


CR 2007/99 - Income tax: treatment of payments received by members of the Tobacco Co operative of Victoria Limited for the termination of Grower's Agreements

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Class Ruling

Income tax: treatment of payments received by members of the Tobacco Co-operative of Victoria Limited for the termination of Grower's Agreements

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① 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 104-25 of the ITAA 1997;
- section 108-5 of the ITAA 1997;
- section 109-5 of the ITAA 1997;
- Subdivision 115-A of the ITAA 1997;
- Subdivision 115-B of the ITAA 1997;
- section 116-20 of the ITAA 1997;

- section 152-40 of the ITAA 1997; and
- Division 392 of the ITAA 1997.

All legislative references in this Ruling are to the ITAA 1997 unless otherwise indicated.

Class of entities

3. The class of entities to which this Ruling applies consists of members of the Tobacco Co-operative of Victoria Limited (TCV) (but not TCV itself) who hold their Selling Entitlement on capital account, and have received a payment for the termination of their Grower's Agreement and cancellation of their Selling Entitlement as a result of entering into a termination contract with TCV (Termination of Grower's Agreement with TCV).

Qualifications

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

5. 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 13 to 28 of this Ruling.

6. 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

8. This Ruling applies from 1 July 2006 to 30 June 2008. However, the Ruling continues to apply after 30 June 2008 to all entities within the specified class who entered into the specified scheme during the term of the Ruling.

9. 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 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 Ruling is inconsistent with an earlier private ruling, the private ruling is taken not to have been made if, when the 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).

Scheme

13. The following description of the scheme is based on information provided by the applicant. The following documents, or relevant parts of them, form part of and are to be read with the description:

- application for Class Ruling from KPMG on behalf of members of TCV dated 26 March 2007;
- sample Growing Agreement between TCV and a member of TCV dated 8 May 1995;
- sample Grower's Agreement between TCV and a member of TCV dated 7 April 1997;
- the *Tobacco Leaf Industry (Deregulation) Act 1994* (Vic);

- sample contracts between TCV and a member of TCV, titled *Termination of Grower's Agreement with TCV*, dated 10 April 2007 and 2 May 2007; and
- correspondence and emails from KPMG relating to the application for a Class Ruling.

14. Until deregulation of the industry in 1994, the tobacco leaf industry in Victoria was controlled by the Tobacco Leaf Marketing Board of Victoria (the old Board) which was a statutory body appointed under the *Marketing of Primary Products Act 1958* (Vic).

15. Under the *Tobacco Leaf Industry Stabilisation Act 1966* (Vic) each tobacco grower was allocated a grower's basic quota which stipulated the amount of leaf the grower was expected to supply to the old Board.

16. In 1994 the tobacco leaf industry in Victoria was deregulated. The *Marketing of Primary Products Act 1958* (Vic) and *Tobacco Leaf Industry Stabilisation Act 1966* (Vic) were repealed by the *Tobacco Leaf Industry (Deregulation) Act 1994* (Vic). As a result, the grower's basic quota ceased to exist. The old Board ceased operations and was dissolved.

17. The Tobacco Co-operative of Victoria Limited (TCV) was incorporated on 7 April 1994 under the *Co-operation Act 1981* (Vic). TCV is not a government authority as it is privately owned by its members.

18. Under section 5 of the *Tobacco Leaf Industry (Deregulation) Act 1994* (Vic), the property, rights and liabilities of the old Board were transferred to TCV on the appointed day. TCV became the successor in law of the old Board.

19. Under section 6 of the *Tobacco Leaf Industry (Deregulation) Act 1994* (Vic), fully paid shares in TCV of \$1 each were deemed to have been allotted to 'eligible holders of quota'. The total nominal value of the shares deemed to have been issued equalled the value of the property and rights of the old Board less its liabilities on the day before the appointed day. An eligible holder of quota was a person who was allocated a grower's basic quota under the *Tobacco Leaf Industry Stabilisation Act 1966* (Vic) as at the day before the appointed day.

