CR 2019/82 - Fairbairn Irrigation Network Limited - receipt of shares

Class Ruling

Fairbairn Irrigation Network Limited – receipt of shares

Relying on this Ruling

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

If this Ruling applies to you, and you correctly rely on it, we will apply the law to you in the way set out in this Ruling. That is, you will not pay any more tax or penalties or interest in respect of the matters covered by this Ruling.

Further, if we think that this Ruling disadvantages you, we may apply the law in a way that is more favourable to you.

Table of Contents **Paragraph**

What this Ruling is about

1. This Ruling sets out the income tax consequences for residents of Australia who received ordinary shares in Fairbairn Irrigation Network Limited (Fairbairn) when the Emerald Channel Irrigation Scheme transitioned to a local management arrangement on 30 June 2019.

2. Full details of this transition and share allocation are set out in paragraphs 9 to 32 of this Ruling.

3. All legislative references are to provisions of the *Income Tax Assessment Act 1997* unless otherwise indicated.

Who this Ruling applies to

4. This Ruling applies to you if you:

- are a resident of Australia (within the meaning of subsection 6(1) of the *Income Tax Assessment Act 1936* (ITAA 1936))
- are not a 'temporary resident' as defined in subsection 995-1(1), and
- received ordinary shares in Fairbairn on the 30 June 2019.

5. This Ruling does not apply to anyone who is subject to the taxation of financial arrangements rules in Division 230 in relation to the scheme outlined in paragraphs 9 to 32 of this Ruling.

Note: Division 230 will not apply to individuals, unless they have made an election for it to apply.

When this Ruling applies

6. This Ruling applies from 1 July 2018 to 30 June 2019.

Ruling

Income tax consequences

7. Your receipt of ordinary shares in Fairbairn on 30 June 2019 will not be assessable as ordinary income under section 6-5 or statutory income under section 6-10.

Capital gain tax consequences

8. Pursuant to subsection 110-25(2), the first element of the cost base of shares in Fairbairn you received on 30 June 2019 is nil.

Scheme

9. The following description of the scheme is based on information provided by the applicant. If the scheme is not carried out as described, this Ruling cannot be relied upon.

10. The Emerald Channel Irrigation Scheme is the system used to supply water under water allocations to irrigators who purchase irrigation services in the Nogoa Mackenzie Bulk Water Supply Scheme.

11. SunWater Limited (SunWater) is a Queensland Government owned corporation which is a bulk water infrastructure developer and manager, owning and operating a number of channel irrigation schemes throughout Queensland.

12. In 2012, the Queensland Government established a project to consider the transition of channel irrigation schemes, including the Emerald Channel Irrigation Scheme, to local management arrangements.

13. Chapter 4A of the *Water Act 2000* (Qld) provides for the transfer of the business, assets and liabilities of SunWater in relation to the Emerald Channel Irrigation Scheme to an irrigation entity (Fairbairn) owned by the irrigators of the scheme. The arrangement is known as a transfer to a 'local management arrangement' or 'local management'.

14. Irrigators of the Emerald Channel Scheme carry on horticultural businesses and the acquisition of water through the Emerald Channel Scheme forms part of the ordinary course of their business.

15. The irrigators of the Emerald Channel Irrigation Scheme are entitled to water allocations in accordance with the provisions of the *Water Act 2000* (Qld).

16. Prior to the transfer to local management, the irrigators' water allocations were supplied pursuant to the Emerald water supply scheme resource operations licence held by SunWater. After the transfer to local management, the irrigators' water allocations are

supplied pursuant to the distribution operations licence held by Emerald Water (Emerald Water distribution operations licence).

Fairbairn

17. Fairbairn is a public company limited by shares established for the purposes of transitioning the Emerald Channel Irrigation Scheme to local management.

