TR 2005/20 - Income tax: the interaction of deemed ownership under Division 240 of the Income Tax Assessment Act 1997 with the 'holding' rules in Division 40

Taxation Ruling

Income tax: the interaction of deemed ownership under Division 240 of the *Income Tax Assessment Act 1997* with the 'holding' rules in Division 40

Contents Para

Preamble

*The number, subject heading, **What this Ruling is about** (including **Class of person/arrangement** section), **Date of effect**, and **Ruling** parts of this document are a 'public ruling' for the purposes of **Part IVAAA of the Taxation Administration Act 1953** and are legally binding on the Commissioner. Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a 'public ruling' and how it is binding on the Commissioner.*

What this Ruling is about

1. This Ruling considers when a taxpayer who is taken to own goods under Division 240 of the *Income Tax Assessment Act 1997* (ITAA 1997)[1] will be taken to 'hold' a depreciating asset for the purposes of Division 40.

2. Division 240 treats a hire purchase agreement[2] as a sale of goods, combined with a loan, for income tax purposes. Division 40 provides various capital allowances, including a deduction for the decline in value of a depreciating asset that a taxpayer holds.[3]

3. This Ruling does not discuss the operation of Division 240 in detail. The Ruling also does not cover a hire purchase agreement that is also a lease of a luxury car for the purposes of Division 42A of Schedule 2E to the *Income Tax Assessment Act 1936* (ITAA 1936).

4. This Ruling only considers the application of items 6 and 10 of the table in section 40-40. The Ruling does not consider the circumstances in which another item of the table in section 40-40 may also have application.

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[1] All legislative references in this Ruling are to the ITAA 1997 unless otherwise stated.
[2] References to a 'hire purchase agreement' in this Ruling are to the term as defined in subsection 995-1(1). See the Definitions section at paragraph 49 of this Ruling.
[3] Section 40-25. The deduction is reduced by the extent to which the asset is used or installed ready for use for a purpose other than a 'taxable purpose' (subsection 40-25(2)).

Date of effect

5. This Ruling applies 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 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).

Ruling

6. A taxpayer ('the notional buyer') who is taken to be the owner of goods under subsection 240-20(2) will not be the holder of the goods for the purposes of Division 40, unless it is reasonable to conclude that the notional buyer will acquire the asset, or that the asset will be disposed of at the direction, and for the benefit of, the notional buyer.

7. Where this requirement is satisfied the notional buyer will be the holder of the asset under section 40-40, whether by reason of the direct operation of item 6 of the table in section 40-40 ('item 6'), or indirectly under item 10 of the table in section 40-40 ('item 10') because of the operation of subsection 240-20(2) and subsection 240-115(1). Either one or the other item will be satisfied because the expressions 'reasonable to expect' and 'reasonably likely' in the context in which those expressions appear, in item 6 and subsection 240-115(1) respectively, have the same meaning.

Explanation

8. The explanation is made up of two parts: the first part contains a general overview of the operation of Divisions 40 and 240 and the second part explains how the two Divisions interact with each other.

Overview of the legislation

Division 40

9. Division 40 is the uniform capital allowances system which became part of the ITAA 1997 on 30 June 2001.[4] It replaced a number of former Divisions of the ITAA 1997 dealing with deductions for capital expenditure including Division 42 (depreciation). The new Division replaced a variety of capital allowances using differing terminology and bases for deduction with a single, consistent system, one which differs from the former provisions in a number of ways. Division 40, among other things, provides a deduction for the decline

[4] The *New Business Tax System (Capital Allowances) Act 2001* (No. 76 of 2001) inserting Division 40 received Royal Assent on 30 June 2001. *Taxation Laws Amendment (No. 1) Act 2001* (No. 72 of 2001) inserting Division 240 also received Royal Assent on 30 June 2001.

in value of a depreciating asset that a taxpayer *holds.*[5] The former Division 42 provided a deduction for depreciation of plant and articles that a taxpayer *owned*.

10. Section 40-40 sets out ten items under which a taxpayer is taken to hold a depreciating asset. The general or 'default' rule is that the taxpayer holds an asset when he, she or it is the owner of the asset (item 10). Other items provide that a taxpayer holds an asset in various other circumstances even though they are not the asset's owner (for example tenants are taken to hold fixtures over which they have certain rights).[6] In the scheme of section 40-40 the earlier items can be seen as special cases that are, in effect, exceptions to the general rule in item 10, and which apply in priority to it.

