

CR 2009/68 - Income tax: payments received under the New South Wales Private Native Forestry Industry Assistance Program: Business Exit Assistance

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Class Ruling

Income tax: payments received under the New South Wales Private Native Forestry Industry Assistance Program: Business Exit Assistance

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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, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is 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 considered in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997);
- section 15-10 of the ITAA 1997;
- Subdivision 20-A of the ITAA 1997;
- section 104-20 of the ITAA 1997;
- section 104-25 of the ITAA 1997;
- Division 110 of the ITAA 1997;
- Division 112 of the ITAA 1997;

- section 116-20 of the ITAA 1997;
- section 116-40 of the ITAA 1997;
- section 118-37 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 is applicants who apply for and receive a Business Exit Assistance payment under the New South Wales Private Native Forestry Industry Assistance Program (the Program).

4. This Ruling does not apply to an applicant who applies for and receives a payment under the Program in their capacity as an employee of a business.

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 10 to 36 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 2008 to 30 June 2012. The Ruling continues to apply after 30 June 2012 to all entities within the specified class who entered into the specified scheme during the term of the Ruling. However, this Ruling will not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of this Ruling (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10).

Scheme

10. 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 the NSW Department of Primary Industries (DPI) dated 2 February 2009;
- NSW Private Native Forestry Industry Assistance Program – Business Exit Assistance – Guidelines -February 2009 (the Guidelines);
- Guidance Notes for Applicants provided at Appendix 1 to the Guidelines; and
- email responses to requests for further information, dated 28 April 2009.

11. As part of the native vegetation reforms associated with the introduction of the *NSW Native Vegetation Act 2003*, Private Native Forest (PNF) owners are required to manage areas of PNF in accordance with the PNF Code of Practice (the Code). It is recognised that the Code may reduce available timber volumes to the PNF industry, which may in turn result in a loss of viability for some PNF businesses.

12. The New South Wales Government has implemented the Program to assist businesses no longer viable as a result of the implementation of the Code, as well as eligible business principals and employees of those businesses.

13. The Program will run until 30 June 2012 and will be overseen by the PNF Conservation Council (PNFCC). Assistance will be provided through the Forestry Projects and Industry Adjustment Unit (FP&IAU) which is part of the NSW DPI.

14. Two types of assistance are provided under the Program: Business Exit Assistance (BEA) and Worker Assistance. Eligible parties may make formal application under either program, but not both. Assistance is in the form of ex-gratia payments.

15. The objectives of BEA are to:
 - assist the restructuring of NSW PNF industry businesses in line with the reduced PNF timber resource availability following the introduction of the Code;
 - provide financial assistance to businesses made unviable as a result of the introduction of the Code, and to their eligible business principals to reduce the impact on PNF industry participants and their families; and
 - help eligible business principals make the transition to new jobs and improve their options for re-employment.
16. The principles underlying the BEA arrangements are:
 - assistance will be available to businesses and their eligible business principals who demonstrate that their business has been made financially unviable as a direct result of resource, harvesting and/or haulage capacity constraints arising from the introduction of the Code;
 - assistance will be provided in recognition of the business and its eligible business principals undertaking to exit their NSW PNF business activity (in any capacity other than as an employee of such a business) for a period of at least three years upon signing a Deed of Release and Indemnity; and
 - assistance is not intended to cover the effects of limitation of either supply or demand arising from the normal operation of the market or other factors not connected with the introduction of the Code.
17. BEA includes the following key components:
 - Exit Assistance, payable to an eligible business and based on the value of the business;
 - Reimbursement of eligible statutory redundancy payments paid by the business as a result of the Code;
 - Reimbursement of professional external accounting costs associated with the preparation of the initial application for Exit Assistance and the Business Valuation Report;
 - Owner Assistance for eligible business principals of the business, based on an actual or nominal wage and payable to the eligible business principal; and
 - Training Assistance to reimburse eligible business principals for eligible training and/or relocation expenses.

Application process

18. There are four steps in applying for BEA:
- apply to the FP&IAU for valuation and initial assessment of the impact of the Code. If a valuation is authorised, external accountancy costs of preparing the application, up to \$5,000, may be reimbursed to the business;
 - an independent assessor is appointed to prepare a Business Valuation Report and assess the financial viability of the business and impact of the Code. If it appears the implementation of the Code has made a business, or a part of a business, unviable, the business will be invited to formally apply to the FP&IAU for Exit Assistance;
 - the PNFCC will make the final decision on eligibility for Exit Assistance, and determine the nominal value payable, based on the valuation report. If eligible, the PNFCC will also approve Owner Assistance and Training Assistance; and
 - final values of assistance will be determined once all applications have been assessed and offers will be made to applicants.

