

Tax Partner Pty Ltd

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Millmerran Community Centre

Landholder Tax Issues - Inland Rail

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Inland Rail - Tax Issues - Overview

- The objective of this presentation is to provide you with an overview of the potential tax (GST, Income Tax and Capital Gains Tax) consequences associated with compensation amounts and other amounts or benefits received in association with the activities carried out in association with the Inland Rail construction activities.

The tax issues covered in this brief presentation will include:

- The potential liability to GST and entitlement to input tax credits in relation to amounts received and paid in association with the Inland Rail activities on your property.
- The potential for the compensation amounts (including reimbursements of costs) to be classified as assessable income and thus considered in calculating a landholder's taxable income.
- The potential application of capital gains tax to the receipt of compensation amounts that are considered to be capital in nature including amounts received for the disposal of part or all of a landholder's property.

GST and Compensation (1)

- Is the property or landholder registered for or required to be registered for GST?
- **Liability to GST** (assuming registered for GST) - Has a supply been made by the landholder in connection with receiving compensation?
- Section 9-5 of the GST Act provides: “You **make** a taxable supply if: (a) you **make** a supply for consideration; and”
- “*Make*” - there is a requirement for a supplier (landholder) to take some positive action to cause a supply to be made, GSTR 2001/4. *In the absence of that positive action then no supply will be made and if no supply is made then there cannot be a taxable supply.*
- In many (but not all) cases when compensation is received for damage to property no supply will be made – no GST liability - GSTR 2001/4.
- Where a supply of farmland is made then it is unlikely to be GST-free because the recipient may not intend that a farming activity be carried out on the land.

GST and Compensation (2)

- Giving up the right to seek compensation may be considered to be a supply but in most cases no separate compensation (amount) is received for giving up the right and so no taxable supply will be made.
- The fact that the acquiring party may have compulsory acquisition powers does not always mean that the landholder will not be making a supply of land particularly if the landholder voluntarily offers their land to the party with compulsory acquisition powers.
- **Entitlement to Input Tax Credits** – this arises from the making of creditable acquisitions and creditable importations, s 11-5 GST Act - Generally acquisitions should relate to specific supplies but what happens where an acquisition was made but no supply was made upon the receipt of compensation?
- Acquisitions of legal services, valuation or accounting services by the landholder will include GST and while the landholder may not make a supply in relation to the compensation receipt they may still be able to claim input tax credits for the acquisitions of professional fees. See later discussion on the tax treatment of reimbursement of professional fees.
- **Hint** – Where possible include GST in the compensation amount if a supply has been “made”!

Taxation – Preliminary Considerations

- While there may be significant similarities between the impact that the construction activities may have on similar properties each compensation agreement will be unique and accordingly the application of taxation to compensation amounts that you may receive is likely to be somewhat different to the taxation of compensation received by other landholders.
- For some landholders they may dispose of all of their land and as a result the business on that land may cease resulting in the landholder separately selling livestock, plant and equipment and other items. Separate tax considerations will apply to the disposal of each item including the disposal of the land.
- Where part of the land owned by the landholder is acquired this may result in impacts on the remaining land and the enterprises carried out on the remaining land and accordingly compensation may be received for the impacts on the remaining land and the enterprises carried out on the land.
- Compensation may relate to impacts on both private and business assets. For example there may be different impacts on the main residence and that part of the land on which a business is carried out.
- Compensation may be for temporary impacts on enterprises carried out on the property including compensation for loss of production in crops, livestock, etc.
- Compensation may relate to permanent impacts on the land and enterprises carried out on the land and for the permanent diminution in attributes or value of the land.

Taxation of Compensation Amounts

The primary guiding principle associated with the taxation of compensation is that:

“It acquires the character of that for which it is substituted”

- While the principle is simple and straightforward, problems arise where a number of “heads of compensation” exists with no clear apportionment of the compensation to each of the “heads”.
- Historically un-dissected compensation amounts were classified as unliquidated damages and considered to be “capital” receipts however un-dissected amounts may now be taxable as capital gains.
- Compensation amounts may be received by means of periodic payments or in lump sum form. Where periodic receipts are received then those periodic receipts (assuming they are assessable) will be brought to account by the taxpayer in determining their taxable income in the year of receipt.
- The fact that compensation amounts are received periodically does not automatically mean that the compensation is revenue in nature.
- Taxation Ruling TR 95/35 provides guidance on the classification of compensation receipts with particular reference to determining whether they are for permanent damage.

Taxation - Based on the “Character” of the Receipt

- **Loss of Profit** - compensation should take the character of that which it replaces ... accordingly generally assessable – Compensation for profits foregone are generally assessable.
- **Recoupments and Reimbursements** – generally assessable if they relate to deductible expenditure otherwise they are merely a recoupment of an outgoing. Reimbursements may include compensation for legal, valuation and accounting fees incurred. What if you spend more than the amount reimbursed?
- **Loss of a Future Income Stream** - compensation for the loss of a future income stream will generally be assessable in the year of receipt; Taxation Ruling TR 92/3. A distinction should be made between compensation for the permanent reduction in the capacity of an asset (permanent damage) and the capitalisation of future profits as well as compensation for temporary loss of profits.
- **Non-cash Compensation** – generally assessable at its market value, s 21A ITAA36 where received by a business or subject to FBT if received in the context of employment.
- **Permanent Damage to Capital Assets** - Where permanent damage occurs to a capital asset the compensation is in many cases considered to be capital in nature; Taxation Ruling TR 95/35 – see also guidance on apportionment. May include loss of quiet enjoyment of ones' property. In some cases the receipt of compensation for permanent damage to property acquired after 19 September 1985 will result in the cost base of the property being reduced.

Taxation – Compulsory Acquisition of Property

- **Disposal of all property owned** – Where there is a compulsory acquisition of some or all of a landholder's land then it is most likely that capital gains tax will need to be considered.
- Distinguish between compulsory easements and disposal of land.
- Where the property includes the landholder's main residence then the component of the compensation that relates to the disposal of the main residence will generally not be subject to income tax or capital gains tax.
- The disposal of land acquired **prior to 20 September 1985** will not be subject to capital gains tax but if significant improvements have been effected to the land after that date there may be a residual application of capital gains tax.
- The disposal of land acquired **after 19 September 1985** will be subject to capital gains tax and it will be necessary to compare the cost base of the land with the compensation received for the disposal of the land. Certain capital gains tax concessions may apply to the disposal of property used in a business. (see next slide).

Small Business Concessions – Disposal of Property

- The disposal of land and associated capital improvements will generally be subject to a consideration of CGT.
- The small business concessions work in conjunction with the 50% general discount. The 50% general discount is not available for all capital gains tax events.
- Basic conditions - CGT event leading to capital gain – Covers all CGT events other than one that is not covered.
 - CGT SBE (\$2 million turnover test) or maximum net asset value test (\$6 million net asset value test) or holding the asset in a partnership or the asset being used by a connected entity or affiliate that is a CGT SBE.
 - Active asset test (asset used in a business)
 - Ownership rules for shares/trust interests
- Concessions
 - 15 year exemption – unlimited (if eligible)
 - 50% reduction
 - Retirement concession – (lifetime limit of \$500,000)
 - Roll-over

Questions / Discussion



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