TR 96/20 - Income tax: assessability and deductibility of prompt payment discounts offered by traders of goods to their customers and certain other discounts

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Taxation Ruling

Income tax: assessability and deductibility of prompt payment discounts offered by traders of goods to their customers and certain other discounts

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*This Ruling, to the extent that it is capable of being a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**, is a public ruling for the purposes of that Part. Taxation Ruling TR 92/1 explains when a Ruling is a public ruling and how it is binding on the Commissioner.*

*[**Note:** This is a consolidated version of this document. Refer to the ATO Legal Database (http://law.ato.gov.au) to check its currency and to view the details of all changes.]*

What this Ruling is about

1. A taxpayer engaged in a business of selling goods (a 'trader') may offer to those of its customers who purchase goods on credit, a discount for settling their credit accounts promptly. A customer might, for example, be offered a 5% discount from the invoice price of goods purchased if payment of the remaining 95% is made within 7 days of the invoice date. A discount of this nature is commonly called a 'prompt payment' or 'settlement' discount.

Class of person/arrangement

2. This Ruling explains:

(a) when the trader, in these circumstances, should include the sale proceeds in assessable income;

(b) when the customer, purchasing goods as trading stock in these circumstances, should claim the purchase price as an allowable deduction;

(c) the effect on the trader's allowable deductions and on the customer's assessable income if the trader's offer of a discount is accepted by the customer; and

(d) that other discounts offered by a trader - such as a cash discount, a trade discount and a quantity or a bulk discount

- are treated differently from that of a prompt payment discount.

3. This Ruling does not deal with a variety of other trade incentives offered by traders (including payments, reimbursements, rebates, allowances and credits) where the conditions on which the incentives become available are satisfied at some time after the time of sale.

Ruling

(a) Trader's assessable income

4. The appropriate basis for determining the amount of income derived by a trader is the accruals (or earnings) method. Under the accruals method, the income of a trader is derived, for the purposes of section 6-5 of the *Income Tax Assessment Act 1997* (ITAA 1997), when the goods are sold and a debt is created.

5. The debt must be one that is due to the trader - that is, the debt must be presently owing to the trader. A debt may be presently owing even though it is not immediately recoverable or is able to be defeased or time is given for it to be paid.

6. The price for which goods are sold under a contract of sale is the full invoice price. There is nothing uncertain or contingent at the time of sale about the price for which the contract has been made. The full invoice price is the debt created by the sale. An accompanying offer by the trader to discount the sale price in consideration for prompt payment does no more than provide an opportunity for the customer to acquire the goods at an actual cost less than their contracted price. But the provision of this opportunity cannot operate retrospectively to reduce the original debt created at the time of sale by the contract of sale.

7. A trader who sells goods to a customer on credit and offers the customer a discount for settling the credit sale promptly, as a general proposition, derives the full invoice sale price in terms of section 6-5 of the ITAA 1997 at the time of sale. The trader should therefore, include at the time of sale, the full invoice price in assessable income.

8. The only exception to this general proposition is if facts are on all fours with *Ballarat Brewing Co v. FC of T* (1951) 82 CLR 364; (1951) 9 ATD 254 - there must be virtual certainty in the light of past experience and policy that the amount of the discount will not be received by the trader.

(b) Customer's allowable deductions

9. A customer purchasing trading stock of a business is allowed a deduction, under section 8-1 of the ITAA 1997, for its purchase price. Broadly speaking, the deduction is allowable in the year in which the purchase price is incurred.

10. For it to be incurred, a liability must be a presently existing one to which the customer is definitively committed. A liability may still be incurred even though it remains unpaid or it may later be defeased.

11. The price for which goods are purchased under a contract of sale is the full invoice price. There is nothing uncertain or contingent at the time of purchase about the price for which the contract has been made. The full invoice price is the liability to which the customer is obligated by the purchase. The accompanying availability to a customer of a discount to the purchase price in consideration for prompt payment does no more than provide an opportunity for the customer to acquire the goods at an actual cost less than their contracted price. But this opportunity cannot operate retrospectively to reduce the original liability created at the time of the purchase by the contract of sale.

12. The customer should therefore, claim at the time of purchase, the full invoice price as an allowable expenditure under section 8-1 of the ITAA 1997.