The business valuation

19. The nominal value of the business will be shown in the Business Valuation Report and is calculated as follows:

1.	Estimate future maintainable EBIT (earnings before interest and tax). This excludes the value of the real or nominal wage of a business principal.
2.	Capitalised using the multiple for estimated future maintainable EBIT
=	Value of Business (1 x 2)
3.	<u>Less:</u> the net realisable value of tangible assets that would normally be acquired with the business, e.g. stock on hand, term agreements, transferable resource agreements, land and buildings, fixtures and fittings, plant and equipment.
=	Net value of business
4.	<u>Add:</u> Additional Factors
=	Nominal Value of Business for Purposes of BEA

20. The additional factors may include the expected or actual loss on sale of assets, being the difference in the value of the asset and the current auction value determined either by the independent valuer or that realised from an arm's length and/or properly advertised commercial disposal. Taxes payable are not eligible for reimbursement or inclusion as an additional factor.

Exit Assistance

21. To be eligible for Exit Assistance the applicant must:
- either:
 - operate a sawmill, or be a primary processor of timber which is sourced from PNFs in NSW; or
 - conduct harvesting or haulage operations providing timber sourced from PNFs in NSW to a primary processor described above;
 - demonstrate to the satisfaction of the PNFCC that it was operating in the NSW PNF industry as at 1 August 2007 and for a period of at least 9 of the 18 months prior to that date;
 - demonstrate to the satisfaction of the PNFCC that it has been, or will be made financially unviable as a direct result of resource, harvesting and/or haulage capacity constraints arising from the introduction of the Code;
 - be able to demonstrate to the satisfaction of the PNFCC that it has taken all reasonable measures to secure resource supply or a supply chain and not have unreasonably declined supply or withdrawn from negotiations pertaining to resource supply or supply chain with traditional or prospective suppliers;
 - agree to make full disclosure concerning wood supply arrangements and negotiations to secure on-going wood supply;
 - meet the principles underlying the BEA arrangements;
 - lodge an application for business valuation before 15 May 2009; and
 - agree that if found eligible for Exit Assistance, the directors, business partners, sole trader or other persons with ownership rights to the business will:
 - sign a Deed of Release and Indemnity (the Deed) releasing the NSW Government from any further claims in relation to the Code that may have impacted on the operations of the business; and
 - fully exit the business activity in the NSW PNF Industry on which the Exit Assistance payment is based (following signing of the Deed and within three months of being offered the level of Exit Assistance) and not re-enter the industry as a principal of a business involved in the NSW PNF industry with the same business activity for a period of three years from the date of signing the Deed.

22. The nominal value of a business does not represent the final level of monetary assistance that may be offered. The final level of Exit Assistance can only be determined once all applications have been assessed as overall funding under the Program is limited to \$29.3 million. Accordingly, the nominal value may be pro-rated.

23. Exit Assistance is a single lump sum payment calculated in accordance with paragraphs 19 and 22 of this Ruling.

Reimbursement of statutory redundancy payments

24. In addition to the lump sum payment of Exit Assistance, reimbursement of eligible statutory redundancy payments paid by the business may be approved. The redundancy payment must have been a legitimate cost of business closure and must have:

- been a direct result of the Code;
- occurred since 1 August 2007;
- been a statutory requirement; and
- been first paid by the business.

25. Approved eligible statutory redundancy payments paid by the business will be reimbursed with the final instalment of Exit Assistance. These amounts are not pro-rated.

Reimbursement of professional external accounting costs

26. The reimbursement of professional external accounting costs is to a maximum of \$5,000 (plus GST if applicable). The Guidelines state that the purpose of this reimbursement is to compensate the applicant for the costs associated with both the preparation of the initial application for assistance and the provision of the information necessary for the independent assessor to complete the Business Valuation Report. The reimbursement is approved at the stage the business is referred for a valuation report.

27. Approved reimbursements of professional external accounting costs will be paid notwithstanding a business is ultimately not eligible or does not participate in the BEA program. These amounts are not pro-rated.

Owner Assistance

28. Where a business is eligible for Exit Assistance its business principals may be entitled to two additional ex-gratia payments (referred to as Owner Assistance and Training Assistance).

29. A business principal is defined as a director, business partner, sole trader, beneficiary of a trust or other person with ownership rights to the business who engages in the day to day operations of the business that is the subject of an Exit Assistance payment.

30. For a business principal to be eligible for Owner Assistance and Training Assistance:

- their business must have been found eligible for Exit Assistance;
- their business entity and all associated persons, including themselves, must have signed the Deed of Release and Indemnity;
- they must have been a principal of the business as at 1 August 2007; and
- they must have been working in the business as at 1 August 2007 and for at least six months of the preceding 12 month period.

