TR 2006/3 - Income tax: government payments to industry to assist entities (including individuals) to continue, commence or cease business

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Taxation Ruling

Income tax: government payments to industry to assist entities (including individuals) to continue, commence or cease business

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This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant 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.

If you rely on this ruling, we must apply the law to you in the way set out in the ruling (or in a way that is more favourable for you if we are satisfied that the ruling is incorrect and disadvantages you, and we are not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

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What this Ruling is about

1. This Ruling applies to recipients of government payments to industry to assist the recipient to continue, commence or cease business. The Ruling does not apply to those exempt entities specified in section 11-5 of the *Income Tax Assessment Act 1997* (ITAA 1997). Unless otherwise stated, all legislative references in this Ruling are to the ITAA 1997.

2. The class of schemes to which this Ruling applies are bounties, subsidies, grants and rebates paid or funded by the Commonwealth or a State, Territory or local government, or government agency.

3. This Ruling contains the Commissioner's opinion on the way in which the following provisions apply to the class of entities and the class of scheme:

- section 6-5;
- section 15-10;
- section 59-30;

- Subdivision 20-A; and
- Subdivision 40-D.

4. This Ruling discusses bounties, subsidies, grants and rebates which fall into the following three broad categories:

Government payments to continue business

These include payments to:

- provide income support;
- assist with operating costs;
- reimburse the cost of obtaining advice to evaluate current business operations;
- assist due to the loss of anticipated business profits flowing from a contract that is cancelled because of government policy or industry restructure;
- assist due to an anticipated loss or diminution in value of a depreciating asset or other assets;
- assist with improving the viability, sustainability and profitability of a business adversely affected by legislative changes;
- encourage business expansion;
- allow restructuring to remain viable;
- assist with capital costs of restructure to remain viable;
- fund the building or construction of depreciating assets;
- assist with interest accruing on business loans;
- provide loans at a concessional rate of interest; or
- undertake research and development activities.

Government payments to commence business

These include payments:

- to assist with the cost of evaluating whether to commence a business;
- to reimburse the cost of taxation advice;
- for the commencement of a business; or
- to assist with the purchase of a depreciating asset.

Government payments to cease business

These include payments:

- for agreeing to surrender part of the profit yielding structure;
- for agreeing to end a business;

- to reimburse the cost of seeking professional advice to finalise business operations; or
- to reimburse a recipient for the loss or reduction in value of depreciating assets.

5. This Ruling does not discuss:

- when a business is considered to have commenced, as that is a question of fact;
- any capital gains tax consequences that may result from a government payment to industry (GPI);
- a GPI to compensate an employee whose employment has ended;
- the claw back or offsetting of benefits of the research and development tax concession under section 73C of the *Income Tax Assessment Act 1936* (ITAA 1936);
- a GPI that is exempt income;[1] or
- a GPI which is non-assessable non-exempt income, other than under section 59-30.[2]

6. Although this Ruling does not deal with CGT issues, taxpayers should be aware that in those cases to which section 15-10 does not apply (for example, because a payment is received for ending a business) there will usually be CGT consequences. In a case where CGT event A1 applies to the disposal of an asset, the GPI may form part of the capital proceeds for the event. In cases where a contractual or other right is created by the taxpayer entering into an agreement in return for the payment (for example – a GPI received for entering into a restraint of trade agreement), CGT event D1 will apply and the receipt will form part of the capital proceeds for the event. If the payment recoups expenditure forming one of the elements of the cost base, the cost base is taken never to have included the original expenditure, thus potentially increasing a future capital gain or decreasing a future capital loss; however, the payment will not itself give rise to a capital gain. The application of these provisions will depend on the particular facts, and since relatively small differences of fact may affect the outcome, taxpayers are advised, in these cases, to seek private rulings.

7. Section 118-20 applies to reduce any capital gain arising because of the receipt of a GPI to the extent that the payment also represents assessable income under any other provision of the income tax law.

8. Section 118-24 applies to disregard any capital gain or capital loss you make from a CGT event that is also a balancing adjustment event that happens to a depreciating asset or a section 73BA depreciating asset.

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[1] Sections 6-20, 11-10 and 53-10.
[2] Sections 6-23 and 11-55.

Previous Rulings

9. This Ruling replaces Taxation Determinations TD 92/170 and TD 98/28, which were withdrawn on and from the issue date of the draft version of this Ruling. To the extent that our views in those Determinations still apply, they have been incorporated in this Ruling.

Ruling

Government payments to continue business

10. A GPI to assist a business to continue operating, except where the payment is for agreeing to give up or sell part of the profit yielding structure, is included as assessable income of the recipient under section 6-5 or section 15-10.

Section 6-5

11. A GPI 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 in the income year in which it is derived.

12. A GPI to assist with business operating costs or liabilities is ordinary income in the hands of the recipient and is assessable under section 6-5 in the income year in which it is derived.

13. A GPI to reimburse, assist with, or directly pay on behalf of the recipient, the costs of obtaining legal, business, accounting, financial or other professional advice in the ordinary course of business will be on revenue account. The reimbursement, or amount of assistance or direct payment on behalf of the recipient, is ordinary income and assessable under section 6-5 in the income year in which it is derived.

14. A GPI for loss of profits because of government policy or industry restructure is assessable under section 6-5 in the income year in which it is derived. This includes where loss of profit is calculated with regard to factors that are not readily identifiable with the reason for the payment (for example, if calculated by an anticipated or estimated loss or diminution in value of plant or equipment).

15. A GPI to evaluate current business operations in relation to expanding a recipient's business is a receipt arising as a product or incident of carrying on the business. The GPI is ordinary income and assessable under section 6-5 in the income year in which it is derived.

15A. GPI paid with the intention of funding the cost of building or constructing a substantial capital asset, but contingent on the performance of a contract to build or construct the asset, will generally be assessable under section 6-5 because the GPI will be derived in the course of carrying on a business of building or constructing the asset. While this will generally be the case where the

entity is a company, it will be a question of scale and degree for other entities.[2A] The building or construction of the asset may alternatively be outside the course of business yet be the result of a transaction entered into with the purpose of making a profit.

Section 15-10

16. A GPI that assists a business to carry on its activities and is:

- a bounty or subsidy;
- capital in nature; and
- received in relation to carrying on a business,

is assessable under section 15-10 in the income year in which it is received.

17. A GPI received:

- in relation to a business that has ceased to be carried on at the time of payment; and
- was for something done by the business when it was being carried on,

satisfies the test in paragraph 15-10(a) that a bounty or subsidy be received 'in relation to carrying on a business'.

18. A GPI to reimburse, assist with, or directly pay on behalf of the recipient, the costs of obtaining legal, business, accounting, financial or other professional advice that are not in the ordinary course of business will not be on revenue account. A reimbursement, or amount of assistance or direct payment on behalf of the recipient, that is not on revenue account but is a bounty or subsidy in relation to carrying on the business is assessable under section 15-10 in the income year in which it is received or paid directly to the supplier on behalf of the recipient.

19. A GPI received to acquire or construct an asset or assist with the capital costs of restructuring, that is an activity in relation to carrying on a business, is assessable income under section 15-10 if the GPI is not ordinary income under section 6-5. This will be the case even if eligibility for the GPI is dependent upon legislative changes having an adverse effect upon a business.

20. A GPI received for agreeing to give up, or sell, part of the profit yielding structure of a business is not received in relation to carrying on a business for the purposes of section 15-10.

[2A] This Ruling does not consider whether Part IVA of the ITAA 1936 would apply to arrangements implemented for the sole or dominant purpose of separating the business-like activity of building or constructing an asset from the related entity or group that legally receives a GPI.

