BUSINESS LAW CONFERENCE

TAXATION ISSUES RELATING TO LEASING TRANSACTIONS

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I first presented this paper in September 2015, so if you attended that seminar, I apologise in advance: this is only a slightly updated version of that paper.

Quick refresher

1. Before descending into this complex area, I wanted to provide a quick reminder of most of the taxation legislation that may affect a leasing transaction.
2. Obviously, the taxation implications are different for landlords and tenants. However, the relevant taxation legislation applies to both landlords and tenants.
3. Some people these days complain about over regulation in our society. Nowhere is over regulation more evident than in the taxation field. Every year, each successive Federal and State government thinks of new ways to change the tax laws when it comes to budget night.
4. The following Federal taxation legislation may be relevant to leasing transactions:
    a. The A New Tax System (Goods and Services Tax) Act 1999;
    b. The Income Tax Assessment Act 1936 (the old Act – in the process of being rewritten);
    c. The Income Tax Assessment Act 1997 (the new Act); and
    d. The Taxation Administration Act, 1953.
5. The Victorian taxation legislation which may be relevant to leases is:
    a. The Land Tax Act 2005 (from 1 January 2006);
    b. Duties Act 2000; and
    c. Taxation Administration Act, 1997.

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A. INCOME TAX

Rental – income tax treatment – landlords

6. As you know, a landlord is required to include any rental received as income in his, her or its annual income tax return.

7. At the same time, a landlord is entitled to claim a deduction for expenses incurred in earning that rental income.

Negative gearing

8. Controversially in some circles, landlords are also currently entitled to claim a deduction for expenses incurred in earning other income (the so called negative gearing regime that currently operates under Australian income tax laws). Those with long memories will recall that the Hawke/Keating government introduced negative gearing in the mid 1980's. After only 6 months, in July 1985, they back flipped, and returned to the original way negative gearing was treated: only allowing landlords to claim deductions for expenses incurred in earning that rental income, and not against income earned from personal exertion. The political disaster which followed saw the reversal of the back flip, so that now, with negative gearing, landlords are entitled to claim a deduction for expenses incurred in earning all their income (not just rental income).

9. Successive Federal governments have toyed with removing negative gearing as an allowable tax strategy. None have actually removed it since Paul Keating did so, and quickly reinstated it.

Income tax treatment – tenants

10. A tenant that is operating a business may be entitled to a tax deduction for rental and other outgoings that it pays for its business premises.

11. However, a tenant is unlikely to be able to claim a tax deduction for rental and other outgoings he or she pays for residential premises (unless those premises are

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used – even in part – for the purpose of conducting a business that generates taxable income).

Income tax treatment – incentives

12. More controversial perhaps is the treatment of incentives, which I deal with later.

B. GST

Taxation implications – GST

13. The Australian Taxation Office describes GST as operating in the following way:[1]
    a. *Goods and services tax (GST) is a broad-based tax of 10% on most goods, services and other items sold or consumed in Australia.*
    b. *Generally, businesses and other organisations registered for GST will:*
        i. *Include GST in the price of sales to their customers*
        ii. *Claim credits for the GST included in the price of their business purchases.*
    c. *So while GST is paid at each step in the supply chain, businesses do not actually bear the economic cost of the tax. The cost of GST is borne by the final consumer, who can't claim GST credits.*
    d. *While businesses don't bear the economic cost of GST, they collect it. As a GST registered business, you'll need to put aside the GST you have collected so it can be paid when due.*
14. There are particular rules concerning the application of GST to property transactions. These rules are very complex. The key issue for a conveyancer is to identify whether GST may be payable on the sale of a property and if so whether the purchase price properly reflects that.
15. The following material is found in the publication by the Australian Taxation Office *GST and property*[2]. The pertinent extracts from that publication are reproduced below.