(c) Effect of accepting discount

- ***Substance and effect of the discount***

13. The substance and effect of an offer of a prompt payment discount in the circumstances described in this Ruling is open to different interpretations. The offer may, for example, provide the customer with an opportunity to later vary the contract price at which goods were purchased. Alternatively, the offer may provide the customer with an opportunity to later defease, in part, the liability created by the contract of sale. While the first of these views is our preferred view, the same result is achieved on either interpretation.

- ***Trader***

14. Under an accruals basis of accounting, sales made on credit are included in assessable income at the time of sale. The debt created by the sale is recognised as a revenue asset under account receivables and replaces the previous revenue asset of trading stock.

15. If the offer of a discount is accepted, the account receivable will be satisfied by the receipt of a lesser amount. The difference between

the amount receivable and the amount actually received represents a revenue loss incurred on the disposal of the account receivable asset.

16. A trader should therefore, claim at the time the account receivable is satisfied, the discount amount as an allowable deduction under section 8-1 of the ITAA 1997. This is so whether the substance and effect of the discount is a later variation of the contract price or is a part defeasance of the liability created by the contract of sale.

- ***Customer***

17. A liability incurred on the purchase of trading stock is a revenue expense. Where the liability is incurred on credit, the amount required to extinguish that liability may not be finally determined until it is paid.

18. If the offer of a discount is accepted and the liability is extinguished by the payment of an amount less than the amount of the liability, the amount of the difference gives rise to a revenue gain because it has the character of income under ordinary concepts.

19. A customer should, therefore, include at the time the liability is satisfied the discount amount as assessable income under section 6-5 of the ITAA 1997. This is so whether the substance and effect of the discount is a later variation of the contract price or is a part defeasance of the liability created by the contract of sale.

(d) Cash discount, trade discount and quantity or bulk discount

20. The conditions on which a cash discount, a trade discount and a quantity or bulk discount are available, are satisfied at the time of sale. Consequently, the sale price at the time of sale is the discounted price.

21. It is the discounted price therefore, that should at the time of sale, be included by a trader as assessable income under section 6-5 of the ITAA 1997 and claimed by a customer as an allowable expenditure under section 8-1 of the ITAA 1997.

Date of effect

22. This Ruling applies to years commencing both before and after its date of issue. The following arrangements apply to assessments made before the issue of this Ruling if a customer did not take up a trader's offer of a discount:

(a) If a trader has included, at the time of sale, only the discounted price in assessable income we will not seek (to the extent allowed by section 170 of the *Income Tax*

Assessment Act 1936 (ITAA 1936)) to include, in accordance with this Ruling, the amount of the discount in assessable income at the time of sale provided the amount of the discount is included in the trader's assessable income when the discount period expires without the discount having been claimed by the customer.

(b) If a customer has claimed, at the time of sale, only the discounted price as an allowable deduction, the customer may, if the customer wishes, amend assessments (to the extent allowed by section 170 of the ITAA 1936) to claim, in accordance with this Ruling, the amount of the discount as an allowable deduction at the time of sale provided the amount of the discount is not also claimed as an allowable deduction when the discount period expires without the discount having been claimed by the customer. If the customer does not wish to amend assessments of earlier years, the customer may claim the amount of the discount as an allowable deduction when the discount period expires without the discount having been claimed by the customer.

23. Notwithstanding paragraph 22 above, the terms of an agreed settlement between a trader or a customer and this Office will not be disturbed (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Explanations

(a) Trader's assessable income

24. It is an accepted principle of income tax law that the method under which a taxpayer accounts for its business or income producing activities for purposes of income tax must 'give a substantially correct reflex of the taxpayer's true income' (see *The Commissioner of Taxes (South Australia) v. The Executor Trustee and Agency Company of South Australia Ltd* (*Carden's* case) (1938) 63 CLR 108; (1938) 5 ATD 98 per Dixon J at CLR 154; ATD 131).

25. Dixon J was demonstrating this principle in *Carden* when he made the point that the basis on which a trading concern ought to be taxed is on its earnings rather than on its receipts. He said (at CLR 156; ATD 132):

> 'The basis of a trading account is stock on hand at the beginning and end of the period and sales and purchases. In such an account book debts represent what before sale was trading stock and it is almost inevitable that they should be taken into consideration upon an accrual and not a cash basis.'