31. Owner Assistance is intended to compensate the eligible business principal for:

- agreeing to cease participating in the particular business activity from which they are exiting for a period of 3 years;
- the fact that the real or nominal wage of a business principal is not included in the adjusted net profit of the business for the purpose of determining the nominal value of the business for the Exit Assistance payment; and
- the undertaking to release and indemnify the Government from any further liability for assistance.

32. The level of assistance payable to the business principal is the amount equal to the real or nominal annual salary for that principal for the income year ended 30 June 2007, as shown in the Business Valuation Report.

Training Assistance

33. Training Assistance of up to \$5,000 is payable to eligible business principals who have formally accepted the offer of Training Assistance. The assistance is designed to assist the business principal with gaining alternative employment and developing their career.

34. Training Assistance may be used towards any combination of:

- approved training;
- costs associated with approved training (including course fees, WorkCover and other necessary licence fees, books and other essential training requirements and reasonable travel and accommodation costs to attend approved training);
- job search related activities;

- counselling and financial planning; and/or
- relocation costs where an individual approved for Training Assistance has found a permanent, full time job which requires relocation to a new area of Australia.

35. Funding is generally not available for the costs of computers or other equipment of a capital nature.

36. Assistance is payable as a reimbursement of actual costs incurred or direct payment to a training provider upon production of invoices and a satisfactory review of documentation. Proof of course completion must be provided.

Ruling

Exit Assistance

Section 6-5: income according to ordinary concepts

37. A payment of Exit Assistance is not income according to ordinary concepts. No part of the payment constitutes assessable income under section 6-5.

Section 15-10: bounty or subsidy

38. A payment of Exit Assistance is not a bounty or subsidy that is received in relation to carrying on a business. No part of the payment constitutes assessable income under section 15-10.

Uniform capital allowances

39. Where a balancing adjustment event occurs for a depreciating asset held by a business that receives a payment of Exit Assistance, no amount of the payment is included in the termination value of the asset.

Subdivision 20-A: assessable recoupment

40. The Exit Assistance payment is not an amount received by way of insurance or indemnity nor is it made in respect of an outgoing or loss for which a deduction is available under a provision listed in section 20-30. Accordingly, the Exit Assistance payment is not an assessable recoupment under Subdivision 20-A.

Capital gains tax

41. A payment of Exit Assistance is subject to the capital gains tax (CGT) provisions in Parts 3-1 and 3-3.

42. The payment of Exit Assistance is apportioned on a reasonable basis under section 116-40 between the various CGT events and CGT assets as follows.

43. To the extent to which the Exit Assistance payment relates to the loss of the goodwill of the business, the payment represents capital proceeds for CGT event C1 under section 104-20 that happens when the goodwill comes to an end.

44. To the extent to which the Exit Assistance payment does not relate to the loss of goodwill, the payment is capital proceeds for CGT event C2 under section 104-25 happening to the entitlement to receive the Exit Assistance payment. This CGT event happens when the applicant receives the payment from the NSW Government.

Reimbursement of statutory redundancy payment/s

Section 6-5: income according to ordinary concepts

45. The reimbursement is in relation to expenses incurred in the cessation of a business or part thereof. The reimbursement is capital in nature and is not received in relation to carrying on a business. The amount is not assessable under section 6-5.

Section 15-10: bounty or subsidy

46. The reimbursement is not a bounty or subsidy that is received in relation to carrying on a business. No part of the payment constitutes assessable income under section 15-10.

Subdivision 20-A: assessable recoupment

47. The reimbursement is an amount received by way of indemnity and is an assessable recoupment under Subdivision 20-A to the extent that the redundancy payments are deductible to the applicant.

Capital gains tax

48. CGT event C2 happens when an applicant receives the payment.

49. Any capital gain or capital loss is disregarded under paragraph 118-37(2)(a).

Reimbursement of professional external accounting costs***Section 6-5: income according to ordinary concepts***

50. The reimbursement is capital in nature and is not received in relation to carrying on a business. The amount is not assessable under section 6-5.

Section 15-10: bounty or subsidy

51. The reimbursement is not a bounty or subsidy that is received in relation to carrying on a business. No part of the payment constitutes assessable income under section 15-10.

Subdivision 20-A: assessable recoupment

52. The reimbursement is not an assessable recoupment under Subdivision 20-A as a deduction is not available for the professional external accounting costs.

Capital gains tax

53. CGT event C2 happens when an applicant receives the payment.

54. Any capital gain is disregarded under paragraph 118-37(2)(a).

Owner Assistance***Section 6-5: income according to ordinary concepts***

55. A payment of Owner Assistance is not income according to ordinary concepts. No part of the payment constitutes assessable income under section 6-5.

Section 15-10: bounty or subsidy

56. A payment of Owner Assistance is not a bounty or subsidy that is received in relation to carrying on a business. No part of the payment constitutes assessable income under section 15-10.