Amounts otherwise assessable

21. To the extent the GPI is assessable as ordinary income or under section 15-10, it is not included in the termination value[3] of a depreciating asset, nor will it be an assessable recoupment[4] under Subdivision 20-A.

Concessional loans, conditional grants, advance payments or repayments

Concessional loans

22. Financial assistance provided by government by way of a loan provided at a concessional rate of interest is not a GPI. The difference between the normal market rate of interest and the concessional rate of interest is also not a GPI.

Conditional grants

23. Government financial assistance to business is sometimes provided on terms where the amount must be repaid unless the recipient meets agreed conditions within a specified period. The grant becomes unconditional when the recipient satisfies the required conditions of the agreement with the funding authority. It is at this time that a GPI is taken to be received, not at the time the conditional grant was paid.

Advance payments

24. An assessable GPI that is an advance payment is derived by the recipient to the extent that the recipient has done everything necessary to be entitled to retain the amount received. An overpaid amount to which the recipient is not entitled and that must be repaid is not derived by the recipient.

Repayments

25. Any amount of a GPI that must be repaid in a later year for which the recipient is not able to claim a deduction is not assessable income and not exempt income under section 59-30.

Government payments to commence or cease business

26. Government payments to industry to commence or cease a business are not assessable as ordinary income of the recipient under section 6-5 or as a bounty or subsidy in relation to carrying on

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[3] See subsection 40-300(3).
[4] See subsection 20-20(1).

a business under section 15-10. However, the GPI may give rise to an assessable recoupment under Subdivision 20-A.

Subdivision 20-A

Reimbursement for purchase of a depreciating asset

27. A GPI received to assist the recipient to commence business with the purchase of a depreciating asset, the cost of which is deductible under Division 40, is assessable income under the assessable recoupment provisions in Subdivision 20-A.

Reimbursement for professional taxation advice

28. A GPI received to commence or cease business, which reimburses the cost of professional taxation advice deductible under section 25-5, is assessable income under the assessable recoupment provisions in Subdivision 20-A.

Reimbursement for cost of finalising a business

29. A GPI received to reimburse costs of finalising business operations deductible under section 40-880, is assessable under the assessable recoupment provisions in Subdivision 20-A.

Subdivision 40-D

Payment for a depreciating asset

30. Although a payment may be made in relation to a depreciating asset its proper character may relate to carrying on a business and therefore assessable under section 15-10. Where it is assessable under section 15-10, the payment is not taken into account in working out a balancing adjustment for the asset as provided for under Subdivision 40-D.

31. Where the payment is actually received for a balancing adjustment event that requires the amount to be included in the termination value of a depreciating asset then it must be taken into account to work out the balancing adjustment under Subdivision 40-D. Also a balancing adjustment is required to be worked out where other balancing adjustment events occur. The balancing adjustment events are where the recipient of the GPI:

- stops holding a depreciating asset;[5]
- stops using the asset for any purpose and expects never to use it again;[6]

[5] Paragraph 40-295(1)(a).
[6] Paragraph 40-295(1)(b).

- stops having it installed ready for use and expects never to install it ready for use again;[7] or
- has not used the asset and decides never to use it.[8]

32. The balancing adjustment amount is the difference between the termination value of the depreciating asset and its adjustable value just before the event occurred. The termination value is generally, the amount that is received or taken to be received for the asset when a balancing adjustment event occurs. Where the termination value of the depreciating asset is greater than its adjustable value just before the event occurred, the difference is included in assessable income.[9] Where the termination value of the depreciating asset is less than its adjustable value just before the event occurred, the difference is allowed as a deduction.[10]

Examples

Government payments to continue business

Example 1 – Payment of drought relief

33. The farm that a primary producer uses for primary production activities is in an area that is experiencing drought conditions. The Federal Minister for Agriculture, Fisheries and Forestry on advice from the National Rural Advisory Council declares the area to be one of exceptional circumstances. The primary producer obtains an exceptional circumstances certificate from their State Rural Adjustment Authority and applies to Centrelink for an exceptional circumstances relief payment. The claim is approved and the primary producer begins to receive a fortnightly exceptional circumstances relief payment at the same rate as the Newstart Allowance.

34. The purpose of the exceptional circumstances relief payment is to provide income support. It supplements the income of the primary producer to the same level of income provided by the social security system. The payment is regular, expected and able to be relied on by the primary producer. The payment replaces the primary producer's income until the conditions for the payment are no longer satisfied. These characteristics support the conclusion that the payment is ordinary income. The primary producer is assessable on this payment as ordinary income under section 6-5 in the income year that it is derived.

Example 2 – Payment of remote assistance

35. A business operator is eligible to apply for a government annual allowance to assist it with the higher costs of carrying on business in a remote area. The business operator applies for the

[7] Paragraph 40-295(1)(b).
[8] Paragraph 40-295(1)(c).
[9] Subsection 40-285(1).
[10] Subsection 40-285(2).

allowance, submitting details of the location of its operating premises, the number of services supplied to the community, the type of services provided and the annual income of the business.

36. The allowance is calculated with reference to the isolation of the business, the number of services it provides and the existing business income. The business operator can use the payment in any aspect of its business operations. The payment has a real connection to the business and is an ordinary incident of the business operations. The calculation of the allowance with reference to business turnover (for example, the number of services provided) and the intention for the amount to be used to meet ongoing operating costs of the business indicate that the payment is income in nature. The allowance is ordinary income and is assessable under section 6-5 in the income year that it is derived.

Example 3 – Payment to assist with employing an apprentice

37. A business is eligible to apply for a government payment to assist with the initial cost to the business of employing an apprentice. A payment to an employer as a financial incentive to take on an apprentice or continue to employ an apprentice is received in the ordinary course of business. As such, it is ordinary income and assessable under section 6-5.

Example 4 – Payment to offset liability

38. An entity that is a wine producer sells wine to a wholesaler. The entity has a liability to pay wine equalisation tax (WET) at the nominated rate on sales to the wholesaler and qualifies for the WET producer rebate to offset its WET liability.

39. The entitlement to the WET producer rebate is a result of the sales made by the business as part of its normal operations. The rebate is calculated with reference to the value of sales (excluding WET and GST liability). The rebate is received in the ordinary course of the entity's wine distribution activities. It is received to offset the liability that arises because of business operations and is calculated with reference to business income. The rebate is ordinary income and is assessable under section 6-5 in the income year that it is received.

Example 5 – Payment to assist with change to operations for environmental purposes – payment in relation to multiple factors

40. A business operates in an industry that uses equipment that produces pollutants and damages the environment. The government offers each business in the industry a grant as an incentive for the business to adopt new manufacturing technology. The business receives a grant as a lump sum payment which is adjudicated by an assessor using the following terms of reference:

- an estimate of the loss in value of the depreciating asset/s being made redundant;
- an estimate of the loss in income incurred by the stoppage in production to allow the new depreciating asset/s to be installed,

and a separate payment for:

- a reimbursement of up to $10,000 for the costs incurred in installing the depreciating asset/s.

41. Apart from the reimbursement amount the payment received is an undissected amount made for multiple claims and is not capable of being separated into assessable and non assessable components. The nature of the payment is determined by examining the character of the lump sum payment in the hands of the recipient.

42. The payment is not a normal incident of the recipient's business, nor is it paid for a purpose for which the business is carried on. The undissected amount is for the sterilisation of the existing depreciating assets and updating to new depreciating assets. The amount is a capital receipt as it is for the sterilisation of the depreciating asset/s and the enduring benefit of the new depreciating asset/s. The reimbursement amount is also a capital receipt for the same reason.

43. The total amount of the payment, comprising the undissected amount and the reimbursement amount, is given as financial assistance to the business to use depreciating assets that are less polluting. The payment is a bounty or subsidy being financial assistance given to assist the business.