11. One exception to the general holding rule is in item 6. Broadly, item 6 applies where:[7]

- a taxpayer has possession, or an immediate right to possession, of the depreciating asset combined with a right, the exercise of which would make it the holder (for example an option to acquire); and
- it is 'reasonable to expect' that the taxpayer will become the asset's holder by exercising that right or that the asset will be disposed of at their direction and for their benefit.

12. The effect of item 6 applying to an arrangement is that the entity in possession, or with a right to immediate possession, of the asset is the holder of the depreciating asset for the purposes of Division 40 and the legal owner is not. Further, the legal owner cannot hold the depreciating asset under another item of the table.[8]

13. Examples of when item 6 may apply include a taxpayer that has possession of goods under certain financing transactions or a taxpayer that has a right to possession under a bare trust arrangement. Example 2 in section 40-40 indicates that item 6 was intended to apply to goods that are subject to a hire purchase agreement. It states that item 6 applies to make a taxpayer the holder of a depreciating asset where the taxpayer is the hirer of goods under a hire purchase agreement. Note 2 to section 40-40 also states that item 6 applies to hire purchase agreements among other things. Other examples of financing transactions where item 6 would apply include a chattel mortgage or retention of title arrangement.

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[5] Section 40-25. The deduction is reduced by the extent to which the asset is used for a purpose other than a 'taxable purpose' (subsection 40-25(2)).
[6] See items 2 and 3 of the table in section 40-40.
[7] See item 6 of the table in section 40-40.
[8] Section 40-40.

14. The Explanatory Memorandum to the New Business Tax System (Capital Allowances) Bill 2001, which inserted Division 40 into the ITAA 1997, confirms that item 6 was intended to apply to goods that are subject to a hire purchase agreement.[9] The policy behind item 6 is that the taxpayer is the economic owner of the goods in these cases and as a result would suffer any loss in value. Therefore, the taxpayer should be entitled to any deductions for the decline in value of the goods instead of the legal owner.[10]

Division 240

15. Division 240 applies to hire purchase arrangements entered into after 27 February 1998. The Bill enacting Division 240 was passed into law on 30 June 2001.[11] The broad scheme of Division 240 is to treat a hire purchase agreement as a sale of the goods concerned by the notional seller to the notional buyer combined with a loan from the notional seller to the notional buyer.

16. Under section 240-20 the notional seller is taken to have disposed of the goods to the notional buyer and the notional buyer is taken to have acquired the goods at the start of the arrangement.[12] The notional buyer is taken to own the goods (subject to satisfying the requirements in section 240-115: see below) until either the arrangement ends or the notional buyer becomes the notional seller under a later arrangement to which Division 240 applies.[13]

17. Section 240-115 provides that the notional buyer is only deemed to own the goods under section 240-20 if:

- the notional buyer would have been the owner or the quasi-owner of the goods if the arrangement had been a sale of the goods;[14] and
- it is reasonably likely that the right, obligation or contingent obligation to acquire the goods will be exercised by, or in respect of, the notional buyer.[15]

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[9] See paragraphs 1.29 and 1.52 of Explanatory Memorandum to the New Business Tax System (Capital Allowances) Bill 2001.
[10] See paragraphs 1.25 to 1.29 of the Explanatory Memorandum to the New Business Tax System (Capital Allowances) Bill 2001. Also see Example 2 and Note 2 to section 40-40.
[11] The amendments introduced in Taxation Laws Amendment Bill (No. 5) 1999 were passed into law as *Taxation Laws Amendment (No. 1) Act 2001* (No. 72 of 2001), which received Royal Assent on 30 June 2001.
[12] Subsection 240-20(1).
[13] Subsection 240-20(2).
[14] Paragraph 240-115(1)(a).
[15] Paragraph 240-115(1)(b).

18. If these requirements are not satisfied in relation to a particular hire purchase agreement, section 240-115 modifies[16] ownership of the goods for the purposes of the capital allowance provisions[17] such that:

- if, apart from the operation of Division 240, an entity other than the notional seller would own the goods, that entity is taken to be the owner of the goods;[18] and
- if, apart from the operation of Division 240, the notional seller would own the goods, no entity is taken to be the owner of the goods.[19]

19. Section 240-15 provides that Division 240 applies for the purposes of the ITAA 1997 and ITAA 1936 generally, other than the capital gains and withholding tax provisions.[20] Thus one would be led to expect that the notional buyer's deemed ownership under Division 240 would have effect for the purposes of the holding rules in section 40-40.[21] It would follow that a notional buyer who is deemed to own the goods under Division 240 is the owner of the goods, and so is the holder, pursuant to item 10, subject to the operation of the other items.

