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General Manager  
Business Tax Division  
The Treasury

By e-mail: [SRWUIP@treasury.gov.au](mailto:SRWUIP@treasury.gov.au)

## **Submission – Tax Treatment of Water Infrastructure Improvement Payments.**

### **1.0 Background**

Thank you for the opportunity to make a submission in regards to the draft legislation and explanatory material for the tax treatment of water infrastructure improvement payments.

RSM Bird Cameron is one of the largest mid-tier accounting firms in Australia & has been providing accounting and taxation advice to agricultural businesses in regional Australia for over 90 years.

We acknowledge that eliminating the timing difference between when the income is taxed and when deductions are available will be a benefit to some taxpayers.

However, there are two groups of taxpayers who will be significantly disadvantaged by this proposed retrospective legislation. They are:

1. Individual irrigators who have sold water shares to the Commonwealth as part of a SRWUIP program.
2. Individual irrigators who have received a qualifying water infrastructure improvement payment, but are eligible for the *Small Business CGT Concessions*.

### **2.0 Irrigators who have sold water shares to the Commonwealth**

We refer to Section 1.27 of the Explanatory Memorandum (EM) which states that where an irrigator transfers to the Commonwealth water entitlements as part of a SRWUIP any capital gain/loss will be disregarded. Consequently, as per paragraph 1.29 of the EM deductions for expenditure will be denied.

C:\Users\jatu\Documents\Submission - Tax Treatment Water Infrastructure Improvement Payments.docx

The below examples demonstrate how individual irrigators who have sold water shares to the Commonwealth as part of a SRWUIP program will be significantly disadvantaged if this retrospective draft legislation is enacted.

### **2.1 Example 1**

In the 2011 financial year, as part of a SRWUIP program, taxpayer A agreed to sell 100ML of water shares to the Commonwealth at \$2,400 per M/L (\$240,000 in total)

Taxpayer A acquired these water shares in 2002 and the shares have a cost base of \$1,200 per M/L (\$120,000 in total)

The \$240,000 received as consideration for the water shares transferred is fully expended on water infrastructure improvements.

Taxpayer A prepares his 2011 tax return correctly applying the current legislation and therefore:

- Records a net capital gain on his tax return of \$60,000 (after 50% CGT discount is applied)
- Claims a \$80,000 tax deduction, being 1/3<sup>rd</sup> of the water infrastructure expenditure.

Under existing legislation Taxpayer A will claim a further \$80,000 deduction in each of the 2012 & 2013 years.

If the proposed draft retrospective legislation is enacted Taxpayer A will:

- Incur significant expenses in preparing amended tax returns which were correctly prepared based on the current legislation at the time
- No longer have to pay tax on a \$60,000 net capital gain, but will however lose access to \$240,000 of legitimately claimed tax deductions.
- Assuming an average tax rate of 30%, this will leave Taxpayer A with an additional \$54,000 tax to pay over the 2011, 2012 & 2013 financial years.

### **2.2 Example 2**

Assume the same facts in Example 1, however the water shares were acquired by Taxpayer A prior to the introduction of capital gains tax:

Taxpayer A prepares his 2011 tax return correctly applying the current legislation and therefore:

- Disregards any gain made on sale of water shares as shares are pre-CGT.
- Claims a \$80,000 tax deduction, being 1/3<sup>rd</sup> of the water infrastructure expenditure.

Under existing legislation Taxpayer A will claim a further \$80,000 deduction in each of the 2012 & 2013 years.

If the proposed draft retrospective legislation is enacted Taxpayer A will:

- Incur significant expenses in preparing amended tax returns which were correctly prepared based on the current legislation at the time
- Will lose access to \$240,000 of tax deductions over the 2011, 2012 & 2013 financial years.
- Assuming an average tax rate of 30%, this will leave Taxpayer A with an additional \$72,000 tax to pay over the 2011, 2012 & 2013 financial years.

### 2.3 Example 3

Assume the same facts in Example 1, however Taxpayer A is eligible to apply the Small Business CGT concessions to eliminate the capital gain made.

Taxpayer A prepares his 2011 tax return correctly applying the current legislation and therefore:

- Applies the Small Business Active Asset Reduction & Small Business Retirement Exemption to eliminate the capital gain made on the water sales.
- Claims a \$80,000 tax deduction, being 1/3<sup>rd</sup> of the water infrastructure expenditure.

