes: points based and other timeshare schemes that do not involve direct property ownership are regulated in NZ as participatory securities under the Securities Act - a prospectus and investment statement will be required. Relief from the Securities Act requirements may be available where sales are made under an Australian product disclosure statement.</p> <p>However, title based or deeded schemes can benefit from the Securities Act (Real Property Proportionate Ownership Schemes) Exemption Amendment Notice 2007 which applies a less rigorous regime where investors obtain property title interests (although a Disclosure Statement is still required to be given to potential investors).</p>	<p>Not applicable.</p>	<p>No: but operators that are members of the NZ Holiday Ownership Council (NZHOC) have voluntarily committed, under NZHOC's Code of Conduct, to offer a cooling off period of 5 working days.</p>
<p>Philippines</p> <p>elizabeth.opena@bakernet.com luisa.fernandez@bakernet.com</p>	<p>Yes: interests in timesharing schemes are regarded as securities under the Securities Regulation Code of the Philippines and cannot be sold or offered for sale or distribution within the Philippines without a registration statement being duly filed with the Philippine Securities and Exchange Commission (unless an exemption is available). A prospectus is submitted as part of the registration statement.</p>	<p>Not applicable.</p>	<p>No.</p>
<p>Singapore</p> <p>andrew.martin@bakernet.com stephanie.magnus@bakernet.com</p>	<p>No: timesharing schemes are unlikely to be regulated as a security or financial instrument in Singapore on the basis that the timesharing scheme is constituted primarily for consumption and not for the generation of profit or income, and does not constitute an issue of shares in a corporation.</p>	<p>Yes: timesharing schemes are regulated by the Consumer Protection (Fair Trading) Act. (Cap. 52A) (the CPFTA). The CPFTA regulates unfair practices in relation to consumer transactions, including sales of interests in most timeshare schemes.</p>	<p>Yes: under the Consumer Protection (Fair Trading) (Cancellation of Contracts) Regulations 2003 (the Regs) a cooling off period of 3 days applies, not including weekends or Public Holidays. Based on comments made by the Minister of State (Trade and Industry) in Parliament in March 2008, the Regs will be amended to increase this period to 5 days. At this time, no specific date for the implementation of this increase has been confirmed.</p>

Jurisdiction & Contact	Are timeshare sales in this jurisdiction regulated as a security or financial instrument?	If not regulated as a security, are timeshare sales in this jurisdiction regulated in any other way?	In this jurisdiction is there any mandatory cooling-off/ rescission period during which timeshare consumers can abort or cancel their purchase of timeshare interests?
<p>South Korea*</p> <p>swkang@kcllaw.com</p>	<p>No: interests in timeshare schemes are not securities under the Securities and Exchange Act. However, the Capital Market Consolidation Act will enter into force on 4 February 2009 and will expand the concept of commercial investment goods, possibly to include timeshare schemes.</p>	<p>Yes: the fair trade provisions of the Regulation of Standardized Contracts Act apply to timeshare purchases.</p>	<p>Yes: if the sales are concluded according to Door to Door Sales, etc. Act, the Instalment Transactions Act or the Consumer Protection Act on Electronic Commerce, a cooling off period of 14, 7 and 7 days respectively will apply.</p>
<p>Taiwan</p> <p>david.liou@bakernet.com</p> <p>sonya.hsu@bakernet.com</p>	<p>No.</p>	<p>Yes: the sale of timeshare in Taiwan is regulated under the Fair Trade Law and the Consumer Protection Law. See also the Regulations on Overseas Timeshare Sales, published by the Taiwan Fair Trade Commission.</p>	<p>Yes: if a consumer purchases a timeshare interest through mail order or a door-to-door sale, the consumer may rescind the purchase contract within 7 days of receipt of the timeshare interests.</p>
<p>Thailand</p> <p>asawin.sangchay@bakernet.com</p>	<p>No.</p>	<p>Yes: timeshare schemes in Thailand are deemed to be direct sales under the Direct Sales and Marketing Act 2002 (the Act). To engage in a direct sales business a person must be registered under the Act, and hold the applicable licence. Also, sales agents must provide documents in Thai which are legible and clearly include the names of the parties, the dates of agreement, details on the delivery of goods or service, and the customer's right to rescind the agreement.</p>	<p>Yes: the Act entitles a consumer to rescind the agreement within 7 days from the date on which the customer can actually start to use the timeshare accommodation (rather than the date of purchase or signing of the agreement).</p>
<p>Vietnam</p> <p>fred.burke@bakernet.com</p> <p>linhchi.nguyen@bakernet.com</p>	<p>No: timeshare is not regulated under Vietnamese law.</p>	<p>Not applicable.</p>	<p>Not applicable.</p>

* Information in relation to New Zealand was provided by Quigg Partners (www.quiggpartners.com), and in relation to South Korea was provided by Kim, Choi & Lim (www.kcllaw.com). These are 3rd party law firms with whom Baker & McKenzie works with from time to time. Baker & McKenzie is not otherwise affiliated with these firms, and does not have offices in these jurisdictions. We are happy to provide further information on these corresponding law firms upon request.

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