TR 95/D9 - Income tax: sale and leasebacks

This document has been finalised by TR 95/30.

Draft Taxation Ruling
Income tax: sale and leasebacks

other Rulings on this topic

IT 28; IT 196; IT 2051; IT 2287; IT 2354; IT 2395; IT 2594; TD 93/142; TD 94/20

contents para

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

What this Ruling is about

Class of person/arrangement

1. This Ruling concerns financing arrangements taking the form of a sale and leaseback of assets that were previously owned and used by the lessee prior to the sale. Under these arrangements, the owner of an asset sells the asset but continues to use the asset as lessee under a lease from the purchaser. However, this Ruling also has relevance to the sale and leaseback of assets that were not used by the lessee prior to the sale.

Effect of sale and leaseback arrangements

2. Sale and leaseback arrangements have a similar effect to providing finance to the original owner of the asset (in this Ruling referred to as the lessee). Considered from this point of view, the discount rate used in calculating the present value of the lease provides the notional interest rate implicit in the lease and often this rate is better than prevailing market interest rates. This is possible because of tax deductions allowable to the purchaser (referred to in this Ruling as the lessor) as a result of the acquisition of the asset.

3. Sale and leasebacks are recognised in the *Income Tax Assessment Act 1936* (the Act) as transactions capable of having a tax effect: subsection 82AB(7) and Division 16D (note also section 51AD and subsection 57AM(33)).

Ruling

4. Depending on the facts, sale and leaseback arrangements will normally constitute ordinary business or commercial dealings. However, there will be circumstances where these arrangements will have different tax effects.

Usual tax treatment of sale and leasebacks

5. Where the asset sold is depreciable, and is sold by the lessee for more than its depreciated value, a balancing charge would normally have to be included in the taxpayer's assessable income under section 59 (see Taxation Rulings IT 28, IT 2051 and IT 2354). Where the disposal of depreciated plant is below its written down value, the difference is an allowable deduction for the lessee.

6. The lessor, as owner of the asset, is entitled to claim a deduction for depreciation, or other deduction, as appropriate. However, the lessor would not be entitled to depreciate the asset for an amount in excess of the sum of the written down value of the asset in the hands of the lessee and any amount included in the assessable income of the lessee: section 60. Where the asset was used for a number of years in the lessee's business operations, it is unlikely that the discretion in subsection 60(2) would be exercised in the lessor's favour (see Taxation Ruling IT 2354).

7. The lease of the asset results in periodic payments by the lessee to the lessor. These are generally deductible to the lessee and the lessor will derive income from the payments on the same basis as for any lease of a similar asset on similar terms where there is no related purchase of the asset from the lessee (see Taxation Rulings IT 28, IT 2051, and Taxation Determination TD 93/142).

8. Normally a lessor would return income from a lease, including a sale and leaseback, by returning the lease income as assessable income and deducting from that income depreciation and any other deductions (the asset method of returning lease income). *FC of T v. Citibank Ltd and Ors* (1993) 26 ATR 423; 93 ATC 4691 (*Citibank* case) has confirmed that the asset method is the correct method of returning lease income in these circumstances. Payments to the lessor to make up the residual value of the asset to a required level would also have an income character.

Market Value

9. In the circumstances of a sale and leaseback the Commissioner will accept a sale price representing the fair market value of the asset at the time of sale. The fair market value will be the price at which an asset can be bought and sold as between a willing but not anxious, arm's length purchaser and vendor, both acting knowledgeably, prudently and without compulsion. Where there is an identifiable, recognised market for the asset in Australia or overseas, the fair market value will ordinarily be the market selling value in that market at the appropriate time.

10. Where no such market exists, the Commissioner will accept the tax depreciated value of the asset. A sale price significantly above or below that tax depreciated value should be based on independent evidence as to the value of the asset. Such evidence would usually be required in the form of an independent valuation by an approved valuer. The value should reflect the value of the asset separated from the business to which it is leased, because, if the lessor were to exercise rights on default this would be the value for which the asset could be sold by the lessor.

