ADVISOR DAY 2021

RURAL PROPERTY & TAX ISSUES

Presenters:
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Tom Delany, CTA, Principal, Tax Partner Pty Ltd

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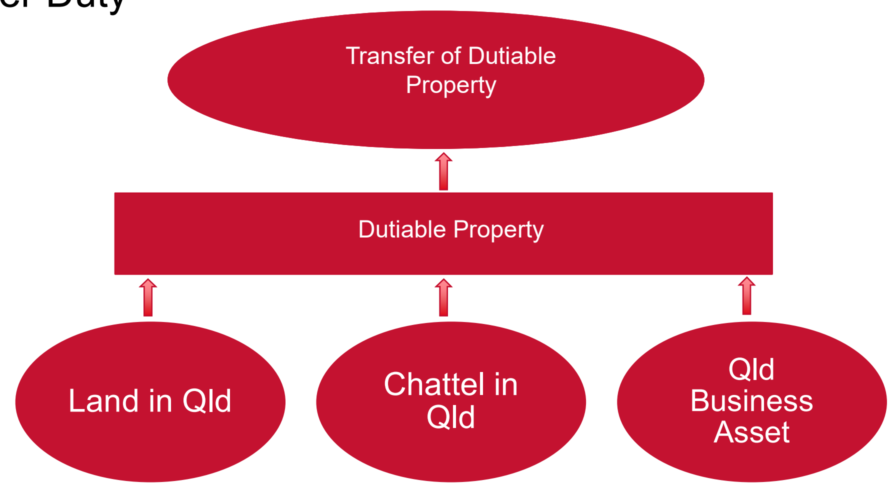
Outline

Advising rural property owners brings with it its own unique set of challenges. The legal issues encountered by our Commercial + Property team often require a team effort with accountants and tax advisors to get the best outcome for our clients. In the spirit of that team approach, Amanda Tolson (Director at Clifford Gouldson and Head of our Commercial + Property team) will present with Tom Delany (Principal, Tax Partner Pty Ltd) on a myriad of issues relevant for advisors to rural land holders including:

- Stamp duty - aggregation and how it works.
- GST:
    - exemptions on a rural property sale; and
    - applicability to chattels/livestock/land/water etc when exemptions apply.
- How different arrangements with land can be documented (e.g mining rights, wind, solar, share farming, agistment) and relevant tax implications.
- Capital/deduction considerations associated with leasing and licence arrangements, including related party arrangements.
- Capital/deduction considerations associated with the placement of structural improvements on land owned by an entity different to the entity carrying on the business on the land.
- Capital gains tax (CGT) considerations arising on the disposal of rural properties.

Transfer Duty



Transfer Duty - aggregation

30 Aggregation of dutiable transactions

(1) This section applies to dutiable transactions that together form, evidence, give effect to or arise from what is, substantially 1 arrangement.

(2) For assessing transfer duty on each of the dutiable transactions, the transactions must be aggregated and treated as a single dutiable transaction.

Aggregation – examples

For subsection (3), relevant circumstances include the following—

(a) whether the transactions are contained in 1 instrument;

(b) whether any of the transactions are conditional on entry into, or completion of, any of the other transactions;

(c) whether the parties to any of the transactions are the same;

(d) whether any party to a transaction is a related person of another party to any of the other transactions;

(e) the time over which the transactions take place;

(f) whether, before the transactions take place, the dutiable property the subject of the transactions was used together, or dependently with one another, by the transferor or transferors;

(g) whether, after the transactions take place, the dutiable property the subject of the transactions will be used together, or dependently with one another, by the transferee or transferees.

