


# ***CR 2019/84 - Treatment of compensation payments received under the Fisheries Act 1995 (Vic) relating to the removal of commercial net fishing from the Gippsland Lakes***

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## Class Ruling

# Treatment of compensation payments received under the *Fisheries Act 1995* (Vic) relating to the removal of commercial net fishing from the Gippsland Lakes

### **❶ 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.

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### **What this Ruling is about**

1. This Ruling sets out the tax consequences of receiving compensation under the *Fisheries Act 1995* (Vic) for the cancellation of a Gippsland Lakes Fishery Access Licence.
2. Full details of this scheme are set out in paragraphs 27 to 37 of this Ruling.
3. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* unless otherwise indicated.

### **Who this Ruling applies to**

4. This Ruling applies to you if you are a Gippsland Lakes Fishery Access Licence holder (Licence Holder) who receives compensation under the *Fisheries Act 1995* (Vic) for the cancellation of your Gippsland Lakes Fishery Access Licence.

### **When this Ruling applies**

5. This Ruling applies from 1 April 2020 to 30 June 2021.

**Ruling**

6. The compensation received under the scheme has three components:
- compensation for the cancellation of the Gippsland Lakes Fishery Access Licence (Fishing Licence) based on a market valuation (Licence Cancellation Component).
  - an allowance for the reduction in value of commercial fishing equipment, including fishing vessels (Fishing Equipment) following the prohibition of commercial fishing (Fishing Equipment Component), and
  - compensation for loss of income (Loss of Income Component).
7. Under the scheme, Licence Holders can elect to surrender their Fishing Licence. If a Licence Holder surrenders their licence, the Fishing Licence will be cancelled from 1 April 2020 (surrendered). If a Licence Holder does not surrender their Fishing Licence, the licence will be cancelled from 1 April 2021 (cancelled).
8. The amount of the compensation received by a Licence Holder will differ depending on whether their Fishing Licence is surrendered or cancelled. Where a Licence is cancelled, the Licence holder will only be entitled to 80% of the compensation they would have received if they had elected to surrender their Fishing Licence.

**Licence Cancellation Component*****Section 6-5 – income according to ordinary concepts***

9. The Licence Cancellation Component is an amount received for the surrender or cancellation of the Fishing Licence, and is not income according to ordinary concepts. The receipt of the Licence Cancellation Component is not assessable income under section 6-5.

***Section 15-10 – bounty or subsidy received in relation to carrying on a business***

10. The Licence Cancellation Component is received for the surrender or cancellation of the Fishing Licence and is not a bounty or subsidy that is received in relation to carrying on a business. Therefore, the receipt of the Licence Cancellation Component is not assessable income under section 15-10.

***Capital gains tax***

11. The Licence Cancellation Component is received for the cancellation or surrender of the Fishing Licence and is subject to the capital gains tax (CGT) provisions in Part 3-1 and Part 3-3. CGT event C2 under section 104-25 will happen when the licence is surrendered or cancelled. The Market Value Component amount (\$371,000 if the Fishing Licence is surrendered, or 80% of that amount if the Fishing Licence is cancelled) represents the capital proceeds for the CGT event in accordance with subsection 116-20(1).
12. If the Fishing Licence was issued to the Licence Holder as a result of the transition from a Master Fisherman's Licence in 1998, and that earlier licence was acquired before 20 September 1985, provided the terms and conditions of the Fishing Licence are not substantially different to the original Master Fisherman's Licence and the underlying activity authorised by the current Fishing Licence has not changed from the original licence

(based on the individual circumstances of the Licence Holder), the Licence Holder may be able to disregard the capital gain or capital loss, under paragraph 104-25(5)(a) as a pre-CGT asset, by virtue of a replacement asset rollover under Subdivision 124-C.

13. A licence that is used in carrying on a commercial fishing operation may be an active asset within the meaning of subsection 152-40(1) for the purposes of the small business concessions in Division 152.<sup>1</sup>

### ***Primary production income***

14. The Licence Cancellation Component received for the surrender or cancellation of the Fishing Licence is not treated as 'assessable primary production income' for the purposes of calculating the 'averaging adjustment' available under Division 392.