Capital gains tax

57. CGT event C2 under section 104-25 happens when the applicant receives the Owner Assistance payment.

58. A capital gain is made if the capital proceeds exceed the cost base of the right to receive the Owner Assistance payment, and a capital loss is made if the capital proceeds are less than the reduced cost base (subsection 104-25(3)).

59. The capital proceeds under subsection 116-20(1) are the amount of the Owner Assistance payment.

60. The cost base or reduced cost base of the right to receive the Owner Assistance payment is determined under Divisions 110 and 112.

Training Assistance

Section 6-5: income according to ordinary concepts

61. A payment of Training Assistance is not income according to ordinary concepts. No part of the payment constitutes assessable income under section 6-5.

Section 15-10: bounty or subsidy

62. A payment of Training Assistance is not a bounty or subsidy that is received in relation to carrying on a business. No part of the payment constitutes assessable income under section 15-10.

Capital gains tax

63. CGT event C2 happens when an applicant's entitlement to receive Training Assistance is satisfied.

64. Any capital gain or capital loss made when the Training Assistance is received is disregarded under paragraph 118-37(2)(a).

Primary Production Income

65. Net capital gains are excluded from assessable primary production income of the applicant for the purposes of Division 392. Therefore payments under BEA, other than the reimbursement of statutory redundancy payment/s, are not included in 'assessable primary production income' for the purposes of Division 392. The reimbursement of statutory redundancy payments resulted from carrying on a primary production business and is included in assessable primary production income for the purposes of Division 392.

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.***

Exit Assistance

Section 6-5: income according to ordinary concepts

66. Subsection 6-5(1) provides that assessable income includes income according to ordinary concepts (ordinary income). Ordinary income 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.

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

68. In *G P International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation*,² the Full High Court stated:

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 business³.

69. In addition, the following principles are relevant when determining the nature of a receipt:

- the question is not determined by the nature of the measure used to calculate the payment;⁴
- where a recipient provides consideration for a payment, the nature of that consideration is generally taken to be the nature of the payment;⁵

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) 34 FLR 375; 77 ATC 4255; (1977) 7 ATR 519

² [1990] HCA 25; (1990) 170 CLR 124; 90 ATC 4413; (1990) 21 ATR 1

³ at CLR 138; ATR 7; ATC 4420

⁴ *Federal Coke case* at ATR 528; ATC 4263, per Bowen CJ and *Californian Oil Products (in liq.) v. Federal Commissioner of Taxation* (1934) 52 CLR 28 at 49, per Starke J

⁵ *Federal Coke case* at ATR 539; ATC 4273, per Brennan J

- a payment that is provided for a purpose which is not part of the recipient's business will not be income in nature;⁶
- a payment to compensate for the restriction of a person's capacity to perform services or to carry on a business may be a capital payment;⁷ and
- a compensation receipt generally takes the character of the item it replaces. Compensation for the loss of a capital asset or an enduring part of a taxpayer's profit-yielding structure will be capital in nature.⁸

70. A payment of Exit Assistance is made in consideration for the applicant ceasing all or a distinct identifiable part of their business. It is a payment for the surrender of a profit-yielding structure and to compensate for the probable loss in value of capital assets. The surrender is neither a normal incident of the applicant's business nor is the payment provided for a purpose for which the business was carried on. The payment is capital in nature and is not ordinary income under section 6-5.

Section 15-10: bounty or subsidy

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

72. 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.

73. The terms 'bounty' and 'subsidy' are not defined in income tax legislation. Following the decisions in *The Squatting Investment Co Ltd v. Federal Commissioner of Taxation*,⁹ *Reckitt and Colman Pty Ltd v. Federal Commissioner of Taxation*¹⁰ and *First Provincial Building Society Ltd v. Commissioner of Taxation*¹¹ (*First Provincial*), it is accepted that a 'subsidy' or 'bounty' includes payments of financial assistance by government.

⁶ *Reckitt & Colman Pty Ltd v. FC of T (Reckitt's case)* 74 ATC 4185; (1974) 4 ATR 501 at ATR 503, ATC 4187, per Mahoney J

⁷ *Dickenson v. Federal Commissioner of Taxation* (1958) 98 CLR 460 at 474-5, per Dixon CJ

⁸ *Reckitt's case* at ATR 503, ATC 4187, per Mahoney J

⁹ (1953) 86 CLR 570

¹⁰ (1974) 4 ATR 501; 74 ATC 4185

¹¹ (1995) 56 FCR 320; 95 ATC 4145; (1995) 30 ATR 207

74. 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 *First Provincial*:

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.¹²

75. 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 the 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.¹³

76. When government payments are received as assistance either to cease a business or give up or sell part of a profit yielding structure, they are not received in relation to 'carrying on' a business.

