

CR 2004/150 - Income tax: capital gains tax: non-exempt registered clubs in New South Wales - poker machine entitlements

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Class Ruling

Income tax: capital gains tax: non-exempt registered clubs in New South Wales – poker machine entitlements

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Preamble

*The number, subject heading, **What this Class Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. CR 2001/1 explains Class Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

What this Class Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax law(s)' identified below apply to the defined class of persons, who take part in the arrangement to which this Ruling relates.

Tax law(s)

2. The tax laws dealt with in this Ruling are:
- Division 50 of the *Income Tax Assessment Act 1997* (ITAA 1997);
 - section 102-5 of the ITAA 1997;
 - subsection 102-5(1) of the ITAA 1997;
 - section 102-10 of the ITAA 1997;
 - Division 104 of the ITAA 1997;
 - section 104-10 of the ITAA 1997;
 - section 104-25 of the ITAA 1997;
 - subsection 108-5(1) of the ITAA 1997;
 - section 109-5 of the ITAA 1997;
 - Division 110 of the ITAA 1997;
 - Division 112 of the ITAA 1997;
 - Division 114 of the ITAA 1997;
 - Division 115 of the ITAA 1997;

- section 115-10 of the ITAA 1997;
- Division 152 of the ITAA 1997;
- Subdivision 152-A of the ITAA 1997;
- Subdivision 152-B of the ITAA 1997;
- Subdivision 152-D of the ITAA 1997;
- Subdivision 152-E of the ITAA 1997;
- section 152-15 of the ITAA 1997;
- subsection 152-40(1) of the ITAA 1997;
- paragraph 152-40(1)(b) of the ITAA 1997;
- section 152-205 of the ITAA 1997; and
- section 152-410 of the ITAA 1997.

Class of persons

3. The class of persons to which this Ruling applies is registered clubs in New South Wales that:

- are governed by the *Registered Clubs Act 1976* (NSW) (RCA 1976);
- hold a poker machine entitlement subject to the *Gaming Machines Act 2001* (NSW) (GMA 2001); and
- are not exempt from income tax under Division 50 of the ITAA 1997.

Qualifications

4. The Commissioner makes this Ruling based on the precise arrangement identified in this Ruling.

5. The class of persons defined in this Ruling may rely on its contents provided the arrangement actually carried out is carried out in accordance with the arrangement described in paragraphs 10 to 17.

6. If the arrangement actually carried out is materially different from the arrangement that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the arrangement entered into is not the arrangement 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 to the income years ended 30 June 2005 to 30 June 2008 inclusive, or substituted accounting periods.

Withdrawal

9. This Ruling is withdrawn from 30 June 2008.

Arrangement

10. The arrangement that is the subject of the Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them, as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description of the arrangement are:

- Letter dated 3 March 2004 from Lawler Partners Pty Ltd ('Lawler Partners') on behalf of the Registered Clubs Association of New South Wales;
- Facsimile dated 19 April 2004 from Lawler Partners;
- Letter dated 7 June 2004 from Lawler Partners;
- The RCA 1976 prior to its amendment by the GMA 2001; and
- The GMA 2001 and regulations.

11. The right to place a gaming machine in a club venue in NSW has been closely regulated by the NSW Government since the legalisation of gaming machines on 1 August 1956.

12. The RCA 1976, which took effect from 1978, reformed the regulatory regime applicable to gaming machines held by registered clubs.
13. On 28 March 2000, the NSW Government 'froze' the number of gaming machines held by each registered club.
14. In December 2001, the regulatory regime for gaming machines held by registered clubs was removed from the RCA 1976 and incorporated into the GMA 2001. This Act commenced operation on 2 April 2002.
15. On the commencement of the GMA 2001 on 2 April 2002, poker machine entitlements were automatically issued to the level of each club's authorised holding of gaming machines.
16. The GMA 2001 removed the 'freeze' but capped gaming machine numbers. It also allowed registered clubs to buy and sell poker machine entitlements thus permitting clubs to increase or decrease their entitlements within the capping rules.
17. Poker machine entitlements may only be traded in blocks of three with one of the three entitlements being forfeited to the licensing authority with each transfer.

Ruling

18. Where a club was granted a poker machine entitlement before 2 April 2002, being the commencement date of the GMA 2001, the club is taken to have acquired the entitlement at the time it was granted under the general acquisition rules in section 109-5 of the ITAA 1997.
19. Where a club has been granted a poker machine entitlement on or after 2 April 2002, the club is taken to have acquired the entitlement at the time it was granted under the general acquisition rules in section 109-5 of the ITAA 1997.
20. Where a club has purchased a poker machine entitlement under a contract on or after 2 April 2002, the entitlement was acquired under the general acquisition rules in section 109-5 of the ITAA 1997 at the time when the club entered into the contract.
21. Where a club has acquired a poker machine entitlement on or after 2 April 2002 otherwise than by grant or a purchase under a contract, the entitlement was acquired under the general acquisition rules in section 109-5 of the ITAA 1997 when the transferor stopped being the owner of that entitlement.
22. A CGT event, under Division 104 of the ITAA 1997, did not happen when a registered club acquired the initial allocation of a poker machine entitlement under paragraph 15(1)(b) of the GMA 2001.