### **Fishing Equipment Component**

#### ***Section 6-5 – income according to ordinary concepts***

15. The Fishing Equipment Component is received for the reduction in value of Fishing Equipment and is not income according to ordinary concepts. Therefore receipt of the Fishing Equipment Component is not assessable income under section 6-5.

#### ***Section 15-10 – bounty or subsidy received in relation to carrying on a business***

16. The Fishing Equipment Component is received for the reduction in value of Fishing Equipment and is not a bounty or subsidy that is received in relation to carrying on a business. Therefore, the receipt of the Fishing Equipment Component is not assessable income under section 15-10.

### ***Assessable recoupment***

17. The Fishing Equipment Component is received for the reduction in value of Fishing Equipment and is not an assessable recoupment of a loss or outgoing under Subdivision 20-A.

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<sup>1</sup> The entitlement of a Licence Holder to CGT concessions, including the issue of whether a Fishing Licence is an active asset of a Licence Holder for the purposes of the small business CGT concessions, is outside the scope of this Ruling. A Licence Holder can request a private ruling to determine these issues.

***Capital allowances – where the Licence Holder operates their Fishing Licence or leases Fishing Equipment to an operator of the licence***

18. Where the Licence Holder owns Fishing Equipment and operates the licence, or leases Fishing Equipment to an operator of the licence, the Fishing Equipment are depreciating assets held by the Licence Holder for the purposes of Division 40. A balancing adjustment event occurs for each asset where the licence holder either:

- disposes of the asset, or
- still holds the asset, but stops using it, and expects never to use it again.

19. The Fishing Equipment Component is not included in the termination value of the assets for the purposes of calculating any balancing adjustment income or balancing adjustment deduction.

***Capital allowances – where the Licence Holder does not own any Fishing Equipment used in operating the licence***

20. Where the Licence Holder does not own any Fishing Equipment used to operate their licence (for instance where the Licence Holder leases their licence to an operator and the operator uses their own equipment), the Licence Holder will not have any Fishing Equipment that is a depreciating asset within the meaning of that term in section 40-30 used for an income-producing purpose.

***Capital gains tax – where the Licence Holder operates their Fishing Licence or leases Fishing Equipment to an operator of the licence***

21. No CGT event happens as a result of receiving the Fishing Equipment Component. Therefore, as provided by section 102-20, there is no capital gain or capital loss. However, the cost base or reduced cost base of the assets comprising the Fishing Equipment will be reduced to the extent that the Fishing Equipment Component relates to a permanent reduction in value of the Fishing Equipment.

***Capital gains tax – where the Licence Holder does not own any Fishing Equipment used in operating the licence***

22. Where the Licence Holder does not own Fishing Equipment, the right to receive the Fishing Equipment Component is the relevant CGT asset, and will be subject to the CGT provisions in Parts 3-1 and 3-3. CGT event C2 will happen under section 104-25 when the right to the Fishing Equipment Component ends (that is, when payment of the amount is received) in accordance with paragraph 104-25(2)(b). The amount of the Fishing Equipment Component (\$60,000 if the Fishing Licence is surrendered, or 80% of that amount if the Fishing Licence is cancelled) represents the capital proceeds for the CGT event under subsection 116-20(1).

***Primary production income***

23. The Fishing Equipment Component is not treated as 'assessable primary production income' for the purposes of calculating the 'averaging adjustment' available under Division 392.

**Loss of Income Component*****Section 6-5 – income according to ordinary concepts***

24. The Loss of Income Component amount (three times the annual average catch value of the catch taken under each licence over the five year period between 1 April 2012 to 31 March 2017 if the Fishing Licence is surrendered, or 80% of that amount if the Fishing Licence is cancelled) is ordinary income in the hands of the recipient and assessable under section 6-5 in the income year in which it is derived.

***Capital gains tax***

25. Any capital gain made as a result of receiving the Loss of Income Component is reduced to nil under section 118-20.

***Primary production income***

26. The Loss of Income Component is 'assessable primary production income' for the purposes of calculating the 'averaging adjustment' available under Division 392.