26. This line of thought was used in *J Rowe & Son Pty Ltd v. FC of T* (1971) 124 CLR 421; 71 ATC 4157 to conclude that the accruals basis is the appropriate method for determining the amount of income derived by a taxpayer carrying on a business of selling goods.

27. The dissenting reasons of Latham CJ in *Carden* were also considered to be of weight in concluding in *Rowe* that the income of a business trading in goods is derived when its stock is sold and a debt is created. The Chief Justice had said (at CLR 125; ATD 110):

> '...trade debts which have accrued due in the relevant year but which have not been paid must be included for the purpose of ascertaining whether or not the business has earned a profit for the year, just as stock in trade at the beginning and end of the year must be taken into account for the same purpose.'

28. This association between the existence of a debt and the sale of trading stock was further supported by von Doussa J (with whose reasons Jenkinson and Spender JJ agreed) in *Gasparin v. FC of T* 94 ATC 4280; (1994) 28 ATR 130 where his Honour said (at ATC 4285; ATR 136) that it was:

> '...correct to lay stress upon the prominence given in *Carden* and *Rowe* to the importance of there being a debt in conjunction with a sale of trading stock before income is derived.'

29. It is clear from this line of decisions that the sale price of trading stock is derived as income of the trader when the sale price becomes a debt due to the trader in the sense that the debt is presently owing.

30. It is also clear that the existence of a debt is not necessarily affected by an inability on the part of the seller to recover immediately the debt by legal action. Gummow J (with whose reasons Northrop and Drummond JJ agreed) made the point in *Barratt & Ors v. FC of T* 92 ATC 4275 at 4281; (1992) 23 ATR 339 at 346:

> 'No doubt a debt that is presently recoverable by action generally will be an amount "derived" in the relevant sense by the creditor.'

31. But this view was later qualified (at ATC 4283; ATR 348) when it was said:

> 'The distinction between the coming into existence of a debt and the operation of impediments upon the recovery of an existing debt is well established and is drawn in many areas of the law.'

and referred as an example to the decision in *Re Pollack; ex parte DFC of T* 91 ATC 4925 at 4930, 4933, 4936; (1991) 103 ALR 133 at 140, 144, 147-149.

32. The meaning of the word 'recoverable' was also the subject of some discussion in *Henderson v. FC of T* (1970) 119 CLR 612; 70

ATC 4016. In respect of the relevant passages in that case, the view was expressed in *Barratt* (at ATC 4284; ATR 349) that:

> '...*Henderson's Case* should not be understood as deciding that an amount cannot be derived unless presently recoverable by action.'

33. It is equally clear that a debt may be due in the sense of presently owing even though it may only become payable at some future date (see, for example, *Rowe* at CLR 450; ATC 4160 - the debt need not be payable in the income year in which the debt is created; and *Henderson* at CLR 651; ATC 4020 - fees are still relevantly recoverable even though time to pay is afforded).

34. If a trader does not offer its customers a settlement discount, the price for which it sells goods is derived as assessable income when the price becomes a presently owing debt according to the terms of the contract of sale. In the simple example where a customer visits a trader's premises, selects the required goods, is provided with an invoice to evidence the purchase of those goods and immediately takes possession of the goods, then without more, the sale price of the goods is derived by the trader at the time of sale even though the trader may allow the customer time to pay the invoice amount.

35. The critical question then becomes whether this conclusion, and the earlier supporting reasons for it, are equally applicable if the trader offers to its customers a discount for prompt payment. For the reasons that follow, we think so.

36. Using the simple example above but with the addition of an offer of a discount for prompt payment, the essence of the contract of sale between the trader and the customer remains a mutual agreement to transfer the goods from the trader to the customer for the full price. That agreement is evidenced by an invoice for that full price. There is nothing uncertain or contingent at the time of sale about the full invoice price - it is the price at which the sale has been mutually negotiated and it is both communicated and quantified. It is the amount of the debt arising out of the sale. Performance of the contract from the trader's perspective is complete - it is required to do no more to satisfy its right to receive the debt - the debt is presently due to it.

