


***IT 2535 - Income tax : capital gains tax : grant of a lease : payment for goodwill or premium on grant of lease.***

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TAXATION RULING NO. IT 2535

INCOME TAX : CAPITAL GAINS TAX : GRANT OF A LEASE :  
PAYMENT FOR GOODWILL OR PREMIUM ON GRANT OF LEASE.

F.O.I. EMBARGO: May be released

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N.O. REF: 87/2478-4

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I 1011260	CAPITAL GAINS TAX	160A
	GOODWILL	160ZS
	LEASE	
	LEASE PREMIUM	

PREAMBLE This Office was asked to consider the capital gains implications of payments received by a lessor on the grant of a lease over a hotel. This ruling deals with this and other situations where a lease is granted over premises.

2. For the purposes of Part IIIA - Capital Gains and Capital Losses - of the Income Tax Assessment Act 1936, the grant of a lease of property is not taken to be a part disposal of the property. By subsection 160ZS(1) the grant constitutes the disposal of an asset (being the lease) created by the lessor, for consideration equal to the premium paid or payable for the grant of the lease. In calculating the amount of any capital gain or capital loss, subsection 160ZS(2) specifies that the cost base of the lease granted comprises only the amounts of expenditure incurred in respect of the grant of the lease.

3. Where a taxpayer grants a lease over a hotel or other premises it will often be the case that the payment received from the lessee relates to more than one item. For example, the lessee may acquire items of plant or trading stock associated with the business. In addition, the payment may also be described as including an amount for the acquisition by the lessee of the goodwill of the business. It has been suggested that in many cases the payment received by the lessor is for the sale of goodwill of the business to the lessee and therefore is not a lease premium within the meaning of section 160ZS.

4. For the purposes of the capital gains and capital losses provisions the term "asset" is defined to mean any form of property, including goodwill. Accordingly, where a taxpayer actually disposes of (rather than leases) goodwill, it will need to be considered under the general provisions of Part IIIA. Whether a capital gain or capital loss arises on the disposal of the goodwill will depend upon the date of acquisition of the goodwill, its cost and the consideration received for the disposal.

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5. The agreement between the lessor and lessee may refer to an amount being received for the sale of goodwill, whereas the amount may be at law and in fact wholly or partly a lease premium, being the amount received as consideration for the grant of the lease.

6. It is considered that the main issue which determines whether the grant of a lease over a hotel is associated with the disposal of goodwill or a lease premium, is whether the goodwill is local or personal. Personal goodwill depends upon the personal reputation of the person who carries on the business and is independent of the premises upon which the business is carried on. Goodwill is local if it depends upon the particular place of business.

7. Whether the goodwill associated with a hotel business is local or personal will be a question of fact. This matter is discussed in the judgment of Rich J. in the High Court case of Federal Commissioner of Taxation v. Williamson (1943) 67 CLR 561 at pages 563-564:-

"As an abstract proposition, there can be no doubt that a particular goodwill may be local or personal or partly one and partly the other. Its character depends on the nature of the business or the circumstances. It is local to the extent to which the trade connection depends on the place in which the business is carried on, for example, where there is only one hotel in a place the connection may be for all practical purposes entirely local. It is personal to the extent to which it is the personality, ability and good reputation of the trader that attracts the trade and not the place where it is carried on. To the extent to which the goodwill is local it is attached to and cannot be severed from the land on which the business is carried on (Tooth & Co. Ltd. v. Commissioner of Stamp Duties (1909) 9 SR (N.S.W.) 652; 26 W.N. 162). To the extent to which it is personal it is only accidentally associated with the land, and may be severed from it and dealt with separately (Rosehill Racecourse Co. v. Commissioner of Stamp Duties (N.S.W.) (1905) 3 CLR 393)."

8. Where the goodwill is local, on the grant of a lease the ownership remains with the owner of the premises as it is not capable of being transferred without the premises. The lessee of the hotel has the use and enjoyment of both the premises and the goodwill for the term of the lease.

9. To determine if the goodwill of a hotel business is local or is separate from the hotel premises and capable of being separated from the premises by the lessor, the following points need to be taken into consideration:-

- (a) the locality of the hotel and the number of other hotels in the surrounding area;

- (b) the method of calculating the payment received. If calculated by reference to the term of the lease, it may be a lease premium;
- (c) the value of the premises with the business and without the business. If the value without the business is less, it would suggest that the goodwill is local;
- (d) the arrangements (ongoing or otherwise) made at the time of entering into the lease to encourage the customers to give their custom to the lessee; and
- (e) the arrangement made in respect of the expiration of the lease. If goodwill has been acquired by the lessee, at the time of expiration the lessee should be able to benefit from that goodwill in other premises.

10. Insofar as the grant of a lease over a hotel is not capable of involving an actual disposal of goodwill because it is not severable from the premises, it is considered that a payment received as consideration in respect of the lease (not including payments relating to the actual disposal of assets such as plant or trading stock) is a lease premium within the meaning of section 160ZS of the Act. This is so even where such a payment is described as being for the sale of goodwill.

11. Where, after examining all the facts of a particular case, it is clear that there is personal goodwill associated with the hotel and that goodwill is disposed of to the lessee of the premises, a payment received for the disposal is to be treated as consideration in respect of the disposal of goodwill and not as a lease premium. For capital gains tax purposes, where the lessor re-acquires the goodwill from the lessee at the expiration of the lease there will be a new acquisition date and cost base.

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12. Paragraphs 5 to 11 of this ruling deal specifically with payments received by a lessor on the grant of a lease over a hotel. The ruling has its basis in the close link that exists between a hotel business and the premises at which it is conducted. In other situations where a similar nexus exists between the business conducted and the premises leased, the ruling will also apply. Examples of situations where this could occur are a lease over a newsagency, service station, motel, restaurant or fast-food outlet.

COMMISSIONER OF TAXATION  
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