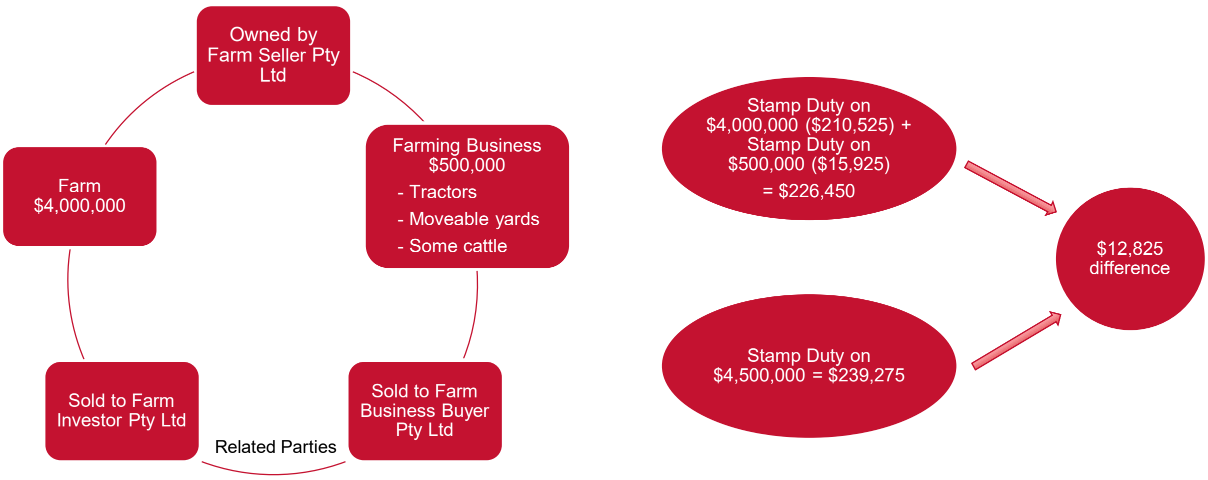
Aggregation – Public Ruling DA030.1.2

- Public Ruling– more details and examples

A purchaser signs five contracts for adjoining properties with five separate unrelated vendors on separate dates over a three month period. Each contract is conditional upon the owners of the other blocks agreeing to sell their properties.

It would be considered that there is sufficient unity of purpose in the dutiable transactions for the transactions to be aggregated. The same reasoning may also apply where all of the contracts are conditional on the granting of some approval by a third party organisation such as the local council.

Aggregation – splitting land & other assets



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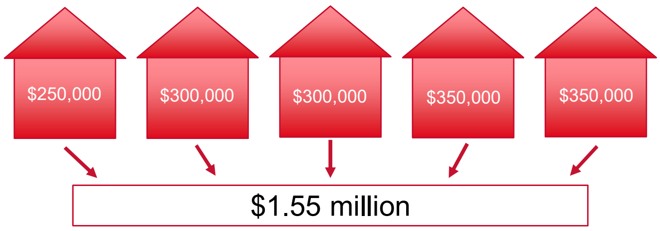
Aggregation – consider it early!



Client considered not making contracts conditional on one another in order to reduce stamp duty

- Separate transactions – total duty = $46,375
- Aggregated transactions – total duty = $69,650

$23,275 extra

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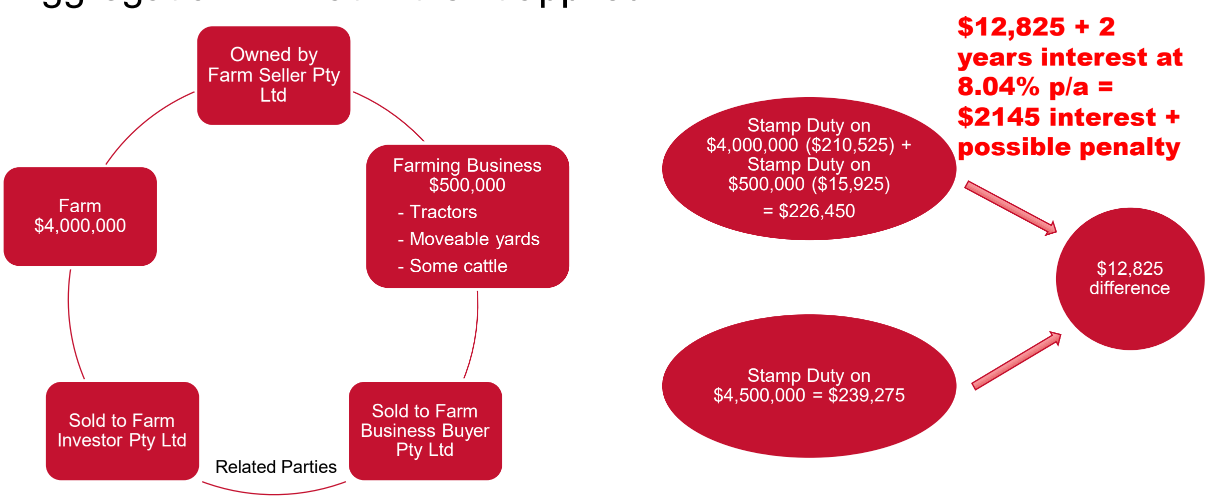
Aggregation – what if it isn't applied?



