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Ruling

Subject: solar feed-in tariff scheme

Question 1

Does the generation of electricity from a small scale photovoltaic solar system on common property of an owners corporation amount to the carrying on of a business by the owners corporation?

Answer

No.

Question 2

Are payments the owners corporation receives from their electricity retailer for the generation of electricity from a solar system assessable income under section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997)?

Answer

Yes.

Question 3

Are the costs associated with the solar system, such as depreciation and maintenance, deductible under section 8-1 of the ITAA 1997?

Answer

Yes, to the extent they are not capital in nature.

Question 4

If the payments are assessable income under section 6-5 of the ITAA 1997 and the solar system is obtained by the owners corporation by resolution or declaration of trust is the income assessable to the owners corporation rather than the individual proprietors?

Answer

Yes.

This ruling applies for the following periods:

Year ending 30 June 2012

Year ending 30 June 2013

Year ending 30 June 2014

Year ending 30 June 2015

The scheme commences on:

1 July 2011

Relevant facts and circumstances

The owners corporation manages a number of townhouses and is proposing to install a grid feeding photovoltaic (PV) system on one of the structures on common land.

The purpose of the PV system is for the owners corporation to produce, by renewable means, about the same amount of power as you consume.

You intend to purchase the system using funds that are identified in your sinking fund plan for this purpose. You intend to purchase the system by way of a resolution or by declaration of trust. The equipment would then become property that the owners corporation holds.

The renewable energy certificates (RECs) would be assigned to the installer of the PB system in exchange for a discount on the price of the system allowing a larger system to be purchased.

You state that you are eligible to participate in a gross feed-in tariff scheme (the scheme).

The PV system is likely to produce a similar amount of electricity to your annual consumption. Under the feed-in tariff you would receive a credit per kilowatt hour resulting in a credit on your electricity account.

The feed-in tariff provides a credit at a premium rate for all of the electricity generated by the PV system which is fed directly into the grid. Customers then purchase the electricity they require for consumption at the retail rate.

You consume electricity for lighting of various paths and parking areas on your site. The electricity is used entirely for lighting of the common land and your consumption occurs entirely between dusk and dawn, precisely when you would expect to have no production from the PV system.

You intend to purchase 100% accredited environmentally friendly power for your night-time consumption. You regard the grid as acting, in effect, like a battery into which you will feed the renewable energy you have made by day and from which you will withdraw an equivalent amount by night.

The credit received on your account for day-time production is expected to approximately match your costs for night consumption of power when considered over the period of the feed-in tariff considering both the supply and the consumption charges. In the earlier years you would expect to receive more credit than debit on the account but by the end of the period electricity costs may have risen to match or exceed the fixed credit.

You have provided an estimate of your electricity costs and an estimate of the credits you expect to receive for the electricity generated by the PV system.

Relevant legislative provisions

Income Tax Assessment Act 1997 Section 6-5.

Income Tax Assessment Act 1997 Subsection 6-5(1)

Income Tax Assessment Act 1997 Subsection 6-5(2)

Income Tax Assessment Act 1997 Subsection 6-5(4)

Income Tax Assessment Act 1997 Section 8-1

Income Tax Assessment Act 1997 Section 8-5

Income Tax Assessment Act 1997 Subsection 20-20(2)

Income Tax Assessment Act 1997 Subsection 20-25(1)

Income Tax Assessment Act 1997 Section 20-30

Income Tax Assessment Act 1997 Section 20-40

Income Tax Assessment Act 1997 Section 25-10

Income Tax Assessment Act 1997 Subsection 25-10(3)

Income Tax Assessment Act 1997 Section 40-25

Does Part IVA apply to this ruling?

Part IVA of the *Income Tax Assessment Act 1936* is a general anti-avoidance rule that can apply in certain circumstances if you or another taxpayer obtains a tax benefit in connection with an arrangement and it can be concluded that the arrangement, or any part of it, was entered into or carried out by any person for the dominant purpose of enabling a tax benefit to be obtained. If Part IVA applies the tax benefit can be cancelled, for example, by disallowing a deduction that was otherwise allowable.

We have not fully considered the application of Part IVA to the arrangement you asked us to rule on, or to an associated or wider arrangement of which that arrangement is part.

If you want us to rule on whether Part IVA applies we will first need to obtain and consider all the facts about the arrangement which are relevant to determining whether Part IVA may apply.