23. When a club disposes of a poker machine entitlement to another entity, such as another club, CGT event A1 happens under section 104-10 of the ITAA 1997. However, when a club surrenders an entitlement to the NSW Government, CGT event C2 happens to that entitlement under section 104-25 of the ITAA 1997.

24. The cost base of a poker machine entitlement is worked out under the provisions of Division 110 of the ITAA 1997 subject to the modifications in Division 112 of the ITAA 1997.

25. Where a club has acquired poker machine entitlements before 20 September 1985 and after 19 September 1985, the club may nominate which entitlement it disposes of.

26. If a club disposes of a poker machine entitlement that was acquired after 19 September 1985, any capital gain that arises is included in the net capital gain or net capital loss of the club as calculated under sections 102-5 or 102-10 of the ITAA 1997 respectively.

27. The principle of mutuality does not apply to capital gains that arise from the disposal by a club of a poker machine entitlement.

28. In calculating its capital gain on the disposal of a poker machine entitlement, a club cannot use the discount method under Division 115 of the ITAA 1997. However, the club may index the cost base up to the September 1999 quarter subject to the relevant conditions under Division 114 of the ITAA 1997 being satisfied.

29. A poker machine entitlement held by a club is an active asset under subsection 152-40(1) of the ITAA 1997.

30. A club that has made a capital gain from the disposal of a poker machine entitlement may apply the small business 50% reduction under section 152-205 of the ITAA 1997 provided the club satisfies the basic conditions under Subdivision 152-A of the ITAA 1997.

31. A club that has a capital gain from the disposal of a poker machine entitlement may apply the small business roll-over in section 152-410 of the ITAA 1997 provided the club satisfies the basic conditions under Subdivision 152-A of the ITAA 1997 and the further conditions in Subdivision 152-E of the ITAA 1997.

Explanation

Acquisition of entitlement

32. Under subsection 108-5(1) of the ITAA 1997 a CGT asset is defined as:

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

33. A poker machine entitlement under the GMA 2001 gives the holder the legal right to operate a gaming machine and falls within the definition of CGT asset.

34. Where a club was granted a poker machine entitlement before 2 April 2002, being the commencement date of the GMA 2001, the club is taken to have acquired the entitlement at the time it was granted under the general acquisition rules in section 109-5 of the ITAA 1997. This covers the initial grant of a poker machine entitlement by the NSW Government.

35. If the NSW Government grants a club a poker machine entitlement on or after 2 April 2002, the club is taken to have acquired the entitlement at the time it is granted under the general acquisition rules in section 109-5 of the ITAA 1997.

36. Where a club purchases a poker machine entitlement under a contract on or after 2 April 2002, the entitlement is acquired under the general acquisition rules in section 109-5 of the ITAA 1997 at the time when the club entered into the contract.

37. Where a club acquires a poker machine entitlement on or after 2 April 2002 otherwise than by grant or a purchase under a contract, the entitlement is acquired under the general acquisition rules in section 109-5 of the ITAA 1997 when the transferor stops being the owner of that entitlement.

38. There was no CGT event under Division 104 of the ITAA 1997 when the registered club acquired the initial allocation of a poker machine entitlement under paragraph 15(1)(b) of the GMA 2001. The rights pertaining to each approved poker machine, kept on the premises of a registered club, for which a poker machine entitlement was allocated, were effectively carried over from the RCA 1976 to the GMA 2001. This was facilitated by paragraph 15(1)(b) and the savings provisions in Schedule 1 of the GMA 2001.

Disposal of entitlement

39. When a club disposes of a poker machine entitlement to another entity, such as another club, CGT event A1 happens under section 104-10 of the ITAA 1997. However, when a club surrenders an entitlement to the NSW Government, CGT event C2 happens to that entitlement under section 104-25 of the ITAA 1997.

Nominating which entitlement disposed of

40. If a club has a number of poker machine entitlements which were acquired both before 20 September 1985 and after 19 September 1985, the club may nominate which entitlement it disposes of. Capital gains arising on the disposal of assets that were acquired before 20 September 1985 are disregarded.

41. However, if the poker machine entitlements are identical, the club will need to decide which particular entitlement is being disposed of. Clubs in this situation will need to keep adequate records of the transaction so that their decision can be supported.

Principle of mutuality

42. The principle of mutuality is based on the proposition that a taxpayer cannot derive income from itself. In the case of corporate entities, the principle recognises that contributions by proprietors are not in the nature of income because 'income consists of moneys derived from sources outside' of the taxpayer (*The Bohemians Club v. Acting Federal Commissioner of Taxation* (1918) 24 CLR 334 at 337).