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[1] ATO Website at https://www.ato.gov.au/Business/GST/
[2] ATO publication: https://www.ato.gov.au/general/property/in-detail/gst/gst-and-property/

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16. Many people are actually carrying on an enterprise when making property transactions but do not register for GST when they are required to do so. Even with a 'one-off' transaction you may still be required to register for GST because your one-off property transactions may be an 'enterprise'.
17. If you are dealing with property (for example, you buy, sell, lease or develop), you may be considered to be conducting an enterprise. If your turnover from these activities is more than the GST registration threshold you may be required to register for GST.
18. For GST purposes, property includes any of the following:
    a. Land
    b. Land and buildings
    c. An interest in land
    d. Rights over land
    e. A licence to occupy land.
19. You apply GST differently to property depending on whether it is either:
    a. Commercial
    b. Residential.
20. When you sell a property, the sale may be, amongst other things:
    a. **Taxable** – this means you are liable for GST on the sale, and you can claim GST credits for anything you purchase or import to make the sale; or
    b. **Input taxed** – this means you are not liable for GST on the sale and you cannot claim GST credits for anything you purchase or import to make the sale.

Residential premises

21. Residential premises include houses, units and flats. It does not include vacant land.
22. Properties are residential premises if they can be occupied, are occupied, or are intended to be occupied, as residences.

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23. Generally speaking, if a residential property is not new (see below) and the parties to the sale are not involved in a business to buy and sell properties, a sale of property is considered to be an input taxed supply.
24. If either the vendor or the purchaser are in the business of buying and selling properties and they are enterprises registered for GST, then the sale will be taxable for GST purposes. In some circumstances, the parties may be required to become registered for GST in respect of the sale.
25. If both parties are registered or required to register for GST in respect of the sale, the vendor can claim GST credits for any purchases it make for the sale but is liable for GST on the sale price. The purchaser is entitled to a tax invoice in respect of the sale that reflects the GST payable by the purchaser.

New residential premises

26. Residential premises are new when any of the following apply:
    a. They have not been sold as residential premises before
    b. They have been created through substantial renovations
    c. New buildings replace demolished buildings on the same land.
27. Residential premises are no longer new residential premises if they have been continuously rented for five years after first becoming new residential premises. They may still be considered new residential premises however, even if they have been rented out continuously for five years where they have been held for a dual purpose. Dual purpose is where the premises are being, for example, marketed for sale whilst being rented out as an input taxed supply. That is because they have not been held 'solely' for making input taxed supplies for at least five years.
28. You can claim GST credits for any purchases you make for the sale of new residential premises (subject to the normal rules on GST credits) and you are liable for GST on the sale.
29. If your residential premises are no longer new, for example, they have been rented for more than five years, they are input taxed.

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30. If GST applies to your sale of new residential premises, you generally pay GST of one-eleventh of the sale price. You may be eligible to use the margin scheme to work out the GST you must pay.
31. The margin scheme is a separate topic not covered in this paper.

Commercial residential premises

32. Commercial residential premises include:
    a. Hotels, motels, inns
    b. Hostels, boarding houses
    c. Caravan parks, camping grounds
    d. Establishments that provide residential premises that are similar to hotels, motels, inns, hostels and boarding houses.
33. Commercial accommodation is accommodation in these commercial residential premises.
34. If you sell commercial residential premises such as hotels, motels, inns, hostels or boarding houses, you are generally making a taxable sale and you are liable for GST of one-eleventh of the sale price.
35. You may be able to claim GST credits on purchases you make that relate to selling your property (subject to the normal rules on GST credits), for example, the GST included in real estate agents' fees.
36. You may also be able to claim a GST credit on other expenses, such as solicitor's fees, that relate to buying the property.

37. Despite sounding a little complex, most transactions involving the sale of property, even leased property, in reality do not create any great difficulties.

