



Class Ruling

Income tax: Victorian Department of Sustainability and Environment – Bushbroker Scheme (Method 1)

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① This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 8-1 of the ITAA 1997;
- section 15-10 of the ITAA 1997;
- section 15-15 of the ITAA 1997;
- section 104-10 of the ITAA 1997;
- paragraph 104-25(1)(a) of the ITAA 1997;
- section 104-35 of the ITAA 1997;
- section 108-5 of the ITAA 1997;

- section 110-25 of the ITAA 1997;
- subsection 110-45(2) of the ITAA 1997;
- section 112-30 of the ITAA 1997;
- section 116-20 of the ITAA 1997;
- subsection 116-30(1) of the ITAA 1997; and
- section 118-20 of the ITAA 1997.

All legislative references in this Ruling are to the ITAA 1997 unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies are the:
 - (a) owners of land (Landowners) who:
 - are the registered proprietors of a fee simple estate over land in the State of Victoria with existing native vegetation;
 - generate native vegetation credits (Credits) by performing management actions relating to the native vegetation present on their land; and
 - hold the land on capital account; and
 - (b) owners of land in the State of Victoria who will use Credits to remove native vegetation on their land (Permit Holders).

The Landowners and Permit Holders are residents of Australia within the meaning of subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936).

Qualifications

4. The Commissioner makes the ruling based on the precise scheme identified in this Ruling.
5. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 9 to 50 of this Ruling.
6. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:
 - this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
 - this Ruling may be withdrawn or modified.

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Date of effect

8. This Ruling applies from 1 July 2012 to 30 June 2013. The Ruling continues to apply after 30 June 2013 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

9. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them form part of and are to be read with the description:

- application for Class Ruling from Victorian Department of Sustainability and Environment dated 10 August 2012.

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

Overview

10. The BushBroker scheme (BushBroker) is a scheme established by the Department of Sustainability and Environment of the State of Victoria (DSE) to improve the quality and amount of native vegetation in Victoria.

11. At present BushBroker is not a statutory scheme, but rather is administered through a variety of private agreements between parties involved in the scheme.

12. The scheme involves Landowners who own land with native vegetation generating Credits. Landowners may then sell these Credits on the open market.

13. Landowners may generate Credits in two ways:

- (a) they may perform management actions relating to the native vegetation present on their land (the First Method); or
- (b) they may transfer some or all of their land to the Crown (or another entity controlled by the Crown) (the Second Method).

14. Market demand for Credits is driven by other land owners, generally property developers, who wish to remove native vegetation from their own land. Planning authorities typically require such land owners to purchase Credits before clearing this vegetation. Once vegetation has been cleared, the Credits expire.

15. Landowners wishing to participate in Bushbroker first lodge an expression of interest with DSE. The expression of interest identifies the site or sites which the Landowner is willing to subject to an agreement, as well as the type of Credits the Landowner is interested in obtaining.

16. Landowners may obtain three different types of Credits, depending on the type of management actions they wish to perform:

- Habitat Hectares: where Credits are generated through protecting, maintaining and improving the management of a remnant patch of native vegetation. This is done through management actions including weed control, rabbit control and stock exclusion.
- Large Old Trees: where Credits are generated through protecting scattered large old trees, or large old trees in a remnant patch from adverse impacts.
- New Recruits: where Credits are generated by the Landowner planting new native vegetation on an area that was previously cleared of native vegetation.

Entry into Landowner Agreement and creation of Credits

17. Following the lodgment of the expression of interest, the Landowner's site will be registered on the BushBroker Register (a database of all Credits and the entities which hold them). DSE will notify the Landowner of this registration, and also provide the Landowner with an initial indication of the potential type and estimated number of Credits that they may receive.

18. A BushBroker project officer will then visit the Landowner's site to conduct an assessment. The project officer will discuss their findings with the Landowner, together with the possible management actions the Landowner is prepared to perform. The information collected forms the basis of a draft management plan and agreement, which are prepared by DSE, and forwarded to the Landowner for review.

19. Once the Landowner has informed DSE they are satisfied with the draft management plan and agreement, DSE will record the allocated Credits as confirmed assets in the BushBroker Register. The Landowner may commence negotiating with Permit Holders to sell the Credits once this has been done.

20. The Landowner and the Secretary of DSE will then execute a written Landowner Agreement. The Landowner Agreement contains details of the management plan and actions the Landowner is obliged to perform as well as the number and type of Credits they will receive. Once the parties have entered into the Landowner Agreement, DSE will record the allocated Credits as full Credits in the BushBroker Register.