77. The Exit Assistance payment received by an applicant is in consideration for the applicant ceasing all or a distinct identifiable part of their business. The payment is not directed at income earning activity and is not a bounty or subsidy in relation to the carrying on of a business for the purposes of section 15-10.

Uniform capital allowances

78. The uniform capital allowance provisions in Division 40 will apply to assets held by an applicant that are depreciating assets within the meaning of section 40-30. Under Subdivision 40-D, a balancing adjustment event will occur for each depreciating asset where the applicant either:

- stops holding the asset;
- stops using the asset for any purpose and expects to never use it again;

¹² *First Provincial* at FCR 333

¹³ *First Provincial* at FCR 332

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

79. If a balancing adjustment event occurs for a depreciating asset, a balancing adjustment amount is worked out by comparing the asset's termination value and its adjustable value at the time of the balancing adjustment event. If the termination value is greater than the adjustable value, the excess is included in assessable income. If the termination value is less than the adjustable value, a deduction is available for the difference.¹⁴

80. The expected or actual loss on the sale of assets may be an additional factor that is taken into account in calculating the nominal value of a business whether or not there is a disposal of an asset. However, the nominal value of a business does not represent the final level of monetary assistance that may be offered. The final level of Exit Assistance can only be determined once all applications have been assessed as overall funding under the Program is limited to \$29.3 million.

81. An applicant who receives the Exit Assistance may choose to retain and continue to use a depreciating asset of the business, dispose of it, or may stop using it expecting never to use it again although they continue to hold it. In these circumstances no part of the Exit Assistance amount received by an applicant is included in the termination value of a depreciating asset under either subsection 40-300(2) or section 40-305 in respect of a balancing adjustment event that may occur for a particular asset.

Subdivision 20-A: assessable recoupment

82. The assessable recoupment provisions in Subdivision 20-A need to be considered where a payment is received as recoupment of certain deductible losses or outgoings and the payment is not otherwise assessable. An amount is an assessable recoupment to the extent that 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.

¹⁴ The amount to be included in assessable income, or available as a deduction, is reduced to the extent that the asset was not used for a taxable purpose.

83. Recoupment of a loss or outgoing is defined in section 20-25 to include:

- any kind of recoupment, reimbursement, refund, insurance, indemnity or recovery however described; and
- a grant in respect of the loss or outgoing.

84. The Exit Assistance payment is for the applicant's agreement to cease carrying on all or part of the business which may in turn result in a loss in value of some assets. The Exit Assistance payment is not an amount received by way of insurance or indemnity nor is it a recoupment of a loss or outgoing for which a deduction is available under a provision listed in section 20-30. Accordingly, the amount is not an assessable recoupment under Subdivision 20-A.

Capital gains tax

85. The apportionment of the Exit Assistance payment pursuant to section 116-40 will depend on the applicant's individual circumstances.

86. Taxation Ruling TR 95/35 provides the Commissioner's guidelines on the apportionment of lump sum compensation receipts for CGT purposes and should be considered in apportioning the Exit Assistance payment. If the applicant allocates the payment on a reasonable basis between the relevant assets, the Commissioner will generally accept that basis of allocation.

87. 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.

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

Payments attributable to goodwill

89. Goodwill is one CGT asset separate and distinct from the other assets of a business under section 108-5.

90. Goodwill has no existence except in relation to a business and therefore the goodwill of a business is lost or destroyed when the business ceases. Even where an applicant undertakes several business activities, if one of the activities is discontinued and that activity constitutes a discrete business in its own right, a loss or destruction of goodwill occurs in relation to the cessation of that business.

91. The part of the Exit Assistance payment that relates to the loss of the goodwill of the business represents the capital proceeds for CGT event C1 happening to the goodwill (section 104-20). This CGT event happens when the goodwill comes to an end (that is, when the business ceases).

92. Taxation Ruling TR 1999/16 explains how the CGT provisions apply to goodwill.

Payments attributable to applicant's right to seek compensation

93. To the extent that an applicant is unable to apportion the lump sum Exit Assistance payment, the amount will be treated as capital proceeds for the satisfaction of the applicant's right to seek compensation from the NSW Government. An applicant's right to seek compensation is a CGT asset under section 108-5.

94. CGT event C2 (section 104-25) happens when the ownership of an intangible CGT asset ends by the asset being satisfied or surrendered. This occurs when, pursuant to the Deed of Release and Indemnity, the applicant surrenders the right to seek compensation from the NSW Government.

95. The cost base of the right to seek compensation is determined under Divisions 110 and 112. It includes the costs of applying for the Exit Assistance payment. The market value of the right to seek compensation is not included as part of the cost base because the market valuation rules do not apply to the acquisition of the right to seek compensation from the NSW Government.