For more information on Part IVA, go to our website www.ato.gov.au and enter 'part iva general' in the search box on the top right of the page, then select: *Part IVA: the general anti-avoidance rule for income tax*

Reasons for decision

The relevant legislation is the *Income Tax Assessment Act 1997* (ITAA 1997). All references to legislation are to the ITAA 1997 unless otherwise stated.

Question 1

Summary

Based on the facts provided, the owners corporation would not be considered to be carrying on a business by receiving payments for the export of excess electricity generated from a small scale photovoltaic solar system.

Carrying on a business

The question of whether a business is being carried on is a question of fact and degree. The courts have developed a series of indicators to determine the matter, these indicators are summarised in Taxation Ruling TR 97/11 *Income tax: am I carrying on a business of primary production*. These indicators are applicable to business activity generally, relevant indicators include:

· the size, scale and permanency of the activity.

· whether there is repetition and regularity of the activity, and

· whether the activity is of the same kind and carried on in a similar manner to that of ordinary trade in that line of business.

Size, scale and permanency of the activity

Paragraph 77 of TR 97/11 states that the larger the scale of the activity the more likely it will be that the taxpayer is carrying on a business. However the size or scale of the activity is not a determinative test and a person may carry on a business though in a small way.

In your case the activity involves the operation of a PV system. Once the PV system is installed no more work other than maintenance is required to operate it. The size and scale of the operation is very small.

A smaller scale of activity may detract from the commercial purpose or character of the activities, for example the activity may more properly be described as the management of a capital investment rather than a business.

However, this factor alone is not conclusive. Paragraph 82 of TR 97/11 states that the smaller the scale of the activity the more important the other indicators become when deciding whether a taxpayer is carrying on a business.

Whether there is repetition and regularity of the activity

Paragraph 55 of TR 97/11 discusses the need for repetition and regularity. It is often a feature of a business that similar sorts of activities are repeated on a regular basis. The repetition of activities by the same person over a period of time on a regular basis helps to determine whether there is the 'carrying on' of a business. TR 97/11 refers to *Hope v. The Council of the City of Bathurst* (1980) 144 CLR 1, 80 ATC 4386, (1980) 12 ATR 231 where 'the transactions were entered into on a continuous and repetitive basis', such that the taxpayer's activities 'manifested the essential characteristics required of a business'.

In your case the measurement of and payments for the electricity generation are the responsibility of the energy company. There is little to no repetition and regularity in terms of action required for the activity to continue, the PV system only requires installation to operate and generate revenue. However, this factor must be considered together with the other relevant indicators.

Whether the activity is of the same kind and carried on in a similar manner to that of ordinary trade in that line of business

The activities of a taxpayer are more likely to be a business when carried on in a manner similar to that in which other participants in the same industry carry on their activities.

The factors below, set out at paragraph 64 of TR 97/11, are used to compare the characteristics of others engaged in the same type of business:

· the volume of sales, if there is a small number of sales it is less likely that a business is being carried on

· the types of customers the taxpayer sells their product to - wholesalers, retailers, the public at large, or friends or relatives - and the manner in which this marketing takes place;

· the sort of expenses incurred by the taxpayer;

· the amount invested in capital items;

You expect to generate recurring receipts from the energy company. The major expense you will incur is the cost and installation of the PV system. There will be no significant operating costs.

You will have a single customer. There would be a contract agreement in place, however, you would not be required to meet or maintain a certain supply level, rather you would merely sell back what the PV system generates.

A business of electricity generation would usually be expected to produce and maintain certain amounts of electricity and meet certain levels of demand. A business of electricity generation would also require a larger scale of production to ensure they were able to manage demand levels. It could not be said that your activity is alike to an ordinary business of solar electricity generation.

From a consideration of the factors above the activity would not amount to the carrying on of a business. The size and scale of the activity is small, there is little repetition and regularity in the activity and the activity when compared to an ordinary business of solar generation could not be said to be similar. As a result the owners corporation would not be considered to be carrying on a business by receiving payments for the export of electricity generated from a small scale PV system.