**Licence holder chooses to give part of the compensation payment to a licence operator**

27. Where a Licence Holder chooses to pass on to a licence operator part of the compensation payment they receive under the scheme, the Licence Holder will not be able to claim a deduction for the payment made to the licence operator as the payment has no link with assessable income of the Licence Holder as required by section 8-1.

**Scheme**

28. 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.

29. The Victorian Government has committed to ending commercial netting in the Gippsland Lakes with a compulsory buy-out of commercial licences.

30. The Victorian Government has amended the *Fisheries Act 1995* (Vic) to provide for the cancellation of Gippsland Lakes Fishery Access Licences over a two-year period (*Marine and Fisheries Legislation Amendment Act 2019* (Vic)).

31. There are currently 10 Gippsland Lakes Fishery Access Licence Holders.

32. The Gippsland Lakes Fishery Access Licence was established by regulation in 1998. Prior to this, fishers operated under a Master Fisherman's Licence with an endorsement to fish in the Gippsland Lakes. Upon establishment of the new licence class these fishers were transitioned directly to the new licence. Some of the Licence Holders went through the licence transition.

33. All Gippsland Lakes Fishery Access Licences will be cancelled on 1 April 2021. However, affected Licence Holders may elect to surrender their licence before 1 April 2020, with the cancellation to take effect on 1 April 2020.

34. Compensation will be available to Licence Holders on surrender or cancellation of their Fishing Licence (Compensation Package).

35. The Compensation Package will comprise three components:

- a fixed amount of \$371,000 which represents the market value of the fishing licence as assessed by the Victorian Valuer-General
- a fixed amount of \$60,000 which represents an allowance for redundant fishing vessels and all commercial fishing equipment. The amount is to account for the reduced value of the fishing vessels and fishing equipment given the prohibition on netting, and therefore, the reduced market demand for the specialised equipment. Entitlement is not dependent on ownership of any fishing vessels and fishing equipment. Any fishing vessels or equipment owned by a Licence Holder at the time of surrender or cancellation of their Fishing Licence will continue to be the property of the Licence Holder, and
- loss of income, based on three times the annual average catch value of the catch taken under each licence over the five year period between 1 April 2012 to 31 March 2017.

36. The amount of the Compensation Package will reduce by 20% if a Licence Holder does not surrender their Fishing Licence (the metrics used to calculate the Compensation Package will be the same).

37. Some Licence Holders do not currently operate their own licence and equipment. Rather, they lease their fishing rights to, or employ, an operator who undertakes the fishing operations.

38. A Licence Holder may choose to pass some of the compensation on to an associated licence operator. There is no obligation that they do so.

## Appendix – Explanation

**ⓘ** *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.*

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### Licence Cancellation Component

#### **Section 6-5 – income according to ordinary concepts**

39. Subsection 6-5(1) provides that assessable income includes income according to ordinary concepts (ordinary income). Taxation legislation does not provide a statutory definition of 'ordinary income'.



40. The characteristics of ordinary income have been developed by case law and generally fall into three categories:

- income from providing personal services
- income from property, or
- income from carrying on a business.

41. Paragraph 85 of TR 2006/3<sup>2</sup> provides guidelines to assist in determining the nature of a receipt, which relevantly include:

- whether or not a particular receipt is ordinary income depends on its character in the hands of the recipient
- regard must be given to all facts, as such a broad view must be taken of a taxpayer's situation and it is necessary to consider the total situation of the taxpayer
- a payment that is provided for a purpose which is not part of the recipient's business will not be income in nature
- a payment to compensate for the restriction of a person's capacity to perform services or to carry on a business may be a capital payment, and
- a payment for surrender of part of the profit earning structure is a capital receipt.

42. The profit-earning structure of a business represents the property or assets used by the business to enable the production of income; it is generally of an enduring nature.

43. The Fishing Licence enables the income-producing activities of a Licence Holder and, as such, forms part of the property or assets used by the Licence Holder to generate income. It is therefore part of their profit-earning structure.