37. Although the offer of a discount is an integral part of the contract of sale and therefore exists at the time of sale, the obligation to provide the discount at that time does not. The obligation to provide the discount is triggered by and arises on the payment of the discounted price within the discount period. The obligation to provide a discount is therefore only a contingent obligation at the time of sale. The contingency may be satisfied at a later time by the occurrence of a specified event. The effect of the occurrence of that later event cannot operate to retrospectively alter the position which existed at the time

of sale. In other words, the offer of a discount provides no more than an opportunity for the customer to acquire the goods at an actual cost less than their contracted price.

38. The contingency and defeasibility to which *Barratt* referred (at ATC 4282; ATR 346) concerned the present state of a right to receive an amount. In the circumstances being considered here, the state of the right to the full invoice price is that of a presently owing debt. The only variable is the amount which that right might ultimately produce. The comments in that case on that point can therefore be distinguished.

39. It has been suggested that the decision of the High Court of Australia (Fullagar J) in *Ballarat Brewing* supports the view that only the discounted price should be included as assessable income of the trader at the time of sale. That case also involved the sale of trading stock with, *inter alia*, a discount for prompt payment - but the discount in that case was almost never refused or withdrawn even though the terms on which it was offered were not always met.

40. Fullagar J saw (at CLR 368; ATD 257) the question at issue in the case as a matter of arriving at 'the correct figure to ascribe to sales'. His Honour referred to the 'truth and reality of the situation' when he said (at CLR 369; ATD 258) that the taxpayer will 'in the light of all past experience and policy, almost certainly receive in respect of book debts' created by sales, only the discounted price. He concluded that the discounted price only should be treated as the sale price because of the taxpayer's peculiar discount policy and practice that discounts were habitually allowed notwithstanding that the terms for their allowance were not always met. The virtual certainty that the amount of the discount would not be received was therefore, critical to the decision in this case because it was an 'inherent characteristic' of the transaction under consideration. That is, the sale price in the peculiar circumstances of the case was in 'truth and reality' the net price.

41. A similar 'inherent characteristic' was identified in *Carden* where the certainty of not receiving an amount of income was decisive in reaching the decision that the actual receipt of an amount of income had to be added to the earning of the amount for the amount to be income derived.

42. Both decisions demonstrate that, for any certainty about not receiving what is otherwise income to influence the determination of the amount or timing of income derived, the certainty must be such an 'inherent characteristic' of the income that it is critical to, or decisive of, those questions about derivation. In other words, the decision in *Ballarat Brewing Co* is limited to cases where the facts are on all fours and is not authority for the general proposition that a trader may

include sales in assessable income according to an assessment of the degree of certainty about not receiving the full proceeds of each sale. If that was a sustainable proposition, many other certainties would also need to be taken into account including the prospects of bad debts and of returns of unwanted or damaged stock.

43. A trader who sells goods to a customer on credit and offers the customer a discount for settling the credit sale promptly should, therefore, include at the time of sale the full invoice sale price in assessable income under section 6-5 of the ITAA 1997.

Alternative view

44. There is an alternative view to the one put in this Ruling which also suggests that only the discounted amount is assessable to the trader at the time of sale and that the discount amount is only assessable on the expiry of the discount period if the discounted amount is not paid before that time. This approach proceeds on the basis that the trader has not 'derived' (or, if it has been derived, has not earned in the sense explained in *Arthur Murray (NSW) Pty Ltd v. FC of T* (1965) 114 CLR 314; (1965) 14 ATD 98) the discount amount until the discount period expires without paying the discounted amount.

45. The discount amount is not derived by the trader on this alternative view because (a) the seller's right to receive that amount is contingent on the settlement period expiring without the customer paying the discounted amount for the goods and (b) the discount amount only matures into a recoverable debt after the settlement period has expired.

46. This alternative view was that taken in Draft Taxation Ruling TR 94/D4 on which this final Ruling is based.

47. For the reasons already advanced in this Ruling, this view is no longer accepted. The position taken in this Ruling reflects the strength and consistency of the comments made on the draft Ruling.