Under existing legislation Taxpayer A will claim a further \$80,000 deduction in each of the 2012 & 2013 years.

If the proposed draft retrospective legislation is enacted Taxpayer A will:

- Incur significant expenses in preparing amended tax returns which were correctly prepared based on the current legislation at the time
- Will lose access to \$240,000 of tax deductions over the 2011, 2012 & 2013 financial years.
- Assuming an average tax rate of 30%, this will leave Taxpayer A with an additional \$72,000 tax to pay over the 2011, 2012 & 2013 financial years.

### 2.4 Proposed Solution:

It is vitally important to note that if Taxpayer A in the above examples did not participate in an SRWUIP program but rather:

- Sold his water shares on the open market, and
- Used the proceeds to upgrade his water infrastructure privately,

he would be considerably better off from a taxation perspective.

This is clearly a discouragement for a taxpayer to participate in an SRWUIP program and appears to go against the intention of the draft legislation.

We therefore suggest that a CGT exemption **not be implemented** for payments received as consideration for sale of water entitlements to the Commonwealth.

### 3.0 Irrigators eligible to apply the Small Business CGT concessions:

We refer to paragraph 1.8 of the EM which indicates that where the transfer of water entitlements is not involved a SRWUIP payment is taxed as either ordinary income or as a subsidy.

Firstly, we **do not agree** that SRWUIP payments received by **individual irrigators** are either ordinary income or a subsidy.

Rather, we believe the payments are a capital receipt, specifically the payments are received as *compensation for the disposal of the right to seek compensation* (CGT Event C2 – s.104-25 ITAA97)

The attached Appendix provides a more detailed explanation as to why we believe the SRWUIP payments are a capital receipt for individual irrigators. The Appendix also contains two extracts from the ATO's register of private rulings which seemingly indicate that the ATO concurs with our view.

Based on the SRWUIP payments being treated as capital receipts, the below example demonstrates how the draft retrospective legislation will result in severe tax consequences for small business taxpayers eligible to apply the small business CGT concessions.

#### 3.1 Example 4

Taxpayer B is a small business entity and is eligible to apply each of the small business CGT concessions.

In April 2010 Taxpayer B received a \$480,000 payment under a SRWUIP program to upgrade his water infrastructure. None of the payment related to the transfer of water entitlements to the Commonwealth.

Taxpayer B expended the \$480,000 grant on eligible water infrastructure expenditure between April & June 2010.

Taxpayer B correctly applied the current legislation in the preparation of his 2010, 2011 & 2012 income tax returns and accordingly:

- Recorded a \$480,000 gross capital gain on his 2010 tax return.
- Applied the *small business active asset reduction* to reduce the capital gain to \$240,000.
- Applied the *Small Business Retirement Exemption* to reduce the remaining capital gain to \$0.  
(NB. The attached appendix includes explanations as to why the CGT concessions can be applied to reduce the capital gain.)
- Claimed a \$160,000 deduction for water expenditure on each of his 2010, 2011 & 2012 tax returns

If the proposed draft retrospective legislation is enacted Taxpayer B will:

- Incur significant expenses in preparing amended tax returns which were correctly prepared based on the current legislation at the time
- Will lose access to \$480,000 of legitimately claimed tax deductions over a three year period.
- **Assuming an average tax rate of 30%, this will leave Taxpayer B with a tax liability from the required income tax return amendments of \$144,000.**

### 3.2 Proposed Solutions

We acknowledge that in the above example 4, if taxpayer B was not eligible for the small business CGT concessions, this draft legislation would likely be of significant benefit to him.

However, to prevent small business taxpayers being hit with severe tax liabilities as a result of a retrospective change to legislation we propose the following solutions:

- Provide the taxpayer with a choice as to whether to apply the CGT exemption to a SRWUIP payment and consequently lose access to the deductions.

At a minimum, this choice should be available for the 2010, 2011 & 2012 financial years to prevent taxpayers being punished for correctly applying the law as it stood at the time; or

- Exempting taxpayers eligible to apply the small business CGT concessions from the final legislation.