18. Fairbairn operates on a not-for-profit basis with all surplus funds required to be retained in the business.

19. The Constitution of Fairbairn includes relevant clauses which have the effect of:

- prohibiting Fairbairn from paying dividends (Article 16 of the Constitution)
- ensuring the assets and income of Fairbairn are applied solely in furtherance of its objects and no portion will be distributed directly or indirectly to the shareholders of Fairbairn except as bona fide compensation for services rendered or expenses incurred on behalf of Fairbairn (Article 5 of the Constitution)
- restricting eligibility to be a shareholder and entitlement to shares by the volume of the water allocation held by that person (Article 7 of the Constitution)
- restricting the ability of shareholders to transfer or sell their Fairbairn shares through certain specified rules (Articles 7, 11, 13, 17 and 32 of the Constitution), and
- prohibiting Fairbairn from making distributions on dissolution or winding up to shareholders. Any surplus assets must instead be transferred for no consideration to a like-minded entity with the objects consistent with the objects of Fairbairn (Article 65 of the Constitution).

20. The objects of Fairbairn (Article 5 of the Constitution) are to:

- own, operate and maintain the Emerald Channel Irrigation Scheme
- provide irrigation services, water transportation services and drainage services to customers
- purchase, sell, transfer or lease water allocations distributed under the Emerald Water distribution operations licence or to facilitate the purchase, sale, transfer or lease of such water allocations
- plan and provide for the renewal and refurbishment of the Emerald Channel Irrigation Scheme infrastructure, plant and equipment to meet anticipated future requirements, and
- do all such other lawful things as are incidental or conductive to (and for the purpose of) the attainment of any of the listed objects.

21. To be eligible to become a shareholder in Fairbairn, an irrigator must be located in Australia and hold a water allocation under the Emerald Water distribution operations licence.

Irrigation offer and transition to local management

22. On 14 January 2019, all eligible irrigators of the Emerald Channel Irrigation Scheme were invited to consider a proposal to transition the Emerald Channel Irrigation Scheme to local management (referred to as the 'Irrigation Offer').

23. The Irrigation Offer set out detailed information about the local management proposal including Fairbairn's proposed structure, governance, operation and management arrangements.

24. The Irrigation Offer asked all eligible irrigators of the Emerald Channel Irrigation Scheme to decide whether they supported the local management proposal to transfer the Emerald Channel Irrigation Scheme from SunWater to Fairbairn by accepting the offer to become a shareholder of Fairbairn.

25. There was no consideration payable by irrigators of the Emerald Channel Irrigation Scheme to accept the offer for, or receive shares in, Fairbairn.

26. The Irrigation Offer set out that a shareholder of Fairbairn would have the opportunity to directly contribute towards the management of the Emerald Channel Irrigation Scheme based on the rights associated with their Fairbairn shares.

27. In order for the transition to local management to proceed, a minimum percentage of irrigators with a water allocation in the Emerald Channel Irrigation Scheme needed to accept the offer to become a shareholder of Fairbairn for nil consideration. The Irrigation Offer closed on 11 March 2019 and the requisite minimum percentage of irrigators accepting the offer to receive Fairbairn shares was achieved.

28. On 30 June 2019, the transfer of the Emerald Channel Irrigation Scheme to local management occurred. The following occurred on 30 June 2019:

- the business, assets and liabilities of the Emerald Channel Irrigation Scheme were transferred from SunWater to Fairbairn, and
- you were issued with shares in Fairbairn.

Shares in Fairbairn

29. Shares in Fairbairn:

- carry no entitlement to a distribution of the assets or income of Fairbairn
- carry no entitlement to a distribution on the dissolution or winding up of Fairbairn
- carry no entitlement to consideration if you cease to hold your shares in Fairbairn
- have limited transferability. Other than by surrender, forfeiture or transmission by death, you are only permitted to transfer your shares to another eligible irrigator to whom you transfer a water allocation
- carry no application fee, and
- carry limited liability.

30. An eligible irrigator of the Emerald Channel Irrigation Scheme is not required to hold any shares in Fairbairn but may hold any number of ordinary shares up to their entitlement to shares (as per Article 7 of the Constitution).

