

TAXATION RULING NO. IT 2158

INVESTMENT ALLOWANCE : CONTRACT FOR ACQUISITION OR
CONSTRUCTION OF ELIGIBLE PROPERTY ENTERED INTO PRIOR TO
1 JULY 1985

F.O.I. EMBARGO: May be released

REF

H.O. REF: 85/1938-2

DATE OF EFFECT: Immediate

B.O. REF:

DATE ORIG. MEMO ISSUED:

F.O.I. INDEX DETAIL

REFERENCE NO:

SUBJECT REFS:

LEGISLAT. REFS:

I 1174761

INVESTMENT ALLOWANCE 82AB(1)(c)(i) & (ii)
CONTRACT FOR ACQUISITION 82AB(7)
OR CONSTRUCTION OF
ELIGIBLE PROPERTY
ENTERED INTO PRIOR
TO 1 JULY 1985

OTHER RULINGS ON TOPIC: TAXATION RULINGS NOS. IT 72, 76, 2142

PREAMBLE

An investment allowance deduction is available in respect of expenditure of a capital nature on the acquisition or construction of a new unit of eligible property. Sub-section 82AB(1) restricts the deduction to expenditure which is incurred under a contract entered into on or after 1 January 1976 and before 1 July 1985. There is an additional requirement that the eligible property must be first used or installed ready for use before 1 July 1987 for the purpose of producing assessable income.

2. With the approach of 30 June 1985 it is timely to set down the approach that will be followed in this office in determining whether or not a contract has been entered into before 1 July 1985.

3. The approach has been formulated against the background that by and large 30 June 1985 is the cut-off date for the investment allowance deduction. The income tax law recognises, however, that there may be taxpayers who have entered into contracts prior to 1 July 1985 for the purchase of eligible property for identified, bona fide use for the purpose of producing assessable income. An investment allowance deduction is preserved when the expenditure is subsequently incurred provided all the other requirements of the law are met. On the other hand an investment allowance deduction is not considered to be preserved where a contract is entered into prior to 1 July 1985 for the acquisition of property for which a taxpayer has no definite use, i.e. where the contract has been entered into for the purpose of preserving an investment allowance deduction in the event that a need to acquire the property subsequently arises.

RULING

4. It will be a question to be decided in each case whether a contract for the acquisition of eligible property has been entered into before 1 July 1985. In the context of the investment allowance deduction the essential elements will be that the contract relates to eligible property which is for identified, bona fide use for the purpose of producing assessable income and that there has been offer and acceptance of the terms of the contract. When offer and acceptance correspond in all material respects there is a contract between the parties. This very question was dealt with by Tadgell J. in *Kearney v. F.C of T.* 84 ATC 4295: 15 ATR 564 and he expressed the concept in these words:-

" ... offer and acceptance must express assent to one and the same thing and there must be no substantial or material variance between them."

5. It is not uncommon for a contract to contain conditions and where this occurs it will be necessary to determine whether the conditions affect the time when the contract was entered into. In some cases a condition may be such that the contract does not become operative until the condition is fulfilled. A taxpayer, for example, may tender for a construction contract and, against the possibility that he will be awarded the contract, he may enter into an agreement for the acquisition of plant and equipment. It may be a term of the agreement that it is conditional upon his being awarded the construction contract. In a case such as this it is considered that a contract for the acquisition of plant and equipment would not come into existence until the condition is satisfied, i.e. until the taxpayer has been awarded the construction contract. In the context of the investment allowance deduction provisions it would be the date upon which the contract came into existence that would be taken into account in determining whether or not a contract had been entered into prior to 1 July 1985.

6. In the same view an investment allowance deduction would not be available in a situation where an order for property is placed by a leasing company and accepted by a supplier prior to 1 July 1985 in the expectation of the leasing company finding a lessee for the property and where delivery of the property to the leasing company is conditional upon the leasing company being able to place the property with a lessee. A similar view is taken of an agreement which permits a leasing company, after having taken delivery of property in the expectation of finding a lessee for it, to return the property to the supplier if the expectation cannot be fulfilled, i.e. if the leasing company is unable to find a lessee for the property. In similar view, a contract which did not identify the subject matter or other essential terms in sufficient detail, e.g. a contract for equipment of a type and of a cost to be determined, would not be sufficient to preserve an investment allowance deduction.