44. The words 'received in relation to carrying on a business' in section 15-10 require a relationship between the payment and the carrying on of the business. The payment is received by the business for replacing assets used in the manufacturing operations of the business. The assets are connected directly to the operations of the business. As such, the payment is received in relation to carrying on the business.

45. The payment is a bounty or subsidy, is received in relation to carrying on a business and is not assessable as ordinary income under section 6-5. Therefore, the payment is assessable income under section 15-10.

Example 6 – Payment to reimburse cost of obtaining advice

46. The taxpayer operates a business that may experience significant negative impacts as a consequence of a government proposal to restrict an industry. The government is offering assistance to eligible businesses through a restructure package. The taxpayer incurs costs in seeking financial, business planning and legal advice to decide whether to apply for government assistance. The taxpayer

applies for, and receives, a payment of $1,000 to partially reimburse the cost of seeking that advice.

47. In considering whether the payment is income it is necessary to examine the relationship between the payment and the business activities of the recipient.

48. The purpose of the payment is to assist the recipient with the costs of seeking advice to assess the impact of industry restructure on the trading operations. It is considered that the payment is given for a purpose that is part of the recipient's normal business operations. Accordingly, it is considered the payment is income according to ordinary concepts and is included in the taxpayer's assessable income under subsection 6-5(1) in the income year in which it is derived.

Example 7 – Payment to encourage expansion within existing operations

49. A company that develops pharmaceutical products intends to expand its research and development for products used in medical procedures. The company makes an application to Aus Industry for a federally funded Commercial Ready Grant to assist with the research and development costs. The application is considered and approved by the Industry Research and Development Board which administers the *Industry Research and Development Act 1986*. The company enters into a Commercial Ready Deed of Agreement with Aus Industry and receives a grant of $1 million.

50. The Commercial Ready Grant is provided specifically for research and development which the company, as a developer of pharmaceutical products, already carries out. The payment is connected to the existing activities of the company and is of a type that a company in the industry would expect to receive. The Commercial Ready Grant for research and development is received in the company's ordinary course of business and is ordinary income. The payment is assessable under section 6-5 in the income year in which it is derived.

Example 8 – Payment to reimburse capital cost of restructure

51. Due to a new environmental initiative a business operator is required to restructure their business and purchase new depreciating assets. The business purchases new plant costing $12,000. Under the government environmental incentive scheme, the business can apply for a reimbursement of this amount up to $10,000. The business applies for, and receives, a lump sum payment of $10,000.

52. The payment of $10,000 is not derived in the ordinary course of carrying on the business and is not considered to be ordinary income.

53. The payment is a bounty or subsidy, being an amount of financial aid from government to help the business meet the new operating requirements put in place by the government's new policy. The restructuring involves the update of the processing operations of the business. The restructure is connected directly to the operations of the business and considered to be in relation to carrying on the business.

54. The payment is a bounty or subsidy, which is not assessable as ordinary income under section 6-5, and is received in relation to carrying on the business. Therefore it is assessable under section 15-10 in the income year in which it is received.

Example 8A – Payment to fund the cost of constructing new assets

54A. To support investment in renewable energy, the government offers a GPI with the intention of reimbursing part of the cost of constructing renewable energy plants. A corporate group which carries on an energy generation business undertakes preliminary work in respect of securing a GPI from the government. A special purpose vehicle (SPV) is then created within the group to receive the GPI and perform the relevant construction activities required under a contract with the government to receive the GPI. Before construction begins, the GPI is paid as a lump sum into a bank account to which the government and the SPV are joint signatories. Under the contract, upon the SPV satisfying each of a series of construction milestones for the construction of the plant, the government undertakes to allow the SPV to drawdown an instalment of the GPI funds. After construction is completed the SPV will either use the plant in the course of an electricity generation business of its own or lease the plant to a related party for use in the course of the related party's energy generation business.

54B. The GPI instalments are derived by the SPV for performance of the obligations under the contract relating to the construction of the plant. The instalments are therefore received in the course of a business of constructing the plant and are therefore assessable under section 6-5 in the income years in which the instalments are derived. Alternatively, the GPI instalments may be considered to have been derived from an isolated transaction entered into with an intention to profit.[10A]

54C. If the GPI is not ordinary income of the SPV, it is assessable under section 15-10 in the income year in which it is received.

[10A] *Federal Commissioner of Taxation v. Myer Emporium Ltd* (1987) 163 CLR 199. Refer to Commissioner's guidelines in Taxation Ruling TR 92/3 *Income tax: whether profits on isolated transactions are income*.

Government payments to commence business

Example 9 – Payment to assist research of new business opportunities

55. As part of an industry restructure the government offers a GPI to entities to encourage them to consider carrying on a business in another industry. The GPI reimburses the entity for the cost of up to $1,000 for market research, feasibility studies or preparation of a business plan for operation in another industry. The GPI is paid to the applicant upon presentation of the receipt for the goods and services or is paid on behalf of the applicant directly to the supplier of the services.

56. As the GPI is preliminary to a business being established it is not a receipt ordinarily received in the normal course of trade, or for which business is being carried on. The GPI is not ordinary income and is not assessable under section 6-5.

57. The GPI is to assist the recipient to consider a new business opportunity and is preliminary to the business being established. Therefore it is not received in relation to carrying on a business and is not assessable under section 15-10. However, the recipient of the GPI will need to consider whether there are any CGT consequences (see paragraph 6 of this Ruling).

Government payments to cease business

Example 10 – Payment for ceasing an identifiable and distinct part of a business activity

58. An entity in the fishery industry carries out separate wholesaling and processing activities. As part of an industry restructure, exit assistance is offered to businesses where the restructure will adversely affect and render unviable a distinct part of the business operations. The entity's processing activities will be adversely affected and no longer be viable. The entity ceases its processing activities and receives an exit payment under the terms of the government grant.

59. The payment is not a normal incident of the recipient's business, nor is it paid for a purpose for which the business was carried on. The payment is for the surrender of part of the profit earning structure. It takes on the nature of the item it replaces and is a capital receipt. The receipt of the payment is capital in nature and is not assessable as ordinary income under section 6-5.

60. The words 'received in relation to carrying on a business' require a relationship between the payment and the carrying on of the business. The payment is not received in relation to carrying on a business as the payment is for giving up part of the profit making structure of the business – the processing activities. As such, the payment is not received in relation to carrying on the business and is not assessable under section 15-10. However, the recipient of the GPI will need to consider whether there are any CGT consequences (see paragraph 6 of this Ruling).

Example 11 – Payment for ceasing an identifiable geographic part of a business

61. A business in the timber industry carries out logging and milling activities in Queensland, New South Wales and Victoria. Each of these locations operates as a separate operation independent of the other location/s. As a result of changes to the timber industry the operations in Victoria are now unviable and the operations will cease. The business receives exit assistance in regards to ceasing their Victorian operations.

62. The payment is not a normal incident of the recipient's business, nor is it paid for a purpose for which the business was carried on. The payment is for the surrender of the profit earning structure. It takes the nature of the item it replaces and is a capital receipt. The receipt of the payment is capital in nature and is not assessable as ordinary income under section 6-5.

63. The words 'received in relation to carrying on a business' requires a relationship between the payment and carrying on the business. The payment is not received in relation to carrying on a business as the payment is for giving up part of the profit earning structure of the business – the Victorian operation. The payment is not received in relation to carrying on the business and is not assessable under section 15-10. However, the recipient of the GPI will need to consider whether there are any CGT consequences (see paragraph 6 of this Ruling).