20. Growers' entitlements to sell tobacco (as advised to them by the old Board prior to its dissolution and represented by their grower's basic quota) ended as a result of the repeal of the *Tobacco Leaf Industry Stabilisation Act 1966* (Vic) and were replaced by shareholdings in TCV. Growers became shareholders, and hence members, of TCV under section 6 of the *Tobacco Leaf Industry (Deregulation) Act 1994* (Vic).

21. TCV took over the marketing functions of the old Board.

22. The members of TCV each entered into a Growing Agreement with TCV for the 1994/95 tobacco growing season.

23. This initial Growing Agreement for the 1994/95 season was replaced by another agreement for subsequent tobacco growing seasons (referred to in this Ruling as the Grower's Agreement).¹ This agreement had a commencement date of 1 August 1996. Each member of TCV entered into a Grower's Agreement on or after 1 August 1996.

24. Under the terms of the Grower's Agreement, TCV would advise each member of the quantity of tobacco leaf they were entitled and required to deliver to TCV during the relevant tobacco leaf season (referred to in this Ruling as the Selling Entitlement). The determination of the quantity of tobacco leaf to be supplied by each member under the Selling Entitlement was based upon the number of shares held by the member in TCV multiplied by a selling entitlement factor. The selling entitlement factor was set by the Board of TCV. The Selling Entitlements were not statutory licences.

25. The tobacco leaf supplied by members was then sold pursuant to ongoing tobacco purchasing agreements and threshing agreements (the tobacco agreements) with certain entities (the Purchasers).

26. TCV entered into Deeds of Termination and Release with the Purchasers agreeing to early termination of the tobacco agreements. As a result of the termination of the tobacco agreements, TCV proposed that the Grower's Agreements with members also be terminated.

27. Each member has entered (or will enter) into a contract with TCV entitled *Termination of Grower's Agreement with TCV*² and on doing so the member's Selling Entitlement ended (or will end) by being cancelled.

28. Each member will receive a payment from TCV in two instalments in consideration for the termination of the Grower's Agreement with the member, and the resulting cancellation of the member's Selling Entitlement. The amount received by each member is calculated by reference to the number of shares held by the member in TCV. However, members will continue to own their shares in TCV after entering into the Termination of Grower's Agreement contract.

¹ Other than details about the member, Selling Entitlement and agreement date, the terms of the Grower's Agreement between TCV and each member of TCV are substantially the same as the sample Grower's Agreement provided.

² Other than details about the member, Selling Entitlement, payment entitlement and agreement date, the terms of the contract entitled *Termination of Grower's Agreement with TCV* between TCV and each member of TCV are substantially the same as the sample termination contracts provided.

Ruling

Section 6-5 – income according to ordinary concepts

29. A payment received for the termination of the Grower's Agreement is not income according to ordinary concepts. No part of the total receipts constitutes assessable income under section 6-5.

Capital gains tax (CGT)

30. CGT event C2 under subsection 104-25(1) happens when a member of TCV enters into the Termination of Grower's Agreement contract which results in the cancellation of the member's Selling Entitlement (a CGT asset under section 108-5). Under paragraph 104-25(2)(a) the time of the CGT event is when the member enters into the Termination of Grower's Agreement contract.

31. Under paragraph 116-20(1)(a) the capital proceeds from the CGT event are the total amounts a member has received, or is entitled to receive, for the cancellation of the Selling Entitlement payable by two instalments. Under subsection 104-25(3) the total amount is included in the calculation of their capital gain or capital loss from the CGT event in the income year in which they enter into the Termination of Grower's Agreement contract.

32. Under subsection 109-5(1) the acquisition date of a member's Selling Entitlement is the date the member entered into the Grower's Agreement that gave rise to the Selling Entitlement. As Grower's Agreements were entered into between members and TCV on or after 1 August 1996, each member's Selling Entitlement is not an asset acquired before 20 September 1985 (pre-CGT).