96. A capital gain cannot be reduced by the general CGT discount as the capital gain does not result from a CGT event happening to a CGT asset that was acquired by the applicant at least 12 months before the CGT event happened.

97. A capital gain may be reduced or deferred by the small business CGT concessions if the requirements in Division 152 are satisfied.

Reimbursement of statutory redundancy payment/s

Section 6-5: income according to ordinary concepts

98. Although a reimbursement of eligible statutory redundancy payments is a reimbursement of what may be deductible expenditure, this, of itself, does not determine whether the reimbursement is income according to ordinary concepts¹⁵. The character of a receipt is assessed by reference to its character in the hands of the taxpayer, not the character of the expenditure which produces the payment to the taxpayer.¹⁶

¹⁵ *Federal Commissioner of Taxation v. Rowe* [1997] HCA 16; (1997) 187 CLR 266; 97 ATC 4317; (1997) 35 ATR 432

¹⁶ *Scott v. FC of T* (1966) 14 ATD 286 at 293; (1966) 117 CLR 514 at 526; *GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation* (1990) 170 CLR 124 at 136-137; 90 ATC 4413 at 4419.

99. The reimbursement of eligible statutory redundancy payments is not a normal incident of the applicant's business, nor is it made for a purpose for which the business was carried on. The reimbursement is in relation to expenditure incurred in the cessation of a business or part thereof and is capital in nature. Accordingly, the reimbursement is not assessable under section 6-5.

Section 15-10: bounty or subsidy

100. The reimbursement is received in relation to the cessation of the business. It is not a bounty or subsidy received in relation to carrying on the applicant's business. The payment is not assessable under section 15-10.

Subdivision 20-A: assessable recoupment

101. An amount received by way of indemnity, that is not income according to ordinary concepts or otherwise assessable, will be an assessable recoupment under subsection 20-20(2) to the extent that it is received as a recoupment of a deductible loss or outgoing.

102. Indemnity is not defined in the Act. The *Macquarie Dictionary, 3rd Edition*, defines 'indemnity' to include 'protection or security, as by insurance, against damage or loss' and 'compensation for damage or loss sustained'.

103. The issue of whether an amount is received by way of indemnity for the purposes of the predecessor provision to subsection 20-20(2) of the ITAA 1997 (paragraph 26(j) of the *Income Tax Assessment Act 1936* (ITAA 1936)) has been considered in various cases including:

- *Federal Commissioner of Taxation v. Wade* (1951) 84 CLR 105;
- *Robert v. Collier's Bulk Liquid Transport Pty Ltd* (1959) VR 280;
- *Goldsbrough Mort & Co Ltd v. Federal Commissioner of Taxation* (1976) 28 FLR 39; 76 ATC 4343; (1976) 6 ATR 580 and
- *Commercial Banking Co of Sydney Ltd v. Federal Commissioner of Taxation* (1983) 70 FLR 433; 83 ATC 4208; (1983) 14 ATR 142.

104. These cases make it clear that an amount received by way of indemnity is not restricted to payments received under a policy of insurance or other contract of indemnity.¹⁷ The cases also make it clear that an amount received by way of indemnity would include a receipt pursuant to an antecedent obligation (whether by virtue of a contract, a statute or a breach of some common law duty of care) to make good or compensate for a loss which arises after the obligation comes into existence.

105. The reimbursement of eligible statutory redundancy payments is made pursuant to an antecedent obligation in the Deed to compensate the applicant for the loss arising from paying the redundancy payments as a result of business closure. Accordingly, a reimbursement of eligible statutory redundancy payments under the Program is an amount received by way of indemnity and is an assessable recoupment under Subdivision 20-A to the extent that the redundancy payments are deductible to the applicant.

106. Under section 8-1, a deduction is allowed for losses or outgoings to the extent the loss or outgoing is incurred in gaining or producing assessable income or is necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income. However, a deduction is not available under this section to the extent that the loss or outgoing is of a capital, private or domestic nature, or is incurred in producing exempt income, or where another provision of the ITAA 1997 prevents a deduction.

107. Losses or outgoings incurred after a taxpayer's business has ceased, or is in the process of closing down may be deductible under section 8-1 provided the 'occasion' of the outgoing or loss is to be found in the business operations directed to gaining or producing assessable income (*Placer Pacific Management Pty Ltd v. Federal Commissioner of Taxation* 95 ATC 4459; (1995) 31 ATR 253 (*Placer Pacific*) and *AGC (Advances) Ltd v. Commissioner of Taxation (Cth)* (1975) 132 CLR 175; 75 ATC 4057; (1975) 5 ATR 243 (AGC)). The Full Federal Court in *Placer Pacific* said at ATC 4464:

..[P]rovided the occasion of a business outgoing is to be found in the business operations directed towards the gaining or production of assessable income generally, the fact that the outgoing was incurred in a year later than the year in which the income was incurred and the fact that in the meantime business in the ordinary sense may have ceased will not determine the issue of deductibility. There is no relevant distinction to be drawn between losses and outgoings. Provided the occasion for the loss or outgoing is to be found in the business operations directed to gaining or producing assessable income, that loss or outgoing will be deductible unless it is capital or of a capital nature.

