


PR 2014/16 - Income tax and fringe benefits tax: tax consequences for Employees and Employers under a LeasePlan novated vehicle lease

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Product Ruling

Income tax and fringe benefits tax: tax consequences for Employees and Employers under a LeasePlan novated vehicle lease

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! This publication provides you with the following level of protection:

This publication (excluding appendixes) is a public ruling for the purposes of the *Taxation Administration Act 1953*.

A public ruling is an expression of the Commissioner's opinion about the way in which a relevant provision applies, or would apply, to entities generally or to a class of entities in relation to a particular scheme or a class of schemes.

If you rely on this ruling, the Commissioner must apply the law to you in the way set out in the ruling (unless the Commissioner is satisfied that the ruling is incorrect and disadvantages you, in which case the law may be applied to you in a way that is more favourable for you – provided the Commissioner is not prevented from doing so by a time limit imposed by the law). You will be protected from having to pay any underpaid tax, penalty or interest in respect of the matters covered by this ruling if it turns out that it does not correctly state how the relevant provision applies to you.

No guarantee of commercial success

The Commissioner **does not** sanction or guarantee this product. Further, the Commissioner gives no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Potential participants must form their own view about the commercial and financial viability of the product. The Commissioner recommends a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for potential participants by confirming that the tax benefits set out in the **Ruling** part of this document are available, **provided that** the scheme is carried out in accordance with the information we have been given, and have described below in the **Scheme** part of this document. If the scheme is not carried out as described, participants lose the protection of this Product Ruling.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the entity(s) who applied for the Product Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Product Ruling.

What this Ruling is about

1. This Product Ruling sets out the Commissioner's opinion on the way in which the relevant provisions identified in the Ruling section apply to the defined class of entities who take part in the scheme to which this Ruling relates. All legislative references in this Ruling are to the *Income Tax Assessment Act 1997* (ITAA 1997) unless otherwise indicated.
2. In this Product Ruling the scheme involves the execution of a LeasePlan Employee Vehicle Lease Agreement Standard Terms (the Standard Agreement) and a LeasePlan Novation Agreement (the Novation Agreement) pursuant to which a car (the Vehicle) is leased from LeasePlan Australia Limited (LeasePlan).
3. This Product Ruling does not address:
 - (a) the treatment of any costs, fees and expenses payable by the Employee or the Employer under the scheme, other than the Monthly Rental, the expenses specifically identified as car expenses at paragraph 63 of this Product Ruling and any reconciliation or settlement amounts payable upon termination of the novated lease
 - (b) whether certain types of expenses paid for by the Employer, beyond those identified at paragraphs 63 and 64 of this Product Ruling, are a 'car expense' (as defined in subsection 136(1) of the FBTA)
 - (c) the taxable value of the car fringe benefit referred to in paragraph 15(e) of this Product Ruling, as calculated under SubDivision B of Division 2 of Part III of the *Fringe Benefits Tax Assessment Act 1986* (FBTAA)
 - (d) the deductibility of amounts equal to the decline in value of the Vehicle under Division 40
 - (e) the application of Division 242 in relation to the lease of a luxury car, other than as per paragraphs 15(c) and 50 to 52 of this Product Ruling
 - (f) any capital gains tax consequences to arise in relation to the scheme
 - (g) the Employer's rights and obligations under *A New Tax System (Goods and Services Tax) Act 1999* in relation to the scheme
 - (h) the tax consequences to arise upon the Employee making a post-tax contribution using the Employee Contribution Method
 - (i) the tax consequences to arise for the Employee under the Concurrent Lease after the Novation Agreement is terminated and all of the Employee's obligations under the relevant Settlement Annexure have been discharged

- (j) an assignment or transfer of any rights and obligations under the Standard Agreement and/or the Novation Agreement, and
- (k) whether the scheme constitutes a financial arrangement for the purposes of Division 230 (Taxation of financial arrangements).

Class of entities

4. This part of the Product Ruling specifies which entities can rely on the Ruling section of this Product Ruling and which entities cannot rely on the Ruling section. In this Product Ruling, those entities that can rely on the Ruling section are referred to as the Employer and the Employee.

5. The class of entities who can rely on the Ruling section of this Product Ruling consists of those entities that enter into the scheme described in paragraphs 16 to 37 of this Product Ruling on or after the date this Ruling is made and on or before 30 June 2017 and:

- (a) are a permanent employee who receives, or is entitled to receive, 'salary or wages' (as defined in subsection 136(1) of the FBTAA) from their employer, or
- (b) are an employer of an employee referred to in paragraph 5(a) of this Product Ruling.

6. The class of entities who can rely on the Ruling section of this Product Ruling does **not** include entities that:

- (a) enter into this scheme before the date of this Ruling or after 30 June 2017, or
- (b) are subject to Division 230 in respect of this scheme. Division 230 will generally not apply to individuals, unless they have made an election for it to apply to them.

Superannuation Industry (Supervision) Act 1993

7. This Product Ruling does not address the provisions of the *Superannuation Industry (Supervision) Act 1993* (SISA). The Commissioner gives no assurance that the scheme is an appropriate investment for a superannuation fund. The trustees of superannuation funds are advised that no consideration has been given in this Product Ruling as to whether investment in this scheme may contravene the provisions of SISA.

Qualifications

8. The class of entities defined in this Product Ruling may rely on its contents provided the scheme actually carried out is carried out in accordance with the scheme described in paragraphs 16 to 37 of this Ruling.