Circumstances where sale and leasebacks may have a different tax effect

Intention of the parties

11. In many sale and leaseback arrangements the likely characterisation of those transactions alone will be as a sale of the asset from the lessee to the lessor, and a leaseback of the asset. This is no less likely where the parties have factored in the tax effects that flow from those characterisations as a necessary ingredient of the deal. However, there may be cases where the intention of the parties is that there is to be no genuine sale of the asset, or if there is, that there is to be an immediate resale back to the lessee, despite documentation to the contrary.

12. In each case the totality of the facts need to be considered to determine the intention of the parties. However, it is not appropriate, for example, to treat the payment by the lessor as a loan, and the lease payments and the payment of the residual as a payment of interest and principal, where, on an objective analysis, the arrangement is truly a sale and a lease.

Characterisation at law

13. There may be cases where, notwithstanding the intention of the parties, the arrangements cannot at law be characterised as a sale and a leaseback:

(a) because the asset is a fixture on land in respect of which the lessor has no interest.

In general, when an item is a fixture on land it is part of the land and owned by the owner of the land and cannot be sold separately from it. Where this is the case the lessor has no asset which could be the subject of a lease.

(b) because the lessee is treated as the owner of the asset by reason of a hire purchase arrangement over the asset.

This result occurs when sale and leaseback arrangements include an agreement that the lessee may acquire the asset at the end of the lease, and the lessee is able to complete that acquisition for no consideration, or for a consideration less than the then market value of the asset. Such leasebacks are treated by the ATO as akin to hire purchase arrangements, giving the lessee the ownership of the asset for depreciation purposes: refer to Taxation Rulings IT 28 and IT 196.

(c) because the lease payments are partly of a capital nature.

This may occur where the lease payments support any person's acquisition of the asset for a consideration less than the then market value.

Section 51AD

14. Section 51AD applies to sale and leaseback arrangements which are predominantly funded by non-recourse debt, and the asset is used by the lessee for a non income-producing purpose.

Part IVA

15. Part IVA will not have a general application to sale and leaseback arrangements: refer to paragraphs 48 to 59 below. However, the ramifications of Part IVA on a particular set of facts will always be judged on a case by case basis: see *Case W58* 89 ATC 524 (at 536).

16. Generally speaking, the terms of the arrangement should be consistent with a commercial sale and unrelated lease and should not have special features. For example variable payment schedules or the

like may suggest that the arrangement is predominantly directed at obtaining a tax benefit.

17. In most situations, sale and leasebacks will be explicable on a commercial basis, for both lessees and lessors, provided:

(a) the proper balancing charge and/or capital gain is included in the assessable income of the lessee and lessor as appropriate;

(b) there is no assignment of the right to income arising from ownership of the asset during the period of the lease;

(c) fair market values are used (both in relation to the sale of the asset (see paragraphs 9 and 10 above), and for the purpose of setting the residual value for the asset (see IT 28));

(d) the overall sale and leaseback arrangement was designed to provide a positive cash result to the lessor before taking into account the tax benefits; and

(e) the commercial elements of the scheme, having regard to the facts of the case, outweigh the tax elements.

18. Similarly, a tax benefit to lessees is unlikely to be the dominant purpose of a party to a sale and leaseback where neither the price at which an asset is sold to the lessor nor the guaranteed residual value of the asset at the end of the leaseback are other than the then fair market values of the asset.

19. However, there may be cases where the weighing up of all the facts will lead to a conclusion that the dominant purpose is to avoid tax. Typically a persuasive factor would be where depreciation deductions or other deductions related to ownership are the predominant benefits obtained by a lessor. Similarly, a dominant purpose to avoid tax might exist where inflated lease payments are made under a scheme, or where the proper balancing charge is not included in assessable income.

