


TD 2002/D10 - 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 Act')?

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This document has been finalised by TD 2003/15.

Draft 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 Act')?

Preamble

Draft Taxation Determinations (DTDs) represent the preliminary, though considered, views of the Australian Taxation Office. DTDs should not be relied on; only final Taxation Determinations represent authoritative statements by the Australian Taxation Office.

1. Where a trading entity taxpayer enters into a sale and leaseback of a capital asset and incurs expenses in establishing 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 a sale and leaseback of its ammonia plant as a fund raising transaction. The full Federal Court, Carr, Lee and Sundberg JJ, held that these expenses were deductible under subsection 51(1) of the Income Tax Assessment Act 1936. His Honour Carr J said at para 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, by consent, the Full Federal Court's decision was set aside and the taxpayer's appeal to the Full Federal Court was dismissed. Consequently, even in the absence of any judicial comments by the High Court, the conclusions of the full Federal Court in relation to this aspect of the decision can no longer be regarded as authoritative.
4. The incidental costs of selling a capital asset or leasing it back can only qualify as a deduction under section 8-1 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.

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

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

As the 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 the costs of a manufacturing or trading company in raising capital, even if recurrently incurred, will be a cost of establishing or enlarging the taxpayer’s profit yielding subject rather than a cost of trading, and will notwithstanding their recurrence, 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.

8. We invite you to comment on this Draft Taxation Determination. We are allowing 4 weeks for comments before we finalise the Determination. If you want your comments considered, please provide them to us within this period.

Comments by date: 25 September 2002

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Previous Draft:

Not previously issued in draft form

Related Rulings/Determinations:

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

Subject references:

- establishment costs
- leasing
- sale and leaseback

Legislative references:

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

Case references:

- GP International Pipecoaters Pty Ltd v. FC of T (1990) 170 CLR 124
- Broken Hill Theatres Pty Ltd v. FC of T (1951-2) 85 CLR 423
- Halstroms 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
- Eastern Nitrogen Ltd v. FC of T (2001) 108 FCR 27; 2001 ATC 4164; (2000) 46 ATR 474; [2001] FCA 366

ATO References

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