9. If the scheme actually carried out is materially different from the scheme that is described in this Product Ruling, then:

- this Product Ruling has no binding effect on the Commissioner because the scheme entered into is not the scheme on which the Commissioner has ruled, and
- this Product Ruling may be withdrawn or modified.

Date of effect

10. This Product Ruling applies prospectively from 16 July 2014, the date it is published. It therefore applies only to the specified class of entities that enter into the scheme from 16 July 2014 until 30 June 2017, being its period of application. This Product Ruling will continue to apply to those entities even after its period of application has ended for the scheme entered into during the period of application.

11. However the Product Ruling only applies to the extent that there is no change in the scheme or in the entity's involvement in the scheme.

Changes in the law

12. Although this Product Ruling deals with the income tax and fringe benefits tax laws enacted at the time it was issued, later amendments may impact on this Product Ruling. Any such changes will take precedence over the application of this Product Ruling and, to that extent, this Product Ruling will have no effect.

13. Entities who are considering participating in the scheme are advised to confirm with their taxation adviser that changes in the law have not affected this Product Ruling since it was issued.

Note to promoters and advisers

14. Product Rulings were introduced for the purpose of providing certainty about tax consequences for entities in schemes such as this. In keeping with that intention the Commissioner suggests that promoters and advisers ensure that participants are fully informed of any legislative changes after the Product Ruling has issued.

Ruling

15. Subject to paragraph 3 and the assumptions in paragraph 37 of this Ruling:

- (a) The extent of the novation under the novated lease will be sufficiently similar to a 'split full novation', as described in Taxation Ruling TR 1999/15,¹ such that the tax consequences relating to a split full novation, as set out in TR 1999/15, will apply to the Employer and Employee as a result of their participation in the novated lease.
- (b) Payments of the Monthly Rental by the Employer under the novated lease (other than payments of the Monthly Rental in respect of a luxury car) will be deductible under section 8-1 in the income year incurred.
- (c) Payments of the Monthly Rental by the Employer under the novated lease in respect of a luxury car will not be deductible (section 242-55). Those payments will instead be taken into account in calculating accrual amounts that are deductible under section 242-50.
- (d) Car expenses paid by the Employer under the novated lease and which are not included in the Monthly Rental (and therefore are not addressed in paragraph 15(b) or 15(c) of this Product Ruling) will be deductible under section 8-1 in the income year incurred.
- (e) The provision of the Vehicle by the Employer to the Employee under the novated lease will constitute a car fringe benefit under subsection 136(1) of the FBTAA and will be subject to fringe benefits tax (FBT).
- (f) FBT incurred by the Employer on the car fringe benefit referred to in paragraph 15(e) of this Product Ruling will be deductible under section 8-1 in the income year incurred.
- (g) The payment of car expenses, including expenses which are in respect of Vehicle Management Services, by the Employer under the novated lease will constitute an exempt benefit under subsection 53(1) of the FBTAA.
- (h) Subject to the possible inclusion of a lease rental reconciliation deficit in the taxable value of the car fringe benefit referred to in paragraph 15(e) of this Product Ruling (as per paragraph 77 of this Product Ruling), no FBT liability will arise for the Employer at the termination of the novated lease.

¹ Taxation Ruling TR 199/15 *Income tax and fringe benefits tax: taxation consequences of certain motor vehicle lease novation arrangements.*

- (i) No FBT liability will arise for the Employer as a consequence of the Employee's entry into the Concurrent Lease created in accordance with the Novation Agreement.
- (j) Payments of the Monthly Rental by the Employer to LeasePlan under the novated lease will not be assessable income of the Employee under section 6-5.
- (k) Provided the scheme ruled on is entered into and carried out as described in this Ruling, the anti-avoidance provisions in Part IVA of the *Income Tax Assessment Act 1936* (ITAA 1936) will not apply to the Employer or the Employee.
- (l) Provided the scheme ruled on is entered into and carried out as described in this Ruling, the anti-avoidance provision of section 67 of the FBTAA will not apply to the Employer.

Scheme

16. The scheme that is the subject of this Ruling is identified and described in the following documents:

- application for a Product Ruling as constituted by documents and information received on 12 March 2014, 13 March 2014, 1 April 2014 and 12 May 2014;
- draft LeasePlan Employee Vehicle Lease Agreement Standard Terms (the Standard Agreement) received on 13 March 2014;
- draft LeasePlan Employee Vehicle Lease Agreement Settlement Annexures (CarPlan Novated Standard, CarPlan Novated Premium Early Return and CarPlan Redundancy Protection) received on 13 March 2014;
- draft LeasePlan Novation Agreement received on 13 March 2014;
- draft LeasePlan Novated Vehicle Leasing Facility Letter received on 1 April 2014; and
- draft Corporate CarPlan Novated Leasing User Guide received on 13 March 2014.

Note: certain information has been provided on a commercial-in-confidence basis and will not be disclosed or released under Freedom of Information legislation.

17. For the purposes of describing the scheme to which this Ruling applies, there are no other agreements, whether formal or informal, and whether or not legally enforceable, which an Employer or Employee, or any associate of an Employer or Employee, will be a party to, which are a part of the scheme. Unless otherwise defined, capitalised terms in this Product Ruling take their meaning as per the Standard Agreement and/or the Novation Agreement, as appropriate.

18. All Australian Securities and Investments Commission (ASIC) requirements are, or will be, complied with for the term of the agreements.

Overview

19. As part of its business of offering novated leasing and salary packaging services, LeasePlan proposes to offer an amended novated leasing package to employers and employees. This amended novated leasing package involves the entry by LeasePlan and an employee (the Employee) into the Standard Agreement and the subsequent entry by LeasePlan, the Employee and their employer (the Employer) into the Novation Agreement.