20. In those cases where Part IVA applies, the Commissioner would have to determine which taxpayer could reasonably be expected, but for the scheme, to have derived assessable income, or not to have then been entitled to a particular tax deduction. How the Commissioner would do this would depend on the facts of each case. In some circumstances it may be appropriate to treat the arrangements as if they were in substance loan arrangements: refer generally to Taxation Rulings IT 28, IT 2287, IT 2395 and IT 2594.

Date of effect

21. 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

Usual tax treatment of sale and leasebacks

22. In summary, the usual tax effect of sale and leaseback arrangements will be as follows:

(a) the lessor is entitled to claim a deduction for depreciation, or other deductions, as appropriate; and

(b) the lessee is entitled to claim the lease payments as a deduction in full.

23. Before 1 July 1990, the ATO accepted that lessors could return lease income under the finance method, in place of the asset method, subject to other conditions and assumptions set out in Taxation Rulings IT 2162 and IT 2166. The ATO withdrew its recognition of this method of returning lease income with effect from 1 July 1990 by Taxation Ruling IT 2594. An addendum to that Ruling enabled lessors to continue to use the finance method until 1 August 1990 in some circumstances. The extension did not apply to sale and leaseback transactions in respect of used property.

Market Value

24. In the circumstances of a sale and leaseback the Commissioner will accept a sale price representing the fair market value of the asset at the time of sale. The fair market value will be the price at which an asset can be bought and sold as between a willing but not anxious, arm's length purchaser and vendor, both acting knowledgeably, prudently and without compulsion. The Commissioner's view is that generally speaking the lessor's rights in respect of a leased asset would apply in circumstances where that asset would be separated from the business, and that a fair market value would reflect this fact.

25. Where there is an identifiable, recognised market for the asset, the fair market value will ordinarily be the market selling value in that market at the appropriate time. It is expected that some independent evidence of market prices should be obtained and be available if

required. The type of evidence will naturally vary with the nature of the asset; however it would usually include details of market selling prices for similar assets at the relevant time.

26. Where no ready market exists, the Commissioner will accept the tax depreciated value of the asset. A sale price significantly above or below that tax depreciated value should be based on independent evidence as to the market value of the asset, and reflect the extent of the lessor's rights as discussed above. Such evidence would usually consist of an independent valuation by an approved valuer, showing the full basis for the valuation. In some cases, where unique or complicated circumstances make valuation contentious, two or more valuations should be obtained in respect of more valuable assets. For such valuations, evidence of the reasoning underlying the acceptance of one valuation in preference to another different valuation, should also be available if required.

Characterisation of the arrangement

The intentions of the parties

27. The form of an arrangement, including the description of the transactions by the contracting parties, often provides the strongest indicator of the proper characterisation of the arrangement. However, there are occasions where the ostensible form of an arrangement may be disregarded where the parties use the ostensible arrangement as a disguise, a facade, a sham, or a false front, to conceal their real transaction (see *Scott v. Commissioner of Taxation (No 2)* (1966) 14 ATD 333; 40 ALJR 265; *Sharrment Pty Ltd and Ors v. Official Trustee in Bankruptcy* (1988) 82 ALR 530; *Ascot Investments Pty Ltd v. Harper and Harper* (1981) 148 CLR 377 and *Gould and Gould; Swire Investments Ltd* (1993) FLC 92-434).

28. The factors in a sale and leaseback arrangement which could, in some circumstances, support the inference that the true characterisation of a particular arrangement is as a loan from the lessor to the lessee include:

(a) evidence from the parties, including the characterisation of the arrangements in the books of the lessee and lessor;

(b) there is no intention that the lessor will ever get physical possession or control of the asset on default or for the purposes of sale as specified in Taxation Ruling IT 28;

(c) the risks of owning the asset are with the lessee and the benefits of ownership of the asset beyond the lease period are with the lessee (e.g. the documentation indicates that the lessee will obtain the benefit of any excess of the sale price over the guaranteed residual value);

(d) further security is required by the lessor for entering into the arrangements, over and above the acquisition of the asset (e.g. the lessee provides or arranges guarantees of minimum net returns to the lessor); and

(e) the sale price of the asset to the lessor, or the residual value of the asset, is in excess of the market value of the asset at the relevant time, that is, when the asset is sold or when the lease terminates.