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Recent Federal Court decision

38. No great difficulties that is until the recent decision of the Full Federal Court in the case of *MBI Properties Pty Limited v Commissioner of Taxation* [2013] FCAFC 112.
39. I have written about this case on my blog: http://melbournepropertylaw.blogspot.com.au/
40. MBI Properties Pty Ltd ("MBI") acquired three apartments in a hotel complex, each of which was subject to a lease entered into between the vendor, South Steyne Hotel Pty Ltd ("South Steyne"), and the operator of the Sebel Manly Beach Hotel, Mirvac Management Ltd ("MML"). MBI, on acquiring the rights of the lessor, became the recipient of a "supply of a going concern" within the meaning of the GST Act. The issue in the case concerned the construction and application of s 135-5(1)(b) of the GST Act and whether, by reason of MBI's assumption of the lessor's rights and obligations with respect to MML, it was thereafter making supplies through an enterprise to which the supplies related.
41. In that case the Full Court of the Federal Court held that a purchaser of a property subject to a lease **does not make any supply to the tenant following completion of the acquisition**. It followed that the purchaser has no GST liability in respect of the ongoing lease.
42. The Federal Court created a wave of uncertainty for GST when it held that the **only relevant supply in respect of a lease occurs on its grant** (see MBI Properties Pty Ltd v FCT [2013] FCA 56, 2 February 2013, upheld on appeal to the Full Federal Court in MBI Properties Pty Limited v FCT [2013] FCAFC 112, 18 October 2013).
43. The decision raised many questions regarding the correct GST treatment in such circumstances.

Position prior to Federal Court decision in MBI

44. Until the Federal Court decision it was generally understood that a lease is a continuing and periodic supply for GST purposes and as a result, when the freehold is sold, the vendor ceases supplying the property under the lease, and

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ceases to have any GST liability in respect of the lease. The accepted view was that the purchaser assumed the supply to the tenant of the property under the lease, and therefore the GST liability in respect of the lease.

45. The Australian Taxation Office (ATO) had issued a public ruling confirming that in substance the ATO would administer the GST law in that way when a sale of a rental property occurred.
46. The Federal Court's decision applied to all leases because the Court held that, under the GST legislation, a lease is **supplied in full at the time of grant of the lease and not continually or periodically over time**. The Court held that there is no provision in the *GST Act* that deems continuation of supply during the continuation of a lease. The supply is the grant of the lease and therefore the supply is complete on the lease coming into existence.

Implications from Federal Court decision

47. This finding by the Court raised a number of questions in circumstances where property is sold subject to a lease, including:

    1. Does the vendor remain liable for the GST in respect of the lease after selling a property, even though the vendor is no longer entitled to receipt of the rental payments? Although the Federal Court decision made this a theoretical possibility, vendors were protected by ATO ruling GSTD 2012/2 which states in paragraph 7:

        "7. The vendor of the commercial premises is not liable for GST relating to the lease where it is no longer in receipt of or entitled to rent or other consideration for the lease following the sale of the reversion."

    2. Should the purchaser of a property subject to a lease continue collecting the GST from the tenant and remitting it to the ATO, even though according to the Full Federal Court decision the purchaser is not making any supply to the tenant?

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48. The Full Federal Court in MBI Properties decided that a purchaser who acquired new residential premises subject to existing leases as a GST-free supply of a going concern was not liable for GST under Division 135 of the GST Act. This was because the purchaser was not intending to make any input taxed supplies through the enterprise which the purchaser acquired.
49. Tenants under any lease which is subject to GST where the underlying land has been sold were also potentially impacted by the decision in MBI Properties. This is because, in order to correctly claim any input tax credits for GST paid, the tenant also needed to be considered to be making an acquisition and be issued with tax invoices by the entity who makes the supply.

The High Court decision

50. The High Court appeal concerned the characterisation, for the purposes of the GST Act, of observance of obligations of lessor and lessee continued by operation of law following the sale and purchase of premises subject to an existing lease.
51. In Commissioner of Taxation v MBI Properties Pty Ltd, [2014] HCA 49 the High Court (French CJ, Hayne, Kiefel, Gageler and Keane JJ) unanimously decided in a joint judgment that the assumption by a taxpayer of a lessor's rights and obligations following its **purchase of premises subject to an existing lease involved the making of supplies for GST purposes – that is, the supply of a lease involves a continuing supply in addition to the grant itself and the GST legislation does not require the consideration (i.e. the rent) to be attributed exclusively to one or other supply**. It is sufficient, and double taxation is avoided, by the attribution of the rent to specific tax periods.
52. The High Court held:

> 36. … There will in general be a supply which occurs at the time of entering into the lease. That supply will involve a grant within the scope of s 9–10(2)(d) combined (as contemplated by s 9–10(2)(h)) with the creation of contractual rights within the scope of s 9–10(2)(e) and with

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the entry into contractual obligations within the scope of s 9–10(2)(g). There will then be at least one further supply which occurs progressively throughout the term of the lease. That supply will occur by means of the lessor observing and continuing to observe the express or implied covenant of quiet enjoyment under the lease. The thing of value which the lessee thereby receives is continuing use and occupation of the leased premises. The special attribution rule in s 156–5, made applicable to a supply by way of lease by s 156–22, does not alter those aspects of the general operation of the GST Act.

37. In observing and continuing to observe the express or implied covenant of quiet enjoyment under the lease, the lessor is appropriately characterised, for the purposes of the GST Act, as engaging in an "activity" done "on a regular or continuous basis, in the form of a lease". The result is that, whether or not the lessor might also be engaged in some other form of enterprise, the lessor makes the supply of use and occupation of the leased premises in the course of the lessor carrying on an enterprise as defined in s 9-20(1)(c).

38. Once the general operation of the GST Act is understood in that way, it is apparent that there is no warrant in the text or policy of the GST Act for reading the reference in the special rule in s 40-35 to a supply of "residential premises" that is a supply "by way of lease" as referring to the supply which occurs at the time of entering into the lease but not as referring to the further supply which occurs by means of the lessor observing and continuing to observe the express or implied covenant of quiet enjoyment under the lease. The reference encompasses both, and both are therefore input taxed.

…

40. In the circumstances which gave rise to the present appeal, there was an input taxed supply of residential premises by way of lease which occurred at the time of the grant of each apartment lease by South Steyne

> to MML. There was then a further input taxed supply of residential premises by way of lease which occurred by means of South Steyne observing its express obligation under the lease to provide MML with use and occupation of the leased premises. MBI's assumption of that express obligation by operation of law on its purchase of the premises from South Steyne resulted in MBI becoming obliged to continue to make the same further input taxed supply of residential premises by way of lease to MML throughout the remaining term of the lease. MBI intended at the time of purchase to observe that ongoing obligation. MBI intended to do so through an enterprise which was the same enterprise as that in which South Steyne had previously engaged and which MBI, by purchasing the premises subject to the lease, had acquired from South Steyne as a going concern.
>
> …
>
> 45. MBI's intended supply of residential premises by way of lease to MML was for a price: the rent to be paid to MBI by MML in observance of MML's continuing obligation under the apartment lease. That is so whether or not that rent can be said also to have been payable in connection with South Steyne's grant of the apartment lease to MML.

Amended GST Ruling

53. As a result of the High Court decision, the Australian Taxation Office issued Addendum to GSTD 2012/1 regarding the GST consequences following the sale of residential premises that are subject to a lease.

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Development lease arrangement with Government agencies

54. On 3 June 2015, the Commissioner published GSTR 2015/2 Goods and services tax: development lease arrangements with government agencies. The Ruling explains the GST treatment of particular transactions arising in the context of development lease arrangements entered into between government agencies and private developers.
55. The Ruling is available on the Australian Taxation Office web site[3], and I will not be covering it in this paper.

C. CAPITAL GAINS TAX

Taxation implications – CGT

56. The following material is publically available on the Australian Taxation Office website[4]. The pertinent extracts from that material are reproduced below.

Basic Overview

57. A capital gain - or capital loss - is the difference between what it cost you to get an asset and what you received when you disposed of it.
58. A taxpayer pays income tax (referred to as capital gains tax (CGT)) on his or her capital gains made during an income tax year.
59. If a taxpayer makes a capital loss, he or she cannot claim that loss against income but they can use it to reduce a capital gain in the same income year. If capital losses exceed capital gains or a taxpayer makes a capital loss in an income year in

[3] ATO Website at http://law.ato.gov.au/atolaw/view.htm?rank=find&criteria=AND~GSTR~basic~exact:::AND~2015%2F2~basic~exact&target=ED&style=java&sdocid=GST/GSTR20152/NAT/ATO/00001&recStart=1&PiT=99991231235958&Archived=false&recnum=1&tot=4&pn=ALL:::ALL

[4] http://www.ato.gov.au/corporate/content.aspx?doc=/content/00208572.htm.