20. The Standard Agreement outlines the process by which a prospective Employee lessee may apply for a lease of a vehicle and sets out the terms and conditions upon which LeasePlan, as the lessor, agrees to lease a vehicle to that Employee.

21. Broadly, LeasePlan's obligations under the Standard Agreement are to provide the Vehicle to the Employee and, where agreed, to provide Vehicle Management Services to the Employee in respect of the Vehicle. The Vehicle Management Services, as selected by the Employer as part of their novated leasing policy, are vehicle operating costs and management services which may include, but are not limited to, maintenance and repairs, registration, insurance (where the Employee does not elect to make their own insurance arrangements), tyres, fuel, roadside assistance, a miscellaneous operating costs budget and a replacement car.

22. The Employee's obligations under the Standard Agreement are, in broad terms:

- (a) to pay LeasePlan all Monthly Rentals in consideration for the provision of the Vehicle (including the cost of any Vehicle Management Services provided by LeasePlan) and all other amounts due and payable under the lease
- (b) to maintain the Vehicle in Good Condition
- (c) to pay all licence fees, duties, premiums and other charges in respect of the Vehicle
- (d) to protect the Vehicle against damage
- (e) not to provide the Vehicle as security
- (f) to comply with all laws regarding the Vehicle, and

- (g) to be responsible to LeasePlan for any damage to the Vehicle other than reasonable wear and tear.

23. The Standard Agreement provides various options for the Employee on termination of the lease (as listed at paragraphs 29 and 30 of this Product Ruling) and, together with the applicable Settlement Annexure (as selected by the Employee at the time of entering into the Standard Agreement), also sets out the Employee's rights and obligations and settlement procedures on termination of the lease.

24. The Standard Agreement is not binding on either party until the Novation Agreement is entered into.

25. The Novation Agreement has the effect of:

- (a) novating the Standard Agreement to the Employer, which creates the 'novated lease' such that all of the Employee's rights and obligations under the Standard Agreement (including the obligation to pay Monthly Rental) are transferred from the Employee to the Employer, as the lessee
- (b) rescinding the Standard Agreement
- (c) novating specified rights and obligations back from the Employer to the Employee (as per paragraph 26 of this Product Ruling), and
- (d) creating a Concurrent Lease (discussed at paragraph 27 of this Product Ruling).

26. The rights and obligations novated back to the Employee relate to termination of the lease (whether at its Scheduled Expiry Date or at an earlier date); the right of the Employee to choose their own insurance policy for the Vehicle; and each of the obligations referred to at paragraphs 22(d) to 22(g) of this Product Ruling.

27. The Concurrent Lease created under the Novation Agreement effectively recreates the Standard Agreement between LeasePlan and the Employee such that the Vehicle is leased by LeasePlan to the Employee on the same terms as the Standard Agreement, but has no operative effect until the Novation Agreement is terminated; all of the Employee's obligations under the relevant Settlement Annexure have been discharged; and the Employee successfully applies to continue the lease without a Novation Arrangement as per paragraph 30(c)(ii) of this Product Ruling.

28. The Employer provides the Vehicle to the Employee as part of the Employee's total remuneration package. The Employee's salary and wages are reduced by an amount equal to the payments made by the Employer under the novated lease during the term of the novated lease.

29. Where the lease is terminated at the Scheduled Expiry Date, the Employee has the following choices:

- (a) apply to continue the lease for an Additional Term

- (b) request to purchase the Vehicle, or
- (c) return the Vehicle to LeasePlan to be sold.

30. If the lease is terminated prior to the Scheduled Expiry Date of the lease, the Employee generally has the following choices:

- (a) request to purchase the Vehicle
- (b) return the Vehicle to LeasePlan to be sold, or
- (c) where the early termination has resulted from the employee's employment with the Employer being terminated:
 - (i) apply to re-novate to a new employer
 - (ii) apply to continue the lease without a Novation Arrangement, or
 - (iii) hand back the Vehicle to LeasePlan.

31. If the Employee requests to purchase the Vehicle from LeasePlan and LeasePlan agrees, the Employee may purchase the Vehicle at the proposed arm's length sale price. If the request to purchase is at the scheduled expiry of the lease, the price will be the market value LeasePlan places on the Vehicle at the date of expiry, plus LeasePlan's costs in connection with the sale of the Vehicle to the Employee (the Purchase Price). If the request to purchase is prior to the Scheduled Expiry Date, the price will be the Vehicle's market value LeasePlan places on the Vehicle at the date of termination, plus LeasePlan's costs in connection with the termination of the lease (the Nominated Early Termination Price). The sale of the Vehicle to the Employee is conducted at arm's length, with LeasePlan invoicing the Employee and the Employee paying LeasePlan directly from after tax income or savings.

32. Shortly after the Employee's payment to purchase the Vehicle, LeasePlan reconciles the operating and management services costs incurred by LeasePlan in respect of the Vehicle with amounts collected by LeasePlan for those costs under the lease. Where costs incurred are greater than the costs collected, LeasePlan recovers that cost from the Employee (either directly where the Employee is no longer employed by the Employer or through the Employer who recovers that amount from the Employee's pre-tax salary or wages). Where the costs incurred are less than costs collected, LeasePlan pays the surplus amount to the Employee (either directly where the Employee is no longer employed by the Employer or through the Employer who refunds the surplus amount to the Employee as additional, taxable salary or wages).

