



TD 2009/D1 - Income tax: does the term 'real property' in paragraph 855-20(a) of the Income Tax Assessment Act 1997 include a leasehold interest in land?

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Draft Taxation Determination

Income tax: does the term ‘real property’ in paragraph 855-20(a) of the *Income Tax Assessment Act 1997* include a leasehold interest in land?

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This publication is a draft for public comment. It represents the Commissioner’s preliminary view about the way in which a relevant taxation 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.

You can rely on this publication (excluding appendixes) to provide you with protection from interest and penalties in the following way. If a statement turns out to be incorrect and you underpay your tax as a result, you will not have to pay a penalty. Nor will you have to pay interest on the underpayment provided you reasonably relied on the publication in good faith. However, even if you don’t have to pay a penalty or interest, you will have to pay the correct amount of tax provided the time limits under the law allow it.

Ruling

1. Yes. In the context of Division 855 of the *Income Tax Assessment Act 1997* (ITAA 1997),¹ the term ‘real property’ in paragraph 855-20(a) includes a leasehold interest in land.

Date of effect

2. When the final Determination is issued, it is proposed to apply both before and after its date of issue. However, the Determination will 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 Determination (see paragraphs 75 to 77 of Taxation Ruling TR 2006/10).

Commissioner of Taxation

29 April 2009

¹ All subsequent legislative references are to the ITAA 1997 unless otherwise indicated.

Appendix 1 – Explanation

❶ This Appendix is provided as information to help you understand how the Commissioner’s preliminary view has been reached. It does not form part of the proposed binding public ruling.

Explanation

3. The effect of subsection 855-10(1) is that a capital gain or capital loss from a CGT event that happens in relation to a CGT asset that is not ‘taxable Australian property’ is disregarded if you are a foreign resident, or the trustee of a foreign trust for CGT purposes, just before the CGT event happens. The categories of CGT assets that are taxable Australian property are set out in section 855-15.² ‘Taxable Australian real property’ is one such category.³ Section 855-20⁴ provides that a CGT asset is taxable Australian real property if it is:

- (a) real property situated in Australia; or
- (b) a *mining, quarrying or prospecting right (to the extent that the right is not real property), if the minerals, *petroleum or quarry materials are situated in Australia.

4. ‘Real property’ is not defined in the ITAA 1997. When a term used in legislation has acquired an established legal meaning, prima facie, that term will be interpreted in accordance with that meaning unless a contrary intention appears from the context.⁵

5. The technical legal meaning of ‘real property’ in Australia has its origins in medieval English common law inherited on British colonisation. Under that law, a distinction developed between ‘real property’ and ‘personal property’ based on the common law remedies then available for the recovery of tangible objects:

If a person dispossessed of an object could recover that object (the *res*) as of right it was classified as real property. The distinguishing characteristic of real property was the quality of being specifically recoverable in a ‘real’ action. Objects not so recoverable were regarded as personal property. A person dispossessed of such objects had a ‘personal’ action for damages against the wrongdoer, but was not entitled to an order requiring the wrongdoer to deliver the actual object. Since only land was specifically recoverable under the early common law, it followed that the category of real property was limited to land.⁶

...

Historically, leaseholds were regarded as personal property for the reason that the early law did not permit the dispossessed leaseholder to recover the land itself. The lessee was limited to an action for damages, mainly because leases were seen as personal commercial arrangements outside the rigid feudal structure of landholding. In time [by the late 15th century],⁷ the leaseholder was enabled to recover the land itself through the action of ejectment, but by that time the anomalous classification of leaseholds as personal property was too well established to be overturned.⁸

² ‘Taxable Australian property’ is defined in subsection 995-1(1) as having the meaning given by section 855-15.

³ Item 1 of the table in section 855-15.

⁴ ‘Taxable Australian real property’ is defined in subsection 995-1(1) as having the meaning given by section 855-20.

⁵ *Attorney-General (NSW) v. Brewery Employees’ Union of NSW* (1908) 6 CLR 469 per O’Connor J at 531.

⁶ Edgeworth B, Rossiter CJ, Stone MA 2004, *Sackville and Neave Property Law: Cases and Materials*, 7th Ed., LexisNexis Butterworths, Australia, pp. 55-56.

⁷ Butt, PJ 2006, *Land Law*, 5th Ed., Lawbook Co., Sydney, p. 93; Hepburn, SJ 2008, *Australian Property Law: Cases, Materials and Analysis*, LexisNexis Butterworths, Australia, p. 258.

⁸ Edgeworth B, Rossiter CJ, Stone MA 2004, *Sackville and Neave Property Law: Cases and Materials*, 7th Ed., LexisNexis Butterworths, Australia, p. 58.