Expenses associated with entry into the Landowner Agreement

21. Landowners may incur a range of expenses prior to entering into the Landowner Agreement (Initial Costs). These expenses are likely to include the following:

- environmental consultants fees;
- contractor expenses;
- legal costs for advice on entering into an agreement; and
- taxation advisory fees.

Content of Landowner Agreement

22. The Landowner Agreement is an agreement made under section 69 of the *Conservation, Forests and Lands Act 1987* (Vic) (Conservation Act). Section 69 empowers the Secretary (of DSE) to enter into an agreement with a land owner in relation to the 'management, use, development, preservation or conservation' of the land in question. Under sections 71 and 72 of the Conservation Act, such an agreement may be expressed as being binding on the land owner's successors in title.

23. If the agreement is expressed in this manner it must be recorded in the Register of Titles. Upon registration, subsection 72(2) of the Conservation Act deems the land owner's successors in title to have notice of the agreement, binds all successors to the terms of the agreement and provides that the agreement runs with the land. All Landowner Agreements are expressed as being binding on successors in titles by clause 5 of the Landowner Agreement, and are recorded in the Register of Titles.

24. Under clause 6.1 of the Landowner Agreement, the Landowner covenants and agrees '[t]o complete the Management Actions specified in the Management Plan to the satisfaction of the Secretary, for the purposes of achieving the Targets, regardless of whether all Credits have been sold to other people'.

25. DSE's obligation to provide Credits to the Landowner is set out in clause 71 of the Landowner Agreement. This obliges the Secretary (of DSE) to 'record the Available Gain' as a Credit on the BushBroker Register and to 'assign that Credit in favour of the Landowner'. Available Gain is defined for these purposes in clause 1.13 of the Landowner Agreement to be 'the estimated improvement in the extent and quality of native vegetation on the Site as assessed on behalf of the Secretary in accordance with' DSE's policies for native vegetation management.

26. Landowners are not entitled to receive further consideration from DSE for performing the management actions. Clause 7.4 of the Landowner Agreement expressly provides that DSE is only obliged to make payments to the Landowner to the extent that 'Credits created pursuant ... [to the Landowner Agreement] have been purchased' and 'monies have been paid to the Secretary in return for Credits purchased'. Further, clause 6.10.2 of the Landowner Agreement provides that 'the Secretary makes no promises in relation to the likely market value of a Credit or that any offer will be made to purchase a Credit'.

27. The Landowner Agreement also provides for certain consequences if Landowners fail to comply with the terms of the Agreement in a manner that downgrades or degrades the ecological condition of the Site. Under clause 9.2 of the Landowner Agreement the Secretary of DSE may 'demand the immediate reimbursement for any payment previously made to the Landowner under' the Agreement. Further, the 'Landowner will be liable to compensate the Secretary for the reasonable cost' of either reinstating the site to its condition, or to achieve an equivalent gain in another location.

28. In addition, under clause 9.3 of the Landowner Agreement, the Secretary may cancel Credits that have been assigned to the Landowner, but only if the Credits remain assigned to the Landowner and relate to the gain affected by the Landowner's actions. Thus Credits may not be cancelled if they have been sold to a Permit Holder.

29. The Landowner's specific management actions are set out in a ten year management plan, which is included as a schedule to the Landowner Agreement. Although the Landowner is only required to actively manage their site over this ten year period, the Landowner Agreement does include obligations which are binding in perpetuity. For example, clause 6.4.1 of the Landowner Agreement provides that the Landowner must not remove native vegetation from the site (except in accordance with the management plan) at any time from the date of commencement.

30. A further schedule to the Landowner Agreement contains two schedules of payments, which are described as Part A and Part B schedules of the Landowner Agreement respectively. The Part A schedule of the Landowner Agreement begins with an Initial Payment, to be made at commencement of the Agreement, and assigns a further annual payment to the following ten years. All payments are expressed as a percentage of the 'Total'. The Total is effectively the purchase price received for Credits which have been sold by the Landowner.

31. The Part B schedule of the Landowner Agreement also assigns payments over a ten year period but does not include any Initial Payment. Each payment is expressed as a percentage of the 'value of remaining Credits'. This is the purchase price of Credits which have been sold by the Landowner and are held by DSE.

