



CR 2006/113 - Income tax: treatment of payments received for the permanent transfer of South Australian water entitlements under the Living Murray Initiative

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Class Ruling

Income tax: treatment of payments received for the permanent transfer of South Australian water entitlements under the Living Murray Initiative

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📌 This publication provides you with the following level of protection:

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 (unless we are satisfied that the ruling is incorrect and disadvantages you, in which case we may apply the law in a way that is more favourable for you – provided 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.

What this Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the relevant provision(s) identified below apply to the defined class of entities, who take part in the scheme to which this Ruling relates.

Relevant provision(s)

2. The relevant provisions dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 15-10 of the ITAA 1997; and
- section 104-10 of the ITAA 1997.

All references are to the ITAA 1997 unless otherwise stated.

Class of entities

3. The class of entities to which this Ruling applies is eligible South Australian tenderers who hold eligible water entitlements and receive payments, from the Australian Government Department of Agriculture, Fisheries and Forestry (DAFF), under the *Australian Government Water Through Efficiency* Request for tenders in relation to the supply or permanent water entitlements for the Living Murray Initiative (LMI).

4. The class of entities referred to in paragraph 3 of this Ruling does not include eligible tenderers who carry on a business of trading in water entitlements or eligible tenderers who are end users for irrigation purposes.

Qualifications

5. The Commissioner makes this Ruling based on the precise scheme identified in this Ruling.

6. The class of entities defined in this Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 14 to 30 of this Ruling.

7. If the scheme actually carried out is materially different from the scheme that is described in this Ruling, then:

- this Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled; and
- this Ruling may be withdrawn or modified.

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Date of effect

9. This Ruling applies from 1 July 2006. However, the 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 Ruling. Furthermore, the Ruling only applies to the extent that:

- it is not later withdrawn by notice in the *Gazette*; or
- the relevant provisions are not amended.

10. If this Class Ruling is inconsistent with a later public or private ruling, the relevant class of entities may rely on either ruling which applies to them (item 1 of subsection 357-75(1) of Schedule 1 to the *Taxation Administration Act 1953* (TAA)).

11. If this Class Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the Class Ruling is made, the following two conditions are met:

- the income year or other period to which the rulings relate has not begun; and
- the scheme to which the rulings relate has not begun to be carried out.

12. If the above two conditions do not apply, the relevant class of entities may rely on either ruling which applies to them (item 3 of subsection 357-75(1) of Schedule 1 to the TAA).

Withdrawal

13. This Ruling is withdrawn from 1 July 2009.

Scheme

14. The scheme that is the subject of the Ruling is described below. This description is based on the following documents. These documents, or relevant parts of them as the case may be, form part of and are to be read with this description. The relevant documents or parts of documents incorporated into this description are:

- Application for Class Ruling from DAFF dated 3 July 2006;
- *Australian Government Water Through Efficiency* Request for tenders (RFT) in relation to the supply of permanent water entitlements for the Living Murray Initiative dated 11 October 2006;
- *Australian Government Water Through Efficiency* tender form and Legal Principles (LP);
- *Natural Resources Management Act 2004* (SA);
- *Irrigation Act 1994* (SA); and
- *Renmark Irrigation Trust Act 1936* (SA).

15. DAFF is undertaking the RFT process to encourage water use efficiency and recover water that can be used to benefit the icon sites under the LMI.

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16. DAFF invites eligible tenderers to submit tenders which:
- propose one or more water efficiency measures to reduce the eligible tenderers' water use;
 - offer to permanently transfer one or more eligible water entitlements (in whole or in part) to DAFF on terms and conditions based on the legal principles set out in Attachment 4 of the RFT; and
 - allows eligible tenderers to indicate that they wish to participate in allocation back arrangements should capacity be available. Details of allocation back arrangements are not settled and are therefore not the subject of this Ruling.

Note: Allocation back arrangements, once finalised, may affect the CGT analysis contained in this Ruling.

17. An eligible tenderer is a person who:
- holds an eligible water entitlement; or
 - is in a position to transfer or procure the transfer of an eligible water entitlement (in whole or in part) because it is an end user for an irrigation entity (clause 3.1 RFT).

Eligible tenderers who are end users for irrigation entities are not the subject of this Ruling.