48. The difference between this alternative view and our preferred view in this Ruling is fundamentally one of timing. That is, while the end result for both a trader and a customer of the type of sale/purchase transaction described in this Ruling is the same under either view, it is the timing of when assessable income and allowable deductions are recognised under section 6-5 and section 8-1 of the ITAA 1997 respectively, that distinguishes them. This is particularly evident where a sale contract entered into in one income year is not finalised until a later income year.

(b) Customer's allowable deductions

49. A customer who purchases goods as trading stock of the customer's business is entitled to allowable deductions under section 8-1 of the ITAA 1997 for the purchase price of the goods.

50. Broadly speaking, expenditure on the purchase of trading stock qualifies as an allowable deduction in the year of income in which it is 'incurred' for the purposes of section 8-1 of the ITAA 1997.

51. The meaning of the word 'incurred' has been judicially interpreted on many occasions. For present purposes though, the following generally accepted broad propositions are relevant:

- incurred 'includes encountered, run into, or fallen upon' but 'does not include ... impending, threatened or expected' (*New Zealand Flax Investments Ltd v. FC of T* (1938) 61 CLR 179 at 207; (1938) 5 ATD 36 at 49);
- a liability is incurred in a year of income if the taxpayer is 'definitively committed' or has 'completely subjected' itself to the liability during the year of income even though the liability remains unpaid at the close of that year of income (*FC of T v. James Flood Pty Ltd* (1953) 88 CLR 492 at 506; (1953) 10 ATD 240 at 244);
- for a liability to satisfy the word incurred, 'what is clearly necessary is that there should be a presently existing liability' (*Nilsen Development Laboratories Pty Ltd & Ors v. FC of T* (1981) 144 CLR 616 at 627; 81 ATC 4031 at 4037); and
- an outgoing may be incurred even though it may later be defeased (*James Flood* at CLR 506; ATD 244; *Commonwealth Aluminium Corporation Ltd v. FC of T* 77 ATC 4151 at 4160; (1977) 7 ATR 376 at 386).

52. In *FC of T v. Raymor (NSW) Pty Ltd* 90 ATC 4461; (1990) 21 ATR 458, the taxpayer purchased, under a contract of sale, a stipulated quantity of trading stock of a particular quality for an agreed price. The purchase price was, however, capable of variation under a rise and fall clause in the contract to take account of variations in the price at which the supplier may purchase the stock over the period the stock was to be delivered to the taxpayer. The court considered, *inter alia*, whether the ascertainment of the precise purchase price was relevant to when the outgoing for trading stock was incurred by the purchaser.

53. Following a consideration of the general propositions above, it was concluded (at ATC 4467; ATR 464):

> '...at the point of time at which the respondent bound itself as a party to each of the contracts, and so became committed to pay the amount shown in each contract ..., it incurred the respective amount, notwithstanding that its obligation could be increased or reduced under the rise and fall provisions of the contract cl. 8. Payment thereafter was strictly irrelevant to the time at which the outgoing was incurred. It merely operated to discharge in the year of income the outgoing already incurred in that year.'

54. And later in the same case (at ATC 4470; ATR 467) it was said:

> 'It was not suggested, nor could it have been suggested that the power to vary the contract price within the limits contained in cl. 8 of the contract rendered the contract too uncertain: cf *Upper Hunter County District Council v. Australian Chilling & Freezing Co Ltd* (1968) 118 CLR 429; *Godecke v. Kirwan* (1973) 129 CLR 629 and *Meehan v. Jones* (1981-82) 149 CLR 571.
>
> Once, however, it is appreciated that an outgoing may be deductible notwithstanding that it may be defeasible, there can be no logical reason why an outgoing pursuant to a contract may not be deductible notwithstanding that the ultimate price payable upon delivery of the goods the subject of a contract may be varied upwards or downwards to reflect the increased cost of the goods.'

55. This general line of reasoning is also evident in discussions on the 'variable liabilities' often found in the foreign exchange gains and losses cases (see, for example, *Texas Company (Australasia) Ltd v. FC of T* (1940) 63 CLR 382; (1940) 5 ATD 298 and *International Nickel Australia Ltd v. FC of T* (1977) 137 CLR 347; 77 ATC 4383) and on the 'estimated liabilities' often found in the insurance cases (see, for example, *RACV Insurance Pty Ltd v. FC of T* 74 ATC 4169; (1974) 4 ATR 610 and *Commercial Union Assurance Co of Australia Ltd v. FC of T* 77 ATC 4186; (1977) 7 ATR 435).

