


TR 94/D21 - Income tax: Disposal of stock of spare parts and consumable stores as part of the sale of a business or as part of a company group restructure.

 This cover sheet is provided for information only. It does not form part of *TR 94/D21 - Income tax: Disposal of stock of spare parts and consumable stores as part of the sale of a business or as part of a company group restructure.*

This document has been Withdrawn.

There is a [Withdrawal notice](#) for this document.



DRAFT TAXATION RULING TR 94/D21

We invite you to comment on this Draft Taxation Ruling. We are allowing six weeks for comments before we finalise the Ruling. If you want your comments considered, please get them to us within this period.

PLEASE ADDRESS ALL COMMENTS TO THE CONTACT OFFICER LISTED BELOW.

TITLE Income tax: Disposal of stock of spare parts and consumable stores as part of the sale of a business or as part of a company group restructure.

LAST DAY FOR COMMENTS : 30 June 1994

CONTACT OFFICER : Ella Rosso

TELEPHONE : (06) 216 1434

FAX NO. : (06) 216 1784

ADDRESS FOR WRITTEN COMMENTS : Australian Taxation Office
PO Box 900
CIVIC SQUARE A.C.T. 2608

Attention: Ms E. Rosso/ Insurance & Superannuation Team

- NOTE:**
- Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office.
 - Draft Taxation Rulings may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings which represent authoritative statements by the Taxation Office of its stance on the particular matters covered in the Ruling.

COMMISSIONER OF TAXATION



Draft Taxation Ruling

Income tax: disposal of stock of spare parts and consumable stores as part of the sale of a business or as part of a company group restructure

contents	para
What this Ruling is about	1
Ruling	2
Assessability to the vendor under section 25 or paragraph 26(j)	4
Application of capital gains and losses provisions to consideration received by the vendor	5
Deductibility to the purchaser	6
Date of effect	7
Explanations	8
Assessability to the vendor under section 25	8
Assessability to the vendor under section 26(j)	15
Application of capital gains and losses provisions to the consideration received by the vendor	17
Deductibility to the purchaser	24

Draft Taxation Rulings (DTRs) represent the preliminary, though considered, views of the Australian Taxation Office.

DTRs may not be relied on by taxation officers, taxpayers and practitioners. It is only final Taxation Rulings which represent authoritative statements by the Australian Taxation Office of its stance on the particular matters covered in the Ruling.

What this Ruling is about

- This Ruling considers, in respect of the disposal of a stock of spare parts and consumable stores as part of the sale of a business or as part of a company group restructure:
 - whether the consideration received by the vendor is assessable income under section 25 or paragraph 26(j) of the *Income Tax Assessment Act 1936*;
 - whether the consideration received by the vendor is subject to the application of the capital gains and losses provisions contained in Part IIIA; and
 - whether the consideration paid by the purchaser is an allowable deduction under subsection 51(1).
- This Ruling only applies to stocks of spare parts and consumable stores either held by a vendor for the vendor's own use or held by a purchaser for the purchaser's own use, (i.e. not stocks acquired for the purpose of sale or exchange). It does not apply to the disposal of stocks of spare parts and consumable supplies which constitute trading stock of the vendor (the taxation consequences of such disposals are determined by the operation of section 36), nor does it apply to the acquisition of stocks which constitute trading stock of the purchaser.
- This Ruling does not apply to disposals of parts and stores other than as part of the sale of the taxpayer's business or the restructure of the company group. For example, it does not apply to disposals of

TR 94/D21

parts which are no longer required for the taxpayer's continuing income-producing activities.

Ruling

Assessability to the vendor under section 25 or paragraph 26(j)

4. If a vendor sells its stock of spare parts and consumable stores as part of the sale of its business or as part of a company group restructure, the consideration received by the vendor is of a capital nature and is not assessable income under section 25.

The consideration is not received by way of insurance or indemnity and is not assessable income under paragraph 26(j).

Application of capital gains and losses provisions to consideration received by the vendor

5. If a vendor sells its stock of parts and consumable stores as part of the sale of its business or as part of a company group restructure for a total amount of consideration (without separately identifying the consideration received in respect of each individual part or item of stores) equal to the acquisition cost of the stock overall (i.e. at cost), there is no capital gain or loss on disposal of those assets either as a whole or in respect of each individual part or item of stores.

In contrast, if the stock of parts and consumable stores is not sold for a total amount of consideration equal to the acquisition cost of the stock overall (i.e. if it is sold for other than cost), the capital gain or loss on disposal will need to be calculated in respect of each asset in accordance with the provisions of Part IIIA.

Deductibility to the purchaser

6. If a stock of parts and stores is acquired as part of the purchase of a business or restructure of a company group, the consideration paid by the purchaser for that stock is not an allowable deduction under subsection 51(1) in the year of the purchase of the business nor is the cost attributable to individual items allowable in the year in which the items are used.