Questions 2, 3 and 4

Summary

Based on the configuration of the solar system you will install on the common property, the arrangement with your energy supplier/retailer and your estimated feed-in tariff payments, the arrangement is other than private or domestic in nature. That being so;

· the payments you receive for the generation of electricity from the solar system are ordinary assessable income under section 6-5 of the ITAA 1997

· the costs you incur in relation to the generation of electricity from the solar system are deductible under section 8-1 of the ITAA 1997 to the extent that they are not capital in nature

· you are able to claim deductions in respect of the decline in value of the capital cost of the system because the solar system is used to produce assessable income, and

· the value of the right granted to you to create renewable energy certificates (RECs) is an assessable recoupment and must also be included in your assessable income.

· any income generated from the solar system would be assessable to the owners corporation provided the solar system is obtained by the owners corporation by way of resolution or declaration of trust.

Potential capital gains tax and goods and services tax consequences may also apply.

Assessable income

Under section 6-5 of the ITAA 1997 assessable income is made up of ordinary income and statutory income. There are no specific legislative provisions relating to money or credits received from electricity suppliers, therefore it is not statutory income.

Under subsection 6-5(1) of the ITAA 1997 ordinary income means income 'according to ordinary concepts'.

Under subsection 6-5(2) of the ITAA 1997 the assessable income of an Australian resident includes the ordinary income you derived directly or indirectly from all sources during the income year.

Under subsection 6-5(4) of the ITAA 1997 in working out whether you have derived an amount of ordinary income, and (if so) when you derived it, you are taken to have received the amount as soon as it is applied or dealt with in any way on your behalf or as you direct.

The tax legislation does not provide specific guidance on the meaning of income according to ordinary concepts. However, a substantial body of case law exists which identifies likely characteristics.

In determining whether an amount is ordinary income, the courts have established the following principles:

· what receipts ought to be treated as income must be determined in accordance with the ordinary concepts and usages of mankind, except in so far as a statute dictates otherwise

· whether the payment received is income depends upon a close examination of all relevant circumstances; and

· whether the payment received is income is an objective test.

· Relevant factors in determining whether an amount is ordinary income include:

· whether the payment is the product of any employment, services rendered, or any business

· the quality or character of the payment in the hands of the recipient

· the form of the receipt, that is, whether it is received as a lump sum or periodically; and

· the motive of the person making the payment, but noting that this latter factor is rarely decisive, as a mix of motives may exist.

In *GP International Pipecoaters Pty Ltd v. Federal Commissioner of Taxation* (1990) 170 CLR 124; 90 ATC 4413; (1990) 21 ATR 1, the Full High Court stated:

To determine whether a receipt is of an income or of a capital nature, various factors may be relevant. Sometimes the character of receipts will be revealed most clearly by their periodicity, regularity or recurrence; sometimes, by the character of a right or thing disposed of in exchange for the receipt; sometimes, by the scope of the transaction, venture or business in or by reason of which money is received and by the recipient's purpose in engaging in the transaction, venture or business.

Ultimately, whether or not a particular receipt is ordinary income depends on its character in the hands of the recipient. The whole of the circumstances must be considered.

Amounts that are periodical, regular or recurrent, relied upon by the recipient for their regular expenditure and paid to them for that purpose are likely to be ordinary income. In addition, receipts from property or investments that are on commercial terms and/or that indicate an intention to make a profit from an activity, are also likely to be ordinary income.

In this instance, it needs to be determined whether the payments or credits received in return for transfer of electricity to the grid are income because of the nature and the circumstances of the receipt. In determining whether the receipts are income, the factual circumstances, and in particular whether the receipts indicate an activity that is more than private or domestic in nature, needs to be considered. Some guidance in the context of rental properties is contained in *Taxation Ruling IT 2167*, which outlines the circumstances when amounts received will be considered income and when they will be considered to be in the nature of family or domestic arrangements.

A solar system is considered to be property and receipts received in connection with it are potentially assessable income. In determining whether or not the payments are assessable income the following are important:

· the terms of the arrangement with the electricity retailer and in particular any requirement on the retailer to buy all electricity that is generated from the system (as occurs under a gross feed in tariff scheme)

· the feed-in tariff payments and whether they are considered to represent a return on your investment in the solar system

· whether there is a realistic opportunity for you to profit from the arrangement, and

· the regularity of payments / credits received from the feed-in tariffs such that they can be relied upon.

Amounts that you receive as a recoupment of a deductible expense (that is the financial benefit arising from the RECs which offset the cost of the system) may also be included in your assessable income. This is explained further below.