43. Where a club disposes of a poker machine entitlement, the proceeds from the transaction are derived from sources outside of the club and are therefore not subject to the principle of mutuality. Any capital gain that arises would be included in the calculation of the club's net capital gain for the year. A net capital gain is included in assessable income under subsection 102-5(1) of the ITAA 1997. A net capital loss calculated under section 102-10 of the ITAA 1997 is carried forward to be applied against capital gains for a later income year.

Discount method

44. In calculating its capital gain on the disposal of a poker machine entitlement, a club cannot use the discount method under Division 115 of the ITAA 1997. The reason is that companies, with a limited exception for life insurance companies, are not identified in section 115-10 of the ITAA 1997 as entities that can make a discount capital gain.

Indexation method

45. A club may index some elements of the cost base of a poker machine entitlement. Indexation is only available up to the September 1999 quarter and the relevant conditions under Division 114 of the ITAA 1997 must be satisfied.

46. For indexation to be available, the poker machine entitlement must have been acquired before 11.45 a.m. (by legal time in the Australian Capital Territory) on 21 September 1999, disposed of after that date and held for at least 12 months in the meantime. Cost base expenditure incurred after that time may not be indexed but still forms part of the cost base of the entitlement.

Small business concessions

47. There are four small business concessions, contained in Division 152 of the ITAA 1997, which may apply to capital gains from CGT events. A capital gain may be reduced or disregarded under the small business concessions if certain conditions are satisfied.

48. A club must satisfy several basic conditions in Subdivision 152-A of the ITAA 1997. Each concession also contains further requirements that need to be satisfied with the exception of the small business 50% reduction which applies whenever the basic conditions for relief are met. A club must satisfy the maximum net asset value test and the active asset test.

49. The small business 15-year exemption in Subdivision 152-B of the ITAA 1997 and the small business retirement exemption in Subdivision 152-D of the ITAA 1997 will not apply to a club because there will not be a controlling individual in the sense required for the application of those concessions.

Maximum net asset value test

50. Under section 152-15 of the ITAA 1997, there is a limit of \$5 million on the net value of the CGT assets that a club and certain related entities may own in order to qualify for the small business concessions. The small business concessions are not available if the net value of the club's CGT assets exceeds \$5 million.

Active asset test

51. A poker machine entitlement, being a CGT asset, is an active asset of a club, under paragraph 152-40(1)(b) of the ITAA 1997, if the club owns it and it is inherently connected with the business carried on by the club.

Available concessions

52. The small business 50% reduction in section 152-205 of the ITAA 1997 and the small business rollover in Subdivision 152-E of the ITAA 1997 may be available if the basic conditions in Subdivision 152-A of the ITAA 1997 are met. The small business 50% reduction will be available without any further conditions being applicable. The small business roll-over will be subject to the further conditions set out in Subdivision 152-E of the ITAA 1997.

Detailed contents list

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Commissioner of Taxation

15 December 2004

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

CR 2001/1; TR 92/1; TR 97/16

Subject references:

- acquisition of CGT assets
 - amusement & gambling equipment
 - capital gains tax

- CGT assets
 - CGT cost base
 - CGT event A1 – disposal of a CGT asset
 - CGT events
 - CGT events C1-C3 – end of a CGT asset
 - CGT exemptions
 - entities & taxpayer groups
 - mutuality principle
 - non-profit associations & clubs

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- non-profit entities
- pre-CGT assets
- statutory licences

Legislative references:

- ITAA 1997 Div 50
- ITAA 1997 102-5
- ITAA 1997 102-5(1)
- ITAA 1997 102-10
- ITAA 1997 Div 104
- ITAA 1997 104-10
- ITAA 1997 104-25
- ITAA 1997 108-5(1)
- ITAA 1997 109-5
- ITAA 1997 Div 110
- ITAA 1997 Div 112
- ITAA 1997 Div 114
- ITAA 1997 Div 115
- ITAA 1997 115-10
- ITAA 1997 Div 152
- ITAA 1997 Subdiv 152-A

- ITAA 1997 152-15
- ITAA 1997 152-40(1)
- ITAA 1997 152-40(1)(b)
- ITAA 1997 Subdiv 152-B
- ITAA 1997 152-205
- ITAA 1997 Subdiv 152-D
- ITAA 1997 Subdiv 152-E
- ITAA 1997 152-410
- Copyright Act 1968
- TAA 1953 Pt IVA
- RCA 1976 (NSW)
- GMA 2001 (NSW)
- GMA 2001 (NSW) 15(1)(b)
- GMA 2001 (NSW) Sch 1

Case references:

- The Bohemians Club v. Acting
Federal Commissioner of Taxation
(1918) 24 CLR 334

ATO references

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