



Class Ruling

Income tax: expiry of sub-leases: RQYS Nominees Pty Limited as trustee for the RQYS New Marina Trust

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❶ 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 in this Ruling are:

- paragraph 104-25(1)(c) of the *Income Tax Assessment Act 1997* (ITAA 1997)
- subsection 109-5(2) of the ITAA 1997
- subsection 110-25(2) of the ITAA 1997
- subsection 116-30(1) of the ITAA 1997
- subsection 116-30(3) of the ITAA 1997
- section 118-40 of the ITAA 1997.

Class of entities

3. The class of entities to which this Ruling applies is all members of the Royal Queensland Yacht Squadron Limited or entities associated with these members such as related company, trust or superannuation fund of the particular members and who:

- are Australian residents for tax purposes
- are lessees under individual Agreement for Construction and Sub-Lease for berths on the Marina 2 Area entered into with RQYS Nominees Pty Ltd in its capacity as trustee for the RQYS New Marina Trust covering the period from 26 February 2010 to 23 February 2035
- hold the Sub-Leases on capital account
- propose to hold new Sub-Leases as described in the scheme on capital account, and
- are not subject to the Taxation of Financial Arrangements rules in Division 230 of the ITAA 1997 in relation to financial arrangements under the scheme;
(Note – Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them).

The entities described above will be referred to in this ruling as Berth Holders.

Qualifications

4. 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 7 to 41 of this Ruling.

5. 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.

Date of effect

6. This Ruling applies from 1 January 2014 to 30 June 2015. The Ruling continues to apply after 30 June 2015 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

7. 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:

- Class ruling application dated 8 April 2014 and information provided in letters dated 18 June 2014 and 18 July 2014;
- Copy of lease between Port of Brisbane Corporation Limited and RQYS Nominees Pty Ltd ACN 130 840 523;
- Copy of a sample Agreement and Sub-Lease between RQYS Nominees Pty Limited ACN 130 840 523 and a Berth Holder;
- Copy of a draft new Sub-Lease to be granted by RQYS Nominees Pty Limited ACN 130 840 523 to a Berth Holder; and
- Copy of lease between the State of Queensland and RQYS Nominees Pty Ltd ABN 64 177 610 049 in respect of one of the Adjoining Leases and its supplementary documents.

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

Existing rental arrangements

8. Royal Queensland Yacht Squadron Limited (Squadron) was incorporated in 1991, when it took over the yachting and sailing activities of an unincorporated association.

9. The RQYS New Marina Trust (Marina 2 Trust) was established in 2008. Its Trustee is RQYS Nominees Pty Limited (Nominees), ACN 130 840 523.

10. The Squadron owns all the issued shares in Nominees and is the sole beneficiary of Marina 2 Trust.

11. The Squadron is an entity exempt from income tax under section 50-1 of the ITAA 1997 as it was established for the encouragement of 'a game or sport' (yachting and sailing) under Item 9.1(c) of the table in section 50-45 of the ITAA 1997.

12. Port of Brisbane Corporation Limited (POBC) was a corporation owned by the Queensland Government pursuant to the *Government Owned Corporations Act 1993 (Queensland)*. It was granted a lease in perpetuity No PPL 0/230123 by the Crown commencing on 14 December 2005 (Crown Lease).

13. POBC granted a lease to Marina 2 Trust for a term of 25 years from 25 February 2010 to 24 February 2035 (Head Lease) with respect to a leased area described in the Form 7 for the purposes of the *Land Titles Act 1997 (QLD)* as:

Sublease 713249810

Lease "MU" on SP221154, Lease "MW" on SP 229558 and Lease "MT" on SP 195358 in Lot 687 on SP 172860

County: Stanley

Parish: Tingalpa

Tittle Reference: 40050538.

14. The leased area is referred to as the Marina 2 Area.

15. POBC also granted two leases to the Squadron on areas adjoining the Marina 2 Area (Adjoining Leases).

16. Marina 2 Trust obtained permission from POBC and other relevant authorities to construct a marina on Marina 2 Area and to grant rights of use and occupation of individual berths to appropriately qualified owners and operators of yachts, motor vessels and small crafts.

17. Marina 2 Trust entered into an Agreement for Construction and Sub-Lease (Agreement) for individual berths in Marina 2 Area with Berth Holders (referred to as the *Berth Owners* in the Agreement).

18. The Agreement covers the period from 26 February 2010 to 23 February 2035 (Term), this being one day prior to the expiration of the 25 year term of the Head Lease on 24 February 2035.

19. Each Agreement provided a Berth Holder with rights of use and occupation of an individual mooring berth at the Marina 2 Area, subject to completion of the construction works by Nominees and performance of certain obligations by the Berth Holder.

20. Each Agreement contains a draft Sub-Lease in the Fourth Schedule (Sub-Lease). The Sub-Lease contains the terms and conditions for the use and occupation of the berth.