33. If the Employee returns the Vehicle to LeasePlan for it to be sold and LeasePlan sells the Vehicle, a lease rental reconciliation is undertaken. This reconciliation compares the net sale proceeds against either the Residual Value of the Vehicle as at the Scheduled Expiry Date (if the return was at the Scheduled Expiry Date of the lease) or the Nominated Early Termination Price (if the return was at early termination). If the net sale proceeds are less than the Residual Value of the Vehicle or the Nominated Early Termination Price (whichever is applicable), the Employee is liable to LeasePlan for the shortfall amount. If the net sale proceeds are greater than the applicable amount, LeasePlan is liable to the Employee for the surplus amount.

34. After the return of the Vehicle, LeasePlan will also undertake a reconciliation of the operating and management services costs incurred by LeasePlan in respect of the Vehicle with the amounts collected by LeasePlan for those costs under the lease. The result of this operating and management services cost reconciliation is combined with the result of the lease rental reconciliation referred to in paragraph 33 of this Product Ruling. If the overall result is a deficit amount, LeasePlan recovers that additional amount from the Employee (either directly where the Employee is no longer employed by the Employer or through the Employer who recovers that amount from the Employee's pre-tax salary or wages). If the overall result is a surplus amount, LeasePlan pays that amount to the Employee (either directly where the Employee is no longer employed by the Employer or through the Employer who refunds the surplus amount to the Employee as additional, taxable salary or wages).

35. If the Employee hands back the Vehicle to LeasePlan, any discrepancy between services provided and amounts paid will be invoiced to the Employee. No other reconciliation or payments (such as those discussed at paragraphs 32 to 34 of this Product Ruling) occur.

36. If the lease is continued, re-novated to a new employer or continued without a novation, no reconciliation or settlement payments occur at that time.

Assumptions

37. This Ruling is made on the basis of the following assumptions:

- (a) the Employer and the Employee are Australian residents for taxation purposes
- (b) the Employer is a 'person', as defined under subsection 136(1) of the FBTAA
- (c) the Employee receives, or is entitled to receive, salary or wages, as defined in the FBTAA, from the Employer
- (d) for the purposes of paragraphs 15(c) and 50 to 52 of this Product Ruling, the Vehicle:
 - (i) is not leased under a short-term hire agreement (as defined in subsection 995-1(1));

- (ii) is not trading stock of the Employee; and
 - (iii) is not a car covered by subsection 40-230(2) (about cars modified to carry individuals with a disability);
- (e) the Vehicle leased under the novated lease is a 'car', as defined under subsection 136(1) of the FBTAA
- (f) the Vehicle leased under the novated lease is not an exempt vehicle pursuant to subsection 8(2) of the FBTAA
- (g) the Employer will make the Vehicle leased under the novated lease available to the Employee for both business and private purposes
- (h) any Purchase Price or Nominated Early Termination Price payable by the Employee at termination of the novated lease to purchase the Vehicle will be at market value and equal or exceed the relevant percentage of cost set out in ATO ID 2002/1004²
- (i) all dealings between the Employer, the Employee and LeasePlan will be at arm's length, and
- (j) the scheme will be executed in the manner described in the Scheme section of this Product Ruling and the scheme documentation referred to in paragraph 16 of this Ruling.

Commissioner of Taxation16 July 2014

² ATO Interpretative Decision ATO ID 2002/1004 *Income Tax: car lease residual values*.

Appendix 1 – Explanation

❶ *This Appendix is provided as information to help you understand how the Commissioner's view has been reached. It does not form part of the binding public ruling.*

Characterisation of the novation

38. TR 1999/15 contains the Commissioner's opinion on the taxation consequences of certain motor vehicle lease novation arrangements and defines a 'novation' (at paragraph 4) as 'a tripartite arrangement whereby the three parties (lessor, lessee and employer) agree to change or transfer all or some of the rights and obligations in a motor vehicle lease entered into between two of the parties'. The transfer of certain obligations of the Employee, as lessee, under the Standard Agreement to the Employer pursuant to the Novation Agreement constitutes a novation.

39. TR 1999/15 also distinguishes between a 'partial novation' and a 'full novation', the latter of which includes a variation known as a 'split full novation'. Each of these concepts are also defined at paragraph 4 of that ruling:

Partial novation is an industry expression that describes a novation (transfer) of a finance lease payment obligation. A partial novation may also occur where there exists both a finance lease and a sub-lease. Under a partial novation the obligation to make lease payments is novated to an employer. Instead of the lessee making payments to the lessor, the employer makes these payments. Commonly, partial novation arrangements include an ancillary transaction whereby the lessee also subleases the vehicle to the employer.

Full novation is a novation (transfer) of all the rights and obligations in a finance lease or in a finance lease and sub-lease arrangement. As a result of a full novation the employer takes over all the rights and responsibilities contained in the original lease.

A variation on the full novation is an arrangement known as a split full novation whereby the lessee's rights and obligations under a finance lease (except the residual payment obligation) are transferred to an employer.

40. The meaning of 'split full novation' is elaborated on at paragraph 34 of TR 1999/15:

Split full novations occur where the finance lease rights and obligations are split between the employer and employee without a sub-lease. The right to use or possession of the motor vehicle and other obligations, for example the lease payment obligations, are novated to the employer. However, the residual value obligation remains with the employee. Thus the expression 'split full novation' came about because what took place was a novation of essentially the full lease notwithstanding that the residual payment obligation remained with the employee.