29. However, that inference will require strong support from the circumstances of the arrangement, and cannot be inferred lightly. This is because some of the factors which can contribute to the conclusion that an arrangement is not, despite its apparent form, intended to take effect as a sale and leaseback will not by themselves usually lead to that conclusion. Many are recognised for particular purposes in the Act as being consistent with a genuine sale and a genuine lease transaction. For example, section 51AD (which deals with certain transactions financed on a non-recourse basis) specifically applies to sale and leaseback transactions; it would not need to do so if sale and leaseback always took effect as a loan, or as a sale and repurchase. Division 16D deals with certain finance leases, and some of the tests for qualifying arrangements for the purposes of that Division include instances where:

(a) the owner disposes of property to the end-user/lessee on the expiration of the arrangement, and the end-user/lessee pays the owner an amount equal to the guaranteed residual value;

(b) the arrangement period is more than 75% of the effective life of the item; or

(c) the capital component of the lease payments is greater than 90% of the residual amount payable at the end of the lease.

30. It is also clear from the authorities that the existence of one or other of these features will not necessarily provide a sufficient basis for characterising an arrangement in a way that is different from that evidenced by the formal documentation. For example, in the *Citibank* case, which dealt with 'finance leases', Hill J commented (ATR at 435-436; ATC at 4702):

> 'Further it is hard to see why it is not correct to say that a taxpayer who purchases a car and gains income from the transaction by entering into a bailment of that car for reward does not use the car for the purposes of gaining or producing assessable income, notwithstanding that the taxpayer never obtains possession of the car nor contemplates that it will, and

notwithstanding that the bailment agreement passes to the bailee all obligations and risks in respect of the car: cf *Tourapark Pty Ltd v. FC of T* (1982) 149 CLR 176; 12 ATR 842.'

31. It should also be noted that in the *Citibank* case the agreement envisaged that the goods would be sold by Citibank for the best price it could obtain and if that was less than 'the residual value', the lessee was to pay the difference to Citibank.

Where the true characterisation is as a loan

32. In those cases, where the sale and leaseback arrangements should properly be characterised as a loan by the lessor to the lessee, the lessee is obliged to make payments part or all of which will be capital in nature (i.e. repayment of principal on a loan), and part or all of which will be revenue in nature (i.e. payment of interest). The lessee is entitled to income deductions only for the revenue component of those payments.

33. As the owner of the asset at the time the sale and leaseback was entered into, the tax position of the lessee should determine any applicable deductions on the basis of continuing ownership. In particular , section 60 will limit depreciation to the written-down value of the asset at the time of the transaction.

34. The lessor should account for the whole transaction as a loan, and include in its assessable income the interest component of the lessee's payments. Generally, the interest component can be calculated on the basis that the putative sale price represents an outstanding loan balance, to be reduced over time by the putative lease payments and any residual value, with interest income to be calculated accordingly from those payments.

Where the intention is that there be a repurchase of the asset by the lessee rather than a lease

35. The following factors could support such a characterisation:

(a) evidence from the parties;

(b) the lease is for a period that is likely to exhaust the remaining useful life of the asset (see *FC of T v. Ballarat Western Victoria TV Ltd* 78 ATC 4630; (1978) 9 ATR 274);

(c) the asset is particularly specialised in character, or remotely located, or the cost of its removal and marketing would exceed its likely value so that the lessor does not have a commercial alternative, on the expiration of the lease, to leaving the asset with the lessee or on the site of the lessee's operations; or

(d) all the risks are with the lessee and the asset will remain with the lessee on payment of the residual value, particularly where the residual value represents a nominal amount, or an amount substantially less than the value of the asset.