33. A capital gain made as a result of the cancellation of a member's Selling Entitlement may be reduced by the general CGT discount if the relevant requirements of Subdivisions 115-A and 115-B are met.

34. A Selling Entitlement that is used by a member in carrying on a business of tobacco leaf growing is an active asset under subsection 152-40(1).

Primary production income

35. A payment received for the termination of the Grower's Agreement is not 'assessable primary production income' for the purposes of Division 392 (long-term averaging of primary producers' tax liability).

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

36. 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 the income tax legislation, it is necessary to apply principles developed by the courts to the facts of a particular case. Whether or not a particular receipt is ordinary income depends on its character in the hands of the recipient.³

37. In *GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation*,⁴ the Full High Court stated (at CLR 138; ATC 4420; ATR 7):

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 purposes in engaging in the transaction, venture or business.

38. Under the *Termination of Grower's Agreement with TCV*, a member receives the payment for the termination of the Grower's Agreement, which effectively cancels their Selling Entitlement. Such a receipt generally takes the character of the item it replaces.⁵

39. The Selling Entitlement formed part of the profit yielding structure of a business of growing tobacco leaf. Payment received for the loss of an asset that is an enduring part of the profit yielding structure of a business is capital in nature.⁶

40. The payment received by a member for the loss of that part of the profit yielding structure of their business is capital in nature and does not constitute assessable income under section 6-5.

³ *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.

⁴ (1990) 170 CLR 124; 90 ATC 4413; (1990) 21 ATR 1.

⁵ *Commissioner of Taxation (NSW) v. Meeks* (1915) 19 CLR 568 at 580 per Griffith CJ.

⁶ *Californian Oil Products Ltd v. Federal Commissioner of Taxation* (1934) 52 CLR 28 at 46; *Glenboig Union Fireclay Co Ltd v. Inland Revenue Commissioners* [1922] SC (HL) 112; (1922) 12 TC 427.

Capital gains tax

41. A payment received by a member from TCV for the cancellation of their Selling Entitlement as a result of the termination of their Grower's Agreement is subject to the capital gains tax provisions in Parts 3-1 and 3-3.

42. The Selling Entitlement of a member is the right to supply tobacco created under the Grower's Agreement. The Selling Entitlement is a CGT asset under section 108-5.

CGT event C2

43. CGT event C2 under subsection 104-25(1) happens when the taxpayer's ownership of an intangible CGT asset ends in certain ways, including by the asset being cancelled. CGT event C2 happens when the Grower's Agreement between TCV and a member is terminated and the member's Selling Entitlement is cancelled. Under paragraph 104-25(2)(a), the time of the CGT event is when a member enters into the Termination of Grower's Agreement contract that results in the cancellation of the Selling Entitlement.

44. Under subsection 104-25(3), a member will make a capital gain if the capital proceeds from the cancellation of the Selling Entitlement are more than its cost base. A member will make a capital loss if the capital proceeds from the cancellation of the Selling Entitlement are less than its reduced cost base.

Capital proceeds

45. Under paragraphs 116-20(1)(a) and (b) the capital proceeds from a CGT event are the money and the market value of any other property that the taxpayer received or is entitled to receive in respect of the event happening. The effect of paragraph 103-10(2)(b) is that, if a taxpayer is entitled to receive money payable by instalments, the total of the instalments is included in calculating the capital proceeds from the CGT event happening.

46. Therefore, the capital proceeds from the termination of a member's Grower's Agreement and the resulting cancellation of the member's Selling Entitlement will include the total amount which the member has received, or is entitled to receive, under the two instalments.

47. The total amount is included in the calculation of the member's capital gain or capital loss from the CGT event under subsection 104-25(3) in the income year in which they enter into the Termination of Grower's Agreement contract.

Acquisition date

48. Under subsection 109-5(1), a taxpayer generally acquires a CGT asset when they become its owner. The acquisition date of the Selling Entitlement is the date the member entered into the Grower's Agreement that gave rise to the Selling Entitlement. As each member entered into a Grower's Agreement on or after 1 August 1996, each member's Selling Entitlement is not a 'pre-CGT' asset.