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GST on the Sale of Farmland and Businesses

- Going concern or farmland
- If the GST can be cashflowed - why do we care about these exemptions?

Purchase price	Duty
$10mill (no GST)	$555,525
$11mill (plus GST)	$613,025

$57,500

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Going concern

- If a farm business as a whole is sold as a going concern, that transaction may be GST-free provided that the enterprise is carried on by the transferor to the date of supply and the transferor supplies all of the things necessary to carry on the enterprise to the transferee, s 38-325 GST Act.

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Going concern – why won't a rural sale qualify?

- Farms commonly don't qualify as a going concern because:
  - ➢ Sold post-retirement (business has not been operating)
  - ➢ Business is continuing to be conducted by seller (on another property)
  - ➢ Selling land but not all machinery (clearing sale)

OR

- The sale does qualify to be a going concern…. But……. it wasn't negotiated on that basis and the buyer may not want to re-negotiate the terms after an offer is accepted.

GST - Sale of farmland

The supply of farm land, even if it does not qualify for the going concern exemption, is GST-free if:

(1) there has been a farming business carried on, on the land, for at least the period of five years before the sale, and

(2) the buyer intends that a farming business be carried on, on the land, s 38-480 GST Act.

This concession applies to the supply of:

- the freehold interest in the land
- the lease of the land from the government or a government authority, or
- the long-term lease of the land.

Water – GST free

- The sale of bulk water by a primary producer is generally GST-free, s 38-285 GST Act. The supply of a right to receive a supply of GST-free water would also be GST-free.

GST, farmland exemption & chattels

- What happens when….
  - Going concern doesn't apply.
  - Farmland exemption does
  - There are still some chattels being purchased with the land

Purchase price must be apportioned between the land and chattels – GST invoice provided by Seller at settlement

GST - Sale of Farmland – other situations

- Although the farmland concession extends to fixtures and fittings on the land, it does not apply to livestock, plant or equipment. Natural growth such as grass, trees and fruit on trees would normally be considered part of the land.
- However, depending on the circumstances, unharvested annual crops such as potatoes may be subject to GST as a separate supply of goods (emblements)(ATO GST Industry Issues — Primary Production: Issue 2.9.1).
- If a farm is subdivided and sold as a number of going concerns, the sales may be GST-free and if the subdivided lots are not going concerns, the sale of the land to an intending farmer may nevertheless be GST-free under s 38-480 GST Act.
- A further, more limited, concession applies where farm land is subdivided and sold to associates for residential purposes, s 38-475 GST Act. Such a sale will be GST-free if the following conditions are satisfied:
  - the land must be subdivided from land where there has been a farming business being carried on for at least five years. It is suggested in Interpretative Decision ID 2009/131 that this business must be carried on up to the commencement of the subdivision. It is, however, not necessary that the seller of the land be the entity that was carrying on that business
  - it must be permissible to use the land for residential purposes. However, the land must not actually contain any buildings occupied as a residence or buildings that are intended for residential use and are capable of being used in that way
  - the land must be sold to an associate of the seller (widely defined to include relatives, partners, related companies and trusts, and other entities associated with the seller in various ways)
  - the sale must be for no payment, or for less than the GST-inclusive market value.