Deductions

The general provision that determines the deductibility of expenses is section 8-1 of the ITAA 1997. Under section 8-1 of the ITAA 1997 you can deduct from your assessable income any loss or outgoing to the extent that it is incurred in gaining or producing your assessable income. However you cannot deduct a loss or outgoing that is capital, private or domestic in nature.

Other provisions in the ITAA 1997 contain specific deductions which section 8-5 of the ITAA 1997 allows you to deduct. Examples of specific deductions include repairs under section 25-10 of the ITAA 1997 and deductions for the decline in value of depreciating assets under section 40-25 of the ITAA 1997.

Repairs and Maintenance

Under section 25-10 of the ITAA 1997 you can deduct expenditure you incur for repairs and maintenance to the solar system as you incur the expense in deriving assessable income from the system.

A repair involves restoring the efficiency of function of the property being repaired without changing its character. A repair may improve to some extent the condition the property was in immediately before repair. A minor and incidental degree of improvement, addition or alteration may be done to property and still be a repair. If the work amounts to a substantial improvement, addition or alteration, it is not a repair and is not deductible under section 25-10 of the ITAA 1997. In addition, under subsection 25-10(3) of the ITAA 1997 expenditure incurred for repairs is not deductible if it is of a capital nature. For further information see *Taxation Ruling TR 97/23 Income tax: deductions for repairs*.

Decline in value

For assets that are capital in nature, you cannot claim deductions under section 8-1 of the ITAA 1997. Instead, under the capital allowances system you may be able to claim deductions for the decline in value of the cost of a capital asset used in gaining your assessable income. You can deduct the decline in value of the capital cost of your solar system where it is used in gaining your assessable income.

Under section 40-25 of the ITAA 1997 you can deduct an amount equal to the decline in value for an income year of a depreciating asset that you hold. A depreciating asset is an asset that has a limited effective life and can reasonably be expected to decline in value over the time that it is used.

You must reduce your deduction by the part of the asset's decline in value that is attributable to your use of the asset for a purpose other than a taxable purpose. The purpose of producing assessable income is a taxable purpose.

A solar system comprises modules of photovoltaic cells, a roof mounting frame, various fixings, electrical wiring and conduits and inverters. The entire solar system is considered to be a single depreciating asset.

Taxation Ruling TR 2010/2 Income tax: effective life of depreciating assets provides a table listing the effective life of depreciating assets. In accordance with TR 2010/2 the effective life of solar power generating system assets on residential property is 20 years.

The cost of the solar system is, generally, amounts you are taken to have paid to hold the solar system, such as the purchase price including its installation and connection costs. It is worked out as at the time you begin to hold the solar system, that is, when it is installed and ready for use. It also generally includes amounts you pay over time to maintain its condition.

For more information on determining the decline in value of your solar system, you should refer to the Guide to depreciating assets 2009-10.

Assessable recoupments

Under Subdivision 20-A of the ITAA 1997, your assessable income may include an amount you receive by way of insurance, indemnity or other recoupment if it is for a deductible expense and it is not otherwise assessable income.

This provision needs to be considered where your solar system produces assessable income and you incur a loss or outgoing (ie expense) to install and own that system.

Under the *Renewable Energy (Electricity) Act 2000* (REE Act), if you install an eligible solar system on your private residence, you have a statutory right to create RECs after the system is installed. You can assign the right to another person, for example the installer of the system, or you may create the RECs and sell them on the market.

Assigning the right to create RECs to another entity (such as the installer) is considered to result in a financial benefit to you. The financial benefit is the reduction in the amount you paid for the purchase and installation of the solar system.

You incur a loss or outgoing when you acquire and install your solar system. The RECs are effectively a financial incentive given to you to purchase the system. The amounts received in respect of the RECs are considered to be an indemnity (and therefore a recoupment) as they satisfy a statutory obligation under the

REE Act to partially compensate you for the cost to install and own the solar system.

The recouped amount is an assessable recoupment where you can deduct an amount for the loss or outgoing for the solar system being the decline in value deduction under Division 40 as outlined above.

Where the cost of the solar system is deductible under Division 40 of the ITAA 1997 over several income years, the total assessable recoupment included in a particular year is the amount of the deduction for the loss or outgoing in that year. Any part of the assessable recoupment that is not included in assessable income in the year it is received is assessable in later income years.