36. Again, this conclusion is not one that can be lightly inferred. However, where the totality of the facts do support this result, the lessor would not be entitled to depreciation deductions in respect of the asset. In addition, the payments described by the parties as lease payments would have a substantial capital component: refer to Taxation Determination TD 94/20. See also *Eon Metals NL v. Commissioner of State Taxation (WA)* (1991) 22 ATR 601; 91 ATC 4841.

Where the law requires a different characterisation

37. In other cases, an arrangement cannot have the effect intended by the parties because of other legal rules.

Fixtures

38. In general, when an item is a fixture on land it is part of the land and owned by the owner of the land and cannot be sold separately from it. For example, see *Mills v. Stokman* (1967) 116 CLR 61.

39. Where an asset, the subject of a sale and leaseback, is a fixture on land of the lessee, there can be no transfer of the legal title of the asset to the lessor separate from the land: see, for example, *Case W18* 89 ATC 223; *AAT Case 4883* (1989) 20 ATR 3278. The proper characterisation in such cases of an arrangement under which money is received initially by the lessee in return for regular payments over a period, and a payment of a guaranteed residue, would usually be as a loan. In these circumstances, the initial payment to the lessee will be a capital sum in the lessee's hands. To the lessor it will be the sum lent under the arrangement. Periodic payments by the lessee, including any residual payment, will be loan repayments, to be dissected into capital and interest components; the lessee being allowed deductions only for the interest component. The lessor will be assessed for income tax purposes on the same basis as for any such loan made by it.

Hire purchase arrangements

40. Arrangements for the repurchase of the asset, whether they are automatic or occur at the option of the lessee, are likely to be regarded as akin to a hire purchase agreement. In these circumstances, the lessee would be allowed a deduction for the revenue component of the payments, and consistent with current ATO practice, for depreciation (see Taxation Rulings IT 28 and IT 196, but cf (1955) 5 CTBR (NS) *Case 90*). As to the extent of the capital component of the lease payment in these circumstances, see 'Capital **Capital Component of Lease Payments**' at paragraph 41 below.

Capital Component of Lease Payments

41. Where a lease or an associated arrangement provides for:

- acquisition of an asset by someone other than the lessor at an undervalue; or
- some or all of its value to be received by someone other than the lessor at the end of the lease,

then the lease will to that extent have a capital character. Deductions for lease payments by the lessee will not be allowed to the extent of that capital component.

42. A lease which secures an option to purchase may include outgoings of a capital nature. It will do so where the lessee seeks to obtain an advantage of a capital nature for itself, such as an option to purchase the leased property (as the lessees did in *Poole and Dight v. FC of T* (1970) 122 CLR 427; 1 ATR 715; 70 ATC 4047, as the hirer did in (1955) 5 CTBR (NS) *Case 90* and as the coal company did in *Darngavil Coal Co Ltd v. Francis (Inspector of Taxes)* (1913) 7 TC 1). If the lessee seeks to secure the option for a subsidiary, the lease payments will also include capital outgoings. This principle was recognised in *Littlewoods Mail Order Stores Ltd v. IRC* [1969] 3 All ER 855; [1969] 1 WLR 1241 and *FC of T v. South Australian Battery Makers Pty Ltd* (1978) 140 CLR 645; 8 ATR 879; 78 ATC 4412 even though some commentators have suggested that the latter case could be authority for the contrary view.

43. However, as a rule of thumb, if the purchase of the asset from the lessor is to be at its then fair market value, the extent of any capital component of the lease payments would be negligible.

Section 51AD

44. Property is not taken to have been owned and used or held for use by the end-user or an associate if the property was first used or

held for use by that person at a time within 6 months before the acquisition of the property by the owner and at that time there was in existence an arrangement that the property would be sold to another person and then leased by the end-user or an associate: subsections 51AD(5) and (6).