32. DSE has not requested that the Commonwealth Environment Minister approve the Landowner Agreement as a Conservation Covenant, as defined in section 31-5, and hence no approval has been provided.

Disposal of Credits by Landowner to Permit Holder

33. Permit Holders wishing to clear native vegetation on their land will generally be advised by the relevant planning authority (the Responsible Authority) that they will need to purchase Credits before the Responsible Authority will authorise the clearing. Once informed of this obligation Permit Holders will contact DSE for assistance in locating suitable Credits.

34. In order to locate suitable Credits, the Permit Holder will lodge an offset search request with DSE. This request will include information such as the clearing site's location, land tenure, vegetation type, quality and quantity of vegetation the Permit Holder intends to clear.

35. A BushBroker project officer assesses the offset search request and matches it to potentially suitable Landowners and Credits. Permit Holders are then placed in contact with these Landowners so that they can negotiate a purchase price. All price negotiations take place directly between Permit Holders and Landowners.

36. DSE has developed an information sheet on developing a price, but does not otherwise assist parties in their price negotiations.

37. Prior to purchasing the Credits, the Permit Holder will prepare a draft offset plan which is lodged with the Responsible Authority. It outlines the native vegetation currently present on their site, as well as details of Credits the Permit Holder proposes to purchase. The Responsible Authority then advises the Permit Holder whether the Credits are a suitable replacement for the native vegetation proposed to be cleared. Permit Holders will only proceed to purchase the Credits once the Responsible Authority confirms their suitability.

38. DSE plays no role in assessing whether the Credits are a suitable replacement for the native vegetation proposed to be cleared, and is not in any way involved in assessing the merits of the Permit Holder's planning application.

39. Once a Landowner and a Permit Holder have agreed on a sale price for the Credits they advise DSE. DSE then prepares a BushBroker Credit Agreement (Credit Agreement) to affect the Credit sale. The Credit Agreement is executed by the Landowner, the Permit Holder and DSE. After it has been executed, DSE updates the BushBroker Register to record the Permit Holder as the new holder of the Credits.

Payment by the Permit Holder and receipt by the Landowner

40. Under clause 4.2 of the Credit Agreement, the Permit Holder is obliged to pay the Purchase Price to DSE 'for the value of Credits purchased'. The Landowner is obliged under clause 5 of the Credit Agreement to 'sell [the Credits] at the Agreed Price to the purchaser, via the [BushBroker] Register'. Once this is done the Permit Holder is recorded as the holder of the Credits in the BushBroker Register, and is free to use the Credits.

41. DSE's obligations upon receiving the purchase price, and the Landowner's rights to payment, are set out in both the Landowner Agreement and the Credit Agreement. Importantly, the Landowner is not entitled to immediate payment of the Purchase Price, and DSE is not obliged to make the Purchase Price immediately available to the Landowner.

42. Broadly, the Purchase Price received by DSE from the Permit Holder is paid progressively to the Landowner as they perform their management actions. Any portion of the Purchase Price which has not been paid is held by DSE for the benefit of the Landowner in accordance with clause 7.6 of the Landowner Agreement.

43. Clause 7.5 of the Landowner Agreement provides that if the Landowner has already sold Credits at the date of the Agreement, the Secretary (of DSE) 'will make the Initial Payment ... to the Landowner as soon as practicable after Commencement ... and all subsequent payments other than the Initial Payment will be made annually by the Secretary in accordance' with the Part A schedule of payments of the Landowner Agreement. As each payment is expressed as a percentage of the Purchase Price, the schedule effectively sets the rate at which the Purchase Price is repatriated to the Landowner.

44. If the Landowner has Credits which remain available for sale by the Landowner at the date of the Landowner Agreement, clause 7.6 of the Landowner Agreement provides that DSE is to pay the Landowner in accordance with the Part B schedule of payments of the Landowner Agreement. This schedule sets the payments as a percentage of the purchase price of Credits which have been sold by the Landowner. Thus it also effectively sets the rate at which the Purchase Price paid by the Permit Holder is repatriated to the Landowner.

45. DSE is only obliged to make a payment to a Landowner once the Landowner has provided it with a report evidencing that they have performed all their management actions to DSE's satisfaction. This reporting obligation is set out in clauses 6.8 and 6.9 of the Landowner Agreement.

46. If the Landowner does not comply with their reporting obligation DSE will withhold payment from the Landowner until the management actions have been completed. DSE may also recoup the Purchase Price and demand compensation if the Landowner fails to perform the management actions.

