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Lease Incentives – tax implications

by Dung Lam and Karin Bergseng

The increasingly competitive commercial leasing market has put into focus:

- (a) a landlord's concern to secure a reliable rental income stream; and
- (b) a tenant's desire to maximise any lease incentives available.

The use of lease incentives is back in vogue as a method of attracting and retaining good tenants. The fact that lease incentives may trigger income tax and GST consequences for both landlords and tenants is often overlooked in the heat of the negotiation.

There can be significant differences in the way that different lease incentives are taxed. This Update summarises these consequences.

A properly considered and structured lease incentive can be tax effective for both landlords and tenants. If a lease incentive is poorly considered from a tax and GST viewpoint, then the "joy" of a successful negotiation can be dulled by an unexpected dysfunctional tax outcome.

This summary assumes that:

- (a) the property leased is commercial premises which the Tenant uses in their business;
- (b) both the Landlord and Tenant are GST registered; and
- (c) the Landlord provides a lease incentive directly to the Tenant.

If your circumstances do not fall within these assumptions, then different tax consequences may arise.

Whilst the summary covers most lease incentives, there may be others which have not been canvassed.

If you are considering granting or entering into a lease or contemplating the negotiation of a lease incentive and you are uncertain of the tax and commercial consequences, then please contact MBP Legal for advice.

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Where a fit-out incentive is provided in the 2009 to 2010 income years, owners of such a fit-out should consider whether they are eligible to claim an investment allowance tax break in respect of the fit-out expenditure.¹

Type of Lease incentive	GST consequences	Tax consequences
<p>Cash payment lease incentive paid by Landlord to Tenant who can use the cash in any manner they wish.</p>	<p>For Landlord Landlord may claim an input tax credit in respect of Tenant’s lease entry supply.</p>	<p>For Landlord The cash payment is immediately tax deductible to the Landlord as an expense incurred in earning assessable income.</p>
	<p>For Tenant Tenant makes a taxable supply being the entry into the lease for the cash payment. Tenant must issue a tax invoice to Landlord and remit GST.</p>	<p>For Tenant Cash payment is assessable as ordinary income. If the cash payment is used to fund the fit-out then the Tenant may claim deductions for capital allowances (i.e. depreciation, capital works and potentially an investment allowance tax break) but this usually is not sufficient in the first income year to fully offset the amount included in assessable income as a result of Tenant receiving the cash payment.</p>

Type of Lease incentive	GST consequences	Tax consequences
<p>Landlord allows a rent free period or a rent discount in respect of a new lease.</p>	<p>For Landlord No GST consequences provided the reduction in rent is merely part of the negotiation of the original terms of the lease.</p>	<p>For Landlord Landlord receives no deduction for the rent given away for free.</p>
	<p>For Tenant No GST consequences provided reduction in rent is merely part of the negotiation of the original terms of the lease.</p>	<p>For Tenant The benefit of the rent free period and the rent discount is not assessable to Tenant.</p>

¹ Please contact us regarding these tax breaks or see our article on these tax breaks at our website. {00100200-2}

Type of Lease incentive	GST consequences	Tax consequences
<p>Landlord allows a rent free period or a rent discount in respect of an existing lease.</p>	<p>For Landlord If Landlord offers rent-free or rent discount period on an existing lease in exchange for Tenant entering into a new lease, then Landlord makes taxable supply of a release from rent obligations in return for consideration of lease entry by Tenant. Landlord must issue a tax invoice to Tenant and pay GST.</p> <p>For Tenant If Landlord offers rent-free or rent discount period on an existing lease in exchange for Tenant entering into a new lease, then Tenant makes a supply of entry into the new lease in return for consideration being release from rent payments.</p> <p>Tenant must issue a tax invoice to Landlord and pay GST. Landlord and Tenant may each claim input tax credits in respect of the lease incentive supplies they make and receive from each other.</p>	<p>For Landlord Landlord receives no deduction for the rent given away for free.</p> <p>For Tenant The benefit of the rent free period and the rent discount is not assessable to Tenant.</p>

Type of Lease incentive	GST consequences	Tax consequences
<p>Fit-out of leased premises is provided by Landlord to Tenant and Landlord <u>OWNS</u> the fit-out.</p>	<p>For Landlord If Landlord owns fit-out then no GST consequences since the supply of fit-out is considered part of the supply of premises under lease.</p> <p>For Tenant If Landlord owns fit-out then no GST consequences.</p>	<p>For Landlord If Landlord owns the fit-out then there is no immediate deduction in respect of fit-out costs. Rather Landlord may claim depreciation and capital works deductions over time on an item by item basis. Landlord may also potentially claim an investment allowance tax break in respect of the fit-out.</p> <p>For Tenant If Landlord owns the fit-out then not assessable income for Tenant.</p>

MBP Legal Comment

This type of rent incentive normally requires a **side agreement between Landlord and Tenant** which, amongst other things, appoints Tenant to act as Landlord's agent in organising the construction of the fit-out. Landlord then reimburses Tenant for the fit-out items owned by Landlord. **MBP Legal can provide specific advice and the appropriate side agreement on request.**

