



TD 2018/15 - Income tax: capital gains: does CGT event D1 happen if a taxpayer grants an easement, profit a prendre or licence over an asset?

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 TD 2018/15 consolidates a number of previous public advice and guidance products, listed at the References section. This has been done as part of a project to review public rulings. The ATO view has not changed as a result of this update.



Taxation Determination

Income tax: capital gains: does CGT event D1 happen if a taxpayer grants an easement, profit à prendre or licence over an asset?

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

This publication (excluding appendices) 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.

Ruling

1. Yes. CGT event D1¹ (about the creation of rights) rather than CGT event A1 (about the disposal of an asset) happens if a taxpayer grants an easement, profit à prendre or licence over an asset. Consequently:

- no part of the cost base of the asset can be taken into account in working out the amount of any capital gain or capital loss that arises from the grant²
- any capital gain or capital loss from the grant cannot be disregarded merely because the asset was acquired prior to 20 September 1985
- any capital gain from the grant is not a discount capital gain³, and
- no exemption is available under Division 118 if the grant relates to a main residence because CGT event D1 is not one of the events listed in subsection 118-110(2) that is relevant to that exemption.

¹ See section 104-35 of the *Income Tax Assessment Act 1997* (ITAA 1997). All legislative references in this Determination are to the ITAA 1997.

² Section 110-10 provides that the rules about cost base are not relevant for CGT event D1.

³ Subsection 115-25(3).

2. In some cases, it may be difficult to determine whether an agreement involves a profit à prendre or a sale of goods. The category into which any particular arrangement falls will depend on the intentions of the parties determined from the terms of the agreement and other relevant circumstances.

Example 1

3. Lisa bought a property on 1 January 1985. On 1 December 2017 she granted an easement over the property to her neighbour and received \$40,000 for doing so. Lisa incurred \$1,000 in legal expenses in relation to the grant of the easement.

4. Lisa will make a capital gain of \$39,000 in respect of the grant of the easement [capital proceeds \$40,000 less incidental costs \$1,000]. The capital gain is not a discount capital gain.

5. Even though Lisa acquired the land over which the easement was granted prior to 20 September 1985, she cannot disregard the capital gain from the grant of the easement. Further, Lisa could not disregard the capital gain even if the property was her main residence.

Example 2

6. Barry owns pre-CGT land on which is situated a disused quarry. On 1 July 2017, Barry entered into two contracts:

- a contract for the sale of an amount of gravel for \$19,999, and
- a contract granting the purchaser of the gravel the right to enter the taxpayer's land over time and remove the gravel as and when required. The consideration given in respect of this contract was \$1.00.

7. Even though the sale of the gravel and the right to remove it are subject to two contracts, the transactions together are taken to constitute the granting of a profit à prendre on 1 July 2017 for \$20,000.

8. Barry calculates his capital gain by deducting from his capital proceeds (\$20,000) any incidental costs he incurred in respect of the grant of the profit à prendre. The capital gain is not a discount capital gain.

9. Sections 6-5 and 118-20 also need to be considered if the particular agreement arises in the context of the carrying on of a business of gravel supply operations or amounts to an isolated profit-making transaction.

Example 3

10. Malcolm owns pre-CGT land that includes standing timber. He cuts down the trees which results in his original asset being split into two (or more) pre-CGT assets – the land and the timber. Any gain or loss from a later sale of the timber is disregarded, because it was acquired pre-CGT.

11. If the land had been acquired post-CGT, the cutting of the timber would result in the original asset being split into two (or more) post-CGT assets. Any gain or loss from the sale of the timber could not be disregarded.

12. Sections 6-5 and 118-20 also need to be considered if the particular agreement arises in the context of the carrying on of a business of timber operations or amounts to an isolated profit-making transaction.

Date of effect

13. This Determination applies to years of income commencing both before and after its date of issue. However, this Determination 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 Determination (see paragraphs 75 and 76 of Taxation Ruling TR 2006/10 *Public Rulings*).⁴

Commissioner of Taxation31 October 2018

⁴ For an easement or profit a prendre granted prior to 21 September 1989, the ATO view was that the grant was a part disposal of the underlying asset (refer to paragraph 3 of Taxation Ruling IT 2561 *Income tax : capital gains : grants of easements, profits a prendre and licences* (now withdrawn) and paragraph 5 of Taxation Determination TD 93/235 *Income tax: capital gains: how are grants of easements treated for the purposes of the capital gains tax (CGT) provisions of the Income Tax Assessment Act 1936?* (now withdrawn).