45. Broadly, a non-recourse debt is one where the lender's rights against the borrower in the case of default in repayment are effectively limited to rights against the property, or against income generated or goods produced by the property. Generally, this test is satisfied either by a contractual limitation of the rights of the creditor against the assets of the borrower or by the fact that the borrower has insufficient assets, other than those specifically listed in paragraph 51AD(8)(a), to satisfy the claims of the creditors in the event of a default. For example, where a special purpose vehicle with no assets is used to borrow the funds, assets held by other companies or trusts owned or controlled by the borrower are not themselves assets 'of the taxpayer' and cannot be taken into account as other assets of the borrower to which a lender could have recourse

Part IVA

46. In limited situations, the general anti-avoidance provisions of Part IVA of the Act might apply where the relevant documentation properly reflects the characterisation of the transactions as a sale and a leaseback.

Scheme

47. A scheme, for the purposes of Part IVA, is widely defined in section 177A. A part of a scheme may itself be a scheme. However, a part of a scheme will not be a scheme if that part is incapable of standing on its own without being robbed of all meaning: see *FC of T v. Peabody* (1994) 28 ATR 344 at 352; 94 ATC 4663 at 4670 (*Peabody* case).

48. Subject to the facts of the case, a scheme could include a sale itself and a leaseback itself or both transactions together, although the latter would be the most common scenario.

49. It could also include arrangements in the context of a sale and leaseback involving steps to avoid the inclusion in the assessable income of a relevant taxpayer of amounts that would otherwise be assessable to the taxpayer under section 59, or steps to assign that income to another entity. It could also include arrangements in the context of a sale and leaseback which seek to produce an artificial sale price for the asset or an artificial guaranteed residual value under a

lease. It could also include arrangements designed to provide deductions for inflated lease payments.

Tax benefit

50. A tax benefit exists for the purposes of Part IVA where it might reasonably be expected that an amount would be included in assessable income or a deduction would not be allowable, to the taxpayer in a year of income, if the scheme had not been entered into or carried out: section 177C. Determining whether this is the case depends on the facts and involves 'a prediction as to events which would have taken place if the relevant scheme had not been entered into or carried out and the prediction must be sufficiently reliable for it to be regarded as reasonable': *Peabody* case ATC at 4671; ATR at 353.

51. It would be usual in sale and leasebacks for a relevant tax benefit to arise because of the availability of depreciation or other amortising deductions in respect of the asset, being deductions which might reasonably be expected not to have been allowable to the lessor if the scheme had not been entered into or carried out. While this matter is dependent on the facts of each case, one scenario could be that the asset, which at all times remains in the possession of the lessee, would continue to be owned by the lessee but for the scheme. The depreciation deductions would have been available to the lessee, not the lessor, in these circumstances. In a case where the lessee needed funds to finance its operations, a reasonable expectation on the facts of that case could be that the lessee would have secured the funds in the form of a loan or some other financing arrangement, and that the assets would not have been sold under these arrangements. Financing options canvassed by the taxpayer before deciding to enter a sale and leaseback would be relevant to this issue. An alternative prediction, depending on the facts, could be that financing arrangements would not have been entered into but for the tax benefits available under the arrangements. In each case, the depreciation deduction would not have been available to the lessor but for the scheme.

52. In sale and leasebacks a relevant tax benefit could also be the deduction for the lease payments where, but for the scheme, the taxpayer would have been entitled to lower deductions, or no deductions at all.

53. But for Part IVA to operate, the identification of a tax benefit alone is not enough without a dominant purpose.

Dominant purpose

54. Taxpayers should note that Part IVA may apply even where the obtaining of a tax benefit is the dominant purpose of only one party to a scheme. For this reason, lessors and lessees should consider the possibility of such a purpose on the part of a counterparty. However, dominant purpose must relate to the whole of the scheme, even where the relevant purpose is that of a person who carries out only part of the scheme: *Peabody* case ATC at 4670; ATR at 352.