¹⁷ See *FCT v. Wade* (1951) 84 CLR 105 per Kitto J at 114-115; per Dixon and Fullagar JJ at 112; *Robert v. Collier's Bulk Liquid Transport Pty Ltd* (1959) VR 280 per Gavan Duffy J at 284-285; *Goldsbrough Mort & Co Ltd v. FCT* (1976) 6 ATR 580; (1976) 76 ATC 4343 per Walters J at ATC 4348-4350; and *Commercial Banking Company of Sydney Limited v. FCT* (1983) 14 ATR 142; 83 ATC 4208 per David Hunt J at ATC 4217-4220.

108. The following cases provide relevant examples of what is the occasion of an outgoing. In *AGC*, the occasion of a debt that turned bad after the cessation of business activities was found to be in the agreement by which the debt was created. In *Placer Pacific*, an outgoing to remedy a defective conveyor system was deductible because the occasion of the outgoing was found to be in the agreement for the supply of the conveyor belt which was alleged to be defective. The Full Federal Court in *Placer Pacific* said that 'a finding to the contrary would lead to great inequity. Many businesses generate liabilities which may arise in the considerable future' and 'to preclude deductibility when those liabilities come to fruition on the basis that the active trading business which gave rise to them had ceased would be unjust.'

109. In *Paklan Pty Ltd (in liq) v. Federal Commissioner of Taxation* (1983) 67 FLR 328; 83 ATC 4456; (1983) 14 ATR 457 (*Paklan*), payments in the nature of retirement allowances to employee directors by a company, which had ceased its engineering practice and was in the process of winding up its affairs, were found by the Federal Court to be not deductible under subsection 51(1) of the ITAA 1936 (the predecessor to section 8-1 of the ITAA 1997). Northrop and Fisher JJ said that 'the payments were in the nature of voluntary grants for past services' and that the company 'has not established a sufficient or any connection between the payment of these funds and the gaining or producing of assessable income'. In *Placer Pacific*, the Full Federal Court said that the comments by Northrop and Fisher JJ in *Paklan* may be taken to suggest that in that case the occasion of the outgoing to pay retirement benefits being incurred was not to be found at all in the earlier business of the taxpayer.

110. In contrast to the payments of the retirement allowances in *Paklan*, the eligible statutory redundancy payments are not voluntary grants for past services. Eligible employees are entitled to receive these payments pursuant to their terms of employment or applicable industry award for being made redundant. The occasion for these payments is to be found in the engagement of the employees to provide services to the business, which is directly referable to the business operations that were directed to gaining or producing assessable income. This fact also stamps the payments with a revenue character (that is the payments are neither capital nor capital in nature). Accordingly, eligible redundancy payments are deductible under section 8-1.

Capital gains tax

111. The right to receive the reimbursement of eligible statutory redundancy payments is a CGT asset under section 108-5. When the reimbursement is paid to the applicant, CGT event C2 will happen under section 104-25. This may result in a capital gain or capital loss.

112. Subsection 118-37(2) provides that any capital gain or capital loss is disregarded if it results from receiving a payment as reimbursement or payment of expenses under a listed scheme or program, including a scheme established by an Australian government agency. The BEA program is a scheme within the meaning of this subsection. Therefore, any capital gain or capital loss is disregarded under paragraph 118-37(2)(a).

Reimbursement of professional external accounting costs

Section 6-5: income according to ordinary concepts

113. The purpose of the reimbursement is to recompense the applicant for expenses incurred in obtaining professional assistance to complete the initial application for Exit Assistance and to provide the information necessary for the independent assessor to complete the Business Valuation Report. The reimbursement is not intended to assist the applicant with the costs of advice received in the course of their normal business operations. The payment is not paid for a purpose for which an applicant's business was carried on and is capital in nature. The reimbursement is not assessable under section 6-5.

Section 15-10: bounty or subsidy

114. For the reasons outlined in paragraph 113 of this Ruling, the reimbursement is not a bounty or subsidy received in relation to carrying on the applicant's business. The payment is not assessable under section 15-10.

Subdivision 20-A: assessable recoupment

115. A successful applicant will receive the payment of Exit Assistance in return for, among other things, the applicant agreeing to cease the whole of or part of a business. Accordingly, expenses incurred in preparing both the application for assistance and the valuation report are for the purpose of ceasing business and are capital in nature. No deduction is available to the applicant for the expenses incurred. Therefore, there is no assessable recoupment under Subdivision 20-A.

