TR 96/6 - Income tax: assessability of benefits arising from the purchase or order of new aircraft

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Australian Taxation Office

Taxation Ruling
Income tax: assessability of benefits arising from the purchase or order of new aircraft

other Rulings on this topic
IT 2631

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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.*

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What this Ruling is about

Class of person/arrangement

1. This Ruling applies to ***purchasers*** who receive benefits from aircraft manufacturers in consideration for entering into agreements to purchase or order new ***aircraft***. These benefits are commonly referred to as ***manufacturers' credits***.

2. This Ruling considers:

(a) the circumstances in which a ***manufacturer's credit*** in the aircraft industry gives rise to assessable income according to ordinary concepts under subsection 25(1) of the *Income Tax Assessment Act 1936* ('the Act'); and

(b) the circumstances in which a ***manufacturer's credit*** in the aircraft industry reduces the purchase or order price of the particular ***aircraft***.

3. Some of the key terms used in this Ruling (and indicated by the use of ***bold italic*** text) are defined in paragraph 5 below.

Date of effect

4. This Ruling applies to years commencing both before and after its date of issue. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of a settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

Definitions

5. The following definitions of key terms apply for this Ruling:

'*aircraft*'

includes airframes, engines, buyer furnished equipment, spare parts, simulators, other forms of aeronautical equipment or other goods and services

'*manufacturer*'

includes a manufacturer of airframes, engines, buyer furnished equipment, spare parts, simulators, other forms of aeronautical equipment or other goods and services

'*manufacturer's credit*'

means the benefit (cash and/or non-cash) made available to the ***purchaser*** of the ***aircraft*** by the ***manufacturer***. The non-cash benefit consists of:

(i) the credit that can be applied towards the cost of goods and services; or

(ii) the provision of goods and services

'*credit memorandum*'

means a credit voucher issued by the aircraft manufacturer evidencing a ***manufacturer's credit*** made available other than as cash or goods and services provided directly

'*purchaser*'

means a party who enters into a purchase agreement or an order to purchase with the ***manufacturer*** to acquire the ***aircraft*** whether or not that party subsequently obtains legal title of the ***aircraft*** from the ***manufacturer***.

Ruling

Assessable income

6. A ***manufacturer's credit*** in the aircraft industry, provided directly or by way of a ***credit memorandum***, gives rise to assessable income under subsection 25(1) of the Act in the hands of the ***purchaser***, unless the intention and conduct of the parties to the purchase agreement is directed at reducing the purchase or order price of the particular ***aircraft***. A ***manufacturer's credit*** will give rise to assessable income irrespective of whether it is:

(a) a cash benefit; or

(b) a non-cash benefit that is convertible to cash; or

(c) a non-cash benefit that is not convertible to cash.

(Section 21A treats non-convertible property or services, provided after 31 August 1988 in the context of a business relationship, as if they were convertible to cash in determining the income derived by a taxpayer).

7. In our view, ***manufacturers' credits*** typically provided in the aircraft industry are directed at conferring a positive benefit on the ***purchaser*** and give rise to assessable income under subsection 25(1).

Cash benefits

8. If a cash benefit is provided to the ***purchaser*** the assessable income amount can be readily ascertained.

Non-cash benefits

9. If a non-cash benefit is provided to the ***purchaser***, which is convertible to cash as a matter of fact or by the operation of section 21A, the amount to be included in the ***purchaser's*** assessable income will be determined by the arm's length value of the non-cash benefit.

Non-cash non-convertible benefits

10. If a non-cash benefit is provided to the ***purchaser***, which is not convertible to cash, section 21A will treat the non-cash benefit as convertible to cash. The assessable income amount to be included in the ***purchaser's*** assessable income will be determined by the arm's length value of the non-cash benefit.

Otherwise deductible rule

11. Where a non-cash benefit is provided after 31 August 1988 and the ***purchaser*** would have been entitled to a deduction for the cost of the benefit, if the ***purchaser*** had incurred that cost as a revenue expense, the arm's length value of the benefit can be taken into account to reduce the assessable income amount by the operation of subsection 21A(3) (the 'otherwise deductible rule').

12. If the non-cash benefit provided to the ***purchaser*** is of a capital nature, the 'otherwise deductible rule' would not apply. However, to the extent that the non-cash benefit consists of plant or articles within the meaning of section 54, the ***purchaser*** may be entitled to claim deductions for depreciation based on the arm's length value of that benefit. If the ***purchaser*** subsequently disposes of that benefit, it will be accepted, for capital gains tax purposes, that the cost base of that benefit is its market value in accordance with subsection 160ZH(9) (see Taxation Ruling IT 2631).