55. In order to determine whether a person entered into or carried out a scheme for the purpose of obtaining a tax benefit regard needs to be given to the objective factors outlined in paragraph 177D(b): refer to *Spotless Services Ltd and Anor v. FC of T* 1993) 25 ATR 344 at 367; 93 ATC 4397 at 4415. In evaluating the criteria in paragraph 177D(b) particular relevance needs to be given to the following factors:

(a) **The manner in which the scheme is entered into or carried out.** A matter relevant here for sale and leasebacks would be whether the value ascribed to the asset is so high or so low that it cannot be justified as reasonably related to the fair market value of the asset. The failure to attempt to arrive at a fair market value for an asset, or the sale of an asset at an inflated or artificial value, or the inclusion in the lease agreement of an unreal or nominal residual value, could highlight the artificiality of the arrangements. These features might also suggest that the underlying rationale for the particular scheme was to obtain a tax benefit. Similar indications exist where an uncommercially low residual value is ascribed to the asset at the end of the lease.

Other relevant features include the manner in which the scheme was marketed (e.g. where the availability of tax benefits are emphasised).

(b) **The form and substance of the scheme.** The factors which show that financing arrangements involving sale and leasebacks are in substance loans are also relevant in determining the objective purpose of arrangements taking that form. However, note the comments of O'Loughlin J in *Peabody v. FC of T* (1992) 24 ATR 58; 92 ATC 4585 at first instance (ATR at 68; ATC at 4594):

> 'Let it be assumed that the scheme did extend to the legitimate purpose of obtaining cheap finance through the use of redeemable preference shares.'

(c) **The time at which the scheme was entered into and the length of the period during which the scheme was**

carried out. This factor is relevant to cases where the arrangements are entered into at a time when the lessee has losses to absorb any balancing charge (particularly where these losses would not be available in subsequent years, e.g. the lessee might be seeking to refresh stale or non-transferable losses) and the lessor is in a position to utilise deductions available as a consequence of its ownership of the asset.

The particular timing of the arrangement (e.g. year end) and the duration of the scheme (e.g. limited to the period during which the lessor obtains a tax benefits around which the scheme is structured) and the nature of the tax benefit (e.g. where there are accelerated depreciation benefits) are also relevant to the question of dominant purpose.

(d) **The result in relation to the operation of the Act that would but for Part IVA be achieved by the scheme.** Genuine sale and leaseback arrangements allow the lessor to claim deductions flowing from the ownership of the assets, even though the asset may have been previously owned by and used by the lessee, continues to be used by the lessee; and is often repurchased by the lessee on the expiration of the lease. These deductions would not otherwise be available to the lessor if finance had been provided to the lessee in some other form, for instance a loan.

(e) **Any change in the financial position of the relevant taxpayer that has resulted from the scheme.** The extent of the commercial profit from the transactions relative to the tax benefits obtained under the arrangements is relevant in determining dominant purpose. However, any income actually included in the assessable income of the lessor on the resale of the asset after the lease is terminated would need to be taken into account in this regard. For example, the later inclusion in the return of the lessor of assessable income based on a realistic residual value will increase the likelihood that the commercial purpose of the arrangement predominates over the purpose of acquiring tax benefits. Of course the question of dominant purpose will depend ultimately on the facts of the particular case, including the amount of the balancing charge, the commercial returns from the transaction(s) in total and relative to profits that could have been derived if the funds had been provided to the lessee in some other way, and the size of the tax benefit.

On the other hand, where steps are taken to avoid the full operation of the balancing charge provisions in section 59, there is a likelihood that the totality of the arrangements, or these extra steps, could be stamped as a scheme entered into with the dominant purpose of avoiding tax.

The same can be said of arrangements to assign assessable income after the lessor has taken advantage of the tax benefits, particularly where the recipient of the assessable income is exempt from tax or has substantial losses which can absorb the income.