6. Today, however, ‘the historical origins of leaseholds as personal property are almost entirely forgotten.’⁹ Indeed, now ‘[f]or all practical purposes, and indeed for most legal purposes, leases are regarded as real property, not personal property.’¹⁰

7. In any event, having regard to the objects and context¹¹ of Division 855, the Commissioner considers that it is clear that ‘real property’ in paragraph 855-20(a) is intended to have a meaning that includes leasehold interests in land. Evidence of this intention can be found within Division 855 and from its surrounding context.

8. First, the Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No. 4) Bill 2006 that introduced Division 855 confirms that ‘real property’ in paragraph 855-20(a) has its ordinary (or common use) meaning, rather than its technical legal meaning. At paragraph 4.28 it states:

Taxable Australian real property generally refers to real property, **within the ordinary meaning of that term**, that is situated in Australia [Schedule 4, item 2, paragraph 855-20(a)] (emphasis added).

9. Secondly, there is nothing within Division 855 (or its extrinsic materials) to indicate that Parliament sought to distinguish between the CGT treatment of freehold and leasehold interests in land situated in Australia (for example, CGT event A1 in section 104-10 happening in relation to a leasehold interest versus CGT event A1 happening in relation to a freehold interest). This is consistent with the term ‘real property’ having its ordinary, common use meaning in the context of Division 855. Indeed, there are vast areas of Australia in which the most common interest in land is a leasehold interest (for example, pastoral leases and the Australian Capital Territory).

10. Thirdly, the CGT treatment of leases would be inconsistent and anomalous if the meaning of ‘real property’ in the context of Division 855 was construed narrowly so as to exclude leasehold interests. Subsection 855-10(2) sets out for various CGT events what the CGT asset is in relation to which the particular CGT event happens. Paragraph 855-10(2)(c) provides that for CGT event F1 (about granting a lease) the CGT asset in relation to which that CGT event happens is the CGT asset that is the subject of the lease. Therefore, if a foreign resident grants a lease over land situated in Australia, the granting of that lease (CGT event F1) is a CGT event that happens in relation to ‘taxable Australian real property’. Accordingly, the foreign resident cannot disregard any capital gain or loss from the granting of that lease.¹²

⁹ Butt, PJ 2006, *Land Law*, 5th Ed., Lawbook Co., Sydney, p. 95. See also Halsbury’s Laws of Australia, 2009, definition of ‘real property’, LexisNexis, paragraph [355-10] and Hepburn, SJ 2008, *Australian Property Law: Cases, Materials and Analysis*, LexisNexis Butterworths, Australia, p. 258.

¹⁰ Butt, PJ 2006, *Land Law*, 5th Ed., Lawbook Co., Sydney, p. 95. See also Halsbury’s Laws of Australia, 2009, definition of ‘real property’, LexisNexis, paragraph [355-10] and Hepburn, SJ 2008, *Australian Property Law: Cases, Materials and Analysis*, LexisNexis Butterworths, Australia, p. 258.

¹¹ The importance of looking at context first and not merely as an aid to the resolution of ambiguity was emphasised by the High Court in *CIC Insurance Ltd v. Bankstown Football Club Ltd* (1997) 141 ALR 618 at 634-5. See also *Greenway Park Development Pty Ltd v. Cridland, Registrar of Titles and Anor* [1992] QCA 430 in which Fitzgerald P and de Jersey J noted that no particular definition of ‘personal property’ could apply in all circumstances; rather it must be determined ‘in the context of the relevant statutory instrument’. Indeed, they concluded that, in the context before them, leasehold interests in land were not ‘personal property’.

¹² Subsection 855-10(1).

11. It is highly unlikely that Parliament intended to subject a foreign resident granting a lease over land situated in Australia to CGT in respect of that dealing but not to so subject a foreign resident dealing in the leasehold interest itself (for example, by way of an assignment). This seemingly absurd outcome would arise if 'real property' were to have its technical legal meaning in the context of Division 855, and therefore strengthens the view that Parliament intended 'real property' to include leasehold interests in that context.

12. Fourthly, a key object of Division 855 is to align Australia's tax laws with international (OECD) practice and Australia's tax treaties.¹³ In this respect, it is noted that Article 13 (alienation of immoveable property) of the OECD Model Convention with respect to Taxes on Income and on Capital¹⁴ assigns taxing rights to the contracting state in which the 'immovable property' is situated. 'Immovable property' is defined in Article 6 primarily by reference to the law of the contracting state in which the property in question is situated, and has long been accepted to include leasehold interests in land.¹⁵ Further, of Australia's 41 tax treaties¹⁶ that expressly deal with the alienation of real property,¹⁷ 39 define 'real property' to include leasehold interests in land¹⁸ and the other two cover the alienation of leasehold interests by referring to direct interests in land.¹⁹ Therefore, if the meaning of 'real property' in the context of Division 855 was construed narrowly so as to exclude leasehold interests in land, the operation of Division 855 (so far as leasehold interests in land situated in Australia are concerned) would be narrower in scope than, rather than aligned with, Australia's tax treaties and the OECD Model Tax Convention. This strengthens the view that Parliament intended 'real property' in the context of Division 855 to include leasehold interests in land. Such an interpretation assists to achieve a key object of Division 855, whereas the contrary view would frustrate achievement of that object.