Appendix – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner’s preliminary view has been reached. It does not form part of the binding public ruling.*

14. CGT event D1 happens if you create a contractual right or other legal or equitable right in another entity. The event happens when the contract is entered into or the other right created.⁵

15. You will make a capital gain if the capital proceeds from creating the right are more than the incidental costs you incurred that relate to the event. You will make a capital loss if those capital proceeds are less than those costs.⁶

16. The rights contemplated by CGT event D1 include:

- An easement – this is a right to use the real property of another for a specific purpose. The most common type of easement is a right of way – the right to travel over another person’s land.
- A profit à prendre – this is a right to enter and remove some product or part of the soil from someone else’s land.⁷
- A licence – this authorises the licensee to do something which would otherwise be unlawful. An example of a licence is the authority to occupy land. A licence is distinguished from a lease by the fact that a licence does not confer the right of exclusive possession of land.⁸

17. The Commissioner has, since 21 September 1989, relied on comments made by the Full Federal Court in *Gray & Anor v. FC of T*⁹ to support the view that the grant of an easement or profit à prendre involves the creation of rights in another entity and does not involve the part disposal of land:¹⁰

In passing I should mention that the provisions... of the Act are such as to bring to tax gains made on the grant, on or after 20 September 1985, of other interests in land held before that date, for instance, an easement or a *profit à prendre*.

18. However, it should be noted that the Commissioner takes the view in Taxation Ruling TR 97/3 *Income tax: capital gains: compensation received by landowners from public authorities* that CGT event D1 does not happen where an easement arises by operation of law – for example, where an easement is created in favour of a public authority by operation of a particular statute (placement of utility poles, utility trenches, water lines or sewer lines).

Characterisation of sale agreement

19. Whether an arrangement is properly characterised as a sale of goods or the grant of a profit à prendre has been the subject of judicial consideration in a number of cases.

⁵ Subsection 104-35(2).

⁶ Subsection 104-35(3).

⁷ *Duke of Sutherland v. Heathcote* [1892] 1 Ch 475.

⁸ *Radaich v. Smith* (1959) 101 CLR 209 at 214, 217 and 223.

⁹ (1989) 24 FCR 37; 89 ATC 4640; 20 ATR 649.

¹⁰ FCR at 45; ATC at 4645; ATR at 654.

Hill J in *Ashgrove Pty Ltd and Ors v. Federal Commissioner of Taxation*¹¹ conducted a review of the authorities and texts. In deciding that both types of arrangements fell into the category of agreements for the sale of goods (to which the right to enter and sever the timber was ancillary), Hill J focused on the fact that the purchaser derived no benefit from further growth and as such did not obtain a benefit from the land itself.

¹¹ (1994) 53 FCR 452.

References

Previous draft:

Not previously issued as a draft

Related Rulings/Determinations:

IT 2561; TD 93/235; TR 95/6; TR 97/3;
TR 2006/10;

Previous Rulings/Determinations:

IT 2561; TD 93/79; TD 93/81; TD 93/235;
TD 93/236; TD 96/35

Legislative references:

- ITAA 1997
- ITAA 1997 6-5
- ITAA 1997 104-35(1)
- ITAA 1997 104-35(2)
- ITAA 1997 104-35(3)

- ITAA 1997 110-10
- ITAA 1997 115-25(3)
- ITAA 1997 Div 118
- ITAA 1997 118-20
- ITAA 1997 118-110(2)
- TAA 1953

Cases relied on:

- Ashgrove Pty Ltd and Ors v. Federal Commissioner of Taxation (1994) 28 ATR 512; 94 ATC 4549
- Duke of Sutherland v. Heathcote [1892] 1 Ch 475
- Gray & Anor v. FC of T (1989) 20 ATR 649; 89 ATC 4640
- Radaich v. Smith (1959) 101 CLR 209

ATO references

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