21. The Agreement also provides for the execution and registration of the Sub-Lease subject to the completion of the construction works.

22. The construction of berths has been completed and Berth Holders have used their berths under the terms and conditions in the Sub-Leases. However, the Sub-Leases have not been registered.

23. Extracts of the relevant terms and definitions in the Agreement relating to the existing rental arrangement are reproduced below:

(a) Clause 5 of the Agreement states that:

5.1.1 The Lease Rental shall be paid by the Berth Owner to Nominees by way of adjustment against the last Tax Invoice submitted by the Berth Owner to Nominees for the performance of Nominees's Works associated with the construction of the New Marina or as otherwise mutually agreed between the Berth Owner and Nominees.

5.1.2 The Berth Owner shall pay the Annual Levy to Nominees, or as it may direct, for the pro-rata period commencing on and from the Commencement Date to the 30th April or 31st April October next following the Commencement Date.

5.1.3 The parties acknowledge and agree that the sums paid in accordance with this clause 5 are for the possession, use and occupation of the Berth throughout the Term and that the Rights and Obligations of the Berth Owner will be recorded in the Sub-Lease.

...

5.1.5 Without limiting clause 6, the Berth Owner will be in default if it:

(a) *does not pay the Deposit or any other sums provided for in clauses 5.1.1 or 5.1.2 when required;*

...

(d) *does not pay any other sums or sums of money provided for in this Agreement as and when they fall due.*

(b) Clause 6 of the Agreement provides:

6.1.1 The Berth Owner commits an event of default if:

(a) (non-payment) it does not pay any money due or payable under this Agreement within seven (7) days of the date upon which it became due.

(c) 'Annual Levy' is defined in the First Schedule to the Agreement as follows:

means the contribution to the operating and all other outgoings, costs and expenses whatsoever more particularly defined in the Sub-Lease which are associated with:

...

(b) the Berth;

...

And which is to be paid by the Berth Owner to Nominees from time to time and for the period specified in Item 13, the amount is as specified in Item 13.

(d) 'Lease Rental' is further defined in the First Schedule to the Agreement to mean 'the amount of money payable in advance by the Berth Owner to Nominees for the use and occupation of the berth throughout the Term, in accordance with clause 5 and as set out in Item 6'.

(e) 'Term' is defined in the First Schedule as 'the period during which the Berth Owner is entitled to and in respect of which the Lease Rental will be paid for the use and occupation of the berth commencing on the commencement Date set out in Item 11 and expiring, subject to the terms of this Agreement and the Sub-Lease, on the Expiry Date set out in Item 12'.

- (f) Under Item 11 the Commencement Date is 26 February 2010 and the Expiry Date under Item 12 is one day prior to the expiration of the 25 year term of the Head Lease.
- (g) Item 6 is the amount of the Lease Rental inclusive of GST.
- (h) The Agreement is defined in the First Schedule to include all schedules, appendices, annexures and exhibits to it. This includes the draft and unregistered Sub-Lease in the Fourth Schedule.

24. Relevant terms and definitions in the Sub-Lease relating to the existing rental arrangements are reproduced below:

- (a) Clause 5 of the Sub-Lease states that:

5. Lease Rental In Advance

5.1. Lease Rental Paid In Advance

5.1.1 The Lease Rental shall be paid by the Berth Owner to Nominees by being adjusted against or deducted from the final Tax Invoice submitted by the Berth Owner to Nominees for construction work in relation to the New Marina

5.2 Lease Rental Not Refundable

5.2.1 The Lease Rental paid by the Berth Owner is not refundable in whole or in part under any circumstances.

- (b) 'Expiry Date' means 'the date set out in Item 6 of the Form 7 of the Sub-Lease and in any event, not less than one (1) day prior to the expiry date of the Lease'.
- (c) 'Lease' is defined as the Head Lease between POBC and Nominees. Item 6 of the Form 7 contains the Term of lease and has been left blank due to the Sub-Lease not having been registered.
- (d) Clause 6 requires Berth Holders to pay an Annual Levy in accordance with a formula from time to time. The Annual Levy is defined as a proportion of all reasonable and relevant outgoings, costs and expenses incurred and/or to be incurred by Nominees in respect of the operation and conduct of Marina 2 and the marina areas covered by the Adjoining Leases.
- (e) Clause 14 states that the Sub-Lease is dependent upon the continuation of the Head Lease and will determine automatically upon termination or sooner termination of the Head Lease.
- (f) Clause 20 provides that:

20.1 If:

20.1.1 the Berth Owner does not pay when due the monies payable under this Sub-Lease and such monies remain unpaid at the expiry of seven (7) days of a written demand on the Berth Owner;

...

then it shall be lawful for the Sub-Lessor, without prejudice to any other rights or remedies the Sub-Lessor may have against the Berth Owner, subject to any laws applicable to the default having been satisfied directly or by agent(s) at any time to re-enter the Berth and to determine this Sub-Lease without prejudice to any rights that may have otherwise accrued to the Sub-Lessor prior to such determination.

