
Taxation Determination

Income tax: are the establishment costs incurred by a taxpayer in entering into a sale and leaseback of a capital asset deductible to the taxpayer under section 8-1 of the *Income Tax Assessment Act 1997* ('the ITAA 1997 Act')?

Preamble

*The number, subject heading, date of effect and paragraph 1 of this Taxation Determination are a 'public ruling' for the purposes of Part IVAAA of the **Taxation Administration Act 1953** and are legally binding on the Commissioner. The remainder of the Determination is administratively binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain how a Determination is legally or administratively binding.*

1. Where a trading entity taxpayer enters into a sale and leaseback of a capital asset and incurs expenses in connection with the transaction, such as valuation and establishment fees, those costs are of a capital nature and not deductible under section 8-1 of the Act.

2. In *Eastern Nitrogen Ltd v. FC of T* (2001) 108 FCR 27; 2001 ATC 4164; (2000) 46 ATR 474; [2001] FCA 366, the Full Federal Court considered whether valuation fees and establishment costs incurred by the taxpayer were deductible in circumstances where the taxpayer had entered into an arrangement for the sale and leaseback of its ammonia plant as a means of obtaining finance for use in its business. The Full Federal Court held that these expenses were deductible under subsection 51(1) of the *Income Tax Assessment Act 1936* (the equivalent of section 8-1 of the ITAA 1997 Act). His Honour Carr J said at paragraph 125:

'[The fees] were necessarily incurred as part of a fund raising arrangement which was engaged in recurrently. They were thus on revenue account.'

3. The Commissioner was granted special leave to appeal to the High Court in relation to this aspect of the Full Federal Court's decision in *Eastern Nitrogen*. However, the matter was not heard by the High Court, because the taxpayer consented to orders from the High Court in favour of the Commissioner, namely, allowing the appeal and paying the costs of the appeal. Consequently, and consistently with the consent orders pronounced by the High Court, the Commissioner maintains the view that this aspect of the decision of the full Federal Court is wrong.

4. The incidental costs of selling a capital asset or leasing it back can only qualify as a deduction under section 8-1 of the ITAA 1997 Act if it is incurred in gaining or producing assessable income or it is necessarily incurred in carrying on a business for that purpose and it is not an outgoing of capital, or of a capital nature.

TD 2003/15

The characterisation of an outgoing as being on revenue or capital account for the purposes of section 8-1:

‘depends on what the expenditure is calculated to effect from a practical and business point of view..’: *Hallstroms Pty Ltd v FC of T* (1946) 72 CLR 634 at 648.

As the High Court said in *GP International Pipecoaters Pty Ltd v. FC of T* (1990) 170 CLR 124 (at p137):

‘The character of expenditure is ordinarily determined by reference to the nature of the asset acquired or the liability discharged by the making of the expenditure, for the character of the advantage sought by the making of the expenditure is the chief, if not the critical, factor in determining the character of what is paid.’

See also *Sun Newspapers Limited and Associated Newspapers Limited v. FC of T* (1938) 61 CLR 337.

5. Generally speaking, the costs of selling and leasing back capital assets are capital transactions and the establishment costs take their character from the advantages obtained by these capital transactions, individually or collectively.

6. It is not appropriate to place much weight on the mere fact that a type of expenditure is recurrent. Recurrence is not a test: see *Broken Hill Theatres Pty Ltd v. FC of T* (1951-2) 85 CLR 423, and *Sun Newspapers, supra*. Thus, for example, costs incurred by a manufacturing or trading company in raising capital, even if incurred recurrently, will be a cost of establishing or enlarging the taxpayer’s profit yielding subject rather than a cost of trading, and, notwithstanding that this type of expenditure is recurrent, will be on capital account.

7. This Taxation Determination does not apply to banks and taxpayers in the business of lending money, because special considerations may be relevant.

Date of effect

8. This Determination applies to years commencing both before and after its date of issue. However, this Determination does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of the Determination (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Commissioner of Taxation

28 May 2003

Previous Draft:

Previously released in draft form as TD 2002/D10

Related Rulings/Determinations:

TR 92/1; TR 92/20; TR 95/30; TR 97/16

Subject references:

- establishment costs
- leasing
- sale and leaseback

Legislative references:

- ITAA 1997 8-1
- ITAA 1936 51(1)
- TAA 1953 Pt IVA

Case references:

- Broken Hill Theatres Pty Ltd v. FC of T (1951-2) 85 CLR 423
 - Eastern Nitrogen Ltd v. FC of T (2001) 108 FCR 27; 2001 ATC 4164; (2000) 46 ATR 474; [2001] FCA 366
 - GP International Pipecoaters Pty Ltd v. FC of T (1990) 170 CLR 124
 - Hallstroms Pty Ltd v. FC of T (1946) 72 CLR 634
 - Sun Newspapers Limited and Associated Newspapers Limited v. FC of T (1938) 61 CLR 337
-

ATO references

NO: 2002/012027

ISSN: 1038-8982