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which he or she does not have a capital gain, the loss can generally be carried forward and deducted it against capital gains in future years.

60. All assets acquired since tax on capital gains came into effect (on 20 September 1985) are subject to CGT unless specifically excluded.
61. Selling assets such as real estate or shares is the most common way a taxpayer makes a capital gain or capital loss. CGT also applies to intangible assets such as business goodwill.
62. Some personal assets are exempt from CGT, including a home, car, and most personal use assets, such as furniture. CGT also doesn't apply to depreciating assets used solely for taxable purposes, such as business equipment or fittings in a rental property.
63. CGT applies to assets of Australian residents anywhere in the world.

Acquiring and owning CGT assets

64. When a taxpayer acquires a CGT asset, he or she needs to start keeping records immediately because they might have to pay tax on it in the future. Their records will help ensure they don't pay more tax than necessary. If the asset is owned jointly with someone else, the owners need to establish each owner's share.

Selling an asset and other 'CGT events'

65. When a taxpayer sells an asset or gives it to someone else there is a 'CGT event'. This is the point at which a capital gain or capital loss is made. There are a number of other CGT events, for example, if a managed fund or other trust distributes a capital gain to a taxpayer, it's a CGT event.

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Working out your capital gain/loss

66. For most CGT events, the taxpayer works out the capital gain or capital loss by subtracting the 'cost base' (what it cost to acquire the asset) from the 'capital proceeds' (what was received when the asset was disposed of). The amount declared on the income tax return is the total of capital gains for the year, less any capital losses incurred and any CGT discounts or concessions to which the taxpayer is entitled.

CGT exemptions, rollovers and concessions

67. Individuals and small businesses can generally discount a capital gain by 50% if they hold the asset for more than one year. In certain circumstances, a capital gain on a CGT event can be deferred, or 'rolled over', until another CGT event happens. There are a number of other CGT concessions specifically for small business.
68. The material below is publically available on the Australian Taxation Office website[5]
69. Most real estate - but generally not a 'main residence' (family home) - is subject to CGT. This includes vacant land, business premises, rental properties, holiday houses and hobby farms. A 'main residence' (family home) is generally exempt from CGT (unless rented out for a time, partially used for business purposes or it's on more than two hectares of land).

Timing of a real estate CGT event

70. When a taxpayer sells or otherwise disposes of real estate, the time of the CGT event is generally when the contract is entered into, not when it settles. If there's no contract, the CGT event is when the change of ownership occurs.

5 http://www.ato.gov.au/corporate/content.aspx?doc=/content/00208572.htm&page=21&pc=001/001/038/003/006.

Selling your home

71. A taxpayer can generally claim the main residence exemption to ignore a capital gain or capital loss from a CGT event that happens to the family home. To get the exemption, the property must have a dwelling on it and the taxpayer must have lived in the dwelling.

Dwellings, adjacent land and associated structures

72. If a taxpayer is selling their home, they can generally claim the main residence exemption for:

    1. The dwelling they live in - a dwelling is anything that is used wholly or mainly for residential accommodation
    2. The land sold with the dwelling, up to a limit of 2 hectares - additional land is subject to CGT
    3. Any associated structures, such as a separate laundry or garage.

73. The dwelling, land and associated structures must be used for private or domestic purposes to qualify for the exemption.

Keeping records for an inherited main residence

74. If a taxpayer inherits a house that was the main residence of the person who left it to them, a capital gain on its subsequent disposal may be exempt from tax. However, until the taxpayer knows this, they should keep records of relevant costs incurred by the taxpayer and the previous owner.