### 4.0 Conclusion

Thank you for taking the time to consider this submission and the tax consequences of the draft legislation for individual irrigators, particularly those who are small business entities.

Should you have any queries in relation to the above please contact the writer on 03 5330 5800 or [jarrad.turnbull@rsmi.com.au](mailto:jarrad.turnbull@rsmi.com.au).

Yours faithfully



Jarrad Turnbull  
Chartered Accountant  
RSM Bird Cameron

## Appendix 1 - Tax Treatment – SRWUIP

Current tax treatment of payments is as follows:

1. Where part of payment relates to compensation for permanent damage to, or permanent reduction of the value of an asset, the tax treatment is as follows.

- If it relates to a pre-CGT block of land, then no CGT consequences
- For a post-CGT block of land, the acquisition costs (cost base) of the land should be reduced by the amount of compensation. No capital gain arises until the land is actually sold.

An example of permanent reduction in value would be if part of the payment was received for a block of land that was disconnected from the water supply and its value was reduced due to lack of water access.

### **Generally no amount of SRWUIP payments relate to permanent damage to an asset**

2. The remainder of the compensation is treated as an 'Undissected Lump Sum Compensation Amount' received as consideration for the disposal of the right to seek compensation. The tax treatment of this amount is as follows:

- The right to seek compensation is deemed to be acquired at the time the compensable wrong occurs - ie. when access to irrigation channels, water wheels etc is removed. Therefore right is acquired at the time the SRWUIP contract is signed.
- As the date of acquisition of the right for CGT purposes is at date of contract signing, it is irrelevant whether the land for which the SRWUIP payment relates to is pre or post CGT - the capital gain is made on the surrender of the right, not on the land.
- CGT Event C2 (cancellation or surrender of a right) is also triggered on the date the contract is entered into.
- The cost base of the right is calculated in reference to any expenditure or outgoing that has a direct and substantial link between the expenditure and receiving the compensation, eg legal fees. In the majority of cases, the cost base of the right will be \$0.
- Capital proceeds are equal to the amount of compensation received.
- 50% CGT Discount is not available as right to compensation has not been held for 12 months.
- Small Business CGT concessions should be available (subject to normal eligibility criteria.) SBE CGT Concessions are available for the disposal of an intangible asset (ie. the right to seek compensation) where the intangible asset is inherently connected with your business. It would be considered that the right to access water would be inherently connected with a farming business.

### **SUMMARY**

CGT Event C2 applies

#### **IRRELEVANT WHETHER LAND IS PRE OR POST CGT**

Full amount of payment treated as disposal of right to seek compensation

Acquisition date is equal to date of compensable wrong - ie. When contract signed

Disposal of right to seek compensation date also equal to contract signature date

Therefore No CGT discount available

SBE concessions can be applied to reduce gain

**See Attached ATO Private Rulings on topic (#92353 & #92654)**



Australian Government  
Australian Taxation Office

## Capital gains tax - compensation

Edited version of private ruling

Authorisation Number: 92353

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### Ruling

#### Questions and Answers:

Is a payment made by the relevant Irrigation Renewal Project (IRP) to a landowner to assist with farm works and loss of benefits assessable as ordinary income under section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997)?

No.

Is a payment made by the relevant IRP to a landowner to assist with on farm works and loss of benefits assessable as a capital gain under part 3-1 of the ITAA 1997?

Yes.

#### This ruling applies for the following period(s):

Year ended 30 June 200

#### Relevant facts and circumstances

As part of the corporation's 'future management strategy and current farming trends it was realised that the corporation had an abundance of infrastructure that was not necessarily required to provide irrigation water to its customers.

The surplus of underutilised assets added considerably to customer water tariffs and the reconfiguration project together with government funding was seen as an opportunity to rationalise up to a targeted X% of assets.

Under the *Water Act 1989* the corporation is required to provide the service of delivering water to the owner or occupier of each serviced property in its irrigation district.

The taxpayer's (the owners) property is a serviced property within the corporation's Irrigation district.

The relevant rural water corporation (the corporation) and the owners have agreed to transfer ownership of sections of the channel and associated assets and propose to enter into a contract to implement the agreement.

The owners will receive an amount for:

1. a loss of benefit, and
2. an undissected amount in full satisfaction of all claims of the owners in connection with the matters contemplated by the agreement and to assist with on farm works.

