

THE RELEVANCE OF INCOME TAX IN CALCULATING COMPENSATION PAYMENTS TO LAND OWNERS UNDER THE MINERAL RESOURCES ACT 1989 (QLD)

By Andrew Smith and Bradley Mills*

The *Mineral Resources Act*, s. 7.36 prevents a mining lease over surface land being granted or renewed unless compensation has been determined between the applicant for the mining lease or renewal of the mining lease and the owner of the land the subject of the application.

Compensation can be determined by way of agreement between the parties or, on the request of one of the parties, can be determined by the Warden's Court.

In negotiations for a settlement, applicants for either a mining lease, or a renewal, are often presented with a claim to meet the land owner's income tax liability on the compensation payment.

The land owner's justification, not without some foundation, is that where the compensation is required by the land owner to obtain further land to replace that affected by the mining lease, that land cannot be acquired unless the amount received by the land owner is sufficient to purchase the land after the Commissioner of Taxation has taken his share.

Clearly, an applicant for a mining lease or a renewal of a mining lease would not entertain such a claim by the land owner unless:

- (1) the overall benefits from the negotiation outweigh the additional time and cost of the compensation being determined by the Warden's Court; or
- (2) more importantly, the Warden's Court is entitled to take into account the taxation effect on the land owner of the receipt of the compensation payment when determining the level of that payment.

The first exception is a matter for commercial judgment and is clearly variable between cases. The second exception is capable of objective determination.

Accordingly, to determine whether income tax should be taken into account in negotiations the question to be answered is:

should the possible income tax liability of the land owner be taken into account by the Warden's Court in the determination of compensation under s. 7.36 of the *Mineral Resources Act*?

To answer this question, the following analysis is required:

- (1) determine whether the compensation payments would be taxable in the hands of the land owner;
- (2) determine if there is any general rule regarding taking the income tax liability on compensation payments into account;
- (3) determine whether that general rule applies to the *Mineral Resources Act*; and
- (4) determine if specific provisions of the *Mineral Resources Act* (ss 7.36 and 7.38) override the general rule.

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TAXATION OF COMPENSATION PAYMENTS

An analysis of the *Income Tax Assessment Act* and relevant case law indicates that a compensation payment will fall to be assessed either as:

- ordinary income under s. 25(1), where the amount is to compensate for loss of a revenue amount; or
- in any other case, under the Capital Gains Tax provisions (Pt IIIA).

In both cases, the entire compensation payment is likely to constitute assessable income of the land owner.

Where the land owner intends to spend the compensation payment on outgoings of the business of the land owner in the same income tax year when the compensation payment is received, a deduction may be available to offset that compensation payment. No income tax may then be payable in relation to the compensation payment.

No such deduction will be available where the payment is used to purchase a capital asset.

GENERAL RULE REGARDING COMPENSATION PAYMENTS

The authorities suggest that in the case of compensation for personal injuries or termination of employment contracts, the taxation liability of the recipient of the compensation payments is not entirely irrelevant — see *British Transport Commission v. Gourlay*¹ and *Henley v. Murray (Inspector of Taxes)*.²

There is also authority that the taxation on loss of profits on the compulsory acquisition of land can be taken into account — see *West Suffolk County Council v. W. Rought Ltd.*³ However, this has not been extended to the actual compensation received for the compulsory acquisition of land — see the New South Wales Supreme Court decision of *Chong v. Fairfield Municipal Council*⁴ (*Chong's case*).

In *Chong's case* Else-Mitchell J. stated⁵ “there is no true analogy between actions for the recovery of compensation for the resumption of land and actions for damages for personal injury”. He found the rule in *Gourlay's case*, which took into account taxation in a personal injuries claim, did not apply to claims of compensation for property resumed by Government authorities. He found that *West Suffolk County Council v. W. Rought Ltd* should be limited in its application to compensation payments representing a loss of profit which was assessable to income tax.

Indeed, *Gourlay's case*, *Henley's case* and *West Suffolk County Council v. W. Rought Ltd* took the taxation effect of the compensation payments into account to *reduce* the compensation payable. To do otherwise, would have provided a windfall to the recipient of the compensation payment. That payment would have placed them in a position where they would have been over-compensated compared to the situation where they had earned the funds for which they were

1. [1956] A.C. 185.

2. [1950] 1 All E.R. 908.

3. [1957] A.C. 403.

4. (1968) 2 N.S.W.R. 766.

5. At 770.

being compensated or, in respect of loss of profits, had earned the profits for which they were being compensated.