Landowner costs incurred while performing the management actions

47. Landowners typically incur a variety of costs over the life on an agreement (General Costs). The nature of the costs incurred will depend on the precise management actions agreed to.

48. In DSE's experience, examples of costs incurred by Landowners include:

- labour and contractor costs;
- material costs such as fencing materials, herbicides, plants, tree guards and baits;
- maintaining and replacing fencing;
- costs associated with stock exclusion; and
- purchase or hire of equipment to undertake activities such as weed spraying or fencing.

Use of Credits by Permit Holders

49. Once they have been recorded as the holder of Credits, Permit Holders may utilise the Credits. The Credits are utilised by being specified in an offset plan as an offset for the clearing of native vegetation.

50. After the Credits are utilised, DSE is informed of this by the Permit Holder, and the Credits are removed from the BushBroker Register.

Ruling

1. Entering into a Landowner Agreement

51. The receipt of Credits pursuant to a Landowner Agreement does not form part of the assessable income of the Landowner under sections 6-5, 15-10 or 15-15.

52. The Initial Costs incurred by the Landowner will not be deductible under section 8-1.

Capital Gains Tax

53. CGT event D1 (creation of rights in another party) happens when the Landowner and DSE enter into the Landowner Agreement (section 104-35).

54. The Landowner will make a capital gain if the capital proceeds from creating the right are more than the incidental costs incurred in creating that right. The Landowner will make a capital loss if those capital proceeds are less than the incidental costs.

55. The capital proceeds from entering into the Landowner Agreement is the market value of the Credits received or entitled to be received under the Landowner Agreement (section 116-20).

56. The incidental costs incurred from entering into the Landowner Agreement represent the Initial Costs, provided remuneration for professional advice about the operation of the ITAA 1936 and ITAA 1997 is to a recognised tax adviser.

2. Sale of Credits

Capital Gains Tax

57. A Credit constitutes a CGT asset as defined under section 108-5.

58. CGT event A1 happens when the Landowner disposes of a Credit (section 104-10).

Capital proceeds

59. The capital proceeds from the disposal of a Credit is the money or the market value of property the Landowner receives or is entitled to receive in respect of the disposal (section 116-20). The money that the Landowner receives or is entitled to receive does not include the amount that the Permit Holder is required to pay to DSE. If no money or property is received or entitled to be received by the Landowner, the capital proceeds will be the market value of the Credit disposed of (subsection 116-30(1)).

Cost base

60. The first element of the cost base of a Credit consists of the property given in respect of acquiring the Credit (section 110-25). This is the market value of the rights created in DSE by the Landowner in entering into the Landowner Agreement divided by the number of Credits received (subsection 112-30(1)).

Tax Consequences for Permit Holders

61. A Permit Holder in the business of developing land for resale at a profit will include the cost of the Credits in the cost of the land and claim a deduction under section 8-1 at the time expenditure to acquire the Credits is incurred. The cost base and reduced cost base of the Credits does not include expenditure that a Permit Holder has deducted or can deduct (subsection 110-45(2)).

62. If the Permit Holder holds the land on capital account, the first element of the cost base of a Credit will be the money paid by the Permit Holder to DSE to acquire the Credit. CGT event C2 will happen at the time the Credits that they own are removed from the BushBroker Register (paragraph 104-25(1)(a)).

3. Receipt of annual payments by Landowner

63. Amounts representing payments from DSE received by the Landowner are ordinary income of the Landowner and are included in the assessable income of the Landowner under section 6-5.

Capital Gains Tax

64. When the Landowner receives an annual payment, CGT event C2 under section 104-25 happens to a part of the Landowner's entitlement to receive annual payments.

65. The capital proceeds from CGT event C2 happening is the amount of the annual payment.

66. The cost base for the part of the right that ends when an annual payment is made is a proportion of the cost base of the Landowner's right to receive annual payments worked out under subsection 112-30(3).

67. Any capital gain made by the Landowner when CGT event C2 happens is reduced (but not below zero) by the amount of the annual payment that is included in the assessable income of the Landowner under section 6-5 (section 118-20).

4. Deductions for the General Costs of Landowners

68. Expenditure by the Landowner on general costs such as labour and administrative costs for performing management actions, costs associated with the Landowner's annual reporting requirements, material costs such as material for repairs, herbicides and baits, cost associated with stock exclusion (other than capital costs) and annual rates and insurances payments (to the extent they relate to the site subject to the Landowner Agreement) are deductible under section 8-1.