Date of effect

7. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to

the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

Assessability to the vendor under section 25

8. An amount derived by a vendor in respect of the sale of spare parts and consumable stores as part of the sale of a business is not assessable income of the vendor under section 25. Similarly, consideration derived by a transferor for the transfer of spare parts and consumable stores as part of a company group restructure is not assessable income of the transferor under section 25. Amounts received on the closing down of a business previously carried on are capital profits rather than profits realised in the course of carrying it on (*Equitable Life and General Insurance Co. Ltd v. FC of T* (1989) 20 ATR 1225; 89 ATC 4972).

9. In *Equitable Life and General Insurance*, the Federal Court of Australia (Wilcox J) decided that the sale of the taxpayer's whole share portfolio as part of the reorganisation of the taxpayer's company group in 1983-1984 constituted a closing down of the business previously carried on (the taxpayer had ceased its life insurance business 7 years earlier). In reaching that conclusion, Wilcox J said:

'Such profits as were realised were capital profits obtained upon the disposal of the business, not profits realised in the course of carrying it on.'

10. That conclusion was different from that reached in relation to profits from share sales in 1982-1983. Applying the principles contained in *London Australia Investment Co. Ltd v. FC of T* ((1976-1977) 138 CLR 106), Wilcox J concluded that in 1982-1983:

'such periodic sales must be regarded as a normal operation in the course of carrying on the business of investing for profit... Consequently, the profits realised by those sales constitute assessable income.'

11. Similarly, in *Modern Permanent Building and Investment Society v. FC of T* (1958) 98 CLR 187, the taxpayer claimed as a deduction a loss which it sustained on the sale of its outstanding loans to another building society. As the sale was made immediately before the society went into voluntary liquidation, the High Court of Australia (Williams J) disallowed the claim on the basis that it was a capital loss.

TR 94/D21

12. At p.191, Williams J. said:

'Any loss upon a loan that such a trader might incur in the course of carrying on its business would be a loss incurred in gaining or producing the assessable income and be an allowable deduction under s.63 of the Act. But a loss incurred upon the realisation of such loans in order to put an end to the business or part of it would in the absence of legislation to the contrary, be a capital loss'.

13. We consider that the transfer of spare parts and consumable stores as part of the sale of a business or as part of a company group restructure is not done in carrying on a business or from the carrying out of an isolated business venture and that any resulting gains do not constitute assessable income of the vendor/transferor.

14. Different consequences may follow if the items constitute trading stock of the vendor or transferor (and section 36 applies) or if the disposal is a normal incident in the carrying on of the profit earning operations of the vendor's or transferor's business.

Assessability to the vendor under section 26(j)

15. Paragraph 26(j) operates to include in assessable income any amount received by way of insurance or indemnity for or in respect of any loss of profit or income which would have been assessable income if the loss had not occurred, and any amount so received for any loss or outgoing which is an allowable deduction.

16. We consider that inherent in the concept of 'indemnity' is that, at some time before making the payment, the payer or some other person had undertaken that it would secure the taxpayer against or compensate the taxpayer for possible loss, and that the payment was made to satisfy that undertaking. We consider that amounts derived on the sale of spare parts and consumable stores as part of the sale of a business or a group restructure do not fall within the concept of indemnity. In addition, such amounts are not received by way of insurance for the purposes of paragraph 26(j).

Application of capital gains and losses provisions to the consideration received by the vendor

17. For the purposes of the capital gains and losses provisions, section 160A defines an asset as meaning 'any form of property'. In the case of a stock of spare parts and consumable stores, each individual part or item of consumable stores is a separate, individual asset, to which the capital gains and losses provisions apply.

18. If a stock of spare parts and consumable stores is sold as part of the sale of a taxpayer's business for its original total cost, and the stock comprises a large number of relatively small value items, it would be impractical to insist on the calculation of a capital gain or loss for each individual part or item of consumable stores.

19. We consider that subsection 160ZD(4) provides a mechanism to dispense with item by item calculations where this is objectively reasonable.

20. Subsection 160ZD(4) provides that:

'where any consideration paid or given in respect of a transaction relates in part only to the disposal of a particular asset, so much of that consideration as may be reasonably be attributed to the disposal of the asset shall be taken to relate to the disposal of the asset.'

In our view, one of the circumstances in which the subsection applies is where an undissected amount of consideration relates to the disposal of multiple assets. For example, a stock of spare parts and consumable stores may be sold as part of the sale of a taxpayer's business and the amount of the consideration on the sale of the business may be apportioned to the total stock without specifically attributing a part of the apportioned consideration to each individual part or item of stores.

21. If the amount of the consideration apportioned to the total stock is equal to the total original cost of the stock, we consider that it is objectively reasonable, in terms of subsection 160ZD(4) to attribute cost to the disposal of each individual part and each item of consumable stores and that item by item calculations are therefore unnecessary.