Capital gains tax

116. The right to receive the reimbursement of professional external accounting costs is a CGT asset under section 108-5. CGT event C2 under section 104-25 will happen when the entitlement to receive the reimbursement is satisfied.

117. Expenditure on professional external accounting services is an incidental cost incurred in relation to the relevant CGT asset. The payment by way of a reimbursement is a recoupment of this expenditure. This recoupment is not assessable income.

118. Any capital gain is disregarded under paragraph 118-37(2)(a) because the payment is a reimbursement provided under a scheme established by an Australian government agency.

Owner Assistance

Section 6-5: income according to ordinary concepts

119. The Owner Assistance payment is not intended to provide income support to the business principal or compensate for a loss of income. The payment is a capital payment. Its purpose is to compensate the principal for their agreement to cease participation in the relevant industry, pursuant to the Deed of Release and Indemnity, resulting in the loss of their capacity to earn income from the business under the restraint of trade. It takes into account the fact that the value of their wage is excluded in calculating the Exit Assistance payment. The Owner Assistance payment is not for an income producing activity of the applicant and is not assessable under section 6-5. The calculation of the payment by reference to real or nominal wages does not change this conclusion.

Section 15-10: bounty or subsidy

120. A payment of Owner Assistance is not a bounty or subsidy received in relation to carrying on the applicant's business as it is received in relation to the cessation of the applicant's business. The payment is not assessable under section 15-10.

Capital gains tax

121. On signing the Deed of Release and Indemnity, the business principal has a right to payment of the agreed Owner Assistance amount. This right is a CGT asset under section 108-5.

122. CGT event C2 under section 104-25 will happen when the entitlement to receive the payment of the Owner Assistance is satisfied, being the time that the payment is made.

123. The applicant makes a capital gain if the capital proceeds exceed the cost base of the right to receive the Owner Assistance payment. The applicant makes a capital loss if the capital proceeds are less than the reduced cost base.

124. The capital proceeds under subsection 116-20(1) are the amount of the Owner Assistance payment.

125. The cost base or reduced cost base of the right to receive the Owner Assistance payment is determined under Divisions 110 and 112.

126. Any capital gain made cannot be reduced by the general CGT discount as the capital gain does not result from a CGT event happening to a CGT asset that was acquired by the applicant at least 12 months before the CGT event happened.

Training Assistance

Section 6-5 – income according to ordinary concepts

127. Training Assistance is paid to the business principal in assisting them with gaining alternative employment and development of their career. It is paid to the principal upon the principal ceasing in their business and is not a product in a real sense of any employment or services rendered, nor is it in any sense relied upon by the applicant for their regular expenditure. Accordingly, the Training Assistance payment does not have the characteristics normally associated with ordinary income and is not assessable under section 6-5.

Section 15-10 – bounty or subsidy

128. The Training Assistance payment is not a bounty or subsidy received in relation to carrying on the applicant's business. It is received in relation to the cessation of the business and is capital in nature. The payment is not assessable under section 15-10.

Capital gains tax

129. On approval of amounts of Training Assistance, the business principal will have a right to reimbursement or payment of their approved expenses. The right to payment is a CGT asset under section 108-5.

130. CGT event C2 under section 104-25 will happen when the entitlement to receive the payment or reimbursement of Training Assistance is satisfied.

131. Any capital gain or capital loss made when CGT event C2 happens is disregarded under paragraph 118-37(2)(a) because the Training Assistance payment or reimbursement of expenses is under a scheme established by an Australian government agency.

Primary Production Income

132. A primary production business is defined in subsection 995-1(1) to include, relevantly, felling trees, planting or tending trees intended to be felled or transporting trees that you have felled to or from processing. The primary production averaging provisions will therefore be relevant to some businesses receiving assistance under the scheme described in this Ruling.

133. Subsection 392-80(2) provides that a taxpayer's 'assessable primary production income' for the current year for the purposes of the primary production income averaging provisions 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. Accordingly, there must be a causal connection between the income received and the primary producer's trade or business.

134. There is a causal connection between the reimbursement of statutory redundancy payments and the applicant's business as a primary producer because the occasion of the liability to make the statutory redundancy payments arises out of the operations of that business. The reimbursement of statutory redundancy payments results from carrying on a primary production business and is included in assessable primary production income for the purposes of Division 392.

135. Other payments received under the BEA program are not included in 'assessable primary production income' for the purposes of Division 392 because any net capital gains are excluded from assessable primary production income of the applicant for the purposes of Division 392.

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References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

TR 95/35; TR 1999/16; TR 2006/10

Subject references:

- assessable recoupment
- balancing adjustment
- bounty or subsidy
- capital gains tax
- Government payment to industry
- ordinary income

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