7. There are other terms or conditions which appear in contracts which do not affect the time at which the contract

becomes operative. The nature of the terms and conditions are such that they are not intended to prevent the contract from immediately coming into existence but rather, to give the parties an opportunity to withdraw from the contract in certain circumstances. Thus a taxpayer may have entered into a contract prior to 1 July 1985 for the purchase of plant and equipment for an identified, bona fide use in producing assessable income subject to finance arrangements already negotiated becoming operative. In the event that the financial arrangements do not proceed, the parties have the option to withdraw from the contract. A condition of this nature would not estop a conclusion that a contract was entered into prior to 1 July 1985. If, on the other hand, a taxpayer entered into a contract for the purchase of eligible property in the knowledge that he would need finance but without having made enquiries about it and the contract was subject to finance being obtained, it may be proper to conclude that the contract was not operative until finance had been obtained.

8. In the context of leasing companies it is considered that a contract in which the lessor retains the right to withhold delivery instructions and payment to the supplier for the property until all the lease documents have been executed by the specified lessee on whose behalf the property has been purchased and any guarantees finalised to the satisfaction of the lessor would not affect the time at which a contract was entered into.

9. In some situations brought to the notice of this office a prospective lessee of eligible property has entered into a contract with a supplier for the purchase of the eligible property on the basis that a specified leasing company is to acquire the property on delivery. The contract of purchase contains a clause to this effect. There are, therefore, three parties to the contract, i.e. the prospective lessee, the leasing company and the supplier. Where a leasing company is a party to a contract of this nature and the contract is entered into prior to 1 July 1985, the investment allowance deduction will be available to the leasing company provided the other requirements of the law are met.

10. Some leasing companies have asked, in the context of the purchase of eligible property for identified, bona fide use by a specified lessee, whether it is necessary for the preservation of the investment allowance deduction that the lease agreement between the leasing company and the specified lessee be entered into prior to 1 July 1985. It is the lessor, being the taxpayer with the primary entitlement to an investment allowance deduction, who must enter into a contract to acquire the eligible property prior to 1 July 1985. In the stated circumstances a failure to execute the lease agreement prior to 1 July 1985 would not affect the availability of the investment allowance deduction. It should be noted that this paragraph does not modify the views expressed in paragraph 6.

11. Expenditure on eligible property to be acquired under a hire purchase agreement would be accepted as qualifying for an

investment allowance deduction where, before 1 July 1985, the prospective hirer/user, having already contracted for the acquisition of the property with the supplier, either agrees with a financier to acquire the property for hire purchase to the hirer or initiates action that results in the financier and the supplier concluding agreement, again before 1 July 1985, under which the finance company will, on delivery of the property, purchase it for hire purchase to the hirer/user.

12. In the sale and lease back area, i.e. situations to which sub-section 82AB(7) applies, an end user may have either purchased eligible property prior to 1 July 1985 or entered into a contract prior to that date for the purchase of eligible property. An investment allowance deduction will not be preserved in a sale and lease back situation unless the end user has entered into a contract prior to 1 July 1985 with a leasing company to acquire the eligible property.

13. It has been proposed to this office that an investment allowance deduction would be preserved in a sale and lease back situation where an end user entered into a contract prior to 1 July 1985 for the purchase of eligible property and, in addition, entered into agreements with a number of leasing companies prior to 1 July 1985 for the sale and lease back of the eligible property on delivery if called upon to do so by the end user. The purpose of entering into the agreements with the leasing companies is to enable the end user to negotiate the most favourable terms when the eligible property is delivered after 1 July 1985. The agreements with the leasing companies are not considered to be contracts for the acquisition of eligible property in the sense required by sub-section 82AB(1) - they are considered to be more in the nature of option agreements which are capable of being converted into contracts for the acquisition of the eligible property at some future time. They are not sufficient to preserve entitlement to an investment allowance deduction.

COMMISSIONER OF TAXATION
9 May 1985

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