- (g) Clause 30 provides that:

30.1 Each of the following obligations of the Berth Owner is an essential term of this Sub-Lease:

30.1.1 the covenants to pay at the times and in the manner specified:

(a) the Lease Rental;

(b) the Annual Levy; and ...

- (h) Clause 32 states that the Sub-Lease and the Agreement contain the entire agreement between Nominees and Berth Holders, notwithstanding any previous agreements, negotiations or understandings between them about the use and occupation of the berths.

- (i) Clause 34.8 further states that the obligations contained in the Sub-Lease and the Agreement comprise the whole agreement between the parties and 'the existence of any implied or collateral or other agreement is negatived, whether arising from any statement, representation, undertaking or warranty given by or on behalf of any party on or before the Agreement'.

25. The Agreement and Sub-Lease do not contain any provision for compensation or reimbursement to Berth Holders in the event of termination or early termination of the Sub-Lease.

26. The 'Lease Rental' payments were expended on the construction of berths.

27. In June 2009 the Queensland Government announced the sale of a number of government assets, including POBC. The sale process was completed in November 2010.

28. The Department of Transport and Main Roads (DOT) acquired the Head Lease from POBC in respect of Marina 2 as part of the sale process.

29. POBC assigned the Head Lease to DOT under the arrangement and accordingly the Head Lease with registration number 713249810 continues to remain in force.

30. None of the Events of Default as specified in clause 12.1 of the Head Lease has occurred at the time of issuing this ruling.

Proposed new rental arrangements

31. DOT has now proposed to terminate the existing Head Lease and to enter into a new Head Lease with Nominees for the Marina 2 Area from a day, to be determined, in the financial year ending 30 June 2015 until 31 December 2051 with no option to renew (New Head Lease).

32. The New Head Lease will be entered into between The State of Queensland (Represented by The Department of Transport and Main Roads) as lessor and Nominees as lessee and will cover the same leased area as described in the existing Head Lease.

33. The New Head Lease will be solely for the purpose of aquatic sports and recreational activities associated with a licensed yacht club, including the business of construction, management, operation and maintenance of a marina, being a facility for the safe berthing, mooring and storage of vessels and other associated facilities, and open water mooring area and the granting and dealing with the assignment of sub-leases of individual berths within the lease area (Permitted Use).

34. Under the New Head Lease, Nominees is allowed to grant sub-leases subject to certain conditions and for the purpose of the Permitted Use.

35. On the cancellation or termination of the existing Head Lease the existing Sub-Leases will be determined pursuant to the terms of the Agreement and Sub-Lease.

36. Pursuant to the terms of the Agreement and Sub-Lease the Lease Rentals paid in advance by Berth Holders are not refundable upon early termination of the Term (clause 5 of the Sub-Lease).

37. Nominees proposes to offer a new Sub-Lease (New Sub-Lease) to each of the existing Berth Holders.

38. The New Sub-Leases are offered unilaterally by Nominees at its absolute discretion. Berth Holders form a minority of the Squadron membership and do not control or have the ability to control or direct the Squadron or Nominees to offer the New Sub-Leases.

39. Payments required under the New Sub-Leases are an Annual Levy and other costs such as a registration fee for the New Sub-Leases and costs associated with any consent to be granted by Nominees under the New Sub-Leases.

40. The Annual Levy is payable by half yearly instalments and is in respect of operating costs of the Marina 2 Area. The Annual Levy is calculated using a specified formula which takes into account the space allocated per each berth as a proportion of the Marina 2 Area and the budgeted operating costs per meter of the Marina 2 Area. The formula may be changed if further mooring berths are constructed or the area of Marina 2 expanded.

41. The rights of Berth Holders under the New Sub-Leases are subject to the New Head Lease.

Ruling

Capital gains tax (CGT) event

42. The Head Lease will be determined when a New Head Lease is executed.
43. The Sub-Leases will expire on the determination of the Head Lease.
44. CGT event C2 (paragraph 104-25(1)(c) of the ITAA 1997) will happen on the expiry of the Sub-Leases.

Capital proceeds

45. Berth Holders receive no capital proceeds from CGT event C2 occurring on the expiry of the Sub-Leases.
46. The market value substitution rule does not apply as sub-section 116-30(1) of the ITAA 1997 is not applicable to CGT event C2 where the event relates to the 'expiry of a CGT asset'.

Capital gain on the expiry of the Sub-Leases

47. A capital gain does not arise because there are no capital proceeds received by Berth Holders and the market value substitution rule does not apply.

