IT 2561 - Income tax : capital gains : grants of easements, profits a prendre and licences

This cover sheet is provided for information only. It does not form part of *IT 2561 - Income tax : capital gains : grants of easements, profits a prendre and licences*

This document has been Withdrawn.
There is a Withdrawal notice for this document.

Generated on: 20 November 2026, 10:28:32 PM

TAXATION RULING NO. IT 2561

INCOME TAX : CAPITAL GAINS : GRANTS OF EASEMENTS, PROFITS A PRENDRE AND LICENCES

F.O.I. EMBARGO: May be released

REF N.O. REF: 89/5189-6 DATE OF EFFECT: see paras 19-20

B.O. REF: DATE ORIG. MEMO ISSUED:

F.O.I. INDEX DETAIL

REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1012029	CAPITAL GAINS	PART IIIA
	EASEMENTS	160C
	PROFITS A PRENDRE	160M
	LICENCES	160R
	LEASES	160U
	PREMIUMS	160ZS

PREAMBLE In the light of the Full Federal Court case of Gray & Anor v FC of T 89 ATC 4640; (1989) 20 ATR 649, this Office has reviewed its interpretation of how the capital gains and losses provisions of Part IIIA of the Income Tax Assessment Act 1936 ("the Act") apply to grants of easements, profits a prendre and licences.

Explanation of terms

2. Some of the essential features of the related, but usually distinct, legal rights referred to above are:

. an easement is a right over someone else's land or property. Examples of easements are rights of way, rights to light and rights to put up signs or nameplates on someone else's land;

. a profit a prendre is a right to enter and remove some product or part of the soil from someone else's land. Rights to remove standing timber or minerals from someone else's land are examples of profits a prendre; and

. a licence is an authority to do something which would otherwise be unlawful. An authority to occupy land (but without exclusive possession as against others) is an example of a licence.

Previous Interpretation of the Law

3. This Office has previously expressed the view that the grant of an easement or profit a prendre by a landowner is a part disposal of the land (i.e. the underlying asset) in terms of section 160R of the Act; on this interpretation the capital gains tax provisions would not apply if the land had been acquired before 20 September 1985.

4. This interpretation, however, did not extend to grants of leases. This was because of the express statement in section 160ZS of the Act that the grant of a lease is not to be taken to be a part disposal of the property over which the lease is granted. Section 160ZS provides that the grant of a lease constitutes the disposal by the lessor to the lessee of an asset (that is to say, the lease) created by the lessor for a consideration equal to the premium paid or payable for the grant of the lease. The cost base of the lease is limited to expenditure incurred by the grantor on the grant of the lease itself; expenditure referrable to the underlying property cannot be taken into account.

Gray's case

5. The relevant facts of Gray's case may be shortly stated. The appellant taxpayers bought, before 20 September 1985, a property on which a service station was situated. In March 1986 they granted a lease of the service station site to a petrol company in exchange for a premium of $200,000. The costs incurred on the grant of the lease amounted to $6,252, leaving a net premium of $193,748. The taxpayers were assessed for the year ended 30 June 1986 on the basis that a net capital gain of $193,748 had accrued to them.

6. Following disallowance of objections lodged by the taxpayers, the assessments were reviewed by the Administrative Appeals Tribunal and found to be correct: Case W11, 89 ATC 187; Case 4825 (1988) 20 ATR 100. The taxpayers then appealed to the Full Federal Court, which unanimously dismissed their appeals.

7. Davies and Einfeld JJ. delivered a joint judgment. Sheppard J. delivered a separate, but concurring, judgment.

8. After examining several relevant provisions found in Part IIIA of the Act, Davies and Einfeld J.J. concluded as follows (ATC p.4643; ATR p.652):

> "The lease which was created in March 1986 was an asset for the purposes of the legislation. ... .
>
> The lease being deemed to be created [under subsection 160ZS(1)] by the lessors, sec. 160M(5) then applied. That subsection has the effect that, for the purposes of Pt IIIA, the creation of the asset by Mr and Mrs Gray constituted the acquisition of the asset by them. By virtue of sec. 160U(6) the lease is taken to have been acquired by Mr and Mrs Gray immediately before the asset was disposed of. By virtue of sec. 160C(2) Mr and Mrs Gray are deemed to have owned the asset disposed of."