44. The loss of the Fishing Licence is a restriction of the capacity of the Licence Holder to produce income by fishing in the Gippsland Lakes; it is a loss of an asset used by the Licence Holder to produce income and as such represents a loss of their profit-earning structure.

45. The loss of the asset and resultant compensation is also outside the normal income-producing activities of the Licence Holder.

46. Therefore, the Licence Cancellation Component is a capital receipt and will not be ordinary income of the Licence Holder assessable under section 6-5.

### ***Section 15-10 – bounty or subsidy received in relation to carrying on a business***

47. 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.

<sup>2</sup> Taxation Ruling TR 2006/3 *Income tax: government payments to industry to assist entities (including individuals) to continue, commence or cease business.*

48. The meaning of 'bounty' or 'subsidy' is explained in paragraphs 93 to 98 of TR 2006/3. Of importance, paragraph 97 states:

Not all government grants are bounties or subsidies for the purposes of section 15-10. It is essential to determine what the grant is actually for. The question as to the nature and quality of any payment must be determined by reference to the agreement or the terms which created in the recipient the right to the government grant. Any factors used to calculate the amount of payment are of marginal, if any, assistance in determining what the payment is for.

49. Paragraph 96 of TR 2006/3 clarifies the meaning of grant (footnotes omitted):

'Grant' is defined to include 'that which is granted, as a privilege or right, a sum of money, as for a student's maintenance, or a tract of land'. A reference to 'bounty or subsidy' includes a grant that encourages business or trade and also a grant to address a detrimental effect on a business or trade.

50. Thus, a payment of a grant from government to address a detrimental effect on a business or trade would be a bounty or subsidy in accordance with section 15-10.

51. The Licence Cancellation Component represents a grant from the Government of Victoria for the surrender or cancellation of the Fishing Licence, which is to compensate the Licence Holder for the market value of the licence. The surrender or cancellation of a Fishing Licence would be detrimental to any fishing business of the Licence Holder, and the payment will be a bounty or subsidy in accordance with section 15-10.

52. For a bounty or subsidy to be assessable under section 15-10 it must be received in relation to carrying on a business. Paragraphs 104 to 106 of TR 2006/3 make it clear that a government payment received in relation to giving up or selling part of the profit-earning structure of the business will not be in relation to carrying on a business. Rather, the payment will relate to the cessation of the business or part of the business operations.

53. As the Licence Cancellation Component is in relation to the surrender or cancellation of part of the profit-earning structure of the Licence Holder, it will not be a bounty or subsidy received in relation to carrying on a business for the purposes of section 15-10.

### **Capital gains tax**

54. A Fishing Licence is a CGT asset under section 108-5. When the licence is surrendered or cancelled, CGT event C2 happens under section 104-25. This CGT event happens when ownership of an intangible CGT asset ends by surrender or cancellation. The time of the CGT event is the effective date of the surrender or cancellation of the Fishing Licence (either 1 April 2020 if surrendered, or 1 April 2021 if cancelled).

55. A capital gain is made if the capital proceeds exceed the cost base of the Fishing Licence, and a capital loss is made if the capital proceeds are less than the reduced cost base (subsection 104-25(3)).

56. The capital proceeds under subsection 116-20(1) for the surrender or cancellation of the licence is the amount included as the Licence Cancellation Component in the Compensation Package (that is, \$371,000 if the Fishing Licence is surrendered, or 80% of that amount if the Fishing Licence is cancelled).

57. The cost base and reduced cost base of the licence is calculated under Divisions 110 and 112. It includes the costs of electing to surrender the Fishing Licence. The cost base or reduced cost base is reduced by any amount that is a deductible expense in accordance with subsection 110-45(1B), 110-45(2) or 110-55(4). In accordance with subsection 110-40(2), if the licence was acquired before 7.30pm on 13 May 1997, any

expenditure relating to the asset cannot form part of the second and third elements of the cost base if it is deductible.