Commissioner of Taxation

8 May 2013

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

1. Entering into the Landowner Agreement

69. Subsection 6-5(1) provides that an amount is included in assessable income if it is income according to ordinary concepts (ordinary income). However, as there is no definition of 'ordinary income' in income tax legislation it is necessary to apply principles developed by the courts to the facts of each case.

70. Whether or not a particular receipt is ordinary income depends on its character in the hands of the recipient. In *GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation* (1990) 170 CLR 124; 90 ATC 4413; (1990) 21 ATR 1, the Full High Court stated:

To determine whether a receipt is of an income or of a capital nature, various factors may be relevant. Sometimes the character of receipts will be revealed most clearly by their periodicity, regularity or recurrence; sometimes, by the character of a right or thing disposed of in exchange for the receipt; sometimes, by the scope of the transaction, venture or business in or by reason of which money is received and by the recipient's purpose in engaging in the transaction, venture or business.

71. In *Dickenson v. Federal Commissioner of Taxation* (1958) 98 CLR 460 the taxpayer, who owned a service station, entered into an arrangement with the Shell Company whereby the taxpayer agreed to only sell the Shell Company's petroleum products for a period of ten years. The arrangement was carried out by executing five interdependent documents. Two of these documents were personal covenants of which the taxpayer was paid two separate lump sums. Kitto J held that:

...a lump sum payment for a restriction of a garage and its proprietor to one brand of petroleum products for a period of ten years, ... seems in the nature of a sale price for a substantial and enduring detraction from pre-existing rights. The restriction does not strike my mind as an obligation undertaken incidentally to the carrying on of the business. Rather does it take a substantial piece out of the ordinary scope of the business activities to which otherwise the appellant might apply himself and for which he might use his premises to adapt some words of the Master of the Rolls.

72. Where a Landowner enters into a Landowners Agreement they agree to complete the Management Actions specified in the Management Plan to the satisfaction of the Secretary, for the purposes of achieving the Targets in perpetuity on the land. Once the Landowner has informed DSE that they are satisfied with the draft management plan and agreement, DSE will record the allocated Credits as confirmed assets on the BushBroker Register. The effect of the transaction is that the use of the land by the current and future Landowners is restricted in perpetuity in accordance with the Landowner's Agreement. In return, the Landowner is entitled to receive Credits.

73. Further, the class of entities to whom this Ruling applies is limited to Landowners who hold their land on capital account.

74. Thus, where a Landowner who holds their land on capital account enters into a Landowner's Agreement which restricts in perpetuity the use of that land, the Credits issued are considered to be capital in nature, and accordingly will not constitute assessable income of the Landowner under section 6-5.

Section 15-15

75. Section 15-15 provides that a profit:

- from the carrying on or carrying out of a profit-making undertaking or plan;
- that is not assessable as ordinary income under section 6-5,

can only be included in a taxpayer's assessable income where the profit arises in respect of the sale of property acquired before 20 September 1985.

76. The Credits issued to a Landowner can be viewed as consideration received by the Landowner:

- for the creation of rights in another party, where the rights restrict the Landowner's use of that land; or
- for the giving up of rights to unrestricted use of the land, where the rights are rights associated with the ownership of land which were acquired by the Landowner when they acquired the land.

77. Where the rights are viewed as being created at the time a Landowner enters into the Landowner's Agreement, the Credits received will not arise in respect of the sale of property. Thus section 15-15 will have no application.

78. Alternatively, where the rights are viewed as being rights associated with the ownership of land, and the land is held on capital account, the rights will also be held on capital account. Thus, the giving up of those rights will be on capital account and section 15-15 will have no application.

Section 15-10 – bounty or subsidy

79. Section 15-10 provides that an amount is included in assessable income if it is:

- a bounty or subsidy;
- received in relation to carrying on a business; and
- not assessable as ordinary income under section 6-5.

80. The terms 'bounty' and 'subsidy' are not defined in income tax legislation. The word 'subsidy', as noted by Windeyer J in *Placer Development Ltd v. Commonwealth of Australia* (1969) 121 CLR 353, derives from the Latin 'subsidium' meaning 'an aid or help'. The Macquarie Dictionary, 2001, rev. 3rd edn, defines subsidy as including 'a grant or contribution of money'. The ordinary meaning adopted by case law is 'aid provided by the Crown (government) to foster or further some undertaking or industry', which includes the payment of a financial grant.