Timing of derivation

13. The question of when the ***purchaser*** derives a ***manufacturer's credit*** as assessable income under subsection 25(1) needs to be determined by reference to the facts of each case, the terms of the purchase agreements and letter and supplementary agreements entered into between the ***purchaser*** and the ***manufacturer***. The ***purchaser*** derives the ***manufacturer's credit*** when it is not required to take any further steps to become entitled to the benefit.

14. If a ***manufacturer's credit*** is transferred to (or applied for the benefit of) an associated entity or another person, carried to any reserve, or otherwise dealt with on the ***purchaser's*** behalf or as the ***purchaser*** directs, section 19 deems the ***purchaser*** to have derived the income from the ***manufacturer's credit***.

Reduction in purchase price

15. A ***manufacturer's credit*** in the aircraft industry reduces the purchase or order price (rather than giving rise to assessable income under subsection 25(1)) if the intention and conduct of the parties to the purchase agreement is directed at reducing the purchase or order price of the particular ***aircraft***. Whether a ***manufacturer's credit*** can properly be characterised as reducing the purchase or order price needs to be determined by reference to the facts of each case, the terms of the purchase agreements and letter and supplementary agreements entered into between the ***purchaser*** and the ***manufacturer***.

16. We consider that there can only be a reduction in the purchase or order price of the ***aircraft*** if the ***manufacturer's credit*** for that ***aircraft*** is applied towards that liability. A ***manufacturer's credit*** will not reduce the purchase or order price if it is applied towards some other liability of the ***purchaser*** to the ***manufacturer*** or some other party. It is rare that a ***manufacturer's credit*** taken in cash affects a reduction in the purchase price of a particular ***aircraft***.

17. In our view, ***manufacturer's credits*** typically provided in the aircraft industry are not directed at reducing the purchase or order price of a particular ***aircraft***. Rather, they are directed at conferring a benefit on the ***purchaser*** and give rise to assessable income under subsection 25(1) (see paragraphs 6 to 12 of this Ruling).

Explanations

Industry practice

Typical contractual arrangements for the purchase or order of new aircraft

18. There are certain characteristics common to most arrangements involving the acquisition of ***aircraft*** and the provision of ***manufacturers' credits*** in the aircraft industry.

19. The purchase agreements for the acquisition of new aircraft from the major airframe manufacturers can also include engines, certain buyer furnished equipment, spare parts, simulators, other forms of aeronautical equipment and other goods and services. New aircraft are delivered by the airframe manufacturer complete with engines and in some cases certain buyer furnished equipment, spare parts, simulators, other forms of aeronautical equipment and other goods and services. The airframe manufacturers' purchase or order price is specified as the list price of airframes, engines, and in some cases buyer furnished equipment, spare parts, simulators, other forms of aeronautical equipment and other goods and services. It is usual practice that the ***purchaser*** enters into separate agreements with the suppliers of engines, buyer furnished equipment, spare parts, simulators, other forms of aeronautical equipment and other goods and services.

20. For financing purposes, the purchase agreements allow, subject to performance guarantees, for the assignment of the contractual rights by the ***purchaser*** to third parties or financiers prior to delivery of the ***aircraft***. This is a common industry practice. The consideration payable by the third party or financier will generally equal the list price of the ***aircraft***. Usually the ***aircraft*** is subsequently financed for

an amount equal to its list price under a lease or hire purchase agreement. The ***purchaser*** will be the end user of the ***aircraft***.

21. Although the terms of sale for the ***aircraft*** are specified in the purchase agreement, a ***manufacturer's credit*** is provided for by way of letter and supplementary agreements. The letter and supplementary agreements made available by airframe manufacturers, where agreed to by the parties, form part of the purchase agreement. In the case of other manufacturers, the letter and supplementary agreements impose additional obligations to those specified in the purchase agreement.

22. Under the letter and supplementary agreements, a ***manufacturer's credit*** is provided in consideration for entering into an agreement to purchase or as a result of entering into an order to purchase.

23. A ***manufacturer's credit*** relates to a specific order for goods and services and generally, a ***purchaser*** becomes entitled to a ***manufacturer's credit*** on delivery of those goods and services. However, in some instances, a ***purchaser*** may become entitled to a ***manufacturer's credit*** when the order is placed or confirmed.