58. For the 2005–06 and earlier income years. CGT rollover for statutory licences, such as a fishing licence, was provided by former section 124-140 (or former section 160ZZPE of the *Income Tax Assessment Act 1936* (ITAA 1936) for income years prior to 1997–98). Under former section 124-140 (or former 160ZZPE) a replacement asset rollover was available when the terms and conditions of the fresh licence were not substantially different to the original licence and the underlying activity authorised by the original licence had not changed. Under section 124-160 (or former paragraph 160ZZPE(2)(a)), if the original licence was acquired prior to 20 September 1985, the fresh licence is also taken to be acquired before 20 September 1985.<sup>3</sup>

59. By Regulations issued in 1998 fishers with a Master Fisherman's Licence who were endorsed to fish in the Gippsland Lakes were transitioned directly to the Fishing Licence. As a consequence of this transition the Fishing Licence may have originated prior to 1998 as a Master Fisherman's Licence.

60. It is for individual Licence Holders to determine, based on their individual circumstances, whether the terms and conditions of, and the activity authorised by, their current Fishing Licence meet the statutory licence rollover provisions in Subdivision 124-C.

61. If the current Fishing Licence was issued to the Licence Holder as a result of the transition from a Master Fisherman's Licence acquired before 20 September 1985, provided the terms and conditions of the current Fishing Licence are not substantially different to the original Master Fisherman's Licence and the underlying activity authorised by the current Fishing Licence have not changed from the original licence (as determined by the individual licence holder based on their circumstances) the current Fishing Licence may be taken to have been acquired before 20 September 1985.

62. Any capital gain or capital loss which results from the surrender or cancellation of a licence taken to be acquired before 20 September 1985, as described in paragraph 61 of this Ruling, is disregarded under paragraph 104-25(5)(a).

63. If a Fishing Licence is taken to be acquired before 20 September 1985 and an additional licence was acquired on or after that date, the new licence is not a capital improvement to the original pre-CGT Fishing Licence. The capital gain or capital loss on the surrender or cancellation of the new licence is to be worked out separately.

64. A capital gain can be reduced by the general CGT discount if the relevant requirements of Subdivisions 115-A, 115-B and 115-C are met.

65. A capital gain can also be reduced or deferred by the small business CGT concessions if the Fishing Licence is an active asset and the other requirements of Division 152 are met. The concessions potentially available are:

- small business 15-year exemption
- small business 50% active asset reduction
- small business retirement exemption, and
- small business rollover.

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<sup>3</sup> The relevant rollover consequences for a fresh licence where the original licence was acquired after 20 September 1985 are found in section 124-155.

***Primary production income***

66. Subsection 392-80(2) provides that a taxpayer's 'assessable primary production income' for the current year is the amount of that taxpayer's basic assessable income for the current year that was derived from, or resulted from, their carrying on a primary production business.

67. A taxpayer's 'basic assessable income for an income year' is defined in subsection 392-45(2) as their assessable income for the income year less, among other things, any net capital gains included in their assessable income under Division 102.

68. Accordingly, a payment received for the surrender or cancellation of a Fishing Licence is not 'assessable primary production income' for the purposes of subsection 392-80(2) because it is capital in nature and any amount included in assessable income as a net capital gain is excluded under subsection 392-80(2).

**Fishing Equipment Component*****Section 6-5 – income according to ordinary concepts***

69. The Fishing Equipment Component is provided to cover for the reduction in value of the Fishing Equipment used by the Licence Holder to derive income (they are income-producing assets) as a result of the prohibition on commercial netting in the Gippsland Lakes. The amount is capital in nature and is not assessable as ordinary income under section 6-5.

***Section 15-10 – bounty or subsidy***

70. The Fishing Equipment Component is provided to cover the reduction in value of the capital assets used by the Licence Holder to derive income as a result of the prohibition on commercial netting in the Gippsland Lakes (the amount is a bounty or subsidy). However, it is part of a package that compensates Licence Holders who are required to exit the Gippsland Lakes fishery. It is received in relation to cessation of business, or a distinct part of the business. Accordingly, the allowance is not assessable under section 15-10.