Lease vs licence

- Legal difference – exclusive possession – *Radaich v Smith*:
  - A lease tenant has a right to exclude all others from the land – even the landlord.
  - A licensee does not hold that right, they have a mere right to occupy.
- Used in different circumstances – driven by:
  - When practically necessary due to a sharing of possession
  - Solar/wind farms prefer a licence until DA and construction complete
  - CGT – apply to leases but not licences

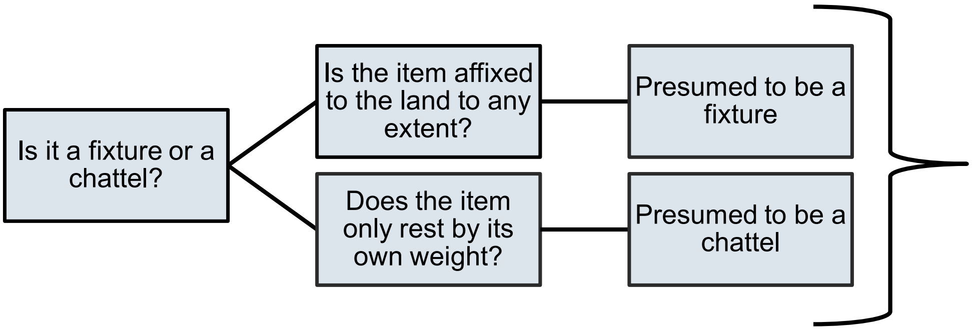
Leases, licences, sharefarming agreement and related parties

- Reasons to enter into these in a related-party scenario:
  - Support the payment of rent from operational entity to landowner
  - Risk (insurance)
  - Security for an operational entity investing in capital improvements on the land
- Share farming agreements:
  - Cannot be registered on title – lease vs share farming agreement
  - Useful for CGT - Taxation Determination TD 95/62 provides that share farming or share cropping is a common farming practice where a farmer is allowed to farm and harvest a crop on someone else's land in return for payment to the owner of that land a percentage of the harvest proceeds. A landholder carrying on a share farming business may be able to establish the land as an "active asset"

Capital improvements – fixtures vs chattels

- Fixtures vs chattels – why is it important?
  - Common scenarios (land sales, mortgagee security, tenant's affixing items and fixtures passing with land on landowner's death).
  - Tax treatment (Tom to discuss capital improvements)

Capital Improvements – fixtures vs chattels



Party seeking to prove otherwise must produce evidence that the opposite intention can be demonstrated. Relevant factors from case law include:

1. Whether intention was the better use/enjoyment of the land, or the better use/enjoyment of the item;
2. Degree of annexation;
3. Whether there will be damage to the property when the item is removed;
4. Whether affixed to remain temporarily or permanently;
5. Who affixed it – owner or tenant?

Taxation of Compensation Amounts - CSG

- Maybe subject to GST if a supply has been made by the landholder.

The primary guiding principle associated with the taxation of compensation is that:
"It acquires the character of that for which it is substituted and that to which it is added"

- 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.
- 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.

Taxation of Compensation Amounts – Wind, Solar…

- Wind, solar, etc…Lease/licence payments are likely to be assessable income but unlikely to be primary production income.

- Compensation for permanent damage to a water supply on land may be revenue or capital.
- Sale of stored water – may be revenue or capital.
- Sale of water allocations are generally on capital account.

- Sale of gravel – if considered a royalty will be revenue in nature if not a royalty may be a part disposal of the land.

- Sale of timber – if considered to be carrying on a business of timber growing or a royalty then most likely will be revenue in nature if not may be a part disposal of the land.

- Carbon sequestration rights – receipts generally considered to be statutory income.

- Conservation covenants – where permanently attached to land it will be a part disposal of the land.

Extended Definition of "Plant"

- A depreciating asset is an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used, except:
  - land; or
  - an item of * trading stock; or
  - an intangible asset, unless it is mentioned in subsection (2).

- Section 45-40(1) ITAA97 defines "Plant" to include –

  (c) fences, dams and other structural improvements, other than those used for domestic or residential purposes, on land that is used for agricultural or pastoral operations; and

  …

  (f) structural improvements that are excluded from paragraph (c), (d) or (e) because they are used for domestic or residential purposes if they are provided for the accommodation of employees, tenants or sharefarmers who are engaged in or in connection with the activities referred to in that paragraph.
- There will be very few structural improvements that will not be plant for primary producers.
- Where they are not plant they may be capital works expenditure and deductible under Division 43.