81. In the present case, the Landowner receives Credits and does not receive any financial payments from the government. As such, no amount is assessable under section 15-10.

Capital Gains Tax

82. Under section 104-35, CGT event D1 happens if you create a contractual right or other legal or equitable right in another entity.

83. By entering into a Landowner Agreement a Landowner is creating contractual rights in the DSE.

84. Under subsection 104-35(2), the time of the event is when the contract is entered into or when the other right is created.

85. Under subsection 104-35(4), the Landowner will make a capital gain if the capital proceeds from creating the right are more than the incidental costs incurred in creating that right. The Landowner will make a capital loss if those capital proceeds are less than the incidental costs.

Capital proceeds

86. Section 116-20 defines capital proceeds as the total of:

- the money you have received, or are entitled to receive, in respect of the event happening; and
- the market value of any other property you have received or are entitled to receive, in respect of the event happening (worked out as at the time of the event).

87. No money has been received by the Landowner in respect of the event happening.

88. The Landowner receives Credits on CGT event D1 happening. The Credits are property and their market value is included as capital proceeds.

89. As property is not defined in the income tax legislation, the ordinary meaning of the word must be used.

90. The CCH *Macquarie Concise Dictionary of Modern Law* defines property as '1. Ownership, 2. Anything capable of being owned'.

91. In *National Provincial Bank Ltd v. Ainsworth* [1965] AC 1175 Wilberforce J provided the following tests:

Before a right or interest can be admitted into the category of property or of a right affecting property, it must be definable, identifiable by third parties, capable in its nature of assumption by third parties, and have some degree of permanence or stability.

92. In the present case, the Credits are defined as 'the unextinguished value assigned by the Register to a defined part of the Subject Land ... which may be relied on as evidence of the provision of Offset and available for trade, subject to the rules of the Register.'

93. The Credits are identifiable by third parties as they are recorded on the BushBroker Register.

94. The Credits are also available for sale immediately on entering into the Landowner Agreement.

95. The incidental costs incurred from entering into the Landowner Agreement are the Initial Costs such as environmental consultants fees, contractor expenses, legal costs for advice on entering into an agreement and taxation advisory costs.

96. These costs are capital in nature and not an allowable deduction under section 8-1.

2. Sale of Credits

97. As the class of entities to whom this Ruling applies excludes Landowners holding Credits on revenue account, the Ruling only applies to Landowners holding Credits on capital account. Thus as the Credits are held on capital account any profit made by a Landowner on sale of their Credits will not be assessable income of the Landowner under section 6-5.

98. As stated in paragraph 75 of this Ruling, section 15-15 provides that a profit:

- from the carrying on or carrying out of a profit-making undertaking or plan,

- that is not assessable as ordinary income under section 6-5,

can only be included in a taxpayer's assessable income where the profit arises in respect of the sale of property acquired before 20 September 1985.

99. As the Credits a Landowner is issued are acquired after 19 September 1985, any profit that arises on the sale of Credits will not be assessable income of the Landowner under section 15-15.

Capital Gains Tax

100. Subsection 108-5(1) defines a CGT asset as:

- any kind of property; or
- a legal or equitable right that is not property.

101. Credits fall within the definition of CGT asset under paragraph 108-5(1)(a).

102. CGT event A1 happens on the disposal of a CGT asset. Under section 104-10, a CGT asset is disposed of when there is a change of ownership, whether because of some act or event or by operation of law.

103. On the sale of Credits, the Landowner will dispose of a CGT asset at the time the Landowner enters into the sale contract. Under subsection 104-10(4), the Landowner will make a capital gain if the capital proceeds from the sale are more than the cost base of the Credits. If the capital proceeds are less than the reduced cost base of the Credits, the Landowner will make a capital loss.

Capital proceeds

104. Subsection 116-20(1) provides that the capital proceeds from a CGT event are the total of:

- the money you have received, or are entitled to receive, in respect of the event happening; and
- the market value of any other property you have received or are entitled to receive, in respect of the event happening (worked out at the time of the event).

105. The capital proceeds from the disposal of the Credits is the money or the market value of property the Landowner receives or is entitled to receive in respect of the disposal (subsection 116-20(1)). The money that the Landowner receives or is entitled to receive does not include the amount that the Permit Holder is required to pay to DSE. If no money or property is received or entitled to be received by the Landowner, the capital proceeds will be the market value of the Credits disposed of (subsection 116-30(1)).