***Subdivision 20-A – assessable recoupment***

71. Under Subdivision 20-A, a taxpayer's assessable income may include an amount received as recoupment of a loss or outgoing if an amount is deductible for the loss or outgoing and the amount received is not otherwise assessable income.

72. The Fishing Equipment Component is made to cover for the reduction in value of the capital assets used by the Licence Holder to derive income as a result of the prohibition on commercial netting in the Gippsland Lakes. The payment is not made in respect of any outgoing for which the recipient can claim a deduction under a provision listed under section 20-30 (for example, the cost of the asset). The payment is also not made in respect of any loss for which the recipient can claim a deduction under a provision listed in section 20-30.

73. Accordingly, the Fishing Equipment Component is not an assessable recoupment of a loss or outgoing under Subdivision 20-A.

***Capital allowances – where the Licence Holder operates their Fishing Licence or leases Fishing Equipment to an operator of the licence***

74. The Fishing Equipment are depreciating assets within the meaning of that term in section 40-30. As such the capital allowances provisions in Division 40 apply to these assets.

75. Under the scheme the assets remain the property of the Licence Holder. Accordingly, the Fishing Equipment Component is not received for the sale of the assets or for the loss or destruction of the assets. The Licence Holder may choose to retain and continue to use the assets (if they have other fishing licences), hold the assets but stop using them and never expect to use them again, or dispose of the assets.

76. Where the Licence Holder retains and continues to use the assets, the assets continue to decline in value for the purposes of the capital allowances provisions of Division 40. As no balancing adjustment event occurs for the assets, the Fishing Equipment Component is not taken into account in working out a balancing adjustment amount for the assets as provided for under Subdivision 40-D.

77. Where the Licence Holder still holds the assets but stops using them and expects never to use them again, a balancing adjustment event occurs under paragraph 40-295(1)(b). Under section 40-300 the termination value of the assets is their market value at the time the Licence Holder stops using them. Accordingly, the Fishing Equipment Component is not included in the termination value for the assets.

78. Where the Licence Holder disposes of the assets, a balancing adjustment event occurs under paragraph 40-295(1)(a) and the termination value for the assets under this event will be the sale proceeds received. The Fishing Equipment Component is not included in the termination value for the assets as the right to receive the payment is not for or in relation to the sale or disposal of the assets.

***Capital allowances – where the Licence Holder does not own any Fishing Equipment used in operating the licence***

79. Where the Licence Holder does not own any Fishing Equipment used to operate their licence (for instance where the Licence Holder leases their licence to an operator and the operator uses their own equipment), the Licence Holder will not hold any Fishing Equipment, which are depreciating assets within the meaning of that term in section 40-30, used for an income-producing purpose.

***Capital gains tax – where the Licence Holder operates their Fishing Licence or leases Fishing Equipment to an operator of the licence***

80. The Fishing Equipment are CGT assets under section 108-5. The right to receive the Fishing Equipment Component is also a CGT asset. However, as the Fishing Equipment Component amount relates most directly to the Fishing Equipment, and not the right to receive that amount, the Fishing Equipment is considered to be the 'relevant assets' for which the payment is received (see paragraphs 69 to 82 of TR 95/35<sup>4</sup>).

81. For CGT purposes, the amount of the Fishing Equipment Component representing the loss in value of the Fishing Equipment represents a recoupment of all or part of the acquisition costs of the Fishing Equipment where the assets are still owned at the time of receipt of the Fishing Equipment Component amount. The cost base or reduced cost base of each CGT asset comprising the Fishing Equipment is reduced to the extent that the

<sup>4</sup> Taxation Ruling TR 95/35 *Income tax: capital gains: treatment of compensation receipts*

Fishing Equipment Component relates to a permanent reduction in the value of the Fishing Equipment, in accordance with subsection 110-40(3), 110-45(3) or 110-55(6).

82. If the Fishing Equipment is later disposed of by the Licence Holder, triggering a CGT event, the reduction in its cost base or reduced cost base as a result of the earlier receipt of the Fishing Equipment Component would be taken into account in determining any capital gain or capital loss.