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Selling rental property

75. A taxpayer may make a capital gain or capital loss when he or she sells (or otherwise cease to own) a rental property. If the sale of the rental property includes depreciating assets, the vendor needs to apportion the capital proceeds between the property and the depreciating assets.

Capital Expenditure on rental/income producing property[6]

76. Capital expenditure on improvements may include extensions, additions or improvements, including initial repairs.
77. These costs form part of the cost base, which a taxpayer uses to work out whether they have made a capital gain or capital loss when the CGT event happens.
78. If the property is a home and it was used to produce income (such as by renting out part or all of it), the taxpayer will need to keep records of the income-producing period and the proportion of the property used to produce income.
79. Since 20 August 1996, if a taxpayer used their home for income-producing purposes, the first time they do this they are taken to have acquired the home at that time for its market value. The taxpayer uses the market value as the acquisition cost to work out a capital gain or capital loss at the time of any subsequent CGT event. The taxpayer will need to keep details of expenses relating to the home after the date it started producing income.

[6] The following commentary is reproduced from the ATO website at http://www.ato.gov.au/corporate/content.aspx?menuid=0&doc=/content/00208572.htm&page=25&H25

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D. STAMP DUTY

Taxation implications – stamp duty

Leases

80. The Victorian government abolished stamp duty for leases from 26 April 2001.

Transfers

81. The High Court very recently dealt with the assessment of duty on transfers of land in Docklands in *Commissioner of State Revenue v Lend Lease Development Pty Ltd; Commissioner of State Revenue v Lend Lease IMT 2 [HP] Pty Ltd; Commissioner of State Revenue v Lend Lease Real Estate Investments Limited* [2014] HCA 51.

Background

82. In 2001, the Victorian Urban Development Authority ("VicUrban") and one of the Lend Lease respondents (together "Lend Lease") made an agreement for the development of the Docklands area. It was agreed that Lend Lease would buy parcels of land in Docklands from VicUrban and that Lend Lease would design, construct and then sell large residential and commercial buildings on that land. It was also agreed that each of VicUrban and Lend Lease would build various forms of infrastructure on and around the land, including a road extension, bridge and park. Each transfer of land was to be made pursuant to a land sale contract. But the development agreement also required Lend Lease to pay to VicUrban not only the amounts payable under each land sale contract but also certain additional amounts, including payments for infrastructure and for remediation of areas on and around the land and a share of gross proceeds received by Lend Lease on sale.
83. Under the *Duties Act* 2000 (Vic), the transfers of land were subject to duty payable by Lend Lease. The Commissioner assessed duty according to the

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consideration for each transfer of land, which it determined to be the total of the sums payable by Lend Lease to VicUrban under the development agreement. Lend Lease objected to the assessments, claiming that the consideration for each transfer was the payment of the amount specified only in the land sale contract. After the Commissioner disallowed the objections, Lend Lease requested that each be treated as an appeal to the Supreme Court of Victoria. Those appeals were dismissed by a single judge of the Supreme Court but were allowed on further appeals to the Court of Appeal. By special leave, the Commissioner appealed to the High Court.

84. The High Court unanimously allowed the appeals. The High Court held that the **transaction** recorded in the development agreement made between VicUrban and Lend Lease **was a single, integrated and indivisible transaction**. The High Court held that the consideration for the transfer of land was the performance by Lend Lease of the several promises of payments under the development agreement, and that the Commissioner was right to include those amounts in the assessments.

E. LAND TAX

Taxation implications – land tax

85. The current LIV form of Lease of Real Estate (Commercial Property) includes the following provisions:
    a. Building outgoings means any of the following expenses … incurred in respect of the land, the building, the premises or any premises in the building which includes the premises –
        i. …
        ii. Taxes including land tax (unless the [Retail Leases] Act [2003] applies) …
    b. The tenant must –
        i. Produce receipts for paid building outgoings within 7 days of a request
        ii. …

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iii. Pay the proportion of the building outgoings specified in item 10

…

86. The Retail Leases Act 2003 includes the following provision:

> S 50(1) A provision of a retail premises lease is void to the extent that it makes the tenant liable to pay an amount for tax for which the landlord or head landlord is liable under the Land Tax Act 2005.
>
> Note
>
> The application of this section is affected by section 121 (notification of amount of land tax).
>
> (2) Subsection (1) does not apply, in the case of a lease entered into at any time on or after 1 May 2003 and before 1 July 2003, in respect of any period before 1 July 2003.