31. The number of Fairbairn shares that an irrigator is entitled to is determined by their water allocation. A person is permitted to hold one ordinary share for every megalitre of their total water allocation.

32. No shareholders or their associates may together hold more than 25% of the shares in Fairbairn at any time.

Commissioner of Taxation
11 December 2019

Appendix – Explanation

➊ ***This Explanation 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.***

Table of Contents **Paragraph**

Income tax

33. Subsection 6-1(1) provides that a taxpayer's assessable income consists of ordinary income and statutory income.

Ordinary income

34. Subsection 6-5(1) provides that your assessable income includes income according to ordinary concepts, which is called ordinary income.

35. Ordinary income is not defined in the income tax legislation. In order to determine whether the receipt of shares in Fairbairn by a shareholder is ordinary income, it is necessary to consider how the courts have determined when a receipt is ordinary income.

36. The High Court's decision in *GP International*[1] provides a useful exposition of when non-recurrent receipts may be ordinary income. The High Court stated:

> '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. The factors relevant to the ascertainment of the character of a receipt of money are not necessarily the same as the factors relevant to the ascertainment of the character of its payment.' ((1990) 170 CLR 124 at 138; 90 ATC 4413 at 4420)

37. In the present case, the elements of periodicity, regularity and recurrence are not present in your receipt of shares in Fairbairn. There is no right or thing disposed of by you in exchange for the receipt of your shares. These facts weigh against a conclusion that the receipt is ordinary income.

38. The High Court in *GP International* noted that the scope of the transaction, venture or business in respect of which the receipt is received and the recipient's purpose in engaging in that transaction will be relevant in the circumstances of that case. The High Court went on to analyse the contract under which the taxpayer had received the receipt as critical in determining the scope of the taxpayer's business and the taxpayer's purpose in engaging in the transaction. After analysing the contract, the High Court concluded that the establishment payments were received by *GP International* as part of the remuneration it earned in the carrying on of its business.

[1] *GP International Pipecoaters Pty Ltd v Commissioner of Taxation (Cth)* [1990] HCA 25.

39. The question in the present case is whether the scope of your business and your purpose in entering the transaction is such that the receipt of shares in Fairbairn is earned in the course of carrying on your business.

40. You carry on a horticultural business and the receipt of shares in Fairbairn would not ordinarily be seen as a return within the scope of such a business. In addition, there is no requirement for you to hold shares in Fairbairn in order to carry on your business, nor are shares in Fairbairn required for you to be eligible to hold water allocation rights and enter water supply arrangements that are necessary to carry on the activities of your business.

41. The receipt of shares in Fairbairn does not have a connection or link to your right to your water allocation, water supply or ownership of land, being things that are necessary to carry on the activities of your business.

42. In these circumstances, it is considered that your receipt of shares in Fairbairn cannot be directly linked to your ongoing income earning horticultural activities.

43. The High Court in *Myer Emporium*[2] dealt with gains from a transaction that was isolated and extraordinary in terms of the normal business operation of the taxpayer. In *Myer Emporium*, the High Court held that the amount was ordinary income rather than a capital receipt. Despite being an isolated transaction, it was in the ordinary course of the taxpayer's business and the receipt was held to be ordinary income on the basis of the taxpayer's profit-making purpose.

44. Taxation Ruling TR 92/3[3] provides guidance on determining whether profits from an isolated transaction are income and therefore assessable as ordinary income under section 6-5. Paragraph 15 of TR 92/3 provides that a profit from an isolated transaction is generally income when both of the following elements are present:

- the intention or purpose of the taxpayer in entering into the transaction was to make a profit or gain, and
- the transaction was entered into, and the profit was made, in the course of carrying on a business or in carrying out a business operation or commercial transaction.

45. In accordance with the reasoning in *Myer Emporium*, your intention would need to be ascertained at the time you received your shares in Fairbairn on 30 June 2019.