56. Using the earlier simple example, the essence of the contract of sale between the trader and the customer is a mutual agreement to transfer the goods from the trader to the customer for the full invoice price. The agreement is evidenced by an invoice for that full invoice price. There is nothing uncertain or contingent at the time of purchase about the full invoice price - it is the price at which the purchase has been mutually negotiated and it is both communicated and quantified. It is the obligation arising out of the contract of sale. Nothing further needs to be done to bring the debt into existence.

57. Although the opportunity for the customer to avail itself of the discount is provided in the contract of sale and, therefore, exists at the time of sale, the right to the discount itself does not. The right to the

discount is only triggered by the payment of the discounted price within the discount period. At the time of sale, the right to a discount is a contingency only which may be satisfied at a later time by the occurrence of a specified event. The effect of the occurrence of that later event cannot operate to alter retrospectively the position which existed at the time of sale. The availability of a discount provides no more than an opportunity for the customer to acquire the goods at an actual cost less than their contracted price. In these circumstances, the incurrence of the liability under the contract of sale and the later satisfaction of that liability are two separate, albeit related events.

58. The customer should, therefore, claim at the time of purchase, the full invoice price as an allowable expenditure under section 8-1 of the ITAA 1997.

Alternative view

59. The alternative view mentioned earlier also takes the view that only the discounted amount is deductible to the customer at the time of sale. The discount amount is only deductible on the expiry of the discount period if the discounted amount is not paid before that time. This approach proceeds on the basis that the customer has not 'incurred' the discount amount until the discount period expires without payment of the discounted price. The discount amount is not incurred on this view because the buyer only has a contingent obligation to pay that amount - it is contingent on the settlement period expiring without the customer paying the discounted price.

60. For the reasons already advanced in this Ruling, this view is no longer accepted.

(c) Effect of accepting discount

- ***Substance and effect of the discount***

61. There are two alternative interpretations of what the offer of a discount amounts to (its substance) and what actually happens when there is an acceptance of that offer (its effect) in the circumstances described in this Ruling.

62. On one view, the offer of a discount provides a mechanism to vary the price at which the goods are sold - to vary the liability created under the contract of sale. The condition on which the discount is available (prompt payment on a credit sale) is met after the time of sale. On the other view, the offer of a discount provides a mechanism to defease some part of the liability created under the contract of sale. In simple terms, the fundamental difference between the two

interpretations is one of reducing a liability in contrast to defeasing a part of a liability.

63. On either interpretation, the end result in the circumstances described in this Ruling is the same - the original debt of the trader and the original liability of the customer is satisfied, in full, by an amount less than the amount of the debt and the liability respectively. The trader suffers a loss of the difference between the amount receivable and the amount received and the customer benefits from a gain of the difference between the amount payable and the amount paid - the different interpretations of the same transaction simply provide alternative explanations of the same end result.

- ***Trader***

64. If a trader has included in its assessable income, at the time of sale, the full invoice price of goods sold but later receives the discounted price in full satisfaction of the higher contract debt, the reduction in the amount that was otherwise receivable to satisfy the debt needs to be reflected in the trader's taxation liability. That should be done by the trader claiming an allowable deduction, under section 8-1 of the ITAA 1997, of an amount equal to the amount of the difference.

65. A trader accounts for its sales on an accruals basis. Under that basis, sales made on credit are included in assessable income at the time of sale. The amount included in the trader's assessable income is the full invoice price. The provision of credit on the sale is recognised in the trader's accounts by the inclusion of an account receivable equal to the amount of the full invoice price. The account receivable, therefore, represents the credit sale made and is the asset that replaces the previous asset of trading stock. It is also accepted that the provision of sales on credit may be an ordinary part of the business of a trader.