Capital loss on the expiry of the Sub-Leases

48. Where Berth Holders have not used the Sub-Leases solely or mainly for the purpose of producing assessable income any capital loss made from the expiry of the Sub-Leases is disregarded in accordance with section 118-40 of the ITAA 1997.
49. Where a Berth Holder has used the Sub-Lease solely or mainly for the purpose of producing assessable income the Berth Holder will make a capital loss if the reduced cost base of the Sub-Lease is greater than zero.
50. The amount of the Lease Rental paid to Nominees will be part of the first element of the reduced cost base for Berth Holders who have used the Sub-Leases solely or mainly for the purpose of producing assessable income.

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.*

CGT event

51. The Sub-Leases are dependent upon the continuation of the Head Lease and will be determined automatically upon termination of the Head Lease.
52. The 'Expiry Date' in the Sub-Leases is defined as one day prior to the expiration of the Head Lease which has a 25 year term.
53. The Sub-Leases will therefore, be determined either on 23 February 2035 or one day before the determination of the Head Lease.
54. The Head Lease will be determined when the New Head Lease is executed.
55. The Sub-Leases will expire one day prior to the determination of the Head Lease.

Capital proceeds

56. Berth Holders do not receive or are not entitled to receive any money or property in respect of the expiry of the Sub-Leases. The Lease Rental payments paid in advance were expended on the construction of berths and are not refundable in whole or in part in any event (clause 5.2.1 of the Sub-Leases).
57. The Agreement and Sub-Leases do not contain any provision for compensation or reimbursement to Berth Holders in the event of an earlier termination of the Sub-Leases.
58. The offering of New Sub-Leases to Berth Holders is at the sole and absolute discretion of Nominees.
59. There is no basis in the Agreement and Sub-Leases for any connection to be drawn between the expiry of the Sub-Leases and the offering of the New Sub-Leases which is at the absolute discretion of Nominees, as the Berth Holders do not take the New Sub-Leases as compensation or reimbursement or pursuant to any compulsion exercised by them on Nominees.
60. As Berth Holders do not receive capital proceeds from CGT event C2 occurring on the expiry of the Sub-Leases the market value substitution rule under subsection 116-30(1) of the ITAA 1997 applies.
61. Subsection 116-30(1) of the ITAA 1997 states that:

If you receive no capital proceeds from a CGT event, you are taken to have received the market value of the CGT asset that is the subject of the event. (The market value is worked out at the time of the event.)

62. However, sub-section 116-30(1) does not apply to CGT event C2 where that event has occurred due to the 'expiry of a CGT asset' (subsection 116-30(3)).

63. Accordingly, the market value substitution rule does not apply on the expiry of the Sub-Leases.

Capital gain or capital loss on the expiry of the Sub-Leases

64. As there are no capital proceeds and the market value substitution rule does not apply, a capital gain does not arise.

For Berth Holders who do not use the Sub-Leases solely or mainly for the purpose of producing assessable income

65. Section 118-40 of the ITAA 1997 states that:

118-40 Expiry of a lease

A capital loss a lessee makes from the expiry, surrender, forfeiture or assignment of a lease (except one granted for 99 years or more) is disregarded if the lessee did not use the lease solely or mainly for the purpose of producing assessable income.

66. Accordingly, where the Berth Holders do not use the leases solely or mainly for the purposes of producing assessable income, any capital loss made from the expiry of the Sub-Leases is disregarded.

For Berth Holders who use the Sub-Leases solely or mainly for the purpose of producing assessable income

67. Berth Holders acquired the Sub-Leases when Nominees granted the Sub-Leases (subsection 109-5(2)).

68. As there are no capital proceeds received by Berth Holders on the expiry of the Sub-Leases Berth Holders who use the Sub-Leases solely or mainly for the purpose of producing assessable income will make a capital loss.

69. Subsection 110-25(2) of the ITAA 1997 states that the first element of the cost base or reduced cost base is the total of:

- (a) the money you paid, or are required to pay, in respect of acquiring it;

70. The Lease Rental, being an amount paid by Berth Holders in acquiring the Sub-Lease, is an acquisition cost and forms part of the first element of the reduced cost base which would be referable to the capital loss made in respect of the expiry of the Sub-Leases.

Appendix 2 – Detailed contents list

71. The following is a detailed contents list for this Ruling:

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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 event C2
- Lease
- Sub-lease
- Head lease

- Expiry of lease

Legislative references:

- ITAA 1997
- ITAA 1997 104-25(1)(c)
- ITAA 1997 109-5(2)
- ITAA 1997 110-25(2)
- ITAA 1997 116-30(1)
- ITAA 1997 116-30(3)
- ITAA 1997 118-40
- TAA 1953
- Copyright Act 1968

ATO references

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Income tax - Capital gains tax - Capital proceeds
Income tax - Capital gains tax - Valuation / market value issues

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