Cost base

106. Subsection 110-25(2) provides that the first element of the cost base of a CGT asset is the total of:

- the money you paid, or are required to pay in respect of acquiring the CGT asset; and
- the market value (worked out at the time of the acquisition) of any other property you gave, or are required to give, in respect of acquiring the CGT asset.

107. No money is paid by the Landowner to acquire the Credits but, under the Landowner Agreement, the Landowner is required to perform management actions and afford permanent protection of the native vegetation on their land. As such, the Landowner creates rights in the DSE and this is considered the giving of property in respect of acquiring the Credits.

108. Accordingly, the first element of the cost base of a Credit is that portion of the market value of the property given that is reasonably attributable to the acquisition of the Credit (subsection 112-30(1)).

Tax Consequences for Permit Holders

109. Trading stock is defined in section 70-10 as including among other things ‘...anything produced, manufactured or acquired that is held for purposes of manufacture, sale or exchange in the ordinary course of a business’.

110. Where a taxpayer is in the business of developing land for resale at a profit the land forms part of their trading stock (*Federal Commissioner of Taxation v. St Hubert's Island Pty Ltd (in liq)* (1978) 138 CLR 210; 78 ATC 4104; (1978) 8 ATR 452).

111. In *Federal Commissioner of Taxation v. Kurts Development Ltd* (1998) 86 FCR 337; (1998) 39 ATR 493; 98 ATC 4877 infrastructure costs and external costs including costs of gaining approval from the local authority were allocated to the value of trading stock.

112. The cost of obtaining the Credits is a cost that the Permit Holder incurs in order to be able to clear their land. As such, it forms part of the cost of that land and is deductible at the time it is incurred. The cost base and reduced cost base of a Credit does not include expenditure that a Permit Holder has deducted or can deduct (subsection 110-45(2)).

113. CGT event C2 happens if your ownership of an intangible CGT asset ends by the asset being cancelled (paragraph 104-25(1)(a)). Accordingly, CGT event C2 will happen at the time the Credits that the Permit Holder owns are removed from the BushBroker Register.

114. The Permit Holder will make a capital gain if the capital proceeds from the cancellation of their Credits are more than the cost base of the Credits. If the capital proceeds are less than the reduced cost base of the Credits, the Permit Holder will make a capital loss (subsection 104-25(3)).

115. Where a Permit Holder holds the land on capital account, the first element of the cost base of a Credit will be the money paid by the Permit Holder to DSE to acquire the Credit. As the Permit Holder receives no money or property for the cancellation of their Credits, the capital proceeds will be the market value of the Credits at the time of cancellation (subsection 116-30(1)).

3. Receipt of annual income by Landowner

Section 6-5 – income according to ordinary concepts

116. In *MIM Holdings Ltd v. Commissioner of Taxation* 97 ATC 4420; (1997) 36 ATR 108, Northrop, Hill and Cooper JJ, relying on *Hayes v. Federal Commissioner of Taxation* (1956) 96 CLR 47 and *Reuter v. Federal Commissioner of Taxation* (1993) 111 ALR 716; 93 ATC 4037; (1993) 24 ATR 527 said that 'amounts paid in consideration of the performance of services will almost always be income'.

117. The question of whether an amount is a product of the taxpayer's services (that is, paid in consideration of the performance of the taxpayer's services) has been considered in a number of High Court decisions. The following guidance is afforded by those decisions:

- the whole of the circumstances must be considered;
- a generally decisive consideration is whether the receipt is the product in a real sense of any employment of, or services rendered by the recipient, or of any business, or any revenue production activity carried on by the recipient;
- other considerations that are relevant but not decisive include:
 - the motive of the donor (payer) in paying the amount;
 - the regularity and periodicity of the payment however a payment in a lump sum does not require a conclusion that the payment is capital; and
 - the recipient's expectation that an amount will be received.

118. The scheme has been established by the DSE to help address the loss of biodiversity. As part of the scheme the Landowner is to receive payment for the improvement or maintenance of biodiversity values.

119. The contract between the Landowner and the Minister specifies the rights and obligations of both the Landowner and the DSE under the Landowner Agreement. It includes a schedule of management actions the Landowner needs to complete to receive payment. Under the Landowner Agreement the Landowner agrees to provide conservation management services to DSE over the specified period for consideration.

120. Standard management actions detailed under the Landowner Agreement include:

- controlling or eliminating weeds;
- constructing fences to control feral fauna, such as rabbits; and
- planting new native vegetation.