How does Division 240 interact with the 'holding' rules in Division 40?

20. The question arises as to whether the notional buyer's deemed ownership under section 240-20 applies for the purposes of Division 40, such that the notional buyer is the owner of the goods, and so is the holder, for the purposes of item 10; or does the notional buyer instead need to satisfy item 6 in order to hold the goods? Or may both provisions apply?

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[16] The modifications also apply if the notional buyer disposes of their interest in the goods or enters into a luxury car lease covered by Division 42A of Schedule 2E to the ITAA 1936 and subleases the car to another person (subsection 240-115(2)).

[17] 'Capital allowance' is defined in subsection 995-1(1) to include deductions under Division 40 of the ITAA 1997.

[18] Subsection 240-115(3).

[19] Subsection 240-115(4).

[20] Section 240-15. The interaction of Division 240 and the former Division 42 had no consequences for capital gains tax (CGT). However, Division 40 displaces the CGT provisions. If Division 240 interacts with Division 40, its rules thus affect the CGT position of the notional buyer and notional seller.

[21] See paragraph 2.5 of the Explanatory Memorandum to the Taxation Laws Amendment Bill (No. 5) 1999. Division 240 was intended to ensure that persons who acquire goods under hire purchase or instalment sale arrangements are treated as the owners of the goods for the purpose of applying the various taxation capital allowance provisions.

21. The Commissioner's view is that the notional buyer can be taken to be the holder of the goods under either item 6 or item 10. The requirements to 'hold' under item 6 and to 'own' under Division 240 were intended by the drafters to achieve the same result, namely, to entitle the economic owner (as opposed to the legal owner) to any deductions for the decline in value of the goods. Although there are two mechanisms in the ITAA 1997 for ascertaining whether the notional buyer is the holder, in the great majority of cases, both mechanisms achieve precisely the same result, and so it does not really matter which item is taken to be satisfied.

22. In arriving at a conclusion as to the effect of the relevant provisions, what matters is the legislative purpose, to be collected from the provisions considered in their entirety, and not their mechanical interaction. The ultimate question is whether a deduction is to be allowable to a particular taxpayer. In construing the provisions, the task, then, is to elicit the result intended by Parliament – that is, whether a deduction is to be allowed, and to whom – rather than the precise means by which the deduction is to be conferred.

23. Divisions 40 and 240 are both intended to implement a single, common legislative purpose of making the hirer under a hire purchase agreement the taxpayer entitled to deductions for the loss in value of the asset, or goods hired under the agreement, in circumstances where the arrangement is substantially one to acquire the asset (so that the loss for any decline in the value of the asset falls on the hirer). Consequently, we do not see it as appropriate to read one provision to the exclusion of the other; rather we consider that item 6 and Division 240 cumulatively express the circumstances in which a hirer of goods is to be the taxpayer entitled to a deduction for the decline in value of the goods, notwithstanding superficial imperfections in the mechanics of their interaction. In saying this, it is acknowledged that there are minor differences in outcome indicated by the two Divisions. Consequently it is necessary to discuss the situations where differences may arise.

Differences between Division 240 and item 6

24. There are two main differences in the way the requirements to 'hold' under item 6 and to 'own' under Division 240 are expressed. The first of these differences is more apparent than real.

'Reasonably likely' (Division 240) and 'reasonable to expect' (item 6)

25. Division 240 deems the notional buyer of goods to be their owner if, among other things, it is 'reasonably likely' that they will become the owner of those goods by exercising a right, or pursuant to an obligation or contingent obligation.[22] On the other hand, item 6 makes the notional buyer the holder of an asset if it is 'reasonable to expect' them to become the holder by exercising an option or other right they have.

[22] Paragraph 240-115(1)(b).