(f) **The nature of any connection between the parties.** This would be relevant, for example, where arrangements are entered into which contain features which are not usually found in sale and leaseback arrangements or where there has been an inflation of the lease payments for the purpose of obtaining excessive deductions.

Reconstruction under section 177F

56. Subject to the facts of the case, where Part IVA applies to a particular sale and leaseback arrangement, the Commissioner might in appropriate circumstances determine that depreciation and other capital amortising deductions are not allowable to the lessor. Similarly, it might be fair and reasonable in these cases to reduce the deductible component of lease payments by the lessee by treating them as including payments of capital, on the same basis as payments under a reducible loan.

57. Correspondingly, in such cases, and depending on the facts, the Commissioner would usually allow depreciation or other amortising deductions to the lessee, based on the written down value of the asset at the time of the sale to the lessor. The lessor would also be permitted to recalculate its profits from the transaction on the basis that the transaction was a loan.

Your Comments

58. If you wish to comment on this draft Ruling, please send your comments by: 27 April 1995
to:

Contact Officer: Michael D'Ascenzo
Telephone: (06) 216 1018
Facsimile: (06) 216 1400; or
Contact Officer: Brett Peterson
Telephone: (06) 216 1542
Facsimile: (06) 216 1784

Address: Taxation Rulings Unit
Australian Taxation Office
PO Box 900
CIVIC SQUARE ACT 2608.

Commissioner of Taxation

16 March 1995

ISSN 1039 - 0731

ATO references
NO 95/1596-8
BO

Not previously released to the public in draft form

Price $1.70

FOI index detail
reference number

subject references
- depreciation
- fixtures
- leasing
- option to purchase
- sale and leaseback

legislative references
- ITAA 51AD
- ITAA Pt III Div 16D
- ITAA 54
- ITAA 60(2)
- ITAA 82AB
- ITAA 57AM
- ITAA 177D
- ITAA 177F
- ITAA Pt IVA
- ITAA Pt III Div 10C and 10D

case references
- (1955) 5 CTBR (NS) Case 90
- Ascot Investments Pty Ltd v. Harper and Harper (1981) 148 CLR 377
- Case W18 89 ATC 223; AAT Case 4883 (1989) 20 ATR 3278
- Case W58 89 ATC 524
- Darngavil Coal Co Ltd v. Francis (Inspector of Taxes) (1913) 7 TC 1
- Eon Metals NL v. Commissioner of State Taxation (WA) (1991) 22 ATR 601; 91 ATC 4841
- FC of T v. Ballarat & Western Victoria TV Limited 78 ATC 4630; 9 ATR 274
- FC of T v. Citibank Ltd and Ors (1993) 26 ATR 423; 93 ATC 4691
- FC of T v. Peabody (1994) 28 ATR 344; 94 ATC 4663
- FC of T v. South Australian Battery Makers Pty Ltd (1978) 140 CLR 645; 8 ATR 879; 78 ATC 4412
- Gould and Gould; Swire Investments Ltd (1993) FLC 92-434
- Littlewoods Mail Order Stores Ltd v. IRC [1969] 3 All ER 855; [1969] 1 WLR 124
- Mills v. Stokman (1966) 116 CLR 61
- Peabody v. FC of T (1992) 24 ATR 58; 92 ATC 4585
- Poole and Dight v. FC of T (1970) 122 CLR 427; 1 ATR 715; 70 ATC 4047
- Scott v. Commissioner of Taxation (No 2) (1966) 14 ATD 333; 40 ALJR 265
- Sharrment Pty Ltd & Ors v. Official Trustee in Bankruptcy (1988) 82 ALR 530

- Spotless Services Ltd and Anor v. FC of T (1993) 25 ATR 344; 93 ATC 4397
- Tourapark Pty Ltd v. FC of T (1982) 149 CLR 176; 12 ATR 842