121. The annual management payment is the product of the land management services performed by the Landowner.

122. Other factors such as the Landowner's expectation to receive payment in return for undertaking the activities as set out in the Landowner Agreement and the purpose of the DSE in making the payment (to provide an incentive for the Landowner to carry out the work) also support the conclusion that the ongoing management payments are the product of the services rendered. The fact that the payments are made in an annual lump sum does not alter this conclusion. Thus, annual payments received by Landowners from the DSE constitute ordinary income of the Landowner and are included in the assessable income of Landowners under section 6-5.

Capital Gains Tax

123. The right of the Landowner to receive annual payments will be discharged or satisfied in part each time the Landowner receives a payment resulting in CGT event C2 in section 104-25 happening to that part of the right.

124. The Landowner will make a capital gain if the capital proceeds for the part of the right that is satisfied is more than the cost base of that part of the right. The capital gain is equal to the amount of the excess (subsection 104-25(3)).

125. A Landowner will make a capital loss if the capital proceeds for the part of the right that is satisfied is less than the reduced cost base of that part of the right. The capital loss is equal to the amount of the difference (subsection 104-25(3)).

126. The capital proceeds for CGT event C2 happening will be the amount of the annual payment.

127. The cost base of the Landowner's right to receive annual payments under the Landowner Agreement is worked out in accordance with Division 110.

128. The first element of the cost base of the right to annual payments is the total of:

- the money you paid, or are required to pay; and
- the market value (worked out as at the time of the acquisition) of any other property you gave, or are required to give,

in respect of acquiring the right.

129. Any capital gain made by the Landowner when CGT event C2 happens is reduced (but not below zero) by the amount of the annual payment that is included in the assessable income of the Landowner under section 6-5 (section 118-20).

4. Deductions for the General Costs of Landowners

130. Section 8-1 allows a deduction for losses or outgoings to the extent that they are incurred in gaining or producing assessable income, or are necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

131. However, a deduction is not available under section 8-1 where the losses or outgoings are of a capital, private or domestic nature, or are incurred in gaining or producing exempt income, or another provision prevents the taxpayer from deducting them.

132. The Landowner may be able to deduct some of the expenses incurred in the course of producing the assessable income as represented by the ongoing management payments. This would typically include the following expenditure:

- labour and administration costs for performing management actions;
- costs associated with the landowner's annual reporting requirements;
- material costs such as materials for repairs, herbicides and baits;
- costs associated with stock exclusion (except to the extent the costs involves the purchase of a capital asset); and
- annual rates and insurance payments (to the extent they relate to the site subject to the Landowner Agreement).

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- capital gains tax
- CGT assets
- CGT capital proceeds
- CGT cost base
- CGT events
- CGT events D1-D3 – bringing into existence a CGT asset
- trading stock

Legislative references:

- ITAA 1936 6(1)
- ITAA 1997 6-5
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- ITAA 1997 8-1
- ITAA 1997 15-10
- ITAA 1997 15-15
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- ITAA 1997 104-25
- ITAA 1997 104-25(1)(a)
- ITAA 1997 104-25(3)
- ITAA 1997 104-35
- ITAA 1997 104-35(2)
- ITAA 1997 104-35(4)
- ITAA 1997 108-5
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- ITAA 1997 110-25
- ITAA 1997 110-25(2)
- ITAA 1997 110-45(2)
- ITAA 1997 112-30
- ITAA 1997 112-30(1)
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- ITAA 1997 116-20

- ITAA 1997 116-20(1)

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- TAA 1953

- Copyright Act 1968

- Conservation, Forests and Lands Act 1987 (Vic)

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- Dickenson v. Federal Commissioner of Taxation (1958) 98 CLR 460
- Federal Commissioner of Taxation v. Kurts Development Ltd (1998) 86 FCR 337; (1998) 39 ATR 493; 98 ATC 4877
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- Hayes v. Federal Commissioner of Taxation (1956) 96 CLR 47
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- National Provincial Bank Ltd v. Ainsworth [1965] AC 1175
- Placer Development Ltd v. Commonwealth of Australia (1969) 121 CLR 353
- Reuter v. Federal Commissioner of Taxation (1993) 111 ALR 716; 93 ATC 4037; (1993) 24 ATR 527

ATO references

NO: 1-4MUKXKV

ISSN: 1445-2014

ATOlaw topic: Income Tax ~~ Assessable income ~~ government payments

Income Tax ~~ Assessable income ~~ other payments

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