Income Tax Assessment Act 1936 relevant at time of 1994 deregulation

49. After the ending of the grower's basic quota under the 1994 deregulation, the members entered into an initial Growing Agreement with TCV which applied to the 1994/95 season. This initial Growing Agreement was replaced by a subsequent Grower's Agreement, which had a commencement date of 1 August 1996. At the time of the cancellation of the grower's basic quota and at the time that members entered into the Grower's Agreement with TCV that gave rise to the Selling Entitlement, the CGT provisions of the *Income Tax Assessment Act 1936* (ITAA 1936) applied. The ITAA 1997 generally applies to CGT events happening from the beginning of the 1998-99 income year.

Statutory licence roll-over not available

50. Former section 160ZZPE of the ITAA 1936 provided CGT roll-over relief in certain circumstances where a new statutory licence was granted by way of renewal or extension of an original statutory licence which had expired or was surrendered. As part of the roll-over, if the original licence was acquired before 20 September 1985, the new licence would also be taken to have been acquired before that date.

51. A prerequisite for the application of former section 160ZZPE of the ITAA 1936 was that both the original licence and the new licence were statutory licences.

52. A 'statutory licence' was defined in former subsection 160ZZPE(4) of the ITAA 1936, as an authority, licence or permit granted by or on behalf of a government or a government authority under a statutory law of the Commonwealth, of a State or of a Territory.

53. TCV was not a government authority. It was not owned by the Commonwealth, a State or a Territory but was privately owned and controlled by its members. TCV did not exercise governmental powers. As TCV was not a government authority, the Selling Entitlements were not statutory licences and accordingly a roll-over under former section 160ZZPE of the ITAA 1936 was not available at the time of the 1994 deregulation. As such, the Selling Entitlements are not taken to have been acquired before 20 September 1985.

Involuntary disposal rollover not available

54. Former section 160ZZL of the ITAA 1936 provided CGT roll-over relief in certain circumstances, including if an asset was compulsorily acquired by an Australian government or an Australian government authority and the taxpayer received another asset (the replacement asset) by way of compensation. As part of the roll-over, if the original asset was acquired before 20 September 1985, the replacement asset would also be taken to have been acquired before that date.

55. Under the *Tobacco Leaf Industry (Deregulation) Act 1994* (Vic), the grower's basic quotas were cancelled as a result of the repeal of the *Tobacco Leaf Industry Stabilisation Act 1966* (Vic) under which they were allocated. As part of the deregulation, shares in TCV were issued to growers.

56. The repeal of the *Tobacco Leaf Industry Stabilisation Act 1966* (Vic), and the consequent cessation of the grower's basic quotas, was not a compulsory acquisition by an Australian government or an Australian government authority for the purposes of former section 160ZZL of the ITAA 1936 but rather an ending of the existing quota arrangements. Accordingly, a roll-over under former section 160ZZL of the ITAA 1936 was not available at the time of the 1994 deregulation. Therefore, the Selling Entitlements are not taken to have been acquired before 20 September 1985.

57. Further, although a member's Selling Entitlement under the Grower's Agreement is calculated by reference to the number of shares held by a member in TCV, the member's shares are separate CGT assets. Even if the other elements of the roll-over were satisfied, the shares in TCV (rather than the Selling Entitlements) would constitute the replacement assets. Therefore, a roll-over under former section 160ZZL of the ITAA 1936 would not have been available in relation to the acquisition of a member's Selling Entitlement.

CGT discount

58. A capital gain made as a result of the termination of the Grower's Agreement and the resulting cancellation of the Selling Entitlement can be reduced by the general CGT discount if the relevant requirements of Subdivisions 115-A and 115-B are met. These include, but are not limited to:

- a requirement for the Selling Entitlement to have been acquired at least 12 months before the cancellation;
- a requirement that the capital gain has been worked out using a cost base calculated without reference to indexation; and
- a requirement that the entity making the capital gain is not a company.