41. The novation under the novated lease does not constitute a partial novation as it transfers more than the Employee's obligation to pay the Monthly Rental to the Employer and, as is common in partial novations, does not involve a separate sub-lease. Pursuant to the terms of the Novation Agreement which novates specified rights and obligations back from the Employer to the Employee (as per paragraph 25(c) of this Product Ruling), the novation under the novated lease does not constitute a full novation either as it does not transfer all of the Employee's rights and obligations under the Standard Agreement to the Employer.

42. Whilst the rights and obligations novated back from the Employer to the Employee pursuant to the terms of the Novation Agreement, as identified at paragraph 26 of this Product Ruling, extend beyond the Employee's rights and obligations in relation to termination of the lease such that it is more than just the residual payment obligation that isn't transferred to the Employer, the extent of the novation under the novated lease is similar to that which arises under a split full novation.

43. *Re Jones and Federal Commissioner of Taxation* [2005] AATA 691; (2005) 60 ATR 1096; 2005 ATC 2236 (*Jones*) similarly involved an arrangement whereby an initial agreement between the employee and the novated leasing company was novated to the employee's employer, with certain specified rights and obligations novated back to the employee. Deputy President Block of the Administrative Appeals Tribunal held in relation to *Jones*, at paragraph 11:

The Retained Rights and the Retained Obligations related in broad terms to rights and obligations arising after termination of the Lease and sale of the vehicle, and so that the Applicant would on sale be entitled to any excess over residual value, and correspondingly obliged to pay any shortfall. The Retained Rights and Retained Obligations related in their terms to what was to occur after termination and sale and so that the novation was during the period of the Lease (and notwithstanding clause 1.3) a full and not a partial novation ...

44. The fact that an indemnity given by the employee in *Jones* to the novated leasing company had the potential to make the employee liable during the period of the lease upon a default by the employer was treated by Deputy President Block, at paragraph 16, as 'so remote a contingency that it need not be regarded in realistic terms as casting any burden on the Applicant'.

45. As in *Jones*, the rights and obligations novated back to the Employee under the novated lease relate substantially, at least 'in broad terms', to rights and obligations arising after the termination of the lease. The balance of the obligations novated back to the Employee are less substantive relative to those novated to the Employer, yet can cast some burden on the Employee, however minimal.

46. The similarities between the novation under the novated lease and that which constitutes a split full novation, as defined in TR 1999/15, are evident and the tax consequences for both the Employer and the Employee under the novated lease are consistent with those set out in TR 1999/15 in respect of split full novations.

Deductibility of the Monthly Rental and other car expenses

47. Section 8-1 allows a deduction for any loss or outgoing to the extent that it is incurred in gaining or producing assessable income or it is necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income, provided that the loss or outgoing is not of a capital, private or domestic nature.

48. TR 1999/15 confirms, at paragraph 7, that the employer in a novated lease is entitled to a deduction for lease expenses where the vehicle is used in the business or provided to an employee as part of a salary packaging arrangement. Taxation Ruling No. IT 2509³ also considers lease novation and, at paragraph 14, confirms the deductibility of lease payments incurred by an employer under subsection 51(1) of the ITAA 1936, being the equivalent of section 8-1 of the ITAA 1997. IT 2509 further confirms, at paragraph 11, that income tax deductions would be allowable for the reimbursement of an employee's car running expenses on the basis that such expenses are 'incurred in relation to the provision of remuneration, in one form or another, to employees'.

49. As the Vehicle is being leased in connection with the Employee's existing employment remuneration (as per paragraph 28 of this Product Ruling), both the Monthly Rental payments made by the Employer to LeasePlan and the car expense payments (such as those referred to in paragraph 22(c) of this Product Ruling and the cost of any Vehicle Management Services which aren't provided for by LeasePlan) made by the Employer in accordance with its novated obligations to do so under the terms of the novated lease are outgoings of the Employer that are necessarily incurred in carrying on a business for the purpose of gaining or producing assessable income (paragraph 8-1(1)(b)) and not outgoings of a capital, private or domestic nature (subsection 8-1(2)). Payments of the Monthly Rental and other car expenses by the Employer under the novated lease are therefore deductible pursuant to section 8-1.

³ Taxation Ruling IT 2509 *Income tax: Income tax and fringe benefits tax consequences of an employee leasing a car to an employer which is subsequently provided back to the employee.*

Monthly Rental payments for luxury cars

50. Division 242 applies to leases of luxury cars. A luxury car is defined in subsection 995-1(1) to mean a car at a time in respect of which section 40-230 would reduce its cost as a depreciating asset if an entity acquired it at that time for its market value. Section 40-230 states that the first element of the cost of a car (after applying section 40-225 and SubDivision 27-B) is reduced to the car limit for the financial year in which the taxpayer started to hold it if its cost exceeds that limit. The car limit is indexed annually and for the 2013-14 financial year is \$57,466.⁴

51. 'Luxury car lease payments', defined in subsection 995-1(1) as an amount that the lessee under the lease is required to pay for the rental or hire of the car to which Division 242 applies, cannot be deducted for any income year (section 242-55). Therefore, the Employer cannot claim a deduction for any income year for payments of the Monthly Rental under the novated lease in respect of a luxury car.

52. The Monthly Rental payments made by the Employer for an income year in respect of such cars are instead taken into account in calculating the accrual amount (as worked out using the formula under subsection 242-35(2)) that is deductible under section 242-50. Pursuant to subsection 242-50(3), the accrual amount, in full or in part, will be deductible from the assessable income of the Employer to the extent that the luxury car lease payments for an income year would be deductible apart from Division 242.

