

Selected Tax Issues in Leasing

Denis Barlin
Barrister

13 Wentworth Selborne Chambers



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Advanced Retail and Commercial Tenancies

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Barrister – 13 Wentworth Selborne Chambers

dbarlin@wentworthchambers.com.au

Overview

- Leases – CGT events
- Rents v premiums
- Tax issues with lease premiums
- Lease incentives
- Lease surrender payments / receipts
- Selected GST issues
- NSW stamp duty

Leases - CGT events

'F' events relate to leases

- CGT event F1 – granting a lease
- CGT event F2 – granting a long term lease
- CGT event F3 – lessor pays lessee to change lease only capital loss)
- CGT event F4 – lessee receives payment for changing lease
- CGT event F5 – lessor receives payment to change lease
- Discount not applied to F1, F2 or F5**

Identifying 'rent' payments v premiums

- Rent [income] vs premiums [capital]

Rent – payment by which lessee / tenant contracts to pay lessor / landlord for use of premises / goods
[United Scientific Holdings Ltd v Burnley Borough Council]

- Nature of rent – ordinary income – linked to use of premises
[Adelaide Fruit and Produce Co Ltd v DFC of T]

Identifying 'rent' payments vs premiums

- **Premium** – payment by potential tenant to induce landlord to grant lease – consideration for grant or assignment of lease

[Australian Mercantile Land & Finance Co v FC of T]

- Nature of premium – capital – linked to access to (not use) of premises.

Identifying 'rent' payments vs premiums

- Reality / substance is definitive

Ex parte Lathouras; Re Vendardos

clause provided payment of: '*... a premium of [amount] monthly in advance...*'

Held – amount was in substance rent.

Case M96

Taxpayer permitted lodger's to reside in a flat, under market rent / meet costs of food

Held – not rent but '*... a partial recoupment of private expenditures ...*'.

Identifying 'rent' payments vs premiums

Case B51

- Provided receipt rent – manner of payment irrelevant
- May be paid in lump sum

Tax – lease premiums

- Prima facie not ordinary income
- CGT event F1
Taxpayer grants a lease and CP includes premium.
- CGT event F1 not a 'discount capital gain'
[115-25(3)]

Lease premiums as income

- Premium assessable if:
 - (1) taxpayer's business includes the receipt of such premiums
[*Kosciusko Thredbo Pty Ltd v FC of T*]
 - (2) disguised as additional / advance rent
[*Dickenson v FC of T*]

Lease premiums - *Kosciusko Thredbo*

- Taxpayer entered into 45 year lease of part of the Kosciusko State Park
- Developed area as a tourist resort
- Constructed apartments which were sub-let for substantial premiums
- Sub-lease reverted within a few years of termination of head lease
- Taxpayer – premiums on capital account as purchase price for a capital asset.

Lease premiums - Kosciusko Thredbo

Rogers J:

'... all other things being equal, the receipt of premiums for parting with a sub-lease for almost the entirety of the balance of the period of the head lease, usually represents a receipt of capital. In those circumstances it is truly the purchase price of a capital asset. Another way of putting the same proposition was that all that the ... [taxpayer] ... was doing here was realising part of the asset, the head lease, to the best advantage.'

Lease premiums - Kosciusko Thredbo

'... However, the better view is that for many years the ... [taxpayer] ... was carrying on its business of selling sub-leases initially of sites and in later years of apartments within the demised area. More recently the sales were by way of time sharing arrangements. The transactions of sale were repetitive and recurrent and were an essential ingredient of the operation of the business and commercial advantage...'

