IT 362 - Timber logging licence - whether cost of licence deductible

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This ruling contains references to repealed provisions, some of which may have been rewritten. The ruling still has effect. Paragraph 32 in TR 2006/10 provides further guidance on the status and binding effect of public rulings where the law has been repealed or repealed and rewritten. The legislative references at the end of the ruling indicate the repealed provisions and, where applicable, the rewritten provisions.

TAXATION RULING NO. IT 362

TIMBER LOGGING LICENCE - WHETHER COST OF LICENCE DEDUCTIBLE

F.O.I. EMBARGO: May be released

REF H.O. REF: 78/5932 F402 DATE OF EFFECT:

B.O. REF: DATE ORIG. MEMO ISSUED: 23.06.82

F.O.I. INDEX DETAIL REFERENCE NO:	SUBJECT REFS:	LEGISLAT. REFS:
I 1103342	TIMBER OPERATIONS TIMBER LOGGING LICENCE STANDING TIMBER	124J

PREAMBLE The question of the deductibility, pursuant to section 124J, of a payment to a vendor for the right to fell standing timber, was considered by the Full Federal Court in the Monaro Sawmills Pty Ltd and Marbut Gunnersen Industries Pty Ltd cases reported at 82 ATC 4182, 12 ATR 926.

2. These appeals which raised identical issues were separately heard at first instance by the Supreme Court of Victoria (McGarvie J) which, in a single judgment (see 81 ATC 4464, 12 ATR 215) dealing with both appeals, allowed that of Monaro Sawmills but dismissed that of Marbut Gunnersen. In its judgment delivered on 4 May 1982, the Federal Court (which heard the appeal by the Commissioner, in the Monaro Sawmills case, and that by Marbut Gunnersen together) allowed both appeals and remitted the question of the application of its judgment to the Supreme Court for consideration.

3. Both the taxpayers had purchased a sawmilling business. Each of the vendors had been granted a licence by the Forests Commission to cut and take away logs from a State Forest. It was the Commission's practice on the sale of a sawmilling business not to transfer the vendor's licence to the purchaser but instead to terminate the licence and grant a new licence on the same terms to the purchaser. It was also the Commission's practice that so long as the holder of a licence maintained satisfactory standards, no other licence to take timber in that area would be granted to anyone else and timber licences would be granted successively to the holder while the timber lasted.

4. In the case of Monaro Sawmills, $240,000 of the consideration paid to the vendor was attributed to the logging rights while, in that of Marbut Gunnersen, the contract expressly stated that the consideration was not apportioned. In each case the Commission, at the request of the vendor and purchaser, terminated the vendor's licence and granted another in the same terms to the purchaser. The Commission subsequently granted further licences to each of the taxpayers.

5. The taxpayers claimed that the amount paid to the respective vendors in respect of the licences was paid to acquire the right to fell standing timber and so much of that amount as was attributable to timber felled during the income year was deductible under section 124J. In the appeals before the Supreme Court, the taxpayers argued that the construction of section 124J adopted by Jenkinson J in Victree Forests Pty Ltd v FC of T, 77 ATC 4236, 7 ATR 575, should not be followed. In addition to this basic submission, counsel for Monaro Sawmills argued that an attachment to the relevant logging licence created a contractural obligation between the Forests Commission and the licence holder so that there was a direct link between the payment and the acquisition by Monaro of rights to fell timber.

6. McGarvie J., as noted above, allowed the appeal by Monaro Sawmills primarily on the basis submitted by counsel that a contractual obligation subsisted between the vendor company and the Forests Commission with the consequence that the consideration paid by Monaro Sawmills to that vendor could properly be regarded as a payment to acquire the right to fell standing timber. That submission was not put by counsel for Marbut Gunnersen, notwithstanding the existance of a similar provision in the log licence, and its appeal was dismissed.

7. In the Federal Court, the major judgment was that of Fox J with whom Davies and Lockhart JJ agreed. Lockhart J added some general observations. Before isolating the crucial elements of the judgment it should be noted that the court regarded both appeals as standing "on the same footing with regard to the finding in relation to the argument based on clause 4" (Fox J. at page 4188, 933) so that any distinction between the two appeals on that basis was eliminated. Indeed, it was conceded on behalf of the Commissioner at the hearing that Marbut Gunnersen could advance argument on that issue notwithstanding its failure to do so before the Supreme Court.

8. Looking at section 124J, Fox J saw the purpose of the provision as "to give a deduction in respect of a particular capital outgoing to the extent that in any year of income the capital asset acquired is consumed in gaining or producing assessable income" (page 4188, 933). Lockhart J echoed the remarks of Taylor J in Standard Sawmilling Co Pty Ltd v FC of T, 74 ATC 4084, 4 ATR 287, to the effect that its purpose was to permit deductions in respect of the exhaustion of working assets in the timber industry.

9. The key to this case was the proper construction of the words "paid to acquire the right to fell standing timber". Both Fox and Lockhart JJ expressly found that it was appropriate to have regard to the general commercial reality of the transaction and adopted the ordinary language meaning of paid "in order to" acquire, etc. - see Fox J at pages 4188-9, 933 and Lockhart J at page 4192, 937. As Fox J observed at page 4188, 933: "The payment must not only have the purpose, but must secure the necessary result". The court concluded that in the present

appeals the amounts were paid in order to acquire the right to fell standing timber.

10. The court overruled the approach of Jenkinson J in Victree Forests (which McGarvie J followed in these appeals).

11. On the question of the proper allocation of the outgoing the court held that:-

(a) the consideration paid in order to acquire the log licence in each case "greatly exceeded what would have been paid for felling rights under the initial grants and assumed renewals" (Fox J at page 4189, 934).

(b) "it is wrong to allow deductions during the period of the initial grants of the respective licence of the full amount paid, regardless of the amount of timber felled" (Fox J at page 4189, 935).

(c) the proper method of apportionment is a question of fact depending upon, inter alia -

(i) the quantum of timber felled;

(ii) the intention of the purchasers at the time of purchase;

(iii) the extent and nature of the available timber;

(iv) whether it is intended to fell all the available timber; and

(v) the effect of inactivity.

12. As to the provision in the Marbut Gunnersen contract expressly not apportioning the purchase of moneys the court regarded this as a neutral factor.

RULING 13. It has been decided to accept the Federal Court's judgment. The judgment clarifies the operation of section 124J following the conflicting judgment in Standard Sawmilling, Victree and the current appeals as; it adopts an approach which is consonant with the commercial realities of these transactions and recognises that the amounts paid are in respect of long term access to the subject timber; and achieves uniformity of treatment between residents of New South Wales and Victoria. Accordingly the judgment may be applied in similar cases. In calculating the relevant deduction to be allowed reference should be made to the factors outlined in paragraph 11 above.

COMMISSIONER OF TAXATION