18. Water efficiency measures are measures to reduce the volume of water required to maintain productive capacity, that is, measures to generate water savings to offset the amount to be transferred to DAFF. Water efficiency measures may take a number of forms and may be on-farm or off-farm. However they must be or have been completed between 1 January 2004 and 30 June 2009. The proposed timeframe for completing the water efficiency measure is specified in the tender form by the eligible tenderer.

19. A water entitlement is an eligible water entitlement if it is listed in Attachment 2 to the RFT. In South Australia, they are:

Ref.	Category	Eligible water entitlement
1	Country towns	Water licence referred to in section 146 of the <i>Natural Resources Management Act 2004</i> (SA) for the River Murray Prescribed Watercourse (as referred to in section 1 of the <i>Water Allocation Plan for the River Murray Prescribed Watercourse</i>), licence number 2334

2	River Murray irrigation	Water (taking) allocation which is endorsed on a water licence referred to in section 146 of the <i>Natural Resources Management Act 2004</i> (SA) for the River Murray Prescribed Watercourse (as referred to in section 1 of the <i>Water Allocation Plan for the River Murray Prescribed Watercourse</i>) and which is to be used within the River Murray Irrigation Management Zone (as referred to in section 5.4 of the <i>Water Allocation Plan for the River Murray Prescribed Watercourse</i>)
3	Lower Murray swamps irrigation	Water (taking) allocation which is endorsed on a water licence referred to in section 146 of the <i>Natural Resources Management Act 2004</i> (SA) for the River Murray Prescribed Watercourse (as referred to in section 1 of the <i>Water Allocation Plan for the River Murray Prescribed Watercourse</i>) and which is to be used in the Lower Murray Reclaimed Areas Irrigation Management Zone (as referred to in section 5.6 of the <i>Water Allocation Plan for the River Murray Prescribed Watercourse</i>)

20. The whole or relevant part of the eligible water entitlement must be transferred between 7 August 2007 and 30 June 2009.

21. The tender must offer to transfer at least 5 megalitres of South Australian eligible water entitlements.

22. An irrigation entity can only offer to transfer that part of its eligible water entitlement which is not allocated to, or required to meet, the entitlements of its end users.

23. The terms and conditions of the transfer are based on the legal principles set out in Attachment 4 of the RFT. Some of these are detailed in the paragraphs below.

24. There will be a contract between DAFF and the successful tenderer (LP 1). Nothing in the RFT, or in any tender or the submission of a tender, creates any binding obligation on DAFF, unless and until a contract is entered into.

25. If the tender is a joint tender, there will be a contract between DAFF and each of the joint tenderers. Each of the joint tenderers will be individually responsible for transferring a particular water entitlement and the joint tenderers are jointly and individually responsible for completing the water efficiency measure (LP 2).

26. Transfer of the eligible water entitlement will not occur until all approvals or consents required for or in connection with the transfer of the eligible water entitlements are obtained (LP 12).

27. The tenderer must do everything necessary to transfer the eligible water entitlement to DAFF by the agreed date as specified in the contract (LP 14).

28. Title to the offered water entitlements will pass to DAFF on transfer of the offered water entitlement (LP 10, 15). The requirement to transfer the offered water entitlement will have the effect that all existing and future water allocations related to the offered water entitlement are also transferred (LP 17).

29. The proposed scheme in South Australia will be by way of transfer of the relevant part of the water allocation of the licence (LP 21). Under section 157 of the *Natural Resources Management Act 2004* (SA), subject to Division 3 (transfer of licences and water allocation) and the relevant water allocation plan, a licensee may transfer the licence (including its water allocation) to another person; or the whole or part of the water allocation of the licence to another licensee. The transfer of the whole or part of the water allocation of a licence between licensees is achieved by variation of the transferring and receiving licences by the Minister. The tenderer is responsible for all fees and charges associated with the transfer of the eligible water entitlement, other than DAFF's costs (LP 23).

30. If the water efficiency measure is proposed to be completed after the transfer of the offered water entitlement, and the successful tenderer does not fully complete the water efficiency measure within the agreed timeframe, DAFF may, at its discretion, by notice to the successful tenderer, require the tenderer to purchase (and that tenderer must purchase) the equivalent of the offered water entitlement from DAFF for the contract price plus interest calculated in accordance with LP 28 (LP 27).