66. When a customer pays to the trader the discounted price within the discount period, the debt between the customer and the trader is satisfied in full. In these circumstances, the trader suffers a loss on the realisation of the receivable because the amount the trader receives for the receivable is less than the amount it represents. The loss is a revenue loss because the account receivable retains the same revenue character as the trading stock asset it replaces. The amount of that receivable represents the amount of assessable income previously included and the practice of providing sales on credit is an ordinary part of the trader's business. On either interpretation of the transaction, the loss suffered by the trader is an allowable deduction under section 8-1 of the ITAA 1997.

67. This view is supported by Professor R W Parsons in his book titled *Income Taxation in Australia: Principles of Income, Deductibility and Tax Accounting*, 1985, at paragraphs 6.308-6.321 where he describes the loss suffered as being 'a failure of a revenue asset to realise its cost'. He also explains that the incurred cost of the receivable is the amount at which the receivable was brought to account as assessable income.

68. The view is also indirectly supported by the decision of Barwick CJ in *AGC (Advances) Ltd v. FC of T* 75 ATC 4057 at 4063; (1975) 5 ATR 243 at 250 where his Honour concluded that the failure to recover unpaid instalments of hire was a trading loss which may be written off under section 8-1 of the ITAA 1997. The Chief Justice likened the purchase of chattels for hire in that case to the purchase of trading stock and concluded that the failure to realise neither the chattel nor the unpaid instalments for its hire resulted in a revenue loss of the amount then owing to the appellant.

- ***Customer***

69. If a customer has claimed as an allowable deduction, at the time of sale, the full invoice price of goods purchased but later satisfies the contract liability by paying the discounted price within the discount period, the reduction in the amount required to satisfy the contract liability needs to be reflected in the customer's taxation liability. That should be done by the customer including in its assessable income, under section 6-5 of the ITAA 1997, an amount equal to the amount of the discount.

70. In respect of the 'variable price' interpretation, some early observations on variable liabilities were made by Dixon J in *Texas Company Australasia Ltd* at CLR 465; ATD 354 when considering the treatment of an exchange loss under the accruals method:

> 'During any given accounting period the profit or loss made by the taxpayer's operations must be ascertained by a comparison between its position at the beginning and at the end, based upon estimates of value and upon the accrual of debits and credits. But discrepancies between the liabilities carried into the period and the cost of defraying them must come into the comparison as an actual reduction or increase of the profit or loss otherwise produced by the comparison, provided always that the liability is one belonging to an income account and that the loss ought not for other reasons be referred to capital. For where liabilities are not fixed in their monetary expression, whether because of contingencies or because they are payable in foreign currency, a difference between the estimate and the actual payment must be born as a business expense and where the continuous course of

> is divided for accounting purposes into closed periods, it is a reduction of the net profit which otherwise would be calculated for the period.'

71. In other words, the amount of a liability which is inherently 'variable' may not be finally determined until it is actually paid. But an uncertainty about the amount which may ultimately be paid in satisfaction of a variable liability which is otherwise deductible, in no way impinges on the deductibility of the variable liability at the time it was incurred.

72. The principles discussed in *International Nickel Australia Ltd* also support the proposition that in all cases involving a variable liability which has been allowed as a deduction, a reduction in the amount required to satisfy the liability gives rise to an assessable gain because the difference has the character of income under ordinary concepts.

73. Mason J said in *International Nickel Australia Ltd* (at ATC 4394; ATR 751) that there is 'a general concept of income which includes within its embrace a reduction in the amount of an outgoing on revenue account'. In his Honour's opinion, the foreign exchange gain cases give expression to this general concept.

74. A reduction in the amount required to extinguish the incurred liability is therefore a gain assessable to the customer under section 6-5 of the ITAA 1997.

75. In respect of the 'defeased liability' interpretation, a gain that results from the defeasance of a liability can also have the character of income under ordinary concepts. This approach was adopted in *Commonwealth Aluminium Corporation Ltd* where the question was whether a royalty paid by the taxpayer was deductible in circumstances where, at the time the royalty was paid, the taxpayer was challenging whether it had been properly levied.

76. Newton J concluded that the defeasible nature of the liability was no bar to its deductibility. His Honour said (ATC 4161; ATR 386):

> 'If in one year of income a defeasible liability is allowed as a deduction under sec. 51, and in a later year the defeasance occurs, so that the liability is divested or destroyed, then it would appear that the amount of the liability will be included in the assessable income of the taxpayer for that later year, provided that the amount can properly be characterised as assessable income of that year, although not simply because it had been allowed as a deduction in the earlier year.'