87. The result of these lease and legislation provisions is that a tenant in a retail lease is not liable for land tax, whilst a tenant in a commercial lease which is not a retail lease is liable for land tax.

Relevant cases?

88. Practitioners may recall the Wantirna Club case (*Richmond Football Club Limited v Verraty Pty Ltd (ACN 076 360 079)* (Retail Tenancies) [2011] VCAT 2104 (3 November 2011).
89. In that case, the parties had a 10-year lease on foot from 1998. Then, there was a substantial variation in 2004. Richmond Football Club claimed that the variation amounted to a surrender and re-grant. As a result, they argued that the Retail Leases Act, 2003 applied, and they were not liable for various outgoings, including land tax, from the date of the variation. As a result, they sought a refund of the amount over paid.
90. In the decision, Senior Member Riegler found (at paragraphs 98 to 99):

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98. In my opinion, the payment of outgoings is analogous to the payment of rent, in that it has a direct connection with the use and occupation of the Premises. In my view, *The Dog Depot* applies in respect of the payment of outgoings. Good consideration was received for the money paid in respect of outgoings. That being the case, it would be unconscionable or unfair to allow RFC to be repaid moneys in respect of outgoings.
99. Therefore, and having regard to the authorities cited above, the claim for money had and received, in so far as it relates to outgoings, must fail.

91. However, he found that land tax was in a different category. Senior Member Riegler found (at paragraphs 100 to 102):

> 100. The position is, however, different in relation to the payment of land tax. There is a disconnect between the benefit enjoyed by the tenant and imposition of the land tax. It represents a cost that is not immediately connected with the tenant's use of the land but rather, it is connected to the landlord's capital wealth. In that sense, the term of the lease, now rendered void by the introduction of the RLA represents a situation closer aligned with what occurred in *David Securities* and in *Roxborough*. In particular, the tenant gets nothing in return for the payment of land tax. In my view, the payment of land tax is a severable component of the total consideration paid and is recoverable as money had and received.
>
> 101. A further distinguishing aspect of the claim, as it relates to land tax is that the offending provision in *The Dog Depot* stated that rent was not payable until the disclosure statement was furnished. In other words, there was no entitlement to claim rent under the lease until a statutory precondition had been met. It still remained a contractual obligation, albeit that the term was unenforceable until a disclosure statement was furnished. In my view, that is different to where the legislature makes a provision in the lease void.

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102. In the present case, the term of the lease requiring payment of land tax is deemed void. It is of no effect and is effectively excised from the lease, as if there never was a contractual obligation to reimburse land tax. It is as if the parties had never agreed that RFC was liable to reimburse the landlord for its land tax liability. That being the case, how can it be said that the payment of something for which there is no contractual obligation to pay represents good consideration.

92. As a result, VCAT ordered the landlord to repay that proportion of the land tax that was not statute barred.

F. LEASE INCENTIVES

Taxation implications – lease incentives

93. Landlords commonly use lease incentives to entice tenants to enter into a lease.
94. Lease incentive often relate to new tenancies in commercial buildings.
95. These inducements can take many forms, including:
    a. Free fit-out of the premises,
    b. Upfront cash payments,
    c. Payment of the tenant's removal costs from the old premises or for the cost of the surrender of any existing leased premises,
    d. Non-cash items such as motor vehicles or boats, expensive paintings, holiday packages, rent-free or rent-discounted periods for the leased premises or for premises in other cities, and
    e. Interest-free loans.
96. In harder economic times, the incentives landlords offer can be a combination of some of the incentives listed.

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What are the income tax implications?