22. In order to satisfy the items of subsection 160ZD(4) the attribution of total cost to individual parts and items of consumable stores must be reasonable in the circumstances of the particular case.

23. However, if the stock of spare parts or consumable stores is being sold or transferred at other than the total cost of the stock, the capital gains and losses provisions require an item by item calculation for each part or item of stores.

Deductibility to the purchaser

24. Expenditure which strengthens and preserves the business organisation or entity or the profit yielding subject is capital expenditure (*Sun Newspapers Ltd & Associated Newspapers Ltd v. FC of T* (1938) 61 CLR 337). At page 359, the High Court of Australia (Dixon J) discussed the distinction between capital and revenue expenditure by saying that it:

TR 94/D21

'...corresponds with the distinction between the business entity, structure, or organisation set up or established for the earning of profit and the process by which such an organisation operates to obtain regular returns by means of regular outlay, the difference between the outlay and returns representing profit or loss.'

25. His Honour described the business structure or entity or organisation as encompassing, depending on the individual business, goodwill, buildings, plant and machinery - in other words, the 'profit-yielding subject'. After saying that the capital/revenue distinction reflected the difference between the profit-yielding subject and the process of operating it, he added at p.360:

'...expenditure and outlay upon **establishing**, replacing and enlarging the profit yielding subject may in a general way appear to be of a nature entirely different from the continual flow of working expenses which are or ought to be supplied continually out of the returns or revenue. The latter can be considered, estimated and determined only in relation to a period or interval of time, the former as at a **point of time**.'(emphasis added)

26. The principles expressed in *Sun Newspapers* were applied by Dixon J. in *Hallstroms Pty Ltd v. FC of T* (1946) 72 CLR 634 where his Honour said at p.647 that:

"...the contrast between the two forms of expenditure corresponds to the distinction between the acquisition of the means of production and the use of them; between establishing or extending a business organisation and carrying on the business; between the implements employed in work and the regular performance of the work in which they are employed; between an enterprise itself and the sustained effort of those engaged in it."

27. Menzies J. in *John Fairfax & Sons Pty Ltd v. FC of T* (1959) 101 CLR 30 at p. 49 describes a revenue expenditure by saying that for an expense to be deductible

'...the outlay must have been incurred in the carrying on of a business, that is, it must be part of the cost of trading operations.'

28. Expenditure incurred in respect of the acquisition of spare parts and consumable stores as part of the acquisition of a business is not deductible to the purchaser under subsection 51(1) because it is of a capital nature. Such expenditure is capital in nature because it relates to the establishment of the profit yielding structure of the business (*Sun Newspapers*) rather than being incurred as part of the cost of trading operations to produce income. Such expenditure relates to the acquisition of the means of production or to the implements or articles employed in work and is different from the continuous flow of working

expenses relating to the process of operating the business. It is expenditure which arises only at one point of time rather than in relation to a period or interval of time.

29. The same is true of consideration attributed to the transfer of spare parts and consumable stores as part of the restructure of a company group. We consider that the consideration attributed to the transfer of such items relates to the business entity, structure or profit-yielding subject and that it is therefore of a capital nature.

30. Some taxpayers have argued that the consideration attributed to the transfer of spare parts and, in particular, consumable stores as part of the sale of a business or group restructure is incurred in respect of the acquisition of revenue assets which are going to be used for the income producing activities of the business being purchased or restructured. Therefore, they have argued, such amounts are of a revenue nature and therefore deductible in the hands of the purchaser in the year of purchase under subsection 51(1).

31. We disagree with that view because, for the reasons discussed above, we consider that the circumstances of the payment, i.e. the acquisition of the business or the business restructure, are such that the payment does not satisfy the requirements of subsection 51(1) in the year of purchase.

Commissioner of Taxation

19 May 1994

ISSN 1039 - 0731

ATO references

NO 92/6750-6

BO

Not previously released to the public
in draft form

Price \$0.80

FOI index detail

reference number

subject references

- company reorganisation
- consumable stores
- consumable stores purchase
- sale of business
- spare parts

legislative references

- ITAA 25
- ITAA 51(1)
- ITAA 26(j)

TR 94/D21

case references

- Equitable Life and General Insurance Co. Ltd v. FC of T (1989)
20 ATR 1225; 89 ATC 4972
- Hallstroms Pty Ltd v FC of T (1946)
72 CLR 634; 8 ATD 190
- John Fairfax & Sons Pty Ltd v FC of T (1959) 101 CLR 30; 11 ATD 510
- London Australia Investment Co. Ltd v FC of T (1976-1977) 138 CLR 106; 77 ATC 4399
- Modern Permanent Building and Investment Society v FC of T 1958
98 CLR 187; 11 ATD 438
- Sun Newspapers Ltd & Associated Newspapers Ltd v. FC of T (1938)
61 CLR 337; 5 ATD 87