Example 12 – Reimbursement of cost of seeking professional advice and for capital costs in ceasing business

64. A doctor in a small inner city family medical practice decides to apply for relocation assistance under the state government relocation programme for medical practitioners. Under this programme, qualifying medical practitioners can apply for a reimbursement of the costs of relocating to a new or expanded medical practice in a country region. The programme also offers reimbursement of the costs of seeking advice about the relocation, and certain of the capital costs of finalising the existing medical practice.

65. The doctor is accepted for inclusion within the programme after providing a proposal to join a small medical practice in a remote area of the state. He applies for a payment under the programme, and receives a percentage of his costs.

66. The amount received for relocating the medical practice to a country region (in contrast to making the city practice bigger or more efficient) is capital in nature and is not received in relation to carrying on a business. Therefore, the amount is not assessable as ordinary income under section 6-5 or assessable as income under section 15-10. However any amount which is a reimbursement of certain deductible expenses,[11] for example capital costs deductible under section 40-880 for ending a practice, is an assessable recoupment under Subdivision 20-A. The recipient of the GPI will need to consider whether there are any CGT consequences (see paragraph 6 of this Ruling).

Example 13 – Payment for ending part of a business calculated by reference to the estimated loss in value of a depreciating asset – operator continues to use the asset

67. Due to an industry restructure, an entity's profit yielding structure is significantly reduced requiring it to cease carrying on part of its business activity. It receives a GPI which is calculated having regard to the estimated loss in value of some items of depreciating assets. The loss in value was assessed by estimating the difference between the value within the business as a going concern and the salvage or auction value as a consequence of ceasing that part of the business in which the items were used. Even though the entity stops carrying on part of its business, it does not dispose of the items but continues to use them in other parts of its business.

68. The payment is not ordinary income as it relates to the change in the income earning structure due to ending part of the business operations.

69. The payment is of a capital nature but is not received in relation to carrying on a business. The payment is not directed at the income earning activity of the business but is for agreeing to end part of the business.

70. The entity retains and continues to use the assets, which continue to decline in value for the purposes of the capital allowance provisions of Division 40. As no balancing adjustment event for the assets occurs, the payment is not taken into account in working out a balancing adjustment for any of the assets as provided for under Subdivision 40-D.

[11] The table in section 20-30 lists the deductions for which recoupments are assessable.

71. The amount received by the entity was paid for its agreement to cease carrying on a part of its business which resulted in a loss in value of the depreciating assets considered to be surplus. The payment was not made in respect of any outgoing the entity may have incurred on the assets, such as their purchase cost. Accordingly, the amount received was not paid for an existent loss or outgoing for any of the entity's assets. The amount received is not an assessable recoupment of a loss or outgoing under Subdivision 20-A. However, the recipient of the GPI will need to consider whether there are any CGT consequences (see paragraph 6 of this Ruling).

Example 13A – Payment for loss in value of depreciating asset where operator no longer uses asset

72. **Alternatively** the business operator in the previous scenario may no longer have any use for the assets and only intends to hold the assets in storage until they can be satisfactorily auctioned. He never intends to use them again.

73. This change in circumstances and intention means that a balancing adjustment event (paragraph 40-295(1)(b)) has occurred for each depreciating asset.

74. The termination value is the market value of the assets when the business operator stops using the assets (as specified under item 1 in the termination value table in subsection 40-300(2)). The GPI is not used in the working out of termination value.

75. The termination value (market value) is used to work out the balancing adjustment. The calculation of any balancing adjustment income (subsection 40-285(1)), or any balancing adjustment deduction (subsection 40-285(2)), is not affected by the receipt of the government payment.

76. Some time after the business ceases the business operator auctions the depreciating assets. On disposal of the assets by auction, a separate balancing adjustment event occurs, and the termination value for the asset under this event will be the sale proceeds received from the auction. The cost of each of the depreciating assets is taken to be the previous termination value of the asset (item 3 in the table to subsection 40-180(2)).

77. The termination value and adjustable value will be used to work out the balancing adjustment under section 40-285.

Example 14 – Payment for surrender of licence that is part of the profit yielding structure

78. A business operator has three licences that are part of the profit earning structure of his business. The government offers an incentive to businesses to end their operations in that industry. The business operator surrenders his three licences and decides to diversify into other business activities. The business operator receives a government payment for each licence surrendered.

79. The licences have the character of capital assets because they are part of the profit earning structure of the business of the taxpayer. The payment is capital in nature and is not ordinary income.

80. The payment for the surrender of the licences is a bounty or subsidy being a payment of government aid. However, the payment is not received in relation to carrying on the continuing business but for giving up the profit earning structure. This ends the business covered by the three licences.

81. Accordingly, the payment received by the business operator for the surrender of three licences is not assessable income under section 15-10 in the income year in which it is received. The recipient of the GPI will need to consider whether there are any CGT consequences (see paragraph 6 of this Ruling).

Date of effect

82. This Ruling applies to years of income commencing both before and after its date of issue. This Ruling does 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 final Ruling.

Commissioner of Taxation
31 May 2006

Appendix 1 – Explanation

This Appendix 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.

Government payments to continue business

83. A GPI received by an entity to assist it to continue its existing business will be:

- ordinary income of the recipient assessable under section 6-5; or
- a bounty or subsidy received in relation to carrying on a business and assessable under section 15-10,

except where the payment is for agreeing to give up or sell part of the profit yielding structure.[11A] If the GPI is not assessable under any of these provisions, the recipient will need to consider whether there are any CGT consequences.

Nature of receipt

Ordinary income

84. 'Ordinary income' includes income according to ordinary concepts. Income according to ordinary concepts is not defined in the taxation legislation. 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.

85. Case law has established the following guidelines to assist in determining the nature of a receipt:

- the nature of a payment is determined by examining the character of the payment in the hands of the recipient;[12]

[11A] In *Berghofer v. FCT* [2008] ATAA 1138 at 30, the Tribunal held that, because an amount was provided on the precondition of an adverse effect on a business, it was not a bounty or subsidy. It stated that this notion was recognised in paragraph 83 of this Ruling with emphasis on the words 'except where the payment is for agreeing to give up or sell part of the profit yielding structure'. However, a payment for giving up or selling part of the profit yielding structure will fall outside section 15-10 because it is not received in relation to carrying on a business as stated in paragraph 20 of this Ruling. It is not because it is not a bounty or subsidy. The Commissioner considers that such an amount may be a bounty or subsidy even if provided on the precondition of an adverse effect (see explanation at paragraphs 93-98 of this Ruling). Such an amount may also be received in relation to carrying on a business.

[12] *Scott v. FCT* (1966) 117 CLR 514 per Windeyer J at 526, *Hayes v. FCT* (1956) 96 CLR 47 per Fullagar J at 55 and *Federal Coke Co Pty Ltd v. Federal*

- regard must be given to all facts,[13] 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;[14]
- it is necessary to apply 'a business conception to the facts of the case';[15]
- the test in determining if a payment is income or capital is an objective test;[16]
- the question is not decided by determining whether the expenditure by the payer is revenue or capital in nature;[17]
- the question is not decided by determining whether any expenditure the recipient is required to make is revenue or capital in nature;[18]
- the question is not decided by determining the nature of the measure used to calculate the payment;[19]
- where a recipient provides consideration for a payment, the nature of that consideration is generally taken to be the nature of the payment;[20]
- a payment that is provided for a purpose which is not part of the recipient's business will not be income in nature;[21]
- periodicity, regularity or recurrence may show a payment to be income;[22]
- a payment paid in consideration for the performance of services is generally income;[23]

Commissioner of Taxation (*Federal Coke* case) (1977) 34 FLR 375 at 402 per Brennan J.

[13] *MIM Holdings Ltd v. Commissioner of Taxation* (*MIM* case) (1997) 363 FCA at 13 per Northrop, Hill and Cooper JJ and *Federal Coke* case (1977) 34 FLR 375 at 387 per Bowen J.