CGT and lease premiums – the wash-up

- S 104-110 & 116-20(2)
CGT - premiums payable are fully assessable to lessor (whether lump sum or instalments)
- From 1 July 2007, lease premiums that are not ordinary income are within CGT provisions.
- No 50% discount for CGT event F1
- Result – less tax (expenses incurred not ordinarily deductible but included in CB)
- Reduce any CG if income – 118-20(1)

Payment of lease premium

- Once off expense
- Deductible?
- S 40-880(5)(d) – not black-hole expense

Lease incentives

- Cash incentive to business taxpayer to enter into lease – assessable (*Montgomery*)
- Incentive to enter into lease to commence new business – not assessable but capital gain? (IT 2631)
- S. 21 A – non-cash business benefits received by business taxpayers (even if not convertible to cash) - assessable

Lease surrender receipts

- Lease surrender receipt ordinary income if:
 - Received in business of trading leases; or
 - Ordinary incident of business activity.
- Otherwise of capital nature – cancellation of a CGT asset (C2)
- 50% CGT discount would apply

Lease surrender payments

- Lease surrender payment is generally a capital, non-deductible outgoing.
- ss 40-880(5)(d) – not deductible
- May be deductible if:
 - (1) taxpayer's (i.e. lessee) business involves entering into and surrendering leases; or
 - (2) lessor's business involves granting and surrendering leases.

Non-compliance with covenant to repair

Lessee pays lessor for non-compliance with covenant to repair:

- Assessable to lessor (s 15-25) provided:
 - Premises lease to derive assessable income; and
 - Amount is not ordinary income
- Deductible for lessee (s 25-15)

Leasehold fixtures and improvements

- For CGT purposes, lessee continues to own an asset that is affixed to land if:
 1. lessee is taken to be owner (within IT 175); or
 2. a law provides that the ownership remains with lessee.
- At end of lease – CGT event A1 happens (i.e. ownership is transferred to lessor)

GST

- Leases of commercial premises *prima facie*:
 - ‘taxable supply’ by landlord;
 - ‘creditable acquisition’ by tenant
- Long-term leases (at least 50 years) - treated as sale

GST – agreement to make a lease

- GST Advice GSTA TPP 009:
- If there is an agreement to lease followed by the entry into the lease:
 - Two ‘supplies’;
 - If there is separate consideration attributable to each.

GST – lease incentives and premiums

Lease incentive by lessor

- Incentive paid by lessor to lessee to enter lease – taxable supply by lessee
- Consideration received by lessee to do something as part of its enterprise (GST for lessee)

Lease premium by lessee

- Premium paid by lessee is a supply by the lessor (i.e. to secure a lease)
- Lessor subject to GST

GST – lease surrender payment

- Considered a supply by the party receiving payment.
- **If payment by lessor:**
 - Lessee must account for the GST
 - Lessor obtain ITC
- **If payment by lessee**
 - Lessor must account for GST
 - Lessee obtain the ITC

GST – specific inducements

- **Non-monetary inducement**
 - Supply by party providing the non-monetary inducement (e.g. lessor provides a vehicle)
 - Supply by other party as consideration (e.g. lessee agrees to enter into lease).
- **Fit-outs**
 - If lessor provides and retains ownership – no GST
 - If lessor contributes amount spent by lessee – treated as a cash incentive (i.e. supply by lessee).
 - If lessor provides plant that transfers to lessee – taxable supply

GST specific inducements

- Income guarantees
 - Supply by lessor of premises and income guarantee equal to the rent.
 - However, if lessee's entry into lease **specifically** in consideration of the income guarantee then:
 - Lessee making taxable supply – agreement to enter into lease (1/11th of GST inclusive value of guarantee); and
 - Lessor makes a taxable supply of the guarantee – consideration is lessee's agreement to enter into lease

NSW Stamp Duty

Abolition of lease duty

- Lease duty abolished on 1 January 2008.
- Any lease first executed on or after 1 January 2008 not liable to lease duty

NSW Stamp Duty

Transfer duty on lease premiums

- 'Dutiable transaction' - a lease in respect of which a premium is paid or agreed to be paid (ss 8(1)(vii) DA).
- Premium – '*... includes an amount paid or payable on the grant of an option ...*' (8(3) DA).
- Transfer duty also applies to the transfer or surrender of a lease of land in NSW [exceptions]
- S. 18 – nominal duty if in conformity to agreement

Contact:

Denis Barlin

Barrister

13 Wentworth Selborne Chambers

(02) 9231 6646

dbarlin@wentworthchambers.com.au