The term 'on farm works' simply equates to the works required for an alternate water supply to the property, for example if a land owner has two meter outlets 100 metres apart and agrees to rationalise one outlet, the corporation would compensate and then remove the outlet. The private channel which was originally serviced by the rationalised outlet would need to be reconnected to the remaining outlet. In this case 100 metres of private channel would need to be constructed to continue servicing the property that was attached to the rationalised outlet. This would be classified as 'on farm works.'

The term 'loss of benefit' is the term used to outline the fact that if an asset is removed or rationalised then the landowner has lost that benefit as to the original intent of the asset. In essence, the project was based on a like-for-like approach, i.e. landowners should not have been any worse off (or better off) than if the rationalisation had not occurred, however the irrigation system would be more efficient and affordable.

In this case the owner's property comprises a certain number of blocks. After the water rationalisation project one of the

blocks will not be connected to the water supply after the removal of a water wheel. Consequently the value of this block has decreased.

### Relevant legislative provisions

*Income Tax Assessment Act 1997* Section 6-5.

*Income Tax Assessment Act 1997* Section 15-10.

*Income Tax Assessment Act 1997* Section 152-1.

### Reasons for decision

*While these reasons are not part of the private ruling, we provide them to help you to understand how we reached our decision.*

You have received a lump sum payment as full and final compensation to assist with on-farm works and loss of benefit necessitated by the rationalisation of the channel system and meter outlets.

Under the *Water Act 1989* the corporation is required to provide the service of delivering water to the owner or occupier of each serviced property in its irrigation district.

The corporation undertook a reconfiguration project to reduce the underutilised components of the system, making the system more efficient and affordable from their point of view. The project was completed on the basis of a non compulsory approach.

'On farm works' simply equates to the works required for an alternate supply to the property. The 'loss of benefit' relates to the fact that an asset has been removed and the landowner has lost that benefit as to the original intent of the asset.

For a compensation payment to be assessable as income under section 6-5 of the ITAA 1997, the payment must be income according to ordinary concepts. The courts have identified a number of factors which indicate whether an amount has the character of income according to ordinary concepts.

A frequent characteristic of income receipts is an element of periodicity, recurrence or regularity, but is not essential for an amount to be income. The proceeds from an isolated transaction outside the ordinary course of business may also be income according to ordinary concepts if the purpose of the transaction is to make a profit or is in the course of the business.

Compensation payments are considered to be income according to ordinary concepts where the payment is compensation for the loss of income or where some portion of the lump sum payment is identifiable and quantifiable as income (Taxation Determination TD 93/58).

The payment is to compensate for a loss of services and the giving up of the right to make any further claim. The payment was not a trading receipt in the course of the business and does not have a direct connection to the income earning activity conducted on the property. The amount of the payment was ascertained by the corporation via a 'business case' calculator which addressed, water savings, GMW assets and project costs. The figure was based on the extent of the rationalisation undertaken on each property.

The payment is unrelated to the income earning activity. It does not possess the characteristics of income, nor can it be described as being a bounty or subsidy for the purposes of section 15-10 of the ITAA 1997. The element of compensation takes it out of the scope of a bounty or subsidy [*Berghofer v FC of T*, 2008 ATC 10-066]. To be assessable as bounties or subsidies under section 15-10 of the ITAA 1997 amounts would need to be '...payments made for the purpose of assisting persons to carry on a business at the time the payments are made, or perhaps, to commence a business in the future' [*Squatting Investment Co Ltd v Federal Commissioner of Taxation* (1953) 86 CLR 570; (1953) 10 ATD 126; (1953) 5 AITR 496].

The amount received is clearly capital in nature and falls within the negative limbs of section 6 of the ITAA 1997. Therefore it is not considered to be assessable income under ordinary concepts.

### Capital gains

You have provided details as to the proposed arrangements with the IRP.

You have provided details of your obligations under this proposed arrangement.

The relevant item of the agreement schedule refers to a description of the works to be completed by the owners;

On farm works will be left to the owner's discretion.

Of the payment received by you of an amount related to a block of land owned by you that was disconnected from the water supply during the rationalisation process. The value of this block was reduced owing to the lack of water access.