[14] *FCT v. Rowe* (1997) 187 CLR 266 at 292 per Gaudron, Gummow and Kirby JJ, *FCT v. Dixon* (1952) 86 CLR 540 at 555 per Dixon CJ and Williams J and *The Squatting Investment Co Ltd v. FCT* (*Squatting* case)(1953) 86 CLR 570 at 627-628 per Kitto J.

[15] *GP International Pipecoaters Pty Ltd v. FCT* (*Pipecoaters* case) (1990) 170 CLR 124 at 141 per Brennan, Dawson, Toohey, Gaudron and McHugh JJ and *First Provincial Building Society v. FC of T* (*First Provincial* case) (1995) 56 FCR 320 at 325 per Hill J.

[16] *Hayes v. FCT* (1956) 96 CLR 47 per Fullagar J at 55 and *MIM* case (1997) 363 FCA 13 per Northrop, Hill and Cooper JJ.

[17] *First Provincial* case (1995) 56 FCR 320 at 325 per Hill J.

[18] *Pipecoaters* case (1990)170 CLR 124 at 137 per Brennan, Dawson, Toohey, Gaudron and McHugh and *MIM* case (1997) 363 FCA 13 per Northrop, Hill and Cooper JJ.

[19] *Federal Coke* case (1977) 15 ALR 449 at 459-60 per Bowen CJ and *Californian Oil Products v. Federal Commissioner of Taxation* (1934) 52 CLR 28 at 49 per Starke J.

[20] *Federal Coke* case (1977) 34 FLR 375 at 401 per Brennan J.

[21] *Reckitt & Colman Pty Ltd v. FC of T* (*Reckitts* case) (1974) 74 ATC 4185 at 4187 per Mahoney J.

[22] *MIM* case (1997) 363 FCA at 13 per Northrop, Hill and Cooper JJ.

- calculation of a payment by reference to expected profits made, or not made by the recipient but that would ordinarily have been expected to have been made, is a factor supporting a conclusion of income;[24]
- a payment provided for a particular revenue expense is a factor supporting a conclusion of income;[25]
- a payment from an isolated transaction entered into with an intention to profit may still be income;[26]
- a payment in a lump sum does not require a conclusion that the payment is capital;[27]
- a payment made to compensate for the restriction of a person's capacity to perform services or to carry on a business may be a capital payment;[28]
- a payment by gift or subsidy to replenish or augment the recipient's capital is not income under ordinary concepts as it is not a product or incident of the recipient's income producing activity;[29]
- a payment for the sterilisation of a capital asset of a business is a capital receipt;[30] and
- a payment for surrender of part of the profit earning structure is a capital receipt.[31]

86. A GPI that is ordinary income is assessable under subsection 6-5(1) in the income year of derivation.

Single payments

87. The treatment of a GPI which is paid for unspecified aspects of a recipient's business activities will vary depending on the terms of the payment and the particular program under which the amount is paid.

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[23] *Hayes v. FCT* (1956) 96 CLR 47 at 57-8 per Fullagar J and *Reuter v. Federal Commissioner of Taxation* (1992) 111 ALR 716 at 730 per Hill J.
[24] *Reckitt & Colman Pty Ltd v. FC of T* (*Reckitts* case) (1974) 74 ATC 4185 at 4187 per Mahoney J.
[25] *Reckitts* case (1974) 74 ATC 4185 at 4188 per Mahoney J.
[26] *Federal Commissioner of Taxation v.Myer Emporium Ltd* (1987) 163 CLR 199 at 209-10 per Mason ACJ, Wilson, Brennan, Deane and Dawson JJ and *Pipecoaters* case (1990)170 CLR 124 at 138 per Brennan, Dawson, Toohey, Gaudron and McHugh JJ. Refer to Commissioner's guidelines in TR 92/3.
[27] *MIM* case (1997) 363 FCA 13 per Northrop, Hill and Cooper JJ.
[28] *Higgs (Inspector of Taxes) v. Oliver* [1951] Ch 899, *Dickenson v. Federal Commissioner of Taxation* (*Dickensons* case) (1958) 98 CLR 460 at 474-5 per Dixon CJ and *MIM* case (1997) 363 FCA 13 per Northrop, Hill and Cooper JJ.
[29] *Pipecoaters* case (1990) 170 CLR 124 at 142 per Brennan, Dawson, Toohey, Gaudron and McHugh JJ and *Hayes v. FCT* (1956) 96 CLR 47 at 54-56 per Fullagar J.
[30] *Glenboig Union Fireclay Co v. IRC* (1922) 12 TC 427 at 463 per Lord Buckmaster.
[31] *Allied Mills Industries Pty Ltd v. Commissioner of Taxation* (*Allied Mills case*) (1988) 20 FCR 288 at 299 per Gummow J.

88. The character of a single lump sum GPI that is not apportioned is determined by examining the character of the whole payment in the hands of the recipient. As such the Commissioner will have regard to all circumstances which give rise to the payment without a disproportionate emphasis upon the form in which the transaction was structured.[32]

89. The decision in *McLaurin v. FC of T*[33] *(McLaurin's* case) stands as authority for the proposition that where damages are paid by way of an undissected lump sum which may, in the calculation by the payer, include income items as well as capital items, that single undissected lump sum will be treated as capital for the recipient. Accordingly where the GPI is a single undissected lump sum received that includes income and capital items the whole amount will be treated as capital. If the amount is wholly within the provisions of section 15-10 then it will be assessable income of the recipient. If the amount does not come within section 15-10 a capital gain or loss may arise on receipt of the GPI.[34]

90. *McLaurin's*[35] case distinguishes between the case where an undissected payment is received for multiple claims and a dissected payment received in respect of several claims. In both the *McLaurin* and *Allsop*[36] cases the High Court rejected the approach of the United Kingdom courts in dissecting amounts into assessable and non-assessable components.

Section 15-10

91. Where the GPI is not assessable as ordinary income consideration needs to be given to whether section 15-10 applies.

92. A GPI is assessable under section 15-10 in the income year in which it is received 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.

Bounty or subsidy

93. Payments of financial assistance by government are commonly referred to as 'bounties', 'subsidies' or 'grants'. As 'bounty', 'subsidy' and 'grant' are not defined terms, the ordinary meaning of these terms applies.

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[32] *Northumberland Development Co Pty Ltd v. FC of T* 94 ATC 4717 at 4721.
[33] *McLaurin v. FC of T* (1961) 104 CLR 381.
[34] CGT event C2 section 104-25.
[35] *McLaurin's* case (1961) 104 CLR 381.
[36] *Allsop v. FCT* (1965) 113 CLR 341.

94. 'Subsidy' is defined as '1. a direct pecuniary aid furnished by a government to a private industrial undertaking, a cultural organisation, or the like; 2. a sum paid, often in accordance with a treaty, by one government to another, to secure some service in return; 3. a grant or contribution of money'.[37] The ordinary meaning adopted by case law is an 'aid provided by the Crown [government] to foster or further some undertaking or industry'.[38]

95. 'Bounty' is defined to include 'a premium or reward, especially one offered by a government'.[39] When 'bounty' and 'subsidy' are positioned together the compound term is interpreted as describing financial assistance given to assist business.[40]

96. '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'.[41] A reference to 'bounty or subsidy' includes a grant that encourages business or trade[42] and also a grant to address a detrimental effect on a business or trade.[42A]

97. 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.

98. Some legislation provides that payments are deemed to be a subsidy for the purposes of section 15-10. For example, a payment, such as an energy grant or a cleaner fuel grant, that is a 'grant' or 'benefit' under section 8 of the *Products Grants and Benefits Administration Act 2000* (PGBAA 2000) is, under section 56 of the PGBAA 2000, taken to be a subsidy for the purposes of section 15-10. However, if such a payment is received as ordinary income, it is assessable under section 6-5 rather than section 15-10.