Primary Production Deductions – UCA (Not SBE)

- **Water Facilities** - Capital expenditure on water facilities for primary production land may qualify for an immediate deduction where it is incurred after 7.30 pm on 12 May 2015, s 40-515 to 40-575 ITAA97.
- **Fencing Assets** - Primary producers may claim an immediate deduction for capital expenditure on fencing assets in the year in which the expenditure is incurred, with effect from 12 May 2015, s 40-515 to 40-575 ITAA97. The meaning of the word "acquisition" was confined to an acquisition of a new fence or a fence that results in an improvement of the land (AJ & PA McBride Ltd 2020).
- **Fodder Storage Assets** - Primary producers may deduct capital expenditure on a fodder storage asset in the income year in which the expenditure is incurred for fodder storage assets first used or installed ready for use on or after 19 August 2018, s 40-515 to 40-575 ITAA97. Expenditure incurred before that (but after 12 May 2015) qualifies for deduction spread over three years.
- **Warning:** The purchaser of primary production land cannot claim a deduction for that part of the purchase price attributable to pre-existing water facilities, fencing assets or water storage assets (Case W9 89 ATC 178; TD 96/40) under Subdivision 40-F ITAA97.
- **Tax Tip** – No balancing adjustment applies to the disposal of Subdivision 40-F ITAA97 items.

Leasing – Capital Allowances (1)

- The availability of deductions to the lessor and lessee may be different as shown in the following table.

Capital Expenditure	Lessor of Farm	Lessee (Carrying on a primary production business)
Plant (may include certain buildings) and Equipment	Entitled to a deduction under Division 40 provided connected to income (lease or otherwise)	Entitled to a deduction under Division 40 (see earlier comments regarding lessee and holding a depreciating asset with a quasi ownership interest) ATO ID 2009/156 provides that a taxpayer can be the owner of a quasi-ownership right over land because it has a lease of the land as a "tenant at will".
Landcare Operations	Entitled to a deduction under Subdivision 40-G provided connected with carrying on a business (unless qualifies as rural land irrigation water provider)	Entitled to deduction under Subdivision 40-G – Special conditions apply.
Capital Improvements to buildings (not classified as plant) on Land	Entitled to Division 43 deductions provided connected to income (lease or otherwise)	If lessee incurs expenditure in the construction of the building, lessee is entitled to claim Division 43 deductions. This reverts to the lessor if there is no longer a lessee (termination or surrender of lease).

Leasing – Capital Allowances (2)

- The availability of deductions to the lessor and lessee may be different as shown in the following table.

Capital Expenditure	Lessor of Farm	Lessee (Carrying on a primary production business)
Electrical	Entitled to a deduction under s 40-645(1) ITAA97 provided it is connected with a business	Entitled to a deduction under s 40-645(1) ITAA97 provided you have an interest in the land or are a share farmer carrying on a business on the land
Telephone lines	Entitled to a deduction under s 40-645(2) ITAA97 provided it is connected with a primary production business	Entitled to a deduction under s 40-645(2) ITAA97 provided that a primary production business was carried out on the land and you had an interest in the land or were a share farmer carrying on a primary production business on the land
Horticultural Plants	Entitled to a deduction if the lessee does not carry on a horticultural business on the land s 40-525(2) ITAA97	Entitled to a deduction if a horticultural business carried out on the land s 40-525(2) ITAA97 (Other special conditions apply)

Leasing – Capital Allowances (3)

- The availability of deductions to the lessor and lessee may be different as shown in the following table.

Capital Expenditure	Lessor of Farm	Lessee (Carrying on a primary production business)
Fodder Storage Assets	Not entitled to a deduction under Subdivision 40-F. May be entitled to a deduction under standard Division 40 provisions.	Entitled to a deduction under Subdivision 40-F ITAA97.
Fencing Assets	Not entitled to a deduction under Subdivision 40-F. May be entitled to a deduction under standard Division 40 provisions.	Entitled to a deduction under Subdivision 40-F ITAA97.
Water Facilities	Not entitled to a deduction under Subdivision 40-F ITAA97 unless qualifies as an irrigation water provider. May be entitled to a deduction under normal Division 40 provisions.	Entitled to a deduction under Subdivision 40-F ITAA97.