26. The word 'likely' has no fixed meaning. Its meaning can vary from 'possible' to 'probable' depending on the context in which it is used. The crux of the point was put by Bowen CJ in *Tillmanns Butcheries Pty Ltd v. Australasian Meat Industry Employees' Union* (1979) 42 FLR 331 where his Honour said at 339:

> The word 'likely' is one which has various shades of meaning. It may mean 'probable' in the sense of 'more probable than not' – 'more than a fifty per cent chance'. It may mean 'material risk' as seen by a reasonable man 'such as might happen'. It may mean 'some possibility' – more than a remote or bare chance. Or, it may mean that the conduct engaged in is inherently of such a character that it would ordinarily cause the effect specified.

27. In relation to the phrase 'reasonably likely', Marks J observed in *Department of Agriculture & Rural Affairs v. Binnie* [1989] VR 836 at 842:

> The expression 'reasonably likely' is substantially idiomatic, its meaning not necessarily unlocked by close dissection. In its ordinary use, it speaks of a chance of an event occurring or not occurring which is real – not fanciful or remote... A chance which in common parlance is described as 'reasonable' is one that is 'fair', 'sufficient' or 'worth noting'.

28. The cases suggest for it to be 'reasonable to expect' something to occur requires a sufficiently reliable prediction that it will occur,[23] or at least an expectation or prediction based on reasonable grounds.[24]

29. The Commissioner considers that in the legislative context in which the phrases appear, the meanings of 'reasonably likely' and 'reasonable to expect' are the same. The purpose of Division 240 is to identify when a hire-purchase agreement amounts to a notional sale; the purpose of Division 40 is to identify the 'economic owner' of an asset in order to allow that taxpayer a deduction for the decline in value of the asset. Under a typical hire-purchase agreement, title to the goods hired under the agreement passes as a matter of course to the hirer. The context of the tests in both Divisions shows that they are concerned with cases where the hirer will become the owner. Accordingly we consider that the expressions 'reasonably likely' in subsection 240-115(1) and 'reasonable to expect' in item 6 both require that it be reasonable to conclude that the notional buyer will acquire the asset or have the goods disposed of at their direction and for their benefit. Both subsection 240-115(1) and item 6 require that the notional buyer have such an expectation of the future and that it is based on a reasonable basis. Accordingly, 'reasonably likely' and 'reasonable to expect' should be given the same meaning in

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[23] *Federal Commissioner of Taxation v. Peabody* (1994) 181 CLR 359 at 385; 94 ATC 4663 at 4671; (1994) 28 ATR 344 at 353.

[24] See *Commissioner of Taxation v. Arklay* (1989) 22 FCR 298 at 302; 89 ATC 4563 at 4567; (1989) 20 ATR 276 at 279 per Sheppard, Wilcox and Hartigan JJ; *Commissioner of Taxation v. McCabe* (1990) 26 FCR 431 at 435; 90 ATC 4968 at 4971; (1990) 21 ATR 992 at 995 per Davies J; *Attorney-General's Department v. Cockcroft* (1986) 10 FCR 180 per Bowen CJ and Beaumont J at 190 and Sheppard J at 196.

interpreting the respective provisions of the ITAA 1997 in which they are found.

30. In making the assessment as to the future, the notional buyer must objectively[25] determine the likelihood that they will acquire the goods, or that the goods will be disposed of at their direction and for their benefit. Factors that may be relevant, but not necessarily conclusive, for the notional buyer in assessing this include:

- independent assessments of the expected market value of the goods at the end of the hire period as against the amount required to purchase the goods under the arrangement;
- the notional buyer's history in deciding to acquire goods under previous hire purchase agreements providing there is nothing to suggest this pattern will change; and
- any other relevant commercial considerations affecting the notional buyer's decision to acquire the goods.

'Right, obligation or contingent obligation' (Division 240) and 'right' (item 6)

31. Division 240 and item 6 differ in the way they describe the contractual mechanisms by which the hirer may become the owner of the goods.

32. Under Division 240, the notional buyer must have, among other things, 'the right, obligation or contingent obligation to acquire the property'.[26] This means the arrangement can involve either a call or put option, or both. This is consistent with the definition of a 'hire purchase agreement' in the ITAA 1997.[27]

33. Item 6 requires the hirer to have 'a right as against the former holder the exercise of which would make the economic owner [that is the hirer] the holder under any item of this table'. Further, the reasonable expectation test in the item requires, among other things, for it to be 'reasonable to expect that the economic owner will become its holder *by exercising the right*' (emphasis added). The reasonable expectation test can also be satisfied in another way: where it is reasonable to expect the asset will be disposed of at the direction and for the benefit of the economic owner. Division 240, on the other hand, appears only to apply where the hire purchase agreement

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[25] This assessment involves the application of an objective test, but, as one of the concomitant elements of that test, the subjective intentions of the taxpayer may be relevant (*Commissioner of Taxation v. Arklay* (1989) 22 FCR 298 at 303; 89 ATC 4563 at 4567; (1989) 20 ATR 276 at 279-280).