Ruling

Section 6-5 – income according to ordinary concepts

31. A payment received for the permanent transfer of the South Australia eligible water entitlement (in whole or in part) under the RFT is not income according to ordinary concepts. The receipt is not assessable as ordinary income under section 6-5.

Section 15-10 – bounty or subsidy

32. A payment received for the permanent transfer of the South Australia eligible water entitlement (in whole or in part) under the RFT is not a bounty or subsidy that is received in relation to carrying on a business. No part of the total receipts constitutes assessable income under section 15-10.

Capital gains tax

33. CGT event A1 under section 104-10 happens when the contract between DAFF and tenderer for the permanent transfer of the South Australia eligible water entitlements is entered into.

Commissioner of Taxation15 November 2006

Appendix 1 – Explanation

❶ *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.*

Section 6-5 – income according to ordinary concepts

34. Subsection 6-5(1) provides that an amount is included in assessable income if it is income according to ordinary concepts (ordinary income). However, as there is no definition of 'ordinary income' in income tax legislation, it is necessary to apply principles developed by the courts to the facts of a particular case.

35. Whether or not a particular receipt is ordinary income depends on its character in the hands of the recipient.¹

36. In *GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation* (1990) 170 CLR 124; 21 ATR 1; 90 ATC 4413 the Full High Court stated at CLR 138; ATR 7; ATC 4420:

To determine whether a receipt is of an income or of a capital nature, various factors may be relevant. Sometimes the character of receipts will be revealed most clearly by their periodicity, regularity or recurrence; sometimes, by the character of a right or thing disposed of in exchange for the receipt; sometimes, by the scope of the transaction, venture or business in or by reason of which money is received and by the recipient's purpose in engaging in the transaction, venture or business.

37. The receipt under the RFT is a once-off receipt. While this is a factor in reaching a conclusion that the receipt is capital in nature, it is not necessarily a determinative factor.² Where a recipient provides consideration for a payment, the nature of the consideration is generally taken to be the nature of the payment (*Federal Coke Co Pty Ltd v. Federal Commissioner of Taxation* (1977) 34 FLR 375).

38. The consideration provided by the tenderer is the permanent transfer of an eligible water entitlement. Therefore, the nature of the water entitlement transferred is relevant in determining the nature of the receipt under the RFT.

¹ *Scott v. Federal Commissioner of Taxation* (1966) 117 CLR 514, *Hayes v. Federal Commissioner of Taxation* (1956) 96 CLR 47, *Federal Coke Co Pty Ltd v. Federal Commissioner of Taxation* (1977) 7 ATR 519; 77 ATC 4255.

² See *MIM Holdings Ltd v. Commissioner of Taxation* (1997) 363 FCA 13 and Taxation Ruling TR 2006/3.

39. In South Australia, an eligible water entitlement under the RFT is either a water licence referred to in section 146 of the *Natural Resources Management Act 2004* (SA) for the River Murray Prescribed Water Course (licence number 2334) or a water (taking) allocation endorsed on a licence referred to in section 146 of the *Natural Resources Management Act 2004* (SA) for the River Murray Prescribed Water Course and which is to be used in the specified irrigation management zone. Persons may not take water from the River Murray Prescribed Water Course unless they have a water licence endorsed with a water (taking) allocation. Accordingly, a licence and/or water (taking) allocation endorsed on a licence confers valuable benefits to its holder.

40. Where a tenderer is not carrying on a business, the receipt under the RFT for the assignment of the share component of the eligible water entitlement is capital in nature and it is not assessable under section 6-5.

41. Where a tenderer is carrying on a business, the eligible water entitlement is a valuable asset that forms part of the tenderers business structure and is capital in nature. The receipt is for the transfer of a capital asset being the eligible water entitlement and is not assessable as ordinary income under section 6-5.

Section 15-10 – bounty or subsidy

42. Section 15-10 provides that an amount is included in assessable income 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.

43. The terms 'bounty' and 'subsidy' are not defined in income tax legislation. The word 'subsidy', as noted by Windeyer J in *Placer Development Ltd v. Commonwealth of Australia*,³ derives from the Latin 'subsidium' meaning 'an aid or help'. The Macquarie Dictionary, 2001, rev. 3rd edn, defines subsidy as including 'a grant or contribution of money'. The ordinary meaning adopted by case law is aid provided by the Crown (government) to foster or further some undertaking or industry.