For example, on 1 July 2009 a taxpayer installed a 10 kilowatt solar system costing $60,000 on the roof of their private residence. They received the right to create RECs to the value of $12,000. They assigned these to the installer, reducing the price they paid for the solar system to $48,000.

The taxpayer claims decline in value of their solar system using the prime cost method and an effective life of 20 years. They can claim a deduction for decline in value of the system of $3,000 for the 2009-10 income year and each of the following 19 income years (being $60,000 x 100%/20). As the taxpayer received the right to RECs to the value of $12,000, this is considered to be an assessable recoupment. As the deduction for decline in value of the system is $3,000 each year, the taxpayer will include an assessable recoupment of $3,000 each year in their assessable income for the first 4 income years.

Taxation Determination TD 2006/31 deals with recoupments for rebates received for the purchase of a depreciating asset for use in a rental property. It provides further guidance on how the recoupment provisions operate in relation to depreciating assets. In addition ATO ID 2010/218 deals with when the right to create RECs is an assessable recoupment, again in the context of rental properties.

Who the income is assessable to

Taxation Ruling IT 2505 entitled *Bodies Corporate Constituted Under Strata Title Legislation*, referred to approaches taken at the time by the various States and Territories with regard to the ownership of common property in strata title developments. It noted the difference between common property being held as agent for the unit owners and common property being held as trustee for the unit owners.

The assessability of moneys received in respect of the common property varies according to the relevant State strata title legislation. In those States where the common property is vested in the body corporate as agent for the proprietors the income derived from the use of the property constitutes assessable income of the individual proprietors.

Where bodies corporate hold the common property as trustee on behalf of the proprietors, money received from the use of the common property is derived on behalf of the proprietors as beneficiaries.

Application to your situation

Under the feed-in tariff scheme described in your ruling application, the electricity company credits or pays a premium feed-in tariff to the electricity account holder for all electricity generated and contributed to the electricity grid. The electricity account holder then buys back electricity from the company according to their consumption. Payment for the electricity generated is separate and not related to the amount of electricity consumed. The rate paid by the electricity account holder for electricity consumed is the same as that available to any other electricity account holder.

In your case, you will receive a payment provided under an arrangement between yourself and the relevant electricity company. The payment will be made under a gross metering tariff scheme. You will receive the payment as a credit to your electricity account. The value of electricity that you will produce and be paid for is not related to the amount of electricity you consume. You expect to receive payments regularly, generally quarterly.

Based on your factual situation, it is considered that all of the payments received for your electricity generated and sold to the electricity company are assessable income because:

· The solar system will be installed on the common property of the townhouses which is controlled by the owners corporation.

· The electricity retailer is required to buy all electricity that is generated from the system under the gross feed-in tariff scheme.

· The feed-in tariff payments are considered to represent a return on your investment in the solar system.

· There is a realistic opportunity to profit from the arrangement.

· The payments from the feed-in tariffs are received regularly and can be relied upon, including to meet regular owners corporation electricity expenses.

As the payments received for the electricity generated are assessable income the expenditure incurred in producing the income from the sale of the electricity generated to the electricity grid would be deductible.

You may be entitled to deductions for the operating expense of the solar system installation, such as:

· decline in value of the solar system based on 20 year effective life;

· interest on the borrowings to acquire the solar system; and

· repairs and maintenance of the solar system.

You have stated the purchase price of the solar system installation takes into account the discounts or credits you may receive in respect of assigning your renewable energy certificates. The grant of the right to you to create the certificates is an assessable recoupment. This is because it is considered to be a grant in respect of a loss or outgoing and you can deduct an amount for that loss or outgoing.

The amount by which the cost of the system is reduced because of the assignment is the value of the assessable recoupment. The amount of the assessable recoupment is applied to reverse the effect of a deduction for decline in value of the full cost of the solar system. Depending on the original cost of the solar system and the amount of the decline in value deductions, the assessable recoupment will reduce such allowable deductions over a number of years.

Based on your facts and circumstances, provided the solar system is obtained by the owners corporation by way of resolution or declaration of trust, any income generated from the solar system would be assessable to the owners corporation.

This ruling does not consider the issues relating to any potential capital gains tax or goods and services tax consequences.