In relation to carrying on a business

99. 'Business' is defined in section 995-1 as 'any profession, trade, employment, vocation or calling, but does not include occupation as an employee'. Taxation Ruling TR 97/11 provides further guidance on whether an activity carried on by a taxpayer amounts to a business.

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[37] Macquarie Dictionary 2001 revised 3rd edition.
[38] *Placer Development Ltd v. Cth* (1969) 121 CLR 353 at 373 per Windeyer J.
[39] *Macquarie Dictionary*, 2001 revised 3rd edition.
[40] *Squatting* case (1953) 86 CLR 570 at 613 per Webb J.
[41] *Macquarie Dictionary*, 2001 revised 3rd edition.
[42] *Reckitts* case (1974) 74 ATC 4185 at 4191 per Mahoney J.
[42A] *Softex Industries Pty Ltd v. FCT* [2002] AATA 1232 at [29] per SL Beddoe SM.

100. A bounty or subsidy will be 'in relation to' carrying on a business when there is a real connection between the payment and the business. The term 'in relation to' includes within its scope payments that have a direct or indirect connection to the business. As stated by Hill J in the *First Provincial* case:

> The words 'in relation to' are words of wide import. They are capable of referring to any relationship between two subject matters in the present case the receipt of the bounty or subsidy, on the one hand, and the carrying on of the business, on the other…..the degree of connection will be 'a matter of judgment on the facts of each case'… What is necessary, at the least, in the present context is that there be a real connection…the relationship need not be direct, it may also be indirect.[43]

101. A bounty or subsidy must be related to 'carrying on' the business not merely for commencing or ceasing a business. As stated by Hill J in the *First Provincial* case:

> the relationship must be to the 'carrying on' of the business. These words may perhaps be understood in opposition to a relationship with the actual business itself. They would make it clear, for example that a bounty received, merely in relation to the commencement of a business or the cessation of the business, would not be caught. The expression 'carrying on of a business' looks, in my opinion, to the activities of that business which are directed towards the gaining or producing of assessable income, rather than merely to the business itself.[44]

Payments to continue business – acquisition or construction of assets, or restructure

102. A GPI received to acquire or construct an asset or assist with the capital costs of restructuring a business to improve the manufacturing, processing, distribution, administrative or other operations of a business is received in relation to carrying on a business.[45] Similarly, a GPI received to assist with the capital costs of restructuring a business to assist that business to improve its overall efficiency is received in relation to carrying on a business.[46] Some business restructures may not be in relation to carrying on a business, for example if a business changes its structure to facilitate a new activity, but this must be decided on the merits of each case.

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[43] *First Provincial* case (1995) 56 FCR 320 at 333 per Hill J and *Re Plant and Commissioner of Taxation* [2004] AATA 1296 at 16, 22 and 23 per Muller DP.
[44] *First Provincial* case (1995) 56 FCR 320 at 332 per Hill J.
[45] *First Provincial* case (1995) 56 FCR 320 at 332 per Hill J.
[46] See *Re Plant and Commissioner of Taxation* [2004] AATA 1296.

Payments to commence business

103. A GPI received by an entity or made on behalf of the entity as assistance to commence a business does not satisfy the requirement of being paid in relation to carrying on a business.[47]

Payments to cease business

104. A GPI received by an entity, or paid directly to a supplier on behalf of the entity, as assistance to cease a business is not received in relation to carrying on a business.[48]

105. But payments received after a business has ceased may be received in relation to carrying on a business if they relate directly or indirectly to activities of the business while it was operating. In the decision in *Reckitt & Coleman Pty Ltd v. FC of T* Mahoney J held that payments received after a business had ceased, but where the payments related to something done when the business was operating, then the payments were received in relation to carrying on a business. Mahoney J stated:

> In my opinion, the words 'in relation to the carrying on of a business' are wide words; no doubt there are some relations which would not fall within the scope of them but even if it be accepted that the payments in question were made in relation to a business which had ceased to be carried on at the time of that payment but by reason of something which had been done when the business was being carried on, the payments would in my opinion properly be held to be 'in relation to the carrying on of the business'.[49]

106. A GPI on capital account for modifying or restricting the profit yielding structure of the business may be in relation to carrying on that business. However, a GPI that is received merely in relation to giving up or selling part of the profit yielding structure of the business is not.

Derivation and timing of derivation of a GPI

107. An amount (including an amount which has been received), will not be included in assessable income for an income year, unless it has been *derived* during that year.[50]

108. The term 'derive' is defined in section 995-1(1) as having a meaning affected by subsection 6-5(4). Under subsection 6-5(4) a recipient is taken to have derived an amount as soon as it is applied or dealt with in any way on their behalf or as they direct. Therefore, if a grant is ordinary income and is paid on behalf of the recipient directly to a supplier in respect of an expense the recipient incurred, it is derived at the time it is so paid to the supplier.

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[47] *First Provincial* case (1995) 56 FCR 320 at 332 per Hill J.
[48] *First Provincial* case (1995) 56 FCR 320 at 332 per Hill J.
[49] *Reckitts* case 74 ATC 4185 at 4192.
[50] There are special rules for STS taxpayers who are accounting for ordinary income using the STS accounting method.

109. If a grant would be assessable as statutory income apart from the fact that the recipient has not received it, the amount becomes assessable as soon as it is applied or dealt with in any way on the recipient's behalf or as directed by the recipient (subsection 6-10(3)). Therefore, if a grant would be assessable under section 15-10 and is paid on behalf of the recipient directly to a supplier in respect of an expense the recipient incurred, it becomes assessable to the recipient at the time it is so paid to the supplier.

110. No Australian judicial decisions precisely cover the timing of derivation of government funding by way of grant or subsidy. However, in *Brent v. FC of T*,[51] the High Court said:

> It has become well established that unless the Act makes some specific provision on the point the amount of income derived is to be determined by the application of ordinary business and commercial principles and that the method of accounting to be adopted is that which 'is calculated to give a substantially correct reflex of the taxpayer's true income. (*The Commissioner of Taxes (South Australia) v. The Executor, Trustee and Agency Company of South Australia Limited (Carden's case)* (1938) 63 CLR 108 at pp 152-154).[52]

111. In *Arthur Murray (NSW) Pty Ltd v. FC of T*[53] the High Court affirmed the proposition that in relation to the question of when income should be judged to have been derived, it was appropriate to have regard to the application of ordinary business and commercial principles. The proposition was applied most recently by the Full Federal Court in *BHP Billiton Petroleum (Bass Strait) Pty Ltd & Anor v. FC of T*[54] where regard was had to expert accounting evidence concerning recognising income in relation to the amounts in question. However, the Court cited the caution expressed in Arthur Murray when they quoted from that case, in BHP Billiton:

> A judicial decision as to whether an amount received but not yet earned or an amount earned but not yet received is income must depend basically upon the judicial understanding of the meaning which the word conveys to those whose concern it is to observe the distinctions it implies. What ultimately matters is the concept; book-keeping methods are but evidence of the concept.[55]

112. Barwick CJ and Kitto and Taylor JJ also said in *Arthur Murray*:

> As Dixon J observed in *Carden's Case*: 'Speaking generally, in the assessment of income the object is to discover what gains have during the period of account come home to the taxpayer in a realized or immediately realizable form.[56]

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[51] *Brent v. FC of T* (1971) 125 CLR 418.
[52] *Brent* case at 420.
[53] *Arthur Murray v. FC of T* (1965) 114 CLR 314.
[54] *BHP Billiton Petroleum (Bass Strait) Pty Ltd & Anor v. FC of T* [2002] FCAFC 433.
[55] *BHP Billiton* at 447.
[56] *Arthur Murray* case at 318.