³ (1969) 121 CLR 353.

44. A payment received for the permanent transfer of the South Australia eligible water entitlements under the RFT is a receipt for the consideration provided by the tenderer and is not a bounty or subsidy for the purposes of section 15-10. Accordingly, no part of the total receipts constitutes assessable income under section 15-10.

Capital gains tax

45. Section 104-10 states that CGT event A1 happens if you dispose a CGT asset.

46. A CGT asset is defined in subsection 108-5(1) as:

- any kind of property; or
- a legal or equitable right that is not property.

47. In South Australia, eligible water entitlements entitle their holders to take water subject to the specification applicable to the licence. They are statutory rights, therefore, they fall within the definition of a CGT asset in subsection 108-5(1).

48. Furthermore, each entitlement is a separate legal right and is a separate CGT asset for the purposes of subsection 108-5(1).

49. CGT event A1 under section 104-10 happens when the contract between DAFF and the tenderer for the permanent transfer of each South Australia eligible water entitlement (whether in whole or in part) under the RFT is entered into.

50. A capital gain is made if the capital proceeds from the disposal of the CGT asset exceed the asset's cost base. A capital loss is made if the capital proceeds from the disposal of the CGT asset are less than its reduced cost base (subsection 104-10(4)).

51. The capital proceeds from the CGT event that happens to the South Australia eligible water entitlement is the payment from DAFF for the permanent transfer of the eligible water entitlement. If you receive a payment in connection with a transaction that relates to more than one CGT event, the capital proceeds from each event are so much of the payment as is reasonably attributable to that event (subsection 116-40(1)).

52. Allocation back arrangements are not dealt with in this Ruling. When final details of the allocation back arrangements are known, the value of the right to participate in such arrangements may constitute additional capital proceeds for the transfer of the water entitlement.

53. Any capital gain or capital loss which results from the disposal of a CGT asset acquired before 20 September 1985 (pre-CGT) is disregarded (paragraph 104-10(5)(a)).

54. A capital gain can be reduced by the general CGT discount if the relevant requirements of Subdivisions 115-A, 115-B and 115-C are met.

55. A capital gain can be reduced or deferred by the small business CGT concessions if the asset is an active asset and the other requirements of Division 152 are met. The concessions available are:

- small business 15-year exemption;
- small business 50% active asset reduction;
- small business retirement exemption; and
- small business rollover.

Appendix 2 – Detailed contents list

56. The following is a detailed contents list for this Ruling:

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 2006/3

Subject references:

- bounties and subsidies
- capital gains tax
- capital receipts
- government payments
- ordinary income

Legislative references:

- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- ITAA 1997 6-5
- ITAA 1997 6-5(1)
- ITAA 1997 15-10
- ITAA 1997 104-10
- ITAA 1997 104-10(4)
- ITAA 1997 104-10(5)(a)
- ITAA 1997 108-5
- ITAA 1997 Subdiv 115-A
- ITAA 1997 Subdiv 115-B
- ITAA 1997 Subdiv 115-C
- ITAA 1997 116-40(1)
- ITAA 1997 Div 152
- Copyright Act 1968
- Irrigation Act 1994 (SA)
- Natural Resources Management Act 2004 (SA)
- Natural Resources Management Act 2004 (SA) 146

- Natural Resources Management Act 2004 (SA) 157
- Renmark Irrigation Trust Act 1936 (SA)

Case references:

- Federal Coke Co Pty Ltd v. Federal Commissioner of Taxation (1977) 34 FLR 375; (1977) 7 ATR 519; 77 ATC 4255
- GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation (1990) 170 CLR 124; 21 ATR 1; 90 ATC 4413
- Hayes v. Federal Commissioner of Taxation (1956) 96 CLR 47
- MIM Holdings Ltd v. Commissioner of Taxation (1997) 363 FCA 13
- Placer Development Ltd v. Commonwealth of Australia (1969) 121 CLR 353
- Scott v. Federal Commissioner of Taxation (1966) 117 CLR 514

Other references:

- Macquarie Dictionary, 2001, rev. 3rd edn, The Macquarie Library Pty Ltd, NSW
- Water Allocation Plan for the River Murray Prescribed Watercourse

ATO references

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