24. In the case where a ***purchaser*** becomes entitled to a ***manufacturer's credit*** prior to the delivery of those goods and services, the ***purchaser*** is obligated to refund the ***manufacturer's credit*** if the order for those goods and services is cancelled.

25. Examples of those goods and services provided by ***manufacturers*** which give rise to a ***manufacturer's credit*** or a ***credit memorandum*** include:

(a) airframes;

(b) engines;

(c) simulators;

(d) special features (aircraft specifications);

(e) buyer furnished equipment;

(f) spare parts;

(g) maintenance support;

(h) service and repairs; and

(i) computer support.

26. A ***purchaser*** can become entitled to a ***manufacturer's credit*** in other circumstances. For example, a ***purchaser*** can become entitled to a ***manufacturer's credit*** where the ***purchaser*** agrees to act as a selling agent for used ***aircraft*** being replaced. An additional benefit in the form of a ***manufacturer's credit*** may be provided by the aircraft manufacturer to the ***purchaser*** in respect of any ***aircraft*** the

purchaser sells independently. The value of the ***manufacturer's credit*** receivable in respect of each used ***aircraft*** sold by the ***purchaser*** is reflected in the letter and supplementary agreements.

Cash benefits

27. A ***manufacturer's credit*** in the form of a cash benefit is usually provided by way of a cheque payment, although in some circumstances it can also be provided in the form of a ***credit memorandum***. Normally, a ***credit memorandum*** is expressed as having a dollar value and can, at the option of the ***purchaser***, be converted to cash or applied against any existing or later debt owing to the aircraft manufacturer. In some instances, a ***credit memorandum*** may be applied against a debt owing to a supplier other than the ***manufacturer*** from whom it was issued.

Non-cash benefits

28. Non-cash benefits in the form of goods and services made available to the ***purchaser***, directly or by the application of ***credit memoranda***, commonly include:

(a) computer software/hardware;

(b) pilot training;

(c) spare parts/equipment; and

(d) engines.

Assessable income

29. Whether or not a particular receipt is income depends on its quality or character in the hands of the recipient (*Scott v. FC of T* (1966) 117 CLR 514 at 526; (1966) 14 ATD 286 at 293).

30. Where a taxpayer carries on a business, it is often necessary to make a 'wide survey' and an 'exact scrutiny' of a taxpayer's activities to determine whether a particular profit derives from the business operation or is part of the business operations of a taxpayer (*London Australia Investment Co Ltd v. FC of T* (1976-1977) CLR 106 at 116; 77 ATC 4398 at 4403; 7 ATR 757 at 762; *Western Gold Mines NL v. DC of T (WA)* (1938) 59 CLR 729 at 740; 1 AITR 248 at 253).

31. In order to determine the true character of a ***manufacturer's credit*** it is necessary to have regard to the whole factual circumstances of which the purchase agreements and letter and supplementary agreements form a part. In *FC of T v. Cooling* 90 ATC 4472; (1990) 21 ATR 13 (*Cooling's* case) the Full Federal Court considered

whether a payment made to a firm of solicitors represented an amount paid for the provision of guarantees and procuring the service company of the solicitors to enter into a lease for new premises, or whether the payment was made to induce the solicitors to move premises. Hill J said (ATC at 4481; ATR at 23):

> 'This however does not mean that in determining the legal effect of a contract between parties (and therefore the characterisation of the payment made under it as being income or capital), regard may not be had to the whole factual matrix of which the contract forms part.
>
> Nothing in what his Lordship [Lord Tomlin in *I R Commrs v. Duke of Westminster* [1936] AC 1] said requires the conclusion that regard cannot be had to the whole context in which the agreement was made to determine the character of a receipt.'

32. The typical arrangements involving the provision of ***manufacturers' credits*** may form part of the obligations in relation to the purchase agreement (in the case of airframe manufacturers) or may impose obligations in addition to those set out in the purchase agreement (in the case of other ***manufacturers***). The relevant consideration in determining the character of the receipt is to determine how the parties applied the ***manufacturers' credits*** and intended them to be treated. The ***purchaser*** has a choice as to whether a ***manufacturer's credit*** is directed at reducing the legal and practical obligations in relation to the purchase or order price of the particular ***aircraft***, or directed to some other end.

33. In some contractual arrangements the ***purchaser*** assigns its contractual rights to purchase the ***aircraft*** to third parties or financiers prior to delivery. The consideration paid by the third parties or financiers to acquire title to the ***aircraft*** is not reduced by the value of the ***manufacturer's credit***. Furthermore, the amount for which an ***aircraft*** