


CR 2008/28 - Income tax: statutory licence roll-over for the replacement of bore licences with aquifer access licences and treatment of payments received under the Achieving Sustainable Groundwater Entitlements Program

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Class Ruling

Income tax: statutory licence roll-over for the replacement of bore licences with aquifer access licences and treatment of payments received under the Achieving Sustainable Groundwater Entitlements Program

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ⓘ 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, we must apply the law to you in the way set out in the ruling (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided we are 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 provisions 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 15-10 of the ITAA 1997;
- section 104-25 of the ITAA 1997;
- Subdivision 124-C of the ITAA 1997; and
- section 124-160 of the ITAA 1997.

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

Class of entities

3. The class of entities to which this Ruling applies is entities who owned licences under Part 5 of the *Water Act 1912* (NSW) (bore licences) that ended and were replaced with aquifer access licences, combined water supply works and use approvals and, if applicable, supplementary water access licences under the *Water Management Act 2000* (NSW) and its regulations in force as at the date of release of this Ruling.
4. The class of entities referred to in paragraph 3 of this Ruling does not include entities that carry on a business of trading in water entitlements.

Qualifications

5. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.
6. 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 14 to 24 of this Ruling.
7. 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

9. This Ruling applies from 1 July 2006 to 30 June 2008. However, the Ruling continues to apply after 30 June 2008 to all entities within the specified class who entered into the specified scheme during the term of this Ruling.

10. This Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

11. If this Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

12. If this Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

13. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Scheme

14. 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:

- request for Class Ruling by the then NSW Minister for Natural Resources dated 23 October 2006;
- additional information provided by the then NSW Minister for Natural Resources dated 19 December 2006;
- *Water Act 1912* (NSW) (the Water Act 1912);
- *Water Management Act 2000* (NSW) (the Water Management Act 2000) as amended to the date of release of this Ruling and its regulations in force at that date; and
- correspondence and emails received from the Department of Water and Energy (DWE) NSW (formerly the Department of Natural Resources) in relation to the application for class ruling.

15. The intergovernmental National Water Initiative (NWI) was agreed to by the Commonwealth and State Governments in June 2004. One of the objectives of the NWI is 'the return of all currently over-allocated or overused systems to environmentally sustainable levels of extractions'.

16. The six major inland groundwater systems in NSW (the Lower Gwydir, Lower Macquarie, Lower Murray, Lower Murrumbidgee, Upper and Lower Namoi and Lower Lachlan) have been over-allocated, and over the past few years some of these systems have also experienced over-extraction.

17. Aquifer access licences provide owners with a share of the sustainable yield applicable to the relevant Water Sharing Plan. Unlike bore licences which are issued for a five year period on payment of a licence fee, aquifer access licences are issued in perpetuity and are fully tradeable. The ASGE Program, which is jointly funded by the NSW and Australian governments, was announced in June 2005. The reform includes the replacement of bore licences with aquifer access licences and combined water supply works and use approvals.

18. Bore licence holders with a history of extraction (HOE) (as defined under the ASGE program) in excess of their replacement aquifer access licence will receive an additional licence called a supplementary water access licence. These supplementary licences are not tradeable. The volume of water available under these supplementary water access licences will be reduced to zero by 1 July 2015. These licences will be cancelled after 1 July 2015.

19. Bore licences end and are replaced when the relevant statutory Water Sharing Plan for each ground water system commences.

20. Water Sharing Plans commenced for each of the groundwater source areas on the following dates:

Statutory Water Sharing Plan	Commencement
Lower Gwydir Groundwater Source	1 October 2006
Lower Macquarie Groundwater Sources	1 October 2006
Lower Murrumbidgee Groundwater Sources	1 October 2006
Lower Murray Groundwater Source	1 November 2006
Upper and Lower Namoi Groundwater Sources	1 November 2006
Lower Lachlan Groundwater Source	1 February 2008

21. The licence holders are not entitled to any payments under the Water Act 1912 or Water Management Act 2000 as a consequence of any actions prior to the actual commencement of the Water Sharing Plan for the water source.

22. The licence holders are not entitled to any payments under the Water Management Act 2000 as a consequence of the progressive reduction in allocated volume under, or the ending of, a supplementary water access licence.

23. Under the ASGE Program, eligible aquifer access licence holders may also be offered a cash payment in situations where their bore licence was replaced with:

- one or more aquifer access licences where the specified share of the sustainable yield of the water source is less than the volume specified by their bore licence; and
- if applicable, a supplementary water access licence.

24. The amount of the cash payment offer under the ASGE Program is calculated by reference to 3 factors:

- the asset component, where the value of the aquifer access licence is less than the value of the bore licence;
- the HOE component, where the HOE, capped at past entitlement levels, is greater than the share of the sustainable yield under the aquifer access licence; and
- the Special HOE component (parts of the Upper and Lower Namoi groundwater sources only), where the licence holder has previously had their usage restricted below their entitlement levels by announced allocations.

Ruling

Section 6-5 – income according to ordinary concepts

25. The replacement of the bore licence with the new water entitlements pursuant to Schedule 10 of the Water Management Act 2000 and, where relevant, the receipt of a payment under the ASGE Program will not give rise to assessable income under section 6-5 of the ITAA 1997.

Section 15-10 – bounty or subsidy

26. The replacement of the bore licence with the new water entitlements pursuant to Schedule 10 of the Water Management Act 2000 and, where relevant, the receipt of a payment under the ASGE Program will not constitute assessable income under section 15-10 of the ITAA 1997.

Capital gains tax

27. CGT event C2 under section 104-25 happens when a bore licence ends on the commencement of the relevant Water Sharing Plan.

28. The capital proceeds from CGT event C2 happening to the bore licence are the total of the market values of the aquifer access licence and combined water supply works and use approval (and, where applicable, the supplementary water access licence) and any cash payment received under the ASGE Program.

29. Roll-over relief under Subdivision 124-C applies for entities who own a bore licence which ends and is replaced by:

- an aquifer access licence and combined water supply works and use approval; and
- a supplementary water access licence (where applicable),

provided that the replacement licence(s) is received by the same entities who owned the original bore licence and in the same shares.

30. If a bore licence was acquired before 20 September 1985 then the replacement aquifer access licence (and, where applicable, a supplementary water access licence) is taken to have been acquired before that date (section 124-160).

31. There is no roll-over relief for any cash payments under the ASGE Program.

Appendix 1 – Explanation

① *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.*

Section 6-5 – income according to ordinary concepts

32. Subsection 6-5(1) provides that assessable income includes income according to ordinary concepts (ordinary income). However, as there is no statutory definition of 'income according to ordinary concepts' it is necessary to apply the principles developed by the courts about the nature of income, to the facts of a particular case.

33. Whether or not a particular receipt is ordinary income depends on its character in the hands of the recipient.¹

34. In *GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation* (1990) 170 CLR 124; (1990) 21 ATR 1; 90 ATC 4413, the Full High Court stated at CLR 138; ATR 7; ATC 4420:

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.

35. The bore licences are valuable capital assets. The replacement of a bore licence with a new water entitlement pursuant to Schedule 10 of the Water Management Act 2000 is the replacement of one capital asset with another capital asset. This, will not give rise to assessable income under section 6-5 of the ITAA 1997.

36. A cash payment under the ASGE Program is a one-off receipt made in some cases as a result of the ending of a bore licence. The amount is received for the ending and replacement of a capital asset and is capital in nature. It is not assessable under section 6-5.

Section 15-10 – bounty or subsidy

37. 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.

¹ *Scott v. Federal Commissioner of Taxation* (1966) 117 CLR 514, *Hayes v. Federal Commissioner of Taxation* (1956) 96 CLR 47, *Federal Coke Co Pty Ltd v. Federal Commissioner of Taxation* (1977) 7 ATR 519; 77 ATC 4255.

38. 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*,² 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.

39. A bounty or subsidy will be 'in relation to' carrying on a business when there is a real connection between the payment and the business. The term 'in relation to' includes within its scope payments that have a direct or indirect connection to the business. As stated by Hill J in *First Provincial Building Society v. FC of T* (1995) 56 FCR 320 at 332:

The words 'in relation to' are words of wide import. They are capable of referring to any relationship between the two subject matters, in the present case the receipt of the bounty or subsidy, on the one hand, and the carrying on of the business, on the other ... the degree of connection will be 'a matter of judgment on the facts of each case'. ...What is necessary, at the least, in the present context is that there be a real connection ... the relationship need not be direct, it may also be indirect.

40. A bounty or subsidy must be related to 'carrying on' the business not merely for commencing or ceasing a business. As stated by Hill J in *First Provincial Building Society v. FC of T* (1995) 56 FCR 320 at 332:

the relationship must be to the 'carrying on' of the business. These words may perhaps be understood in opposition to a relationship with the actual business itself. They would make it clear, for example that a bounty received, merely in relation to the commencement of a business or the cessation of the business, would not be caught. The expression 'carrying on of a business' looks, in my opinion, to the activities of that business which are directed towards the gaining or producing of assessable income, rather than merely to the business itself.

41. Government payments to industry received by an entity as assistance either to cease a business or give or sell part of the profit yielding structure of the business are not in relation to the 'carrying on' of the business.

42. The replacement of the bore licence with new water entitlements pursuant to Schedule 10 of the Water Management Act 2000 does not constitute a bounty or subsidy received in relation to carrying on a business and will not give rise to assessable income under section 15-10 of the ITAA 1997. A payment received under the ASGE Program is for the permanent loss of a licence and is not a bounty or subsidy for the purposes of section 15-10 of the ITAA 1997. Accordingly, no part of the total receipt constitutes assessable income under section 15-10 of the ITAA 1997.

² (1969) 121 CLR 353.

Capital gains tax

43. Subsection 104-25(1) provides that CGT event C2 happens if a CGT asset you own ends in one of a number of ways, including by cancellation or expiry.

44. A CGT asset is defined in subsection 108-5(1) as:

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

45. Bore licences entitle their owners to take water subject to the specifications applicable to the licence. They are statutory rights and, therefore, they are CGT assets within the definition of a CGT asset under subsection 108-5(1).

46. Accordingly, CGT event C2 happens when a bore licence comes to an end. This will be at the time that the Water Sharing Plan commenced for the water source.

47. A capital gain is made from CGT event C2 if the capital proceeds from the ending of a CGT asset exceed the asset's cost base. A capital loss is made if the capital proceeds from the ending of the CGT asset are less than the asset's reduced cost base (subsection 104-25(3)).

48. The capital proceeds from a CGT event are the total of the money you receive, or are entitled to receive and the market value of any property you have received or are entitled to receive, in respect of the event happening (subsection 116-20(1)).

49. The capital proceeds from CGT event C2 happening to a bore licence under the ASGE program is the total of the market value of the aquifer access licence, the combined water supply works and use approval, and any supplementary water access licence, and any cash payment under the ASGE Program. It is likely that the value of the combined water supply works and use approval (and, where applicable, the supplementary water access licence) will be minimal.

Statutory licence roll-over

50. Section 124-140 provides that there is roll-over if:

- your ownership of one or more statutory licences ends and CGT event C2 happens;
- as a result of the ending of the original licence(s), you are issued with one or more new licences; and
- the new licence authorises substantially similar activity as that authorised by the original.

A bore licence is a statutory licence for the purposes of subsection 124-140(3).

51. Where licence owners receive an aquifer access licence and a combined water supply works and use approval (and, where applicable, a supplementary water access licence), the ending of the bore licence satisfies the requirements of paragraph 124-140(1)(a).

52. Paragraph 124-140(1)(b) provides that roll-over is only available if you get a new licence(s) for the original licence. The issue of new licences under the ASGE Program satisfies this requirement.

53. Paragraph 124-140(1)(c) provides that the new licence must authorise substantially similar activity as that authorised by the original licence. Where licence owners receive an aquifer access licence and a combined water supply works and use approval (and, where applicable, a supplementary access licence) under the ASGE Program the new licence(s) authorises the same activity as the original licence, being extraction of the underlying water. Therefore, the requirements of the provision are met and rollover relief under Subdivision 124-C applies.

Consequences of roll-over

54. A capital gain or loss that a licence owner makes because of the ending of their bore licence(s) is disregarded to the extent that a replacement licence(s) is received (section 124-145). There is no roll-over for that part of the capital gain to which the cash payment relates (the ineligible part) (subsection 124-150(1)).

55. An aquifer access licence (and, where applicable, a supplementary water access licence) is taken to have been acquired before 20 September 1985 if the bore licence was acquired before that date (section 124-160).

56. In working out the cost base (or reduced cost base) of the ineligible part, the cost base of the bore licence(s) must be apportioned over the new licences and the cash amount on a reasonable basis. The 2002 values assigned under the ASGE Program should be used for this purpose (paragraph 124-141(1)(a) of the *Income Tax (Transitional Provisions) Act 1997*).

57. The first element of the cost base (or reduced cost base) of the new licence(s) is such amount as is reasonable having regard to:

- the total cost bases of all the original licences;
- the number, market value and character of the original licences; and
- the number, market value and character of the new licences;

(subsections 124-155(2) and 124-155(3)).

58. The first element of the cost base of the aquifer access licence, combined water supply works and use approval (and, where applicable, the supplementary water access licence) is an appropriate portion of the total cost base of the bore licence that is replaced (subsection 124-155).

Other capital gains tax concessions

59. A capital gain that cannot be disregarded under the roll-over (that is, in relation to any cash payment) may be reduced by the general CGT discount if the relevant requirements in Subdivisions 115-A, 115-B and 115-C are met.

60. The capital gain may also be reduced or deferred by the small business CGT concessions if the original licence is an active asset and the other requirements of Division 152 are met. The concessions available include the:

- small business 15-year exemption (Subdivision 152-B);
- small business roll-over (Subdivision 152-E);
- small business 50% active asset reduction (Subdivision 152-C); and
- small business retirement exemption (Subdivision 152-D).

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Subject references:

- bounties & subsidies
- capital gains tax
- capital receipts
- government grants income
- income

Legislative references:

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- ITAA 1997 6-5(1)
- ITAA 1997 15-10
- ITAA 1997 104-25
- ITAA 1997 104-25(1)
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- ITAA 1997 108-5(1)
- ITAA 1997 Subdiv 115-A
- ITAA 1997 Subdiv 115-B
- ITAA 1997 Subdiv 115-C
- ITAA 1997 116-20(1)
- ITAA 1997 Subdiv 124-C
- ITAA 1997 124-140
- ITAA 1997 124-140(1)(a)
- ITAA 1997 124-140(1)(b)
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- ITAA 1997 124-140(3)
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- TAA 1953
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- Income Tax (Transitional Provisions) Act 1997 124-141(1)(a)
- Copyright Act 1968
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- Water Management Act 2000 (NSW)

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Case references:

- Federal Coke Co Pty Ltd v. Federal Commissioner of Taxation (1977) 34 FLR 375; (1977) 7 ATR 519; 77 ATC 4255
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ATO references

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