83. However, as the Fishing Equipment are also depreciating assets, any capital gain or capital loss arising from a CGT event (other than CGT event K7) that is also a balancing adjustment event will be disregarded under section 118-24.

84. If the Fishing Equipment was used (or installed ready for use) for a non-taxable purpose, the balancing adjustment event will cause CGT event K7 under section 104-235 to happen (subject to exceptions in subsection 104-235(1A)). A capital gain or capital loss from CGT event K7 will not be disregarded (paragraph 118-24(2)(a)).

85. A capital gain which results from CGT event K7 can be reduced by the general CGT discount if the relevant requirements of Subdivisions 115-A, 115-B and 115-C are met.

86. The small business CGT concessions in Division 152 do not apply to capital gains under CGT event K7 (subsection 152-10(1)). Those concessions relate to the use of an asset in a small business and a capital gain from CGT event K7 arises from the use of an asset for a non-taxable purpose.

### ***Capital gains tax – where the Licence Holder does not own any Fishing Equipment used in operating the licence***

87. The right to receive the Fishing Equipment Component is a right to receive a payment, which is a CGT asset (section 108-5). There is nothing in the *Fisheries Act 1995* (Vic) (as amended) which requires a Licence Holder to actually own any Fishing Equipment to be entitled to receive the Fishing Equipment Component amount. They are entitled to the amount as Licence Holders. Where a Licence Holder does not own any Fishing Equipment there are no CGT assets which have suffered a loss in value. As such, the relevant asset for CGT purposes will be the right to receive the compensation (paragraph 82 of TR 95/35).

88. CGT event C2 happens when ownership of an intangible CGT asset ends by, among other things, being cancelled or surrendered (section 104-25). Up and until receipt of the payment, the right to receive the payment remains. On receipt of the payment the right to payment ends. Thus, CGT event C2 happens under subsection 104-25(2) when the Fishing Equipment Component amount is received, as this is when the CGT asset ends. The capital proceeds for the CGT event under subsection 116-20(1) will be the amount of the Fishing Equipment Component (\$60,000 if the Fishing Licence is surrendered, or 80% of that amount if the Fishing Licence is cancelled).

89. As this right to compensation occurs after 20 September 1985 it will be a post-CGT asset.

90. Where no Fishing Equipment is owned by the Licence Holder or is used in their business operations, the right to receive compensation will not be an active asset for the purposes of Division 152. This is because the right to receive compensation will not be inherently connected with a business that is carried on (whether alone or in partnership) by you, your affiliate, or another entity that is connected with you (refer to paragraph 152-40(1)(b)).

**Primary production income**

91. Subsection 392-80(2) provides that a taxpayer's 'assessable primary production income' for the current year is the amount of that taxpayer's 'basic assessable income' for the current year that was derived from, or resulted from, their carrying on a primary production business.

92. Subsection 392-45(2) defines 'basic assessable income' as assessable income less, among other things, any net capital gains.

93. As explained in paragraphs 69 to 79 of this Ruling, there is no amount relating to the Fishing Equipment Component included in assessable income under:

- section 6-5 as ordinary income
- section 15-10 as a bounty or subsidy
- Subdivision 20-A as an assessable recoupment, nor
- Division 40 as a balancing adjustment.

94. If a net capital gain is included in assessable income as a result of CGT event C2 or CGT event K7, it will be excluded from basic assessable income under subsection 392-45(2).

95. As such, there is no assessable income relating to the Fishing Equipment Component, included in 'basic assessable income' under subsection 392-45(2).

**Loss of Income Component****Section 6-5 – income according to ordinary concepts**

96. A compensation receipt generally takes the character of the item it replaces.<sup>5</sup> Paragraph 85 of TR 2006/3 provides additional factors to be considered in determining the nature of a receipt. Of relevance:

- The nature of a payment is determined by examining the character of the payment in the hands of the recipient.
- A payment in a lump sum does not require a conclusion that the payment is capital.
- The calculation of a payment by reference to expected profits made, or not made by the recipient but that would ordinarily be expected to have been made, is a factor supporting the conclusion of income.