9. Their Honours went on to hold that the capital gains tax provisions applied because there had been a disposal after 19 September 1985 of an asset that had been acquired and owned by the taxpayers after that date. In arriving at their decision their Honours also observed that Division 5 (leases) of Part

IIIA does not provide an entire code, and that it must be read in the light of, and together with, the other provisions of Part IIIA.

10. Sheppard J. took a similar view of the law. He gave the following interpretation to subsection 160ZS(1) and paragraph 160M(5)(c) (ATC p.4644; ATR p.653):

> "The subsection [subsection 160ZS(1)] deals with the disposal, that is, the granting of the lease, rather than the acquisition thereof. But, for present purposes, the important words of it are 'constitute the disposal by the lessor to the lessee of an asset ... created by the lessor'. The words 'asset ... created by the lessor' take one back to para. 160M(5)(c) which uses the expression 'creation of an asset', and constitutes such creation the acquisition of the asset by the person creating it, in this case the lessors, that is, the applicants."

11. Sheppard J. concluded that, once the asset had been created, paragraph 160M(5)(c) deemed there to be an acquisition of the asset by the taxpayers and that a capital gains tax liability arose on the disposal (in this case under section 160ZS) of the asset.

12. Of particular relevance for the purposes of this Ruling is the following observation made by Sheppard J. (ATC p.4645; ATR p.654):

> "In passing I should mention that the provisions of subsec. 160U(3) and (6) of the Act are such as to bring to tax gains made on the grant, on or after 20 September 1985, of other interests in land held before that date, for instance, an easement or a profit a prendre".

13. Subsection 160U(3) provides that, if an asset is acquired or disposed of under a contract, the time of acquisition or disposal is the time of the making of the contract. The relevant part of subsection 160U(6) provides that where the asset was created by a person ..., the asset shall be taken to have been acquired by the ... person -

> if the asset did not exist (either by itself or as part of another asset) before the disposal - immediately before the asset was disposed of; ... .

14. Although this observation made by Sheppard J. is obiter dictum it is regarded by this Office as a correct statement of the law. The observation is consistent with the reasoning of all three judges. (cf. for example, by Davies and Einfeld JJ in regard to "the creation of other new assets":

> "It [the Act] places the grant of a lease for a premium in a like position to the creation of other new assets. It treats the capital gain on the creation of the new asset on or after 20 September 1985 as an assessable gain". (ATC p.4644; ATR p.653) (Emphasis added.))

15. By parity of reasoning, this statement of the law would apply equally to the grant of a licence or other comparable rights.

RULING

16. An easement, profit a prendre or licence (or other comparable right) is an asset created at the time it is granted. The asset is taken by paragraph 160M(5)(c) of the Act to have been acquired by the grantor. Subsection 160C(2) then treats the grantor as owning the asset. The time of acquisition is determined by section 160U.

17. Where the ownership of the asset changes - i.e., where the grantee becomes the owner of the easement, profit a prendre or licence (or other comparable right) - there is a disposal of the asset by the grantor (and an acquisition of the asset by the grantee) in terms of subsection 160M(1). Alternatively, the grant of the easement, profit a prendre or licence (or other comparable right) may, by reason of subsection 160M(6), constitute the disposal of the asset created by the grantor.

18. It follows that, if the grant of the easement, profit a prendre or licence (or other comparable right) occurs on or after 20 September 1985, there is an acquisition by the grantor of a new asset created after that date. Therefore, the capital gains provisions apply on the disposal of the new asset. This is so notwithstanding that the underlying asset, for example the land, may have been acquired before 20 September 1985. Accordingly, our earlier interpretation regarding the grant of an easement or profit a prendre no longer applies.

Date of effect of this Ruling

19. As the view contained in this Ruling is at variance with the interpretation previously given, this Ruling is to apply only to easements and profits a prendre granted on or after the date of this Ruling. This limitation, however, does not apply to grants of licences (or other comparable rights) and leases because, in these cases, there has been no departure from an earlier interpretation of the law.

1989 Budget Announcement

20. On 15 August 1989 the Treasurer announced that the commencement date of certain provisions of Part IIIA of the Act, including section 160ZS (leases), was to be amended. While the legislation to give effect to that decision has not as yet been introduced into the Parliament, the terms of the announcement foreshadow that such legislation will broadly provide that grants, before 23 May 1986, of leases, licences and other comparable rights or interests in or over property acquired prior to 20 September 1985 will be excluded from the capital gains tax.

COMMISSIONER OF TAXATION
21 September 1989