Small business concessions

59. A capital gain may be further reduced or disregarded by the small business CGT concessions if the Selling Entitlement created under the Grower's Agreement is an active asset of a member and the other requirements of Division 152 are met. The small business CGT concessions that are relevant to members are:

- the 50% active asset reduction;
- the retirement concession; and
- the roll-over.

The 15-year exemption can not apply because members have not owned their Selling Entitlements for at least 15 years. The Grower's Agreements between TCV and the members were all executed on or after 1 August 1996.

60. A Selling Entitlement used by a member in carrying on a business of tobacco leaf growing is an active asset under subsection 152-40(1).

Primary production income

61. Subsection 392-80(2) provides that a taxpayer's *assessable primary production* income for the current year is the amount of that taxpayer's *basic assessable income* for the current year that was derived from, or resulted from, their carrying on a primary production business.

62. A taxpayer's *basic assessable income* for an income year is defined in subsection 392-45(2) as their assessable income for the income year less, among other things, any net capital gain included in their assessable income under Division 102.

63. Payments received for the termination of the Grower's Agreement may result in a net capital gain being included in a member's assessable income under Division 102. Therefore, the payments received for the termination of the Grower's Agreement are excluded from being *assessable primary production income* for the purposes of Division 392 (long-term averaging of primary producers' tax liability).

Appendix 2 – Detailed contents list

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

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References

Previous draft:

Not previously issued as a draft

Subject references:

- capital gains tax
- income tax
- income vs capital
- ordinary income
- primary production income
- tobacco growing

Legislative references:

- ITAA 1936
- ITAA 1936 160ZZL
- ITAA 1936 160ZZPE
- ITAA 1936 160ZZPE(4)
- ITAA 1997
- ITAA 1997 6-5
- ITAA 1997 6-5(1)
- ITAA 1997 Div 102
- ITAA 1997 103-10(2)(b)
- ITAA 1997 104-25
- ITAA 1997 104-25(1)
- ITAA 1997 104-25(2)(a)
- ITAA 1997 104-25(3)
- ITAA 1997 108-5
- ITAA 1997 109-5
- ITAA 1997 109-5(1)
- ITAA 1997 Pt 3-1
- ITAA 1997 Subdiv 115-A
- ITAA 1997 Subdiv 115-B
- ITAA 1997 116-20
- ITAA 1997 116-20(1)(a)
- ITAA 1997 116-20(1)(b)
- ITAA 1997 Pt 3-3
- ITAA 1997 Div 152
- ITAA 1997 152-40
- ITAA 1997 152-40(1)
- ITAA 1997 Div 392
- ITAA 1997 392-45(2)

- ITAA 1997 392-80(2)
- TAA 1953
- TAA 1953 Sch 1 357-75(1)
- Copyright Act 1968
- Marketing of Primary Products Act 1958 (Vic)
- Tobacco Leaf Industry Stabilisation Act 1966 (Vic)
- Tobacco Leaf Industry (Deregulation) Act 1994 (Vic)
- Co-operation Act 1981 (Vic)

Case references:

- Commissioner of Taxation (NSW) v. Meeks (1915) 19 CLR 568
- Californian Oil Products Ltd v. Federal Commissioner of Taxation (1934) 52 CLR 28
- Federal Coke Co Pty Ltd v. Federal Commissioner of Taxation (1977) 7 ATR 519; 77 ATC 4255
- Glenboig Union Fireclay Co Ltd v. IR Commrs [1922] SC (HL) 112; (1922) 12 TC 427
- GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation (1990) 170 CLR 124; 90 ATC 4413; (1990) 21 ATR 1
- Hayes v. Federal Commissioner of Taxation (1956) 96 CLR 47
- Scott v. Federal Commissioner of Taxation (1966) 117 CLR 514

ATO references

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