Provision of Vehicle a car fringe benefit

53. Subsection 7(1) of the FBTA provides that where, in respect of the employment of an employee, a car held by a person (such as an employer) is applied to a private use by the employee or an associate of the employee, or is taken to be available for the private use of the employee or an associate of the employee, then the application or availability of the car shall be taken to constitute a benefit provided by the person (employer) to the employee or associate in respect of the employment of the employee.

54. Paragraph 162(1)(b) of the FBTA provides that a car is held by a person when the car is leased to that person. Pursuant to the assumption at paragraph 37(b) of this Product Ruling, the Employer is a 'person' as defined in subsection 136(1) of the FBTA.

⁴ Taxation Determination TD 2013/15 *Income tax: what is the car limit under section 40-230 of the Income Tax Assessment Act 1997 for the 2013-14 financial year?*

55. As the Employer will assume the role of lessee under the novated lease and be the person to whom the Vehicle is leased by LeasePlan, the Employer will hold the Vehicle for the purposes of subsection 7(1) of the FBTA. Pursuant to the assumption at paragraph 37(g) of this Product Ruling, the Vehicle will then be provided to the Employee and taken to be available for their private use over the term of the lease.

56. The provision of the Vehicle to the Employee under the novated lease will therefore be a car benefit under subsection 7(1) of the FBTA. This is consistent with the view expressed in paragraph 8 of TR 1999/15 which, in the context of full novations, states that a car benefit arises under the FBTA where the employer is lessee of a car that is provided for the private use of the employee or associate of the employee.

57. The provision of the Vehicle to the Employee under the novated lease will also constitute a car fringe benefit, defined in subsection 136(1) of the FBTA to mean a fringe benefit that is a car benefit. Broadly, a fringe benefit is defined in subsection 136(1) of the FBTA to include a benefit provided to an employee by an employer in respect of the employee's employment, and which is not otherwise excluded.

58. A deduction for FBT or FBT instalments is allowable to taxpayers where it represents an outgoing that meets the conditions of section 8-1 (see paragraph 14 of Taxation Ruling TR 95/24).⁵ FBT payable by the Employer in respect of the provision of the car fringe benefit by the Employer to the Employee, for the reasons set out in paragraphs 54 to 57 of this Product Ruling, will therefore be deductible under section 8-1 as it is an outgoing which is integral to the remuneration and retention of the Employee; is necessarily incurred in carrying on the Employer's business for the purpose of gaining or producing assessable income; and is not of a capital, private or domestic nature.

Payment of car expenses are exempt benefits

59. Paragraph 53(1)(a) of the FBTA provides that a car expense payment benefit in respect of a car that is a benefit which is attributable to a period when the car was provided as a car fringe benefit is an exempt benefit.

60. A car expense payment benefit is defined in subsection 53(3) of the FBTA as 'an expense payment benefit where the recipients expenditure is a car expense'. Car expense is defined in subsection 136(1) of the FBTA, in relation to a car, as an expense incurred in respect of the registration, insurance, repairs, maintenance or fuel for the car.

⁵ Taxation Ruling TR 95/24 *Income tax: deductibility of fringe benefits tax.*

61. Expense payment benefit is defined in subsection 136(1) of the FBTAA by reference to a benefit referred to in section 20 of that Act. Section 20 of the FBTAA provides that an expense payment benefit is a payment made by a person (the provider) in discharge of the whole or part of an obligation of another person (the recipient) to pay a third person in respect of an amount of expenditure incurred by the recipient, or the reimbursement by the provider of the recipient in whole or part in respect of an amount of expenditure incurred by the recipient.

62. Where the Employee (as the recipient for the purposes of section 20 of the FBTAA) incurs expenditure in respect of registration, insurance, repairs, maintenance and fuel costs in relation to the Vehicle and the Employer (as the provider for the purposes of section 20 of the FBTAA), under the terms of the novated lease, either reimburses the Employee for such expenditure or pays a third party directly for these expenses, such reimbursements and payments will be car expense payment benefits under subsection 53(3) of the FBTAA, that is, expense payment benefits where the Employee's expenditure is a car expense.

63. Car expenses in this regard will include the payment of all licence fees, duties, premiums and other charges in respect of the Vehicle (as per paragraph 22(c) of this Product Ruling) by the Employer to the extent that they are incurred in respect of the registration of, or insurance in respect of, the Vehicle, as well as the payment by the Employer for each of the type of services referred to at paragraph 21 of this Product Ruling as the Vehicle Management Services. The cost for these services will constitute car expenses for the purposes of section 53 of the FBTAA, regardless of whether or not they are initially paid for by LeasePlan.

64. Any taxes incurred by the Employer as a result of the lease and its administration will not be regarded as car expenses.

65. The provision of the car expense payment benefits by the Employer to the Employee in respect of the Vehicle, attributable to a period (the term of the lease) when the Vehicle was provided as a car fringe benefit (as per paragraph 15(e) of this Product Ruling), will be exempt benefits pursuant to paragraph 53(1)(a) of the FBTAA. This outcome is consistent with that set out in paragraph 12 of IT 2509 which provides that the reimbursement of car running expenses by the employer under a novated lease are exempt from fringe benefits tax under section 53 of the FBTAA to the extent that they qualify as car expense payment benefits.

FBT consequences on termination

Purchase of the Vehicle by the Employee

66. Paragraphs 10 and 15 of IT 2509 provide that FBT will be payable by an employer under a novated lease on the benefit that the employee obtains by purchasing the car for less than its market value at the expiration of the lease.

67. Under the terms of the novated lease, the Employee has the obligation to pay the residual of the lease and, as per paragraphs 29 and 30 of this Product Ruling, this includes the option of requesting the purchase of the Vehicle from LeasePlan for the residual value upon termination of the lease, either at the Scheduled Expiry Date or prior to that date. Any potential benefit received by the Employee upon the purchase of the Vehicle at termination could be regarded as a residual fringe benefit where the market value of the Vehicle at the time of its purchase is greater than its agreed residual value.

68. A residual fringe benefit is defined in subsection 136(1) of the FBTAA to mean a fringe benefit that is a residual benefit. A residual benefit, also defined in subsection 136(1) of the FBTAA, means a benefit that is a residual benefit by virtue of section 45 of that Act. Section 45 of the FBTAA provides that a benefit is a residual benefit for the purposes of the FBTAA if the benefit is not a benefit by virtue of a provision of SubDivision A of Divisions 2 to 11 (inclusive).

69. In *Granby v. Federal Commissioner of Taxation* (1995) 30 ATR 400; 95 ATC 4240 (*Granby*), the Federal Court determined that where a lessor and lessee had dealt with each other at arm's length in the initial lease transaction, the acquisition by a lessee of the relevant property for its residual value at the completion of the lease was also a dealing at arm's length. Whilst *Granby* concerned the capital gains provisions of the ITAA1936, it is noted in Taxation Determination TD 95/63,⁶ at paragraph 2, that the ATO accepts that the views of the Federal Court in *Granby* regarding the arm's length dealing also apply to the FBTAA.

70. TD 95/63 states, at paragraph 6, that the taxable value of a fringe benefit arising under certain types of leasing arrangements, including novations, from the purchase by the employee at the residual value, will depend on whether or not the lease is a bona fide lease. To that end, paragraph 4 of that TD provides that the ATO will generally accept a lease agreement as a bona fide lease where the residual value under that agreement is equal to or exceeds the minimum residual value calculated in accordance with the percentages of the original cost (as set out in the table in Taxation Ruling No. IT 28⁷), and where there is no express or implied agreement under which ownership would pass to the lessee at the end of the lease.

⁶ Taxation Determination TD 95/63 *Fringe benefits tax: where a car is acquired at the end of a lease, is the acquisition at the residual value an 'arm's length transaction' for the purposes of section 43 of the Fringe Benefits Tax Assessment Act 1986 (FBTAA)?*

⁷ Taxation Ruling IT 28 *Leasing arrangements of plant & machinery.*

71. IT 28, which provides minimum residual values for leased plant and machinery, has since been updated in Taxation Determination TD 93/142⁸ and ATO ID 2002/1004. ATO ID 2002/1004 sets out the minimum residual values for leased cars. TD 93/142 states, at paragraph 1, that '[t]he residual value of a leased item should reflect its market value at the end of the lease, not its written down value.'

72. The purchase of the Vehicle at termination by the Employee will not give rise to the provision of a residual benefit under section 45 of the FBTAA to the Employee by the Employer and will therefore not incur a fringe benefits tax liability as:

- (a) the initial dealing (and all subsequent dealings) between LeasePlan, the Employer and the Employee will be at arm's length and on commercial terms, as confirmed by the assumption at paragraph 37(i) of this Product Ruling;
- (b) the residual value for the purchase of the Vehicle (being the Purchase Price or the Nominated Early Termination Price, as applicable) by the Employee is the market value at termination which equals or exceeds the percentage of the cost as set out in ATO ID 2002/1004, as confirmed by the assumption at paragraph 37(h) of this Product Ruling; and
- (c) there is no express or implied agreement under which ownership will pass to the Employee at termination of the lease. The Employee may request to purchase the Vehicle, at which point they and LeasePlan must each agree to the transfer of the Vehicle at an agreed price if the Vehicle is to be sold, but has no right to purchase the Vehicle.

73. Where an operating and management services cost reconciliation (as referred to in paragraph 32 of this Product Ruling) gives rise to a deficit amount that is payable by the Employer and then recovered from the Employee's pre-tax salary or wages, a car expense payment benefit, as defined in subsection 53(3) of the FBTAA, arises. As per paragraph 65 of this Product Ruling, the provision of this car expense payment benefit by the Employer to the Employee in respect of the Vehicle, attributable to a period (the term of the lease) when the Vehicle was provided as a car fringe benefit (as per paragraph 15(e) of this Product Ruling), will be an exempt benefit pursuant to paragraph 53(1)(a) of the FBTAA.

⁸ Taxation Determination TD 93/142 *Income tax: in calculating the residual value of a leased item, may a lower residual value than those outlined in IT 28 be adopted in light of the more generous depreciation rates?*

Return of the vehicle to LeasePlan to be sold to another person

74. Under the terms of the novated lease and as per paragraphs 29 and 30 of this Product Ruling, the Employee may also pay the residual of the lease by choosing to return the vehicle to LeasePlan to sell upon termination of the lease at the Scheduled Expiry Date or, where permitted, prior to that date.

75. The settlement procedures which arise in these circumstances, as described at paragraphs 33 and 34 of this Product Ruling, provide a certain balancing amount which is either payable by the Employee to LeasePlan (if in deficit) or by LeasePlan to the Employee (if in surplus). Where a payment is owed by the Employee to LeasePlan and the employee is still employed by the Employer, LeasePlan invoices the Employer who recovers the additional cost from the Employee's pre-tax salary or wages.

76. Where the deficit amount is referable to the operating and management services cost reconciliation (as referred to in paragraph 34 of this Product Ruling) and is paid by the Employer before being recovered from the Employee's pre-tax salary or wages, an exempt car expense payment benefit will arise as per paragraph 73 of this Product Ruling.