46. By accepting the offer for shares in Fairbairn, you displayed an intention to participate in the ongoing management of the Emerald Channel Irrigation Scheme in accordance with the rights and obligations attached to your shares.

47. You are not entitled to any distribution of assets and income of Fairbairn or any distribution on the dissolution or winding up of Fairbairn. Shares in Fairbairn have limited transferability.

48. As you will not be entitled to any distribution of assets, income or cash consideration as a result of holding, or ceasing to hold, shares in Fairbairn, there is no evidence that you had an intention or motive to make a profit or gain from becoming a shareholder in Fairbairn.

49. Your receipt of shares in Fairbairn is considered to be a receipt on capital account. There is not a sufficient nexus between the receipt of shares and your business activities to consider the receipt of shares in Fairbairn to be on income account.

---

[2] *Commissioner of Taxation v Myer Emporium* [1987] HCA 18.
[3] Taxation Ruling TR 92/3 *Income tax: whether profits on isolated transactions are income.*

50. Accordingly, the receipt of ordinary shares in Fairbairn on 30 June 2019 will not be included in your assessable income as ordinary income under section 6-5.

Statutory income

51. Your assessable income also includes some amounts that are *not* ordinary income.[4] Amounts that are *not* ordinary income, but are included in your assessable income by provisions about assessable income, are called *statutory income*.[5]

52. These amounts are included by provisions about assessable income. For a summary list of these provisions, see section 10-5. Section 10-5 includes in assessable income:

- bounties and subsidies (section 15-10), and
- non-cash business benefit (section 21A of the ITAA 1936).

Bounties and subsidies

53. Section 15-10 includes in assessable income, a bounty or subsidy that:

- you receive in relation to carrying on a business; and
- is not assessable as ordinary income under section 6-5.

54. A bounty or subsidy will be 'in relation to carrying a business' where 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*[6]:

> 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 judgement on the facts of each case'. … What is necessary, at the least, in the present context is there be a real connection … the relationship need not be direct, it may also be indirect. … The expression 'carrying on 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.

55. In the present case, the transfer of the Emerald Channel Irrigation Scheme to local management was implemented as a result of the requisite percentage of eligible irrigators accepting the offer to become shareholders of Fairbairn. However, there is no requirement for an eligible irrigator to be a shareholder in Fairbairn in order to carry on the activities of their business. Every eligible irrigator is entitled to their water allocation and water supply regardless of whether or not they are a shareholder of Fairbairn.

56. Therefore there is no real connection between your receipt of shares in Fairbairn and the activities of your horticultural business from which assessable income is derived.

57. Accordingly, your receipt of shares in Fairbairn is not considered to be a bounty or subsidy assessable under section 15-10.

Non-cash business benefits

[4] Subsection 6-10(1).
[5] Subsection 6-10(2).
[6] *First Provincial Building Society Ltd v Commissioner of Taxation* [1995] FCA 87.

58. According to section 21A of the ITAA 1936, in determining the income derived by a taxpayer, a non-cash business benefit that is not convertible to cash will be treated as if it were convertible to cash.[7] If a non-cash business benefit (whether or not convertible to cash) is income derived by a taxpayer:

- the benefit will be brought into account at its arm's length value reduced by the recipient's contribution (if any), and
- if the benefit is not convertible to cash – in determining the arm's length value of the benefit, any conditions that would prevent or restrict the conversion of the benefit to cash will be disregarded.[8]

59. For section 21A of the ITAA 1936 to apply to the receipt of shares in Fairbairn, there must be a 'non-cash business benefit' and 'income derived' by the shareholder.

60. The phrases 'non-cash business benefit' and 'income derived by a taxpayer' are defined in subsection 21A(5) of the ITAA 1936 as follows:

> ***income derived by a taxpayer*** means income derived by a taxpayer in carrying on a business for the purpose of gaining or producing assessable income.
>
> ***non-cash business benefit*** means property or services provided after 31 August 1988:
>
> (a) wholly or partly in respect of a business relationship; or
>
> (b) wholly or partly for or in relation directly or indirectly to a business relationship.