The balance of the payment received, is an undissected sum and it is considered best categorised as, the disposal of the right to seek compensation.

Taxation Ruling TR 95/35 explains how to treat the two amounts under the capital gains tax provisions is as follows:

**Compensation for permanent damage to, or permanent reduction in the value of, the underlying asset.**

Where compensation is received by a taxpayer in respect of permanent damage to a post capital gains tax (CGT) underlying asset of the taxpayer or for a permanent reduction in the value of a post CGT underlying asset of the taxpayer, and there is no disposal of that underlying asset at the time of the receipt, we consider that the amount represents a recoupment of all or part of the total acquisition costs of the asset.

Accordingly, the total acquisition costs of the post-CGT asset should be reduced by the amount of compensation. No capital gain or loss arises in respect of the asset until the taxpayer actually disposes of the underlying asset.

The payment would be treated in the above manner.

**Disposal of the right to seek compensation**

If the amount of compensation is not received in respect of any underlying asset, the amount relates to the disposal by the taxpayer of the right to seek compensation. Accordingly, any capital gain arising on the disposal of the right is calculated using the cost base of the right

The undissected amount would fall into this category because the property in this instance is not the relevant asset as it was neither permanently damaged nor was its value permanently reduced.

Any capital gain arising maybe eligible for the small business CGT concessions under Division 152 of the ITAA1997.

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# Assessability of a compensation payment

Edited version of private ruling

Authorisation Number: 92654

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## Ruling

### Issue 1

#### Question:

Are the compensation payments assessable as ordinary income under section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997)?

#### Answer:

No.

### Issue 2

#### Question:

Are the compensation payments assessable as a capital gain under Part 3-1 of the ITAA 1997?

#### Answer:

Yes.

#### This ruling applies for the following period(s):

Year ended 30 June 2008

#### The scheme commences on:

1 July 2007

#### Relevant facts and circumstances

Under the *Water Act 1989* the Corporation is required to provide the service of delivering water to the owner or occupier of each serviced property in its irrigation district.

The owner's property is a serviced property within the Corporation's Irrigation district. The property was purchased prior to 1985.

The corporation and the owners have agreed to transfer ownership of sections of the channel and associated assets and have entered into two contracts to implement the agreement.

The owners received two compensation amounts.

In the first contract the corporation agreed to (in part):

- pay the owners as compensation to assist with on-farm works and loss of benefit necessitated by the rationalisation of the channel system
- transfer ownership of the channel and all associated corporation assets associated with that portion of the property to the owners arrange for, and meet the cost of, replacing with an electronic meter outlet that complies with the required metering standard on the downstream end of the channel
- arrange for, and meet the costs of, decommissioning meter outlets and regulators on the channel
- facilitate and meet the cost of the purchase of the Crown Reserve over the channel associated with that portion of the property on behalf of the owners

give possession of the channel located within the property together with all associated corporation assets to the owners on the date of installation of the electronic meter outlet, and

- arrange for the corporation's asset register and billing information and customer care system to be uploaded accordingly.

The owners shall:

- accept ownership of the channel together with all corporation assets associated with that portion of the property
- accept the payment as full and final compensation to assist with farm works and loss of benefit necessitated by the rationalisation of the channel, meter outlets and all associated corporation assets
- agree with the corporation to replace the outlet with an electronic meter outlet
- agree for the corporation to decommission some meters and regulators on the channel, and agree to take ownership of the channel located within the property together with all associated corporation assets on the date of installation of the electronic meter outlet.

In the second contract the corporation agreed to (in part):

- pay the owners the amount as full and final compensation to assist with farm works and loss of benefit necessitated by the rationalism of the channel, meter outlet and all Corporation assets associated with that portion of the property
- arrange for and meet the cost of removing meter outlet on the channel
- arrange for and meet the costs of decommissioning the road culvert and regulator on the channel.

The owners shall:

- accept payment of the amount as full and final compensation to assist with farm works and loss of benefit necessitated by the rationalisation of the channel, meter outlet and all Corporation assets associated with that portion of the Property
- agree for the corporation to remove meter outlet on the channel agree for the Corporation to decommission the road culvert and regulator on the channel.