113. The above passages were made in relation to subsection 25(1) of the ITAA 1936. However, section 6-5 expresses the same ideas as in subsection 25(1) of the ITAA 1936, and these passages can be accepted as having equal relevance to the operation of section 6-5: see subsection 1-3(2).

114. The reference by the High Court in *Arthur Murray* to the significance of an amount not being income unless it had been earnt occurred again in the following passage, which contains the major part of their reasons why in that case, the prepaid fees in relation to dancing lessons not yet *delivered*, should not be treated as income derived at that time. The Court said:

> Thus, in determining whether in such a case actual receipt had to be added to earning in order to find income, uncertainty of receipt, inherent in the circumstances of the earning appeared to his Honour to be decisive. Likewise, as it seems to us, in determining whether actual earning has to be added to receipt in order to find income, the answer must be given in the light of the necessity for earning which is inherent in the circumstances of the receipt [57]

115. The closest authority to government funding by way of grant or subsidy is the decision of the Administrative Appeals Tribunal (AAT) in *Case U7*.[58] That case concerned a company which had applied for a grant from the Commonwealth under the former *Industrial Research and Development Incentives Act 1976*. It had received, at the discretion of the paying agency, an 'advance' of grant monies it would become entitled to on making certain expenditure on the agreed to research and development (R&D) activities. These monies were repayable if this expenditure was not made, or made for less than the amount prepaid.

116. The issue before the AAT was whether the company should be taxed on the whole of the grant monies received during that year, or only so much of it as had been directed towards the conduct of the R&D activities. The AAT referred to the decision in *Arthur Murray* and considered that there was a close analogy between the company's situation and that of a prepayment under a contract for future services, notwithstanding that the company was not held to be contracting to render future services to the Commonwealth. The AAT considered that the company in the year in question had not done all that was required of it to earn the full amount prepaid to it.

[57] *Arthur Murray* case at 319.
[58] *Case U7* 87 ATC 127; (1987) *Tribunal Case 20* 18 ATR 3120

Concessional loans, conditional grants, advance payments or repayments

Concessional loans

117. Neither a concessional loan, nor the difference between the normal market interest rate and a concessional rate of interest on loans provided by government, is a GPI. However, if the borrower is liable for the full interest charge but a proportion of the full interest charge is provided or offset by government, the amount provided or offset is assessable. It is up to the parties to an agreement to determine the interest rate charged. A lower than market rate of interest is not a GPI because it is not a payment. It may give rise to a non-cash business benefit but, to the extent the loan is used in the business, the otherwise deductible rule will apply (see paragraphs 125 to 127 of this Ruling).

Conditional grants

118. Conditional grants made by government that are convertible to a grant after a specified period or on attainment of milestones and subject to agreed performance criteria are not in themselves a GPI at the time they are received.

119. Where a recipient satisfies the terms of a conditional grant and is entitled to have the conditional grant converted to a grant, a GPI has been earned in the income year of conversion to the extent that the amount is no longer conditional or subject to repayment. Depending on the terms of the agreement, this might be at different points during the period. If the grant is assessable as ordinary income the amount is included as assessable income in the year in which it is derived (subsection 6-5(2)).

Advance payments

120. A GPI that is an advance payment of ordinary income based on an estimate of a recipient's entitlement, with the condition that any over payment must be repaid once the actual entitlement is determined, is only derived to the extent that the recipient is entitled to the amount received. Any over payment to which the recipient is not entitled and which must be repaid is not derived. Payments received in advance should be included in assessable income except to the extent of any amount that has clearly not been derived.

121. Where a recipient has an entitlement to claim additional amounts, those amounts will be derived in the income year in which the entitlement arises.

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[59] [Omitted.]

Repayments

122. A GPI which:

- must be repaid; and
- is repaid in a later year; and
- the repayment cannot be deducted for any income year,[60]

is not assessable income and not exempt income and is not included in assessable income for an income year under section 59-30. This provision applies to the 2003-04 income year and following years. Section 170(10AA) of the ITAA 1936 allows the amendment of an assessment at any time to give effect to section 59-30.[61]

123. The amount which is not assessable and not exempt income does not include any amount of interest or penalty.

Primary production income

124. An assessable GPI that is derived from, or results from, carrying on a primary production business[62] is primary production income. 'Assessable primary production income' for averaging primary producers' tax liability is defined in subsection 392-80(2) as 'basic assessable income for the current year that was derived from, or resulted from, your carrying on a primary production business'.

Bounty or subsidy received otherwise than in cash

125. If a non-cash bounty or subsidy is assessable income under section 15-10, the amount to include in assessable income is the money value of the benefit.

126. Section 21 of the ITAA 1936 deems that the 'money value' of any consideration paid or given 'otherwise than in cash' is paid or given. Accordingly, the 'money value' of any benefit received through a government grant is deemed to have been paid to the recipient and, if applicable, is included as assessable income under section 15-10. As a general rule the Tax Office will accept a fair market value of the non-cash benefits.

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[60] A GPI that is repaid and is a loss or outgoing necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income (other than a loss or outgoing that is capital in nature, private or domestic in nature, incurred in relation to exempt income or prevented from deduction by a provision of the ITAA 1997 or ITAA 1936) is deductible under section 8-1.

[61] Section 170(10AA) of the ITAA 1936 applies for the 2004-05 and later years of income. Section 170(10AB) of the ITAA 1936 applies for the 2003-04 year of income.

[62] Refer to paragraph 8 of TR 97/11 for the Commissioner's view on activities that constitute primary production activities.

127. If a non-cash bounty or subsidy is ordinary income derived by a business taxpayer, the amount assessable under section 6-5 is the arm's length value of the benefit. Subsection 21A(2) of the ITAA 1936 requires that non-cash business benefits that are income of a business taxpayer be included in assessable income at arm's length value, less any contribution made by the recipient. In determining the arm's length value of a business benefit that is not convertible to cash, any conditions that would prevent or restrict the conversion of the benefit to cash are disregarded. Subsection 21A(3) of the ITAA 1936 reduces the amount assessable if the recipient of the benefit would have been entitled to a once-only deduction if they had incurred the expenditure in respect of the benefit.

Government payments to commence or cease business

128. Government payments to industry to commence or cease business are not assessable as ordinary income under section 6-5 or as a bounty or subsidy in relation to carrying on a business under section 15-10. However, the GPI may be taken into account in determining whether there is an assessable recoupment under Subdivision 20-A. If the GPI is not assessable under any of these provisions, the recipient will need to consider whether there are any CGT consequences.

Section 6-5

129. A GPI to assist with the cost of evaluating whether to commence a business, or to enable a business to commence are preliminary to establishing a business. As the GPI is preliminary to a business being established it is not ordinarily received in the normal course of trade, or a receipt for which business is being carried on. The GPI is not ordinary income and is not assessable under section 6-5.

130. A GPI that, in the hands of the recipient, is a payment for the ending of the business[63] is capital in nature. These types of payments may relate to the capital assets of the business. Assets that are fundamental to the business operations are capital assets and part of the profit earning structure of the business. These capital assets could include contractual rights, licenses, logos, quotas, symbols and time allocations.

131. A GPI that represents payment for the cancellation of a contract where the contract is of such importance to the structure of the business that it is a capital asset will generally be capital in nature.[64]

132. A GPI that reimburses the recipient for the cost of advice to finalise business obligations is not assessable as ordinary income under section 6-5. This type of payment is not received in the normal course of business operations.

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[63] Refer to *Dickenson* case (1958) 98 CLR 460 at 483 and *Allied Mills Industries v. FCT* (1988) 89 ATC 4365 at 4371.
[64] *Allied Mills* case.