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Apportionments on Acquisition (1)

- The general realities in the sale negotiation will see the vendor typically wanting to allocate value to CGT assets while the purchaser will typically be wanting to maximise value on revenue assets such as trading stock and depreciating assets that will result in being able to access tax deductions.
- **Horticultural plants** – A deduction available based on the vendor's original establishment expenditure.
- **Water facilities** – Generally no deduction where a previous owner has claimed a deduction.
- **Fodder Storage Assets** - Generally no deduction where a previous owner has claimed a deduction under Subdivision 40-F ITAA97.
- **Fencing Assets** - Generally no deduction where a previous owner has claimed a deduction under Subdivision 40-F ITAA97.
- **Livestock** - Treated as trading stock and a deduction is available to the purchaser – s 70-90 ITAA97 may apply to the vendor.
- **Grain/Wool/Cotton (post harvest/shearing)** – Generally treated as trading stock and a deduction is available. Grain and other fodder on hand to feed livestock may be treated as a consumable.
- **Standing Crops** - s 70-85 ITAA97 treats standing crops as trading stock for the purposes of Subdivision 70-D.

Apportionments on Acquisition (2)

- **Primary Production Land** – Allocated cost will form part of the asset's cost base. Main residence?
- **Landcare operations** – No deduction to subsequent owners for landcare costs.
- **Electricity and Phone Connections** - No deduction to subsequent owners for these costs.
- **Buildings (e.g. houses & sheds) used in primary production business** – if not plant then generally, a deduction of 2.5% of the vendor's original construction cost will be allowed, under Division 43 ITAA97.
- **Plant and equipment or depreciating assets** - Depreciation deductions based on acquisition cost.
- ***Contracts (eg supply to Coles)*** - Treated as a CGT asset (Intangible).
- **Water (Physical water stored on farm)** – Generally no deduction (ATO position). However if allocated a specific value in the contract an argument for a deduction may be sustained.
- **Water licences (not held for trading)** - Treated as a CGT asset.
- **Goodwill (if any) (eg stud farm name)** - Treated as a CGT asset (intangible).

- **Tip** – Recommended that you engage a quantity surveyor.

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SBE Taxpayers – IAWO and Pooling

- **Instant Asset Write-Off** - Section 328-180 ITAA97 - Assets costing less than $1,000, $20,000, $25,000, $30,000, $150,000 or unlimited (see 6 October 2020 budget).

Warning: There is no rollover for assets that have been claimed under the instant asset write off either during the lifetime of a taxpayer or on their death. (May create a disincentive to restructure).

- **Pooling** - Assets not eligible for IAWO can be pooled (no assets being added to pools until after 30 June 2023).
- Depreciation - 30% for existing pool assets and 15% for new pool assets, s 328-190 ITAA97.
- Where the closing pool balance was less than $150,000 on 30 June 2020 then the balance of the pool is to be deducted and the full pool balance is to be deducted as at 30 June 2021.
- Where the pool value is less than zero the amount by which the balance is less than zero is included in assessable income.

SBE Taxpayers – PP Deductions (1)

New Items

- While s 328-175(1) ITAA97 provides that once an entity elects to depreciate under the SBE depreciation rules it must depreciate all of its assets under the SBE rules an exception exists for primary production deductions in s 328-175(3)(4) ITAA97.
- **Exception: primary production** - (3) *If you are a * small business entity for the income year, for each * depreciating asset you use to carry on a * primary production business and for which you could deduct amounts under Subdivision 40-F (about primary production depreciating assets) or Subdivision 40-G (about capital expenditure of primary producers and other landholders) apart from subsection (1), you can choose:*
    - *to deduct amounts for it under Subdivision 40-F or 40-G; or*
    - *to calculate your deductions for it under this Subdivision.*