As part of the corporation's strategy and current farming trends it was realised that the corporation had an abundance of infrastructure that was not necessarily required to provide irrigation water to its customers. The surplus of underutilised assets added considerably to customer water tariffs and the Reconfiguration Project together with Government funding was seen as an opportunity to rationalise up to a targeted 20% of assets.

Compensation for the area was ascertained via a business case calculator which assessed, water savings, Corporation Assets and Project costs particular to the project. This figure was based on the extent of rationalisation undertaken and agreed to by the landowner. Government funding of \$2,000 per megalitre (water savings) was the main contributor for the project. All projects were based on a non-compulsory approach.

The term "On Farm Works" simply equates to the works required for an alternate water supply to the property, for example if a land owner has two meter outlets 100 metres apart and agrees to rationalise one outlet, the Corporation would compensate and then remove the outlet. The private channel which was originally serviced by the rationalised outlet would need to be reconnected to the remaining outlet. In this case 100 metres of private channel would need to be constructed to continue servicing the property that was attached to the rationalised outlet. This would be classified as "On Farm Works".

The term "Loss of Benefit" is the term used to outline the fact that if an asset is removed or rationalised then the landowner has lost that benefit as to the original intent of the asset. In essence, the project was based on a like-for-like approach, that is, landowners should not have been any worse off (or better off) than if the rationalisation had not occurred, however the irrigation system would be more efficient and affordable.

It is the intention of the corporation to make a non-compulsory offer to landowners. Detailed offer documents will be provided highlighting all implications of the strategy and they have 60 days to respond. If the offer is not accepted it will be shelved.

#### **Relevant legislative provisions**

*Income Tax Assessment Act 1997* Section 6-5.

*Income Tax Assessment Act 1997* Section 104-25.

*Income Tax Assessment Act 1997* Paragraph 108-5(1)(b).

#### **Reasons for decision**

While these reasons are not part of the private ruling, we provide them to help you to understand how we reached our decision.

#### Issue 1:

You have received a lump sum payment as full and final compensation to assist with on-farm works and loss of benefit necessitated by the rationalisation of the channel system and meter outlets.

Under the *Water Act 1989* the Corporation is required to provide the service of delivering water to the owner or occupier of each serviced property in its irrigation district.

The Corporation undertook a Reconfiguration project to reduce the underutilised components of the system, making the system more efficient and affordable from their point of view. The project was completed on the basis of a "Non Compulsory" approach.

"On farm works" simply equates to the works required for an alternate supply to the property. The "loss of benefit" relates to the fact that an asset has been removed and the landowner has lost that benefit as to the original intent of the asset.

For a compensation payment to be assessable as income under section 6-5 of the ITAA 1997, the payment must be income according to ordinary concepts. The courts have identified a number of factors which indicate whether an amount has the character of income according to ordinary concepts.

A frequent characteristic of income receipts is an element of periodicity, recurrence or regularity, but is not essential for an amount to be income. The proceeds from an isolated transaction outside the ordinary course of business may also be income according to ordinary concepts if the purpose of the transaction is to make a profit or is in the course of the business.

Compensation payments are considered to be income according to ordinary concepts where the payment is compensation for the loss of income or where some portion of the lump sum payment is identifiable and quantifiable as income (Taxation Determination TD 93/58).

The payment is to compensate for a loss of services and the giving up of the right to make any further claim. The payment was not a trading receipt in the course of the business and does not have a direct connection to the income earning activity conducted on the property. The amount of the payment was ascertained by the Corporation via a "Business Case" calculator which addressed, water savings, the assets and project costs. The figure was based on the extent of the rationalisation undertaken on each property.

The payment is unrelated to the income earning activity. It does not possess the characteristics of income, nor can it be described as being a bounty or subsidy for the purposes of section 15-10 of the ITAA 1997. The element of compensation takes it out of the scope of a bounty or subsidy (*Berghofer v. FC of T* 2008 ATC 10-066). To be assessable as bounties or subsidies under section 15-10 of the ITAA 1997 amounts would need to be '...payments made for the purpose of assisting persons to carry on a business at the time the payments are made, or perhaps, to commence a business in the future' (*Squatting Investment Co Ltd v Commissioner of Taxation* (1953) 60 ArgLR 366; 10 ATD 126; (1953) 26 ALJR 658; (1953) 5AITE 496; (1953) 86 CLR 570).