77. The defeasance of the contract liability, in the circumstances of this Ruling and to the extent of the discount amount, is clearly a

common, ongoing and ordinary part of the business of a customer buying trading stock. The defeased discount amount is therefore a gain assessable to the customer under section 6-5 of the ITAA 1997.

(d) Cash discount, trade discount and quantity or bulk discount

78. A trader generally sets the price at which it is prepared to sell an item of goods and, in the day to day course of trade, expects to sell the item for that price. There will be occasions, such as those involving a prompt payment discount, where the trader is prepared to reduce the price at which it would normally sell the goods. In the case of a prompt payment discount, the reduction in price is the result of events occurring after the sale is effected.

79. There are other occasions however, where the reduction in sale price is effected at the time of sale. These occasions include:

- ***Cash discount*** - a trader is often prepared to sell an item of goods for an immediate payment of an amount less than the price for which it is prepared to sell the same item on credit. The practice of offering the item at a discounted price in these circumstances may be explained by the reduced cost, time and effort required by the trader in managing a cash sale; the trader's strategy of managing its cash flow; and/or in economic arguments about the present value of money.
- ***Trade discount*** - it is common practice for a trader to offer to its 'business' customers a discount from the price at which it ordinarily sells goods to the general public. A trader's offer of a lower price in these circumstances is often made in recognition of, or to encourage, regular and continuing patronage from business customers. The sale may be made on cash or on credit.
- ***Quantity or bulk discount*** - a trader will often be prepared to sell a larger quantity or value of goods at a price per item lower than it would normally sell those same goods in smaller quantities or value. The discount offered in these circumstances recognises and encourages the well worn notion that the association of a large turnover with a smaller profit margin per transaction is preferable to the association of a small turnover with a greater profit margin per transaction.

80. For each of these discounts, the condition on which the discount is available is met at the time of sale. In the case of a cash discount, payment of the discounted price is made at the time of sale; in the case of a trade discount, the customer is a 'business' customer at the

time of sale; and in the case of a quantity or bulk discount, the commitment to purchase a particular quantity or value of goods is made at the time of sale. The discounted price is therefore, the price for which the goods are sold.

81. In each of these circumstances, a trader should include, at the time of sale, the discounted price in assessable income under section 6-5 of the ITAA 1997. Similarly, a customer should claim, at the time of purchase, the discounted price as an allowable expenditure under section 8-1 of the ITAA 1997.

Examples

Example 1 - prompt payment discount

82. A wholesale trader of widgets sells $1,000 worth of them to a retail customer on 30 June 2005, offering the customer a 5% discount on the sale price if the balance of the price is paid in full on or before 7 July 2005.

83. Whether the customer takes up the trader's offer of a discount or not:

(a) the trader derives, as assessable income under section 6-5 of the ITAA 1997, the $1,000 sale price on 30 June 2005; and

(b) the customer incurs, as an allowable deduction under section 8-1 of the ITAA 1997, the $1,000 purchase price on 30 June 2005.

84. If the customer takes up the trader's offer of a discount by paying the discounted price of $950 to the trader on 7 July 2005:

(a) the trader incurs, as an allowable deduction under section 8-1 of the ITAA 1997, a loss of $50 ($1,000 sale price less $950 received) on 7 July 2005; and

(b) the customer derives, as assessable income under section 6-5 of the ITAA 1997, a gain of $50 ($1,000 purchase price less $950 paid) on 7 July 2005.

Example 2 - prompt payment discount

85. A wholesale trader may sometimes offer a prompt payment discount which varies according to the volume or value of goods purchased. A trader may, for example, offer a basic prompt payment discount of 5% on all purchases up to and including 1,000 items or $1,000 worth of goods but offers a further 1% discount (on total

purchases) for each additional 100 items or $100 worth of goods purchased.

86. The discount offered in these circumstances retains the character of a prompt payment discount - introducing an element of variability in the rate or amount of the discount does nothing to alter that character - and should, therefore, be treated in the manner explained in this Ruling for a prompt payment discount.

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