Pre-existing Items

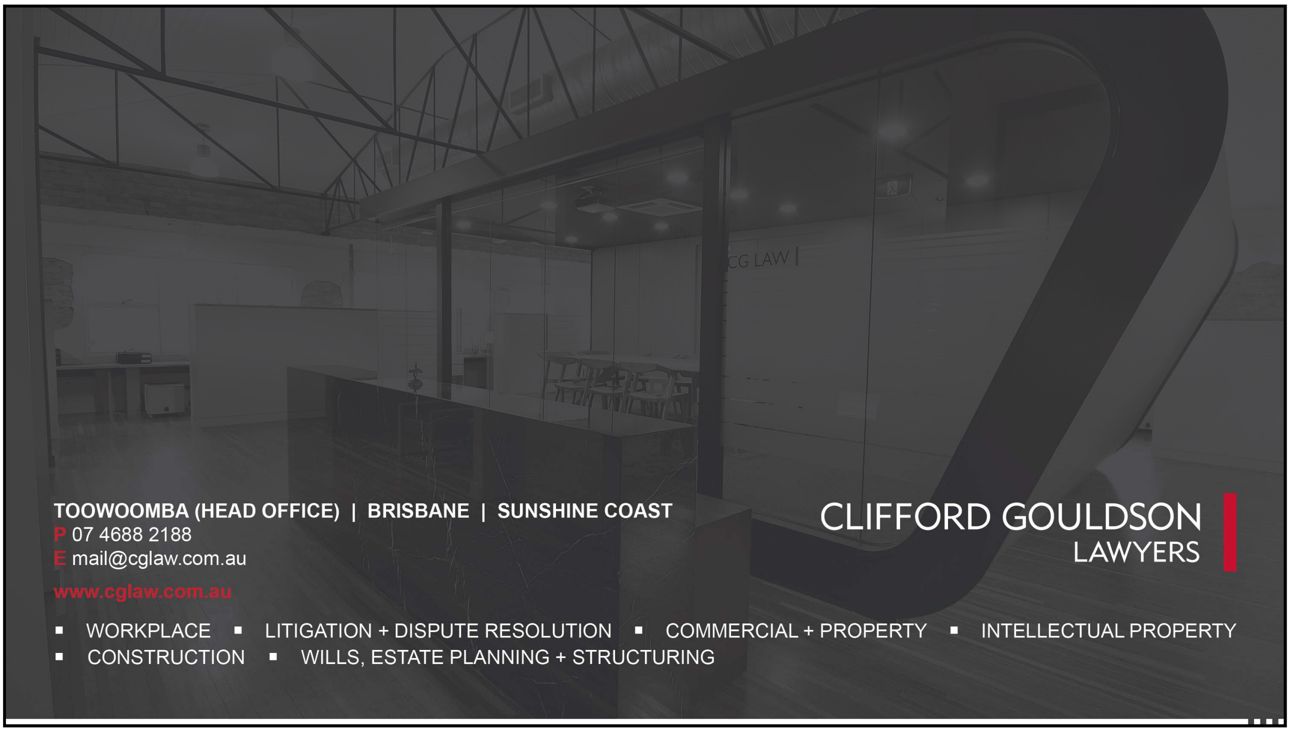
- Given that no deduction is available under subdivision 40-F and 40-G ITAA97 for pre-existing primary production items then SBE entities do not have the choice of using those provisions and must use the SBE rules if they are available.

SBE Taxpayers – PP Deductions (2)

- **Budget 6 October 2020 -** For small and medium sized businesses (ie those with aggregated annual turnover of less than $50 million), full expensing will apply to second-hand assets.
- ATO – 2nd Hand Water Facilities - See also for Fencing and Fodder Storage - Special rules apply for:
  - depreciation
  - claiming a deduction under other provisions.
- **Depreciation** - You can't claim a deduction for the depreciation of a second-hand water facility, fencing and fodder storage under subdivision 40-F ITAA97 unless you can prove that no one else has or can deduct an amount for the asset's depreciation under that subdivision.
- **Claiming under other provisions** – The ATO have indicated that primary producers who are considered a small business entity may choose to use the small business simplified depreciation rules to claim a deduction for certain second-hand assets.

Small Business Concessions – Disposal of Rural Property

- The disposal of land and associated capital improvements will generally be subject to a consideration of CGT.
- The small business concessions are set out in Division 152 ITAA 97 and work in conjunction with the 50% general discount.
- Basic conditions (Subdivision 152-A ITAA 97)
  - CGT event leading to capital gain – Covers all CGT events other than CGT event K7
  - CGT SBE (turnover test) or maximum net asset value test (s 152-15 ITAA 97) 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 (s 152-35 ITAA 97)
  - Ownership rules for shares/trust interests
- Concessions
  - 15 year exemption (Subdivision 152-B ITAA 97) – unlimited (if eligible)
  - 50% reduction (Subdivision 152-C ITAA 97)
  - Retirement concession (Subdivision 152-D ITAA 97) – (lifetime limit of $500,000)
  - Roll-over (Subdivision 152-E ITAA 97)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