Chong's case was followed in the unreported decision of *L R Bellharz Investments Pty Ltd v. The Darling Harbour Authority* (23 April 1991). The case concerned a claim for additional compensation on the compulsory acquisition of land due to its claimed special value. The claimed special value was due to the status of the land as pre-dating the impact of the Capital Gains Tax legislation. In rejecting the applicant's claim Bignold J. said:

... there is no reason for not applying *Chong* in the present case by holding that no compensation is payable under s. 124 of the *Public Works Act* 1912 in respect of the applicant's claim to special value based upon an estimate of financial loss referable to capital gains tax implications suffered by the applicant by virtue of its land being vested in the respondent.

Both *Chong's* case and *L R Bellharz Investments Pty Ltd v. The Darling Harbour Authority* were followed in the recent decision in the Land and Environment Court in New South Wales of *Russellan Pty Ltd v. Roads & Traffic Authority of New South Wales*.⁶

These authorities clearly support the view there is no basis for taking the income tax liability of a party into account when determining compensation for the compulsory acquisition of land by Government authorities.

CAN THE GENERAL RULE EXPOUNDED BY CHONG'S CASE BE APPLIED TO COMPENSATION PAYMENTS UNDER THE MINERAL RESOURCES ACT?

The grant or renewal of a mining lease, although not a compulsory acquisition of land, is clearly compulsory in nature and it is reasonable to apply the same principles — see *Smith v. Cameron*.⁷

In *Smith v. Cameron*, Mr White of the Land Court states:⁸

In particular, I see an affinity and similarity between the imposition of an encumbrance on the appellant's land by means of the grant of a mining lease and that of the compulsory taking of an easement over land for public purposes. These similarities are evident in the principles laid down by the Land Appeal Court for consideration in the latter and are better set out in the case of *P. Joyce v. The Northern Electric Authority of Queensland*.⁹

In referring to the decision of the Warden's Court, the subject of the appeal in that case, Mr White commented in relation to the Warden's assessment:¹⁰

In doing so, he likened, rightly in my opinion, the use of the land for mining purposes to a compulsory acquisition of land for a limited period which in my view opens the door for the application of the various principles and practices of valuation applied in determining compensation for the taking of limited rights over land for public purposes.

If further support is needed, the *Mineral Resources Act*, cl. 7.38(4)(e) states that in determining compensation the Warden's Court shall include an additional amount to reflect the compulsory nature of the action under the Part. The "action" referred to is the grant of the mining lease or renewal of the mining lease over the land.

6. 23 April 1992, No. 305-04 of 1991.

7. (1986) 11 Q.L.C.R. 64.

8. At 73.

9. (1974) 1 Q.L.C.R. 171.

10. At 73.

The above authorities support the conclusion that the decision in *Chong's* case not to take the taxation considerations in relation to the compensation payment into account is applicable to compensation determined by the Warden's Court under the *Mineral Resources Act*.

DO SPECIFIC TERMS OF THE MINERAL RESOURCES ACT IN CLAUSE 7.38 OVERRIDE THE GENERAL RULE IN CHONG'S CASE?

A general rule can always be overridden where there are clear words to the contrary in the legislation or an intention to override the general rule can be found by necessary implication.

Section 7.38 of the *Mineral Resources Act* sets out those matters for which compensation can be provided and those matters that must be considered by the Warden's Court.

The relevant parts of s. 7.38 are:

- (3) Upon an application made under subsection (1), a Warden's Court shall settle the amount of compensation an owner of land is entitled to as compensation for —
 - (a) In the case of compensation referred to in section 7.36 —
 - (i) deprivation of possession of the surface of land of the owner;
 - (ii) diminution of the value of the land of the owner or any improvements thereon;
 - (iii) diminution of the use made or which may be made of the land of the owner or any improvements thereon;
 - (iv) severance of any part of the land from other parts thereof or from other land of the owner;
 - (v) any surface area rights of access;
 - (vi) all loss or expense that arises,
 as a consequence of the grant or renewal of the mining lease; and

...
 - (4) In assessing the amount of compensation payable under subsection (3)—
 - (a) Where it is necessary for the owner of land to obtain replacement land of a similar productivity, nature and area or resettle himself or relocate his livestock and other chattels on other parts of his land or on the replacement land, all reasonable costs incurred or likely to be incurred by the owner in obtaining replacement land, his resettlement and the relocation of his livestock or other chattels as at the date of the assessment shall be considered; . . .