97. The income tax treatment of such lease incentives can vary depending on the nature of the incentive provided.

Tenants

98. For tenants who receive a lease incentive, the question is whether the incentive is assessable in their hands as "ordinary income" or alternatively under a specific income tax provision.
99. Some incentives may affect the extent to which the tenancy costs are tax deductible for the tenant.
100. There are now a number of cases that have considered whether certain lease incentives are assessable to the tenant.
101. In summary, tenants can expect the Commissioner of Taxation to treat lease incentives they receive as assessable income.
102. According to an article by Moore Stephens, Accountants, the tax treatment for the tenant in respect of certain types of lease incentives received is as follows[7]:

Lease incentive	**Tax treatment**
Cash payment	Assessable
Rent free period	Not assessable
Rent discount	Not assessable
Interest-free loan	Tax-free provided it is a genuine business loan
Free fit-out:	
If landlord owns fit-out	Not assessable
If tenant owns fit-out	Assessable but capital allowance

7 http://www.mondaq.com/australia/x/395334/Income+Tax/The+income+tax+implications+of+property+lease+incentives

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	deductions may be permitted
Free plant	Assessable but capital allowance deductions may be permitted
Holiday packages	Tax-free to tenant (note costs non-deductible to landlord)
Removal expenses	Assessable
Surrender payments	Assessable

Landlords

103. For landlords, the primary tax issue is typically whether the provision of the incentive would be an allowable deduction either under the general deduction rules or some other specific provision (such as the capital allowance provisions).

104. As a general proposition, provided that the expense is not capital or private and domestic in nature, the provision of lease incentives should give rise to an allowable deduction if the landlord is in the business of leasing properties.

105. Rent-free periods are not deductible, as rent foregone is not a loss or an outgoing.

Keep proper records

106. It goes without saying that the relevant lease incentive should be properly documented as part of the lease agreement, and as required by taxation laws, those records must be kept for minimum statutory periods and produced on request in the event of an audit.

Negotiation in relation to depreciable assets

107. One of the main areas of contention in relation to fit out will be depreciation.

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108. Both parties will be looking to claim a tax benefit. Any fit out provided by the landlord will be able to be depreciated by the landlord in its tax return.

109. However, it may be that the tenant can negotiate a different (tax-free) incentive from the landlord, and agree to pay for its own fit out in order to gain the right to claim depreciation.

110. These matters are usually negotiable between the parties.

Recent case about landlord attempting to recover lease incentives from tenant's guarantor

111. The High Court decision in *Andrews v Australia and New Zealand Banking Group Ltd* (2012) 247 CLR 205 has renewed interest in contractual 'penalties'.

112. In *GWC Property Group Pty Ltd v Higginson & Ors* [2014] QSC 264, the Supreme Court of Queensland had to consider the issue of contractual penalties in relation to lease incentives. This case has also rated a mention on the blog.

113. This issue is not strictly relevant to a paper about the taxation treatment of incentives. However, you should bear in mind that, as a landlord, if you can't recover an incentive from a tenant that has agreed to reimburse you, you may be entitled to a deduction for the loss suffered as a result.

114. Clearly, any tax deduction will be dependent upon the circumstances of each case.

Taxation consequences

115. The plaintiff landlord in that case failed in its attempt to claw back the amount of the incentive paid to the tenant. As a result, the landlord will not have to pay tax on that amount.

116. However, the previous owner of the property incurred the expense of the fit out (for example) in the first place. It would have been entitled to the tax benefits associated with that expenditure (for example, depreciation on an income producing asset) until it sold the property.

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117. After the current landlord purchased the property, its entitlement to make an ongoing claim for depreciation depends upon how the contract of sale dealt with the depreciable items. If they were specified in the contract of sale as being sold at their written down value, then the purchaser/landlord could continue to claim depreciation on them.

118. At the same time, the defendant/guarantors do not have to pay the amounts sought (as they were found not liable for that claim). Therefore, they will not be able to claim a tax deduction.

Conclusion

119. The area of taxation continues to generate a large amount of litigation, whether it is Federal or State taxation.

120. I hope I have highlighted some of the recent problem areas.

121. No doubt the various taxation regimes are fertile ground for further and ongoing litigation.

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