The amount received is clearly capital in nature and therefore it is not considered to be assessable as ordinary income under section 6-5 of the ITAA 1997.

#### Issue 2

The Commissioners view on the treatment of compensation receipts is outlined in Taxation Ruling TR 95/35.

#### **Compensation for permanent damage to, or permanent reduction in the value of, the underlying asset.**

**If an amount of compensation is received by an entity wholly in respect of permanent damage suffered to a post-capital gains tax (CGT) underlying asset of the entity or for a permanent reduction in the value of a post-CGT underlying asset of the entity, and there is no disposal of that underlying asset at the time of the receipt, the amount represents a recoupment of all or part of the total acquisition costs of the asset.**

**The underlying asset is the asset that, using the 'look-through' approach, is disposed of or has suffered permanent damage or has been permanently reduced in value because of some act, happening, transaction, occurrence or event which has**

**resulted in a right to seek compensation from the person or entity causing that damage or loss in value or against any other person or entity.**

**If there is more than one underlying asset, the relevant underlying asset is the asset which leads directly to the payment of the amount of compensation.**

**Permanent damage or reduction in value does not mean everlasting damage or reduced value, but refers to damage or a reduction in value which will have permanent effect unless some action is taken by the entity to put it right.**

Accordingly, the total acquisition costs of the post-CGT asset should be reduced by the amount of the compensation. No capital gain or loss arises in respect of that asset until the entity actually disposes of the underlying asset.

Compensation received by an entity has no CGT consequences if the underlying asset which has suffered permanent damage or a permanent reduction in value was acquired by the entity before 20 September 1985 or is any other exempt CGT asset.

## Disposal of the right to seek compensation

**The right to seek compensation is the right of action arising at law or in equity and vesting in the entity on the occurrence of any breach of contract, personal injury or other compensable damage or injury. A right to seek compensation is an asset for the purposes of Part IIIA.**

**The right to seek compensation is acquired at the time of the compensable wrong or injury, and includes all of the rights arising during the process of pursuing the compensation claim. The right to seek compensation is disposed of when it is satisfied, surrendered, released or discharged.**

If the amount of compensation is not received in respect of any underlying asset, the amount relates to the disposal by the entity of the right to seek compensation.

Accordingly, any capital gain arising on the disposal of that right is calculated using the cost base of that right.

### **Undissected lump sum compensation amount.**

An undissected lump sum compensation receipt is any amount of compensation received by the entity where the components of the receipt have not been and cannot be determined or otherwise valued or reasonably estimated.

If the amount of compensation received is an undissected lump sum, the whole amount is treated as being consideration received for the disposal of the right to seek compensation.

Paragraph 108-5(1)(b) of the ITAA 1997 specifically includes a legal or equitable right within the definition of a CGT asset. An entity's right to seek compensation is therefore classified as an intangible CGT asset.

Section 104-25 of the ITAA 1997 discusses CGT event C2 which refers to cancellation, surrender and similar endings. Subparagraph 104-25(1)(d) of the ITAA 1997 states, in part, that CGT event C2 happens if your ownership of an intangible CGT asset ends by the asset being surrendered or forfeited.

Subsection 104-25(2) of the ITAA 1997 states that the time of the event is: (a) when you enter into the contract which results in the asset ending; or (b) if there is no contract when the asset ends.

The facts in your case show that you have received two undissected lump sum payments as full and final compensation to assist with on-farm works and loss of benefit necessitated by the rationalisation of the channel system and water outlets.

As these payments are undissected lump sum compensation amounts, the whole amount is treated as being consideration received for the disposal of the right to seek compensation.

It is therefore considered that CGT event C2 happened when you entered into the contract with the Corporation.

## Disclaimer

You cannot rely on the rulings in the *Register of private binding rulings* in your tax affairs. You can only rely on a private ruling that we have given to you (or to someone acting on your behalf). For more information about relying on rulings refer to the relevant private rulings fact sheet(s).

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If you follow our information and it turns out to be incorrect, or it is misleading and you make a mistake as a result, we will take that into account when determining what action, if any, we should take.

Some of the information on this website applies to a specific financial year. This is clearly marked. Make sure you have the information for the right year before making decisions based on that information.

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