The first observation in relation to these requirements is that there is no specific reference to taxation. Can it be inferred by necessary implication from the wording in the section?

Considering the matters for which compensation can be provided, the only provision that could potentially include income tax is the reference to "expense" in cl. 7.38(3)(vi). The term "expense" is not a term of art; it is a vague and general term — see *Simpson v. Inland Revenue Commissioners*.¹¹ At least in one case

11. [1914] 2 K.B. 842.

concerning wills, the term has been held to include estate duty, that is, a form of tax — see *Re Berrey's Will Trusts, Greening v. Warner*.¹² However, that case is distinguishable due to the special rules that have been adopted in regard to wills.

In general an expense is seen as an item to decrease a tax liability. The actual tax liability itself is not usually viewed as an expense. The use of “expense” rather than the term “outgoing” is also important. There is authority that “outgoing”, although its precise meaning is open to doubt, is a word with a wide meaning and may fairly comprehend rates and taxes. See *R. v. Shaw*¹³ per Patteson J.

Even where the term “expense” can be found to encompass “income tax”, s. 7.38 makes clear that the expense incurred by the land owner must be related to the grant or renewal of the mining lease, that is there must be a direct cause and effect relationship between the loss and expense, and the grant or renewal.

The land owner does not incur an income tax liability due to the grant or renewal of the mining lease. The income tax liability will arise only as a result of compensation being determined by agreement or under cl. 7.38, by the Warden's Court. It is the receipt of compensation that may result in an income tax liability not the grant or renewal of the mining lease. The income tax liability is accordingly one step removed from the grant or renewal of the mining lease. It occurs as a result of the compensation payment which in turn results from the grant or renewal of the mining lease.

With no direct relationship between the income tax and the grant or renewal of the mining lease, the further matter to be considered under s. 7.38(4) is of no relevance. On this basis alone, it can be concluded that s. 7.38 does not contemplate taking into account the income tax liability of the land owner in relation to the compensation payment.

The following additional arguments can be raised as to why income tax should not be taken into account:

- (1) The compensation payable under the *Mineral Resources Act* is clearly a matter which is intended to be capable of determination on a factual basis.

It cannot be determined where income tax is involved. Income tax is an impost of Government which for future years cannot be determined with accuracy. One reason for this is that the taxation rules may, and often do change. This has proven to be the case in many areas of the *Income Tax Assessment Act* over recent years.

In addition, it may not be possible to determine the land owner's future taxation position at the times when the compensation payments are received. It is possible, for example, that the land owner may be in a tax loss position, meaning no income tax is payable.

If this is so the question is raised as to whether the land owner should be compensated for the use of those losses. An analysis is then required to determine whether the land owner could otherwise have used those losses in later years. Losses prior to the 1990 year may only be used within seven years or they will be lost. If the losses were incurred prior to the 1990 year they may well be lost if they are not used to offset the compensation payment.

12. [1959] 1 All E.R. 15 at 17.

13. (1848) 12 Q.B. 419 at 427.

If the losses are due to retrenchment payments the loss may not in any case have been capable of being carried forward.

All these variables point to the conclusion that, if income tax is to be taken into account, it is likely a lot of guesswork will be involved and an objective factual determination of the compensation will not be possible.

It is submitted that this lack of certainty, and the requirement to indulge in educated guesswork, runs contrary to the intention of the *Mineral Resources Act*.

- (2) The land owner might well be over-compensated if the income tax liability is taken into account.

For example, if the land owner purchases further land to compensate for the surface area he is to lose, then that further land will be owned in addition to the land the subject of the mining lease. The new land acquired would have a cost to the land owner equal to the amount paid for that land, that is, the compensation payment less tax.

Where the cost base of the land the subject of the mining lease is below the cost base of this new land, the land owner would clearly be in a better position as regards a future sale. He could sell the new land with a lower tax liability than if he sold the land the subject of the mining lease. He will also receive the benefit of indexation on a higher amount and is potentially sheltering a greater capital gain from income tax than can be sheltered on the land the subject of the mining lease. It follows then that he is being over-compensated. That is the very situation the courts in cases such as *British Transport Commission v. Gourlay* sought to avoid by taking income tax into account.

CONCLUSION

The Warden's Court is not entitled to take the income tax liability of a land owner into account when assessing the level of compensation under s. 7.36 of the *Mineral Resources Act*. It follows that applicants for a new mining lease or the renewal of an existing mining lease need not entertain any claim by a land owner to be grossed up for his income tax liability when negotiating compensation with the land owner.