13. In light of the above, the Commissioner considers that 'real property' in paragraph 855-20(a) includes a leasehold interest in land.

¹³ See paragraph 855-5(2)(a) and paragraph 4.7 of the Explanatory Memorandum to Tax Laws Amendment (2006 Measures No. 4) Bill 2006.

¹⁴ OECD Committee on Fiscal Affairs, Model Convention with respect to Taxes on Income and on Capital, 17 July 2008.

¹⁵ *Freke v. Lord Carbery* (1873) LR 16 Eq 461.

¹⁶ The tax treaties are contained in the schedules to the *International Tax Agreements Act 1953*.

¹⁷ Australia's only other non-Airline Profits tax treaty (the German Agreement) does not contain an 'Alienation of property' article. However, it is worth noting that 'income from real property' in article 6 of that agreement includes 'income from leases of land': see paragraph 2 of the Protocol to that agreement.

¹⁸ The Russian Agreement defines 'real property' to include 'land and any other interest in or over land', which includes a leasehold interest in land: see paragraphs 13(1) and 6(2).

¹⁹ See article 13 of the Swiss Agreement and article 13 and paragraph 6(2) of the Malaysian Agreement.

Appendix 2 – Alternative views

❶ *This Appendix sets out alternative views and explains why they are not supported by the Commissioner. It does not form part of the proposed binding public ruling.*

Alternative view

14. The alternative view is that ‘real property’ in paragraph 855-20(a) should be construed according to its technical legal meaning. The technical legal meaning of real property does not include leasehold interests in land. Therefore, under the alternative view, a leasehold interest in land situated in Australia is not ‘real property’ under paragraph 855-20(a).

15. As noted in the Explanation section of this Determination, the Commissioner considers that this alternative view is not consistent with the objects and context of Division 855, which clearly indicate that an ordinary, common use meaning of ‘real property’, which includes leasehold interests in land, is intended. On the contrary, applying the technical legal meaning of ‘real property’ in the context of Division 855 would produce unintended and anomalous outcomes in relation to the treatment of leases and would prevent achievement of one of the key objects of Division 855.

Appendix 3 – Your comments

16. You are invited to comment on this draft Determination. Please forward your comments to the contact officer by the due date.

17. A compendium of comments is also prepared for the consideration of the relevant Rulings Panel or relevant tax officers. An edited version (names and identifying information removed) of the compendium of comments will also be prepared to:

- provide responses to persons providing comments; and
- publish on the Tax Office website at www.ato.gov.au.

18. Please advise if you do not want your comments included in the edited version of the compendium.

Due date: 29 May 2009
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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/10

Subject references:

- capital gains
- CGT taxable Australian property
- foreign resident
- land
- leasehold
- real property

Legislative references:

- ITAA 1997
- ITAA 1997 104-10
- ITAA 1997 Div 855
- ITAA 1997 855-5(2)(a)
- ITAA 1997 855-10(1)
- ITAA 1997 855-10(2)
- ITAA 1997 855-10(2)(c)
- ITAA 1997 855-15
- ITAA 1997 855-20
- ITAA 1997 855-20(a)
- ITAA 1997 995-1(1)
- International Tax Agreements Act 1953
- International Tax Agreements Act 1953 Sch 9
- International Tax Agreements Act 1953 Sch 15
- International Tax Agreements Act 1953 Sch 16

- International Tax Agreements Act 1953 Sch 46

Case references:

- Attorney-General (NSW) v. Brewery Employees' Union of NSW (1908) 6 CLR 469; (1908) 14 ALR 565; [1908] HCA 94
- CIC Insurance Ltd v. Bankstown Football Club Ltd (1997) 187 CLR 384; (1997) 141 ALR 618; [1997] HCA 2
- Freke v. Lord Carbery (1873) LR 16 Eq 461
- Greenway Park Development Pty Ltd v. Cridland, Registrar of Titles and Anor [1992] QCA 430

Other references:

- Butt, PJ 2006, Land Law, 5th Ed., Lawbook Co., Sydney
- Edgeworth B, Rossiter CJ, Stone MA 2004, Sackville and Neave Property Law: Cases and Materials, 7th Ed., LexisNexis Butterworths, Australia
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- OECD Committee on Fiscal Affairs, Model Convention with respect to Taxes on Income and on Capital, 17 July 2008
- The Explanatory Memorandum to the Tax Laws Amendment (2006 Measures No. 4) Bill 2006

ATO references

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