97. Paragraph 11 of TR 2006/3 makes it clear that a government payment to provide income support because of an actual or expected reduction in business income is ordinary income in the hands of the recipient and assessable under section 6-5.

98. The Loss of Income Component is a payment to compensate the Licence Holder for loss of income that would have been earned from fishing in the Gippsland Lakes. The Loss of Income Component amount is determined by using the annual average catch value of the catch taken under the licence held by the Licence Holder over the five-year period between 1 April 2012 and 31 March 2017. As the Loss of Income Component is calculated by reference to profits that would ordinarily be expected to be made in operating the Fishing Licence, it is considered to be income in character and assessable under section 6-5.

<sup>5</sup> *Commissioners of Taxation (NSW) v Meeks (Public Officer of the Sulphide Corporation Limited)* [1915] HCA 34, per Griffith J.

**Capital gains tax**

99. The right to receive the Loss of Income Component is a right to receive a payment, which is a CGT asset (section 108-5). CGT event C2 happens under section 104-25 when the right to receive the Loss of Income Component ends. This happens at the time the payment is made (subsection 104-25(2)).

100. As the Loss of Income Component is included in assessable income under section 6-5, any capital gain made from the CGT event C2 is reduced to nil under section 118-20.

**Primary production income**

101. Relevantly, 'primary production business' is defined in section 995-1 to mean carrying on a business of 'conducting operations relating directly to taking or catching fish'.

102. Subsection 392-80(2) provides that a taxpayer's assessable primary production income for an income year is the amount of their basic assessable income for the income year that 'was derived from, or resulted from, carrying on a primary production business'. Accordingly, there must be a causal connection between the income received and the primary producer's trade or business.

103. Where a Licence Holder is conducting fishing operations in the Gippsland Lakes they will be carrying on a primary production business and any ordinary income from that business will be 'assessable primary production income'.

104. Because the Loss of Income Component is to compensate for loss of ordinary income that could have been earned by the Licence Holder from fishing in the Gippsland Lakes, there is a causal link between the receipt of the compensation and the carrying on of a primary production business. Without the commercial fishing business there would be no entitlement to compensation. As such it is accepted that the Loss of Income Component will be 'assessable primary production income' for the purposes of calculating the 'averaging adjustment' available under Division 392.

**Licence Holder chooses to give part of the compensation payment to a licence operator**

105. Section 8-1 allows a deduction for a loss or outgoing to the extent that it is

- (a) incurred in gaining or producing assessable income or
- (b) necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income.

106. To be deductible under the first limb of section 8-1 a loss or outgoing must be relevant and incidental to the gaining or producing of assessable income.<sup>6</sup>

<sup>6</sup> *Ronpibon Tin NL v Commissioner of Taxation (Cth)* [1949] HCA 15.



107. For an outgoing to be deductible under the second limb of section 8-1 as expenditure necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income, it must have the character of a working or operating expense of the entity's business or be an essential part of the cost of its business operations. In *John Fairfax & Sons Pty Ltd v Commissioner of Taxation (Cth)* [1959] HCA 4 Menzies J stated:

... there must, if an outgoing is going to fall within its terms, be found (i) that it was necessarily incurred in carrying on a business; and (ii) that the carrying on of the business was for the purpose of gaining assessable income. The element that I think is necessary to emphasise here is that the outlay must have been incurred in the carrying on of a business that is, it must be part of the cost of trading operations.

108. A voluntary payment by a Licence Holder to a licence operator to pass on part of the compensation amount received under the scheme is not an outgoing that is relevant to gaining or producing assessable income of the Licence Holder. Further, the payment does not have the character of a working or operating expense (it does not relate to gaining income), and is not an expense that is essential to the business operations of the Licence Holder (it is not necessarily incurred).

109. As such, the Licence Holder cannot claim a deduction for any such payment under section 8-1.

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Not previously issued as a draft

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TR 95/35; TR 2006/3; TR 2006/10

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