61. In the present case, your receipt of shares in Fairbairn is not considered ordinary income derived by you as explained in paragraphs 34 to 50 of this Ruling. Therefore, your receipt of shares in Fairbairn is not considered a non-cash business benefit received by you under section 21A of the ITAA 1936.

Capital gains tax

62. Section 110-25 provides the general rules about the cost base of a CGT asset. The cost base of a CGT asset consists of five elements.[9] The first element of the cost base of a CGT asset is the total of:

- the money paid, or are required to be paid, in respect of acquiring it; and
- the market value of any other property given, or are required to be given, in respect of acquiring it (worked out as at the time of the acquisition).[10]

63. Division 112 contains modifications to the general rules about the cost base and reduced cost base of a CGT asset. Section 112-20 contains the market value substitution rule. Paragraph 112-20(1)(a) provides that if you did not incur any expenditure to acquire a CGT asset from another entity, the first element of the cost base and reduced cost base of the asset is its market value. However, subsection 112-20(3) provides situations in which the market value substitution rule in subsection 112-20(1) does not apply.

64. There are some situations in which the market value substitution rule does not apply including where a share in a company or a right to acquire a share in a company is issued or allotted to the acquirer and the acquirer did not pay or give anything for it.[11]

---

[7] Subsection 21A(1) of the ITAA 1936.
[8] Subsection 21A(2) of the ITAA 1936.
[9] Subsection 110-25(1).
[10] Subsection 110-25(2).
[11] Table Item 5 in subsection 112-20(3).

65. In accepting the Irrigation Offer, you were not required to provide consideration of any kind for the receipt of Fairbairn shares. In these circumstances, the market value substitution rule does not apply to your receipt of shares in Fairbairn.

66. Accordingly, the first element of the cost base of a share in Fairbairn at the time you received it on 30 June 2019 is nil.

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 92/3

Legislative references:

- ITAA 1936 6(1)
- ITAA 1936 21A
- ITAA 1936 21A(1)
- ITAA 1936 21A(2)
- ITAA 1936 21A(5)
- ITAA 1997
- ITAA 1997 6-1
- ITAA 1997 6-1(1)
- ITAA 1997 6-5
- ITAA 1997 6-5(1)
- ITAA 1997 6-10
- ITAA 1997 6-10(1)
- ITAA 1997 6-10(2)
- ITAA 1997 10-5
- ITAA 1997 15-10
- ITAA 1997 110-25
- ITAA 1997 110-25(1)
- ITAA 1997 110-25(2)
- ITAA 1997 Div 112
- ITAA 1997 112-20
- ITAA 1997 112-20(1)
- ITAA 1997 112-20(1)(a)
- ITAA 1997 112-20(3)
- ITAA 1997 Div 230
- ITAA 1997 995-1(1)
- TAA 1953
- Water Act 2000 (Qld)

Case references:

- Commissioner of Taxation v Myer Emporium [1987] HCA 18; 163 CLR 199; 87 ATC 4363; 18 ATR 693
- First Provincial Building Society Ltd v Commissioner of Taxation [1995] FCA 87; 56 FCR 320; 95 ATC 4145
- GP International Pipecoaters Pty Ltd v Commissioner of Taxation [1990] HCA 25; 170 CLR 124; 21 ATR 1; 90 ATC 4413

ATO references

NO:	1-IZ8WE1U
ISSN:	2205-5517
BSL	PGI
ATOlaw topic:	Income tax ~~ Assessable income ~~ Ordinary income Income tax ~~ Assessable income ~~ Other types of income ~~ Government payments Income tax ~~ Assessable income ~~ Other types of income ~~ Grants Income tax ~~ Assessable income ~~ Other types of income ~~ Non-cash benefits Income tax ~~ Assessable income ~~ Statutory income Income tax ~~ Capital gains tax ~~ Cost base and reduced cost base