77. To the extent that the deficit amount is referable to a shortfall in the Monthly Rental due to LeasePlan by the Employer under the novated lease (that is, the lease rental reconciliation referred to in paragraph 33 of this Product Ruling), it will form part of the taxable value of the car fringe benefit (as per paragraph 15(e) of this Product Ruling) where the Employer, in relation to the Vehicle, elects to apply the cost basis under section 10 of the FBTAA. To the extent that the Monthly Rental payable as a shortfall upon settlement forms part of the taxable value of the car fringe benefit, it does not give rise to a further fringe benefits tax liability as another type of fringe benefit pursuant to subsection 8(1) of the FBTAA which provides:

8(1) [Exempt application or availability for private use]

Except insofar as section 7 provides that the application or availability of a car held by a person is a benefit, the application or availability of a car held by a person is an exempt benefit.

78. The lease rental reconciliation referred to in paragraph 33 of this Product Ruling is not referable to car expenses (as defined in subsection 136(1) of the FBTAA) and therefore will not give rise to a car expense payment benefit under subsection 53(3) of the FBTAA. Whilst a payment by the Employer upon settlement of a deficit under a lease rental reconciliation will constitute an expense payment benefit for the purposes of section 20 of the FBTAA, subsection 8(1) of the FBTAA will apply to exempt the expense payment benefit on the basis that the payment is referable to the provision of a car.

Other options at termination

79. None of the other options available to the Employee upon termination of the lease, as per paragraphs 29 and 30 of this Product Ruling, can give rise to the payment of any settlement amounts by the Employer. There will therefore be no provision of a taxable fringe benefit by the Employer under any of those options.

FBT consequences on entry into the Concurrent Lease

80. As per paragraph 27 of this Product Ruling, the Employee has no rights or obligations under the Concurrent Lease until the Novation Agreement is terminated and all of the Employee's obligations under the relevant Settlement Annexure have been discharged. Any benefit derived by the Employee under the Concurrent Lease will therefore not arise while the novated lease is in operation and cannot be attributable to the Employer who is not a party to the Concurrent Lease.

Monthly Rental not assessable to the Employee

81. Under Division 6, assessable income consists of both ordinary income and statutory income to the extent the ordinary or statutory income is not exempt income or non-assessable non-exempt income. Section 6-5 includes income according to ordinary concepts (ordinary income) in assessable income and subsection 6-5(4) provides that an amount of ordinary income will be taken to be received as soon as it has been applied or dealt with in any way on behalf of or as directed by the taxpayer.

82. Statutory income is an amount which is not ordinary income but which is included in assessable income by statutory provision (subsection 6-10(2)) and subsection 6-10(3) provides that an amount that would otherwise be statutory income of a taxpayer but for the fact that it is not received becomes statutory income of the taxpayer as soon as it is applied or dealt with in any way on behalf of or as directed by the taxpayer.

83. Under the novated lease, as a result of the execution of the Novation Agreement, the Employer is responsible for paying the Monthly Rental to LeasePlan. These payments are not amounts being paid by the Employer on behalf of the Employee, but in respect of the rights and obligations that have been assumed by the Employer under the Novation Agreement.

84. Accordingly, payments of the Monthly Rental under the novated lease by the Employer to LeasePlan are not amounts that are applied or dealt with on behalf of the Employee or as the Employee directs and will not constitute ordinary income derived by the Employee pursuant to subsection 6-5(4), nor will these payments constitute statutory income of the Employee pursuant to subsection 6-10(3). This is consistent with the view expressed in paragraph 26 of TR 1999/15 which confirms that 'there are no income tax consequences for the employee during the period when the employer makes the lease payments' in either a full novation or a split full novation.

85. At the time the Concurrent Lease becomes operative (that is, once the Novation Agreement is terminated; all of the Employee's obligations under the relevant Settlement Annexure have been discharged; and the Employee successfully applies to continue the lease without a Novation Agreement), it is the Employee (not the Employer) who is responsible for making the Monthly Rental payments. No amounts could therefore be said to be applied or dealt with in any way on behalf of or as directed by the Employee under the Concurrent Lease so as to constitute assessable income.

Anti-avoidance

86. Provided that the scheme ruled on is entered into and carried out as disclosed in this Ruling, it is accepted that the scheme is an ordinary commercial transaction and neither Part IVA of the ITAA 1936 or section 67 of the FBTA will apply.

Appendix 2 – Detailed contents list

87. The following is a detailed contents list for this Ruling:

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References

Previous draft:

Not previously issued as a draft

*Related Rulings/Determinations:*IT 28; IT 2509; TD 93/142; TD 95/63;
TR 95/24; TR 1999/15; TD 2013/15*Subject references:*

- deductions & expenses
- exempt car expense payment benefits
- fringe benefits tax
- FBT car expenses
- FBT car fringe benefit
- income tax
- luxury car lease
- novation
- product rulings
- public rulings
- tax administration
- termination of leases

Legislative references:

- FBTAA 1986
- FBTAA 1986 7(1)
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- FBTAA 1986 20
- FBTAA 1986 45
- FBTAA 1986 53
- FBTAA 1986 53(1)
- FBTAA 1986 53(1)(a)
- FBTAA 1986 53(3)
- FBTAA 1986 67
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- ANTS(GST)A 1999
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- TAA 1953

Case references:

- Re Jones and Federal Commissioner of Taxation [2005] AATA 691; (2005) 60 ATR 1096; 2005 ATC 2236
- Granby v. Federal Commissioner of Taxation (1995) 30 ATR 400; 95 ATC 4240

Other references:

- ATO ID 2002/1004

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