Type of Lease incentive	GST consequences	Tax consequences
<p>Cash contribution to fit-out of leased premises is provided by Landlord to Tenant who undertakes the fit-out as principal and Tenant <u>OWNS</u> the fit-out.</p>	<p>For Landlord Where Landlord provides a cash contribution to fit-out owned by Tenant, then Landlord may claim an input tax credit in respect of Tenant's lease entry supply.</p> <p>For Tenant Where Landlord provides cash contribution to the fit-out owned by the Tenant, then Tenant makes a taxable supply of entry into the lease in return for cash. Tenant must issue a tax invoice to Landlord and remit GST.</p>	<p>For Landlord If Tenant owns fit-out then Landlord may deduct the cash contribution.</p> <p>For Tenant Cash contribution is assessable as ordinary income. Tenant may claim depreciation and capital works deductions in respect of the fit-out over time on an item by item basis (and potentially an investment allowance tax break).</p>

Type of Lease incentive	GST consequences	Tax consequences
<p>Fit-out of leased premises is undertaken by Landlord who then TRANSFERS OWNERSHIP of the fit-out to Tenant.</p>	<p>For Landlord Where Landlord transfers ownership of the fit-out to Tenant then Landlord makes a taxable supply of the fit-out in return for consideration being Tenant's entry into the lease. Landlord must issue a tax invoice to Tenant and remit GST.</p> <p>For Tenant Where Landlord transfers ownership of fit-out to Tenant, the Tenant makes a taxable supply by entering into the lease for the fit-out consideration. Tenant must issue a tax invoice to Landlord and remit GST.</p> <p>Landlord and Tenant may each claim input tax credits for the lease incentive supplied.</p>	<p>For Landlord If Tenant owns fit-out then Landlord may deduct fit-out costs.</p> <p>For Tenant Where Tenant obtains ownership of the fit-out then its arm's length value is assessable as ordinary income. Tenant may claim depreciation deductions in respect of the fit-out over time on an item by item basis.</p>

Type of Lease incentive	GST consequences	Tax consequences
<p>FREE plant and equipment is provided to the Tenant.</p>	<p>For Landlord Landlord makes a taxable supply of plant and equipment in return for consideration being Tenant's entry into the lease. Landlord must issue a tax invoice to Tenant and remit GST.</p>	<p>Landlord Deductible as an expense incurred to produce assessable income.</p>
	<p>For Tenant Tenant makes a taxable supply being their agreement to enter into the lease in return for consideration being the plant and equipment. Tenant must issue a tax invoice to Landlord and remit GST.</p> <p>Landlord and Tenant may each claim input tax credits in respect of the lease incentive supplies they make and receive from each other.</p>	<p>For Tenant Arm's length value of the free plant and equipment is assessable as income. Tenant may claim depreciation deductions on plant and equipment provided it is used for income producing purposes.</p>

Type of Lease incentive	GST consequences	Tax consequences
<p>Provision of holiday packages from Landlord to Tenant – disguised rent incentives.</p>	<p>For Landlord Provided Landlord is the recipient of the holiday package supply a Landlord can claim an input tax credit in respect of the holiday package. If the recipient of the supply is Tenant but Landlord pays consideration for the supply then no input tax credit can be claimed by either Landlord or Tenant in respect of the holiday supply.</p>	<p>For Landlord Generally not deductible because it represents non-deductible entertainment expenditure.</p>
	<p>For Tenant Tenant makes a taxable supply being their agreement to enter into the lease in return for consideration being the holiday package. Tenant must issue a tax invoice to Landlord and remit GST.</p>	<p>For Tenant Generally tax free where complete holiday package – i.e. the lease incentive is wholly non-deductible for Landlord because it represents non-deductible entertainment expenditure.</p>

Type of Lease incentive	GST consequences	Tax consequences
<p>Payment of Tenant’s removal expenses.</p>	<p>For Landlord Provided Landlord is the recipient of the removal supply, then Landlord can claim an input tax credit for the removal supply. If the supply recipient is the Tenant but Landlord pays consideration, then no input tax credit can be claimed by either Landlord or Tenant in respect of the removal supply.</p> <p>For Tenant Tenant makes a taxable supply of entry into the lease agreement in return for Landlord’s payment of expenses. Tenant must issue a tax invoice to Landlord and remit GST.</p>	<p>For Landlord Deductible as an expense incurred to produce assessable income.</p> <p>For Tenant Generally assessable as ordinary income. Exceptions are where the removal costs relate to the transport of trading stock, files and consumables – in such a case the Tenant is not taxed on this incentive.</p>

Type of Lease incentive	GST consequences	Tax consequences
<p>Landlord provides to Tenant a full recourse interest free loan.</p>	<p>For Landlord No GST as input taxed financial supply by Landlord.</p> <p>For Tenant No GST as input taxed financial acquisition supply by Tenant.</p>	<p>For Landlord No deduction.</p> <p>For Tenant Not assessable as income.</p>

Type of Lease incentive	GST consequences	Tax consequences
<p>Landlord provides to Tenant a non-cash benefit less than \$300.</p>	<p>For Landlord Landlord makes a taxable supply of non-cash benefit in return for consideration being Tenant’s entry into the lease. Landlord must issue a tax invoice to Tenant and remit GST.</p> <p>For Tenant Tenant makes a taxable supply by agreeing to enter into the lease in as consideration for the non-cash benefit. Tenant must issue a tax invoice to Landlord and remit GST.</p> <p>Landlord and Tenant may each claim input tax credits in respect of the lease incentive supplies they make and receive from each other.</p>	<p>For Landlord Deductible as an expense incurred to produce assessable income.</p> <p>For Tenant Exempt income.</p>