Section 15-10

133. A GPI to assist with the cost of evaluating whether to commence a business, or to enable a business to commence is preliminary to establishing a business. As the GPI is preliminary to a business being established it is not received in relation to carrying on the business and is not assessable under section 15-10.

134. A GPI for ending a business or for cancelling a contract which ends a business is a payment which relates to the cessation of the business. The GPI is not in relation to carrying on a business (refer to paragraphs 104 to 106 of this Ruling) and is not assessable under section 15-10.

135. A GPI that reimburses the recipient for the cost of advice to finalise business obligations is not assessable under section 15-10 as it does not relate to the carrying on of a business.

Subdivision 20-A

136. The assessable recoupment provisions in Subdivision 20-A need to be considered where a GPI is received as recoupment of certain deductible losses or outgoings and is not otherwise assessable. The provisions in Subdivision 20-A may apply even if the entity is not in business.

137. An amount is an assessable recoupment under these provisions to the extent it is:

- not income under ordinary concepts or otherwise assessable; and
- received either:
  - by way of insurance or indemnity as recoupment of a deductible loss or outgoing; or
  - as recoupment (other than by way of insurance or indemnity) of a deductible loss or outgoing that is listed in the table in section 20-30.

The items listed in section 20-30 include deductions for bad debts, rates or taxes, research and development activity expenditure, tax related expenses and capital allowances.

138. For the purposes of Subdivision 20-A, recoupment of a loss or outgoing includes any kind of recoupment, reimbursement, recovery, refund, insurance or indemnity. It also includes a grant in respect of a loss or outgoing. In addition, you are taken to receive an amount as recoupment of a loss or outgoing if another entity pays the amount for you in respect of a loss or outgoing you incur.

Reimbursement for purchase of a depreciating asset

139. A GPI paid to assist a new business with the purchase of a depreciating asset will not be assessable under section 6-5 as ordinary income if the GPI is capital in nature. The GPI will not be assessable under section 15-10 if it is received in relation to the commencement of a business.

140. The business will be able to claim deductions for the decline in value of the depreciating asset under the capital allowances provisions in Division 40. Capital allowances deductible under Division 40 is an item in the table of section 20-30. As such, to the extent that the GPI is a recoupment of the cost of the depreciating asset (for which capital allowance deductions are available for the decline in value), it is an assessable recoupment under Subdivision 20-A. The amount of assessable recoupment may be included over more than one income year, limited to the amount that can be deducted under Division 40.

Reimbursement for professional taxation advice

141. A GPI paid to reimburse the cost of obtaining tax related advice to determine whether to commence a business will not be assessable under section 6-5 as ordinary income. It is not a receipt ordinarily received in the normal course of trade or a receipt for which business is being carried on. The GPI will not be assessable under section 15-10 as it is preliminary to a business being carried on.

142. A GPI paid to reimburse the cost of obtaining tax related advice to cease business will not be assessable under section 6-5 as ordinary income. It is in relation to cessation and not a receipt ordinarily received in the normal course of trade or a receipt for which business is being carried on. The GPI will not be assessable under section 15-10 as it is in relation to cessation.

143. Where the business can claim deductions for the cost of taxation advice under section 25-5, a recoupment of the cost of such tax related advice is an assessable recoupment under Subdivision 20-A. Section 25-5 is an item in the table of section 20-30.

Reimbursement for cost of finalising a business

144. Some costs involved in either accepting a GPI or finalising business obligations may be deductible under section 40-880, if they are costs to stop carrying on a business and there is no other provision which takes the expenditure into account or specifically denies a deduction.

145. A GPI received as reimbursement of such costs is not ordinary income, nor is it assessable under section 15-10 because it is received in relation to ending the business rather than carrying on the business. To the extent the GPI is a reimbursement of costs for which a deduction is available under section 40-880, it is an assessable recoupment under Subdivision 20-A. Capital allowances under Division 40 are listed in the table in section 20-30 as one of the deductions for which recoupments are assessable.

Subdivision 40-D

Payment for a depreciating asset

146. Where the amount of a GPI is calculated having regard to some effect on a depreciating asset but that asset continues to be held for current or future use, there is no balancing adjustment event. There is no need to work out a balancing adjustment for the asset as provided for under Subdivision 40-D (refer to Example 13 in paragraphs 67 to 71 of this Ruling).

147. Where a balancing adjustment event does occur, the recipient is required to work out a balancing adjustment for the asset under section 40-285. The application of these provisions will depend on the particular facts. If the GPI is not actually for the sale of the asset (for example, a sale to the government body) or for the loss or destruction of the asset, the amount of the payment is not used in the relevant balancing adjustment calculation. It is necessary to consider if the GPI in these circumstances, and similarly the GPI mentioned in paragraph 146 of this Ruling, is assessable income of the recipient under section 6-5 or section 15-10.

148. A balancing adjustment event occurs for a depreciating asset where a taxpayer:

- stops holding a depreciating asset;[65]
- stops using the asset for any purpose and expects never to use it again;[66]
- stops having it installed ready for use and expects never to install it ready for use again;[67] or
- has not used the asset and decides never to use it.[68]

[65] Paragraph 40-295(1)(a).
[66] Paragraph 40-295(1)(b).
[67] Paragraph 40-295(1)(b).
[68] Paragraph 40-295(1)(c).

149. The balancing adjustment amount is the difference between the termination value of the depreciating asset and its adjustable value just before the event occurred. Where the termination value of the depreciating asset is less than its adjustable value just before the event occurred, the difference is allowed as a deduction.[69] Where the termination value of the depreciating asset is greater than its adjustable value just before the event occurred, the difference is included in assessable income.[70] In certain circumstances, the taxpayer may be able to reduce any assessable balancing adjustment by the cost of a replacement asset if the involuntary disposal rules in section 40-365 are satisfied.

150. The termination value is, generally, the amount that is received or taken to be received for the asset when a balancing adjustment event occurs.[71] Where a depreciating asset is lost or destroyed, the termination value is the amount received or receivable under an insurance policy or otherwise for the loss or destruction.[72]

151. If the recipient stops using the depreciating asset, or having it installed ready for use, for any purpose and expects never to use it again even though the asset is still held, the termination value is the market value of the asset when the recipient stops using it or having it installed ready for use.[73]

152. If the recipient decides never to use a depreciating asset that has not been used but is still held, the termination value is the market value of the asset when the business operator makes that decision.[74]

153. If a depreciating asset is used for both taxable and non-taxable purposes, the balancing adjustment amount must be reduced by the amount that is attributable to the non-taxable use . There may also be CGT consequences.[75]

Definitions

154. 'Government' means the Commonwealth or a State, Territory or local government or government agency.

'Government payment to industry' means a payment by the government, or entity chosen by the government to administer government funds.

'Bounty' means a premium, reward or grant, especially one offered by a government.

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[69] Subsection 40-285(2).
[70] Subsection 40-285(1).
[71] Section 40-305.
[72] Item 8 in the table in subsection 40-300(2).
[73] Item 1 in the table in subsection 40-300(2).
[74] Item 2 in the table in subsection 40-300(2).
[75] Section 40-290.

'Business' is defined in section 995-1 and means any profession, trade, employment, vocation or calling, but does not include occupation as an employee.

'Depreciating asset' is as defined in subsection 40-30(1), in broad terms as an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used.

'Grant' means that which is granted, as a privilege or right, including a sum of money by government to encourage business.

'Payment' includes a grant, bounty, subsidy, rebate, or other benefit.

'Subsidy' means a direct pecuniary aid or grant furnished by a government to a private industrial undertaking, a cultural organisation, or the like.

Appendix 2 – Detailed contents list

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TD 92/170; TD 98/28

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- assessable recoupment
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- grant
- ordinary income
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