[26] Paragraph 240-115(1)(b).

[27] See subparagraph 995-1(1)(a)(i) of the definition of 'hire purchase agreement'. An instalment sale can also meet the definition (see paragraph 995-1(1)(b)).

entitles the hirer to acquire the goods, and not to a case where the hirer may nominate a person to whom title is to be transferred.[28]

34. It can be seen, therefore, that under the Division 240 test, both a call and put option can be taken into account in determining the likelihood of the notional buyer acquiring the goods. Under the item 6 test the existence of a put option in favour of the notional seller is irrelevant to the main reasonable expectation test.[29] Consequently this distinction between the two provisions is a real one.

35. It is understood, however, that it is very rare for an ordinary hire-purchase arrangement to contain a put option. Further, it is understood to be rare for the hirer to be entitled to require a disposition of the asset to someone else.

Does it matter whether the hirer holds the goods under item 10 or item 6?

36. In the vast majority of cases, whether the hirer holds the goods under item 6 or item 10 (via the operation of Division 240) of the hold table in section 40-40 will be academic. This is because, as discussed, the meaning of the phrases 'reasonable to expect' and 'reasonably likely' in their contexts are the same. Furthermore, hire purchase agreements will generally confer a right on the hirer to acquire the goods at the end of the hire period rather than impose an obligation or contingent obligation to acquire on the hirer. Accordingly, the application of the tests in Division 240 and item 6 will, for the most part, produce the same outcome so far as whether the hirer is the holder of the goods under Division 40.

If Division 240 is satisfied but item 6 is not, or vice versa, which applies?

37. In the two rare cases mentioned in paragraph 35, a different result could follow from the differences in expression. There are three possible views as to which item applies in these cases. Division 240 could operate to the exclusion of item 6 in relation to hire purchase agreements;[30] item 6 could operate to the exclusion of Division 240 in relation to deductions for decline in value of depreciating assets; or both provisions might apply.

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[28] However, a hirer who is entitled to acquire goods may contract to sell them before acquiring title. In such a case, a transfer by direction operates as a simultaneous acquisition and disposal by the hirer.

[29] It is perhaps possible, however, that it might be relevant in considering whether the asset will be disposed of at the direction and for the benefit of the notional buyer, although generally a put option would be exercised only where it is for the benefit of the notional seller.

[30] It should be noted that item 6 would have a residual operation for non-hire purchase cases. A beneficiary in possession of trust property who has an absolute entitlement to have title to that property transferred to him will be the holder under item 6 of that property if it is a depreciating asset.

38. The issue as to whether one test prevails, and which, or whether both may apply, is finely balanced. There are sound arguments for all positions. Both Divisions could be regarded as exclusive codes for their treatment of their subject matter, Division 40 for the specific matter of deductions for the decline in value of assets, Division 240 for the general taxation treatment of goods hired under hire purchase agreements. Either (but not both) could therefore be regarded as intended to operate to the exclusion of the other. However, neither may be regarded as more specific than the other.[31] Both were enacted simultaneously,[32] though Division 40 is the later in origin[33] and time of application.[34]

39. Both Division 40 and Division 240 have been drafted with a mechanism to enable the hirer of goods to obtain decline in value deductions for the goods. However, the competing evidence within each Division means it is difficult to conclusively determine the legislative intent with respect to the interaction of the two Divisions, especially since the intended interaction of Division 240 with Division 42 was superseded at the moment of its enactment.

40. The provisions in Division 240 (including the Guide) were specifically amended to replace their original references to 'Division 42' (the former Division dealing with depreciation of plant) to 'Division 40'.[35] That is, the 'owner' language used in Division 240 was originally designed, among other things, to conform with the 'owner' requirements in Division 42.[36] But the replacement of the references to Division 42 with references to Division 40 suggests that Division 240 was intended to interact with Division 40 as it did with the former Division 42.[37] For instance, the Guide to Division 240 states 'if the property is not trading stock, the notional buyer may be able to deduct amounts for the expenditure under Division 40';[38] and 'the notional seller loses the right to deduct amounts under Division 40'.[39]

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[31] Division 240 is arguably more specific in that it only applies to hire purchase agreements while item 6 does not; and item 6 is arguably more specific because it applies only for decline in value deductions under Division 40 while Division 240 has effect for income tax purposes generally.
[32] Refer to footnote 4
[33] Taxation Laws Amendment Bill (No. 5) 1999 enacting Division 240 was introduced on 11 March 1999. New Business Tax System (Capital Allowances) Bill 2001 enacting Division 40 was introduced on 24 May 2001.
[34] Division 240 applies to arrangements entered into after 27 February 1998. Broadly, Division 40 applies after 30 June 2001.
[35] *New Business Tax System (Capital Allowances – Transitional and Consequential) Act 2001*.
[36] See paragraph 2.5 of the Explanatory Memorandum to Taxation Laws Amendment Bill (No. 5) 1999.
[37] See paragraph 12.133 of the Revised Explanatory Memorandum (Senate) to the New Business Tax System (Capital Allowances – Transitional and Consequential) Bill 2001. See also paragraph 12.133 of the Explanatory Memorandum to the New Business Tax System (Capital Allowances) Bill 2001.
[38] Subsection 240-7(2).
[39] Subsection 240-3(4).

41. Consequently, it is not easy to construe how items 6 and 10 were intended to apply, having regard to each other. On one view, a taxpayer who is taken to be the owner under Division 240 may never qualify to be the holder under item 6, because there will never be an 'economic owner' who is not also the 'former holder'. This is the literal effect of taking the hirer to be the owner for the purposes of Division 40. On another view, 'owner', 'legal owner' and 'equitable owner' in item 10 must, having regard to item 6, refer only to persons who in truth are such owners, not notional or deemed owners.

42. If it matters which item applies, the Commissioner's view is it would not be appropriate to construe item 6 so as to leave it with no operation with respect to hire purchase agreements. This is because Note 2 and Example 2 in section 40-40 clearly indicate that within the uniform capital allowances system, item 6 was intended to be applied, on its own terms, to hire purchase agreements to determine whether a hirer is the holder of the goods and entitled to any decline in value deductions.

43. If the deemed ownership under Division 240 always applied for the purposes of item 10, there would be no need for item 6 to cover hire purchase agreements. This would mean that Note 2 and Example 2 in section 40-40 and the comments in the Explanatory Memorandum in relation to section 40-40 are all incorrect. That is, they all purport to illustrate item 6 arrangements that do not actually need to be considered under item 6. Examples and notes within the ITAA 1997 are not operative but are part of the Act. As such, they are a significant intrinsic aid to construction.[40] Accordingly, in concluding that item 6 must be satisfied in these circumstances, the Commissioner is adopting a view that is consistent with the note and example in section 40-40.

44. To give this effect to item 6 is not inconsistent with the apparent legislative purpose of Division 240. Item 6 may be seen as essentially a way of directly implementing the policy of Division 240 so far as it regards capital allowances for goods under hire purchase agreements, following the replacement of 'ownership' of plant and articles by the holding of depreciating assets as the basis for affording the capital allowance.

45. It does not necessarily follow, however, that no operation is to be given to Division 240 for the purpose of determining who holds a depreciating asset in those cases (hire purchase agreements with only put options) which do not fall within the words of item 6. The question is whether a legislative purpose is to be discerned of retracting the entitlement of hirers to capital allowances in those cases. The references in Division 240 to Division 40 appear to give a contrary indication. There is no positive reason for supposing that Parliament intended to retract capital allowances for hirers in these cases. As it is not clearly evident that Division 40 was enacted with the purpose of retracting capital allowances in those circumstances in which they would have arisen for hirers of goods had Division 42

[40] Sections 2-35 and 2-45.

continued in operation (or to put it another way, it is not clearly apparent that there was an intention to re-instate the entitlement of legal owners to claim depreciation in these circumstances), it will be the practice of the Commissioner to allow decline in value deductions to hirers of goods who are owners under Division 240 as holders under item 10 in those cases where they are not holders under item 6.

Example

Example 1

46. Farm Co has entered into a hire purchase agreement with Machine Co in respect of a crop harvester. Under the terms of the agreement Farm Co will pay monthly hire payments including an interest component over a period of 3 years. At the conclusion of the hire period, Farm Co may exercise a right to acquire the harvester for 20% of the original purchase value of the machine. An independent valuation suggests that the harvester is likely to have a fair market value significantly in excess of the exercise price at the end of the hire period.

47. Farm Co would have been the owner of the harvester if the arrangement had been a sale. It is also 'reasonably likely' that Farm Co will exercise its right to acquire the harvester at the end of the hire period. The expected market value of the machine is significantly more than Farm Co's exercise price. There is no other evidence to suggest any contrary action by Farm Co. Therefore, section 240-20 will deem Farm Co to be the owner of the machine. Similarly, it is also 'reasonable to expect' that Farm Co will exercise its right to acquire the harvester. Either item 6 or item 10 will apply so that Farm Co is the holder of the harvester for Division 40 purposes.

48. Farm Co will be entitled to claim a deduction for the decline in value of the harvester if the other requirements in Division 40 are satisfied.

Definitions

49. A 'notional seller' has the meaning given by subsection 240-17(1):

> An entity is the ***notional seller*** if it is a party to the hire purchase agreement, and:
>
> a) actually owns the goods; or
>
> b) is the owner of the goods because of a previous operation of Division 240.

50. A 'notional buyer' has the meaning given by subsection 240-17(2):

> An entity is the ***notional buyer*** if it is a party to the hire purchase agreement and, under the agreement, has the right to use[41] the goods.

51. A 'hire purchase agreement' is defined in subsection 995-1(1) as:

> ***hire purchase agreement*** means:
>
> (a) a contract for the hire of goods where:
>
> (i) the hirer has the right, obligation or contingent obligation to buy the goods; and
>
> Note: An example of a contingent obligation is a put option.
>
> (ii) the charge that is or may be made for the hire, together with any other amount payable under the contract (including an amount to buy the goods or to exercise an option to do so), exceeds the price of the goods; and
>
> (iii) title in the goods does not pass to the hirer until the option referred to in subparagraph (a)(i) is exercised; or
>
> (b) an agreement for the purchase of goods by instalments where title in the goods does not pass until the final instalment is paid.

Detailed contents list

52. Below is a detailed contents list for this draft Taxation Ruling:

[41] 'Right to use' is defined in subsection 995-1(1) to include the right to possess.

Commissioner of Taxation
14 December 2005

Previous draft:

TR 2005/D12

Related Rulings/Determinations:

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

Subject references:

- capital allowances
- depreciating asset
- depreciating asset holder
- hire purchase

Legislative references:

- TAA 1953 Pt IVAAA
- ITAA 1936 Sch 2E Div 42A
- ITAA 1997 2-35
- ITAA 1997 2-45
- ITAA 1997 Div 40
- ITAA 1997 40-25
- ITAA 1997 40-25(2)
- ITAA 1997 40-40
- ITAA 1997 Div 42
- ITAA 1997 Div 240
- ITAA 1997 240-3(4)
- ITAA 1997 240-7(2)
- ITAA 1997 240-15
- ITAA 1997 240-17(1)
- ITAA 1997 240-17(2)
- ITAA 1997 240-20
- ITAA 1997 240-20(1)
- ITAA 1997 240-20(2)
- ITAA 1997 240-115
- ITAA 1997 240-115(1)
- ITAA 1997 240-115(1)(a)
- ITAA 1997 240-115(1)(b)
- ITAA 1997 240-115(2)
- ITAA 1997 240-115(3)
- ITAA 1997 240-115(4)
- ITAA 1997 995-1(1)
- ITAA 1997 995-1(1)(a)(i)
- ITAA 1997 995-1(1)(b)
- New Business Tax System (Capital Allowances) Act 2001
- New Business Tax System (Capital Allowances – Transitional and Consequential) Act 2001
- Taxation Laws Amendment (No. 1) Act 2001

Case references:

- Attorney-General's Department v. Cockcroft (1986) 10 FCR 180
- Commissioner of Taxation v. Arklay (1989) 22 FCR 298; 89 ATC 4563; (1989) 20 ATR 276
- Commissioner of Taxation v. McCabe (1990) 26 FCR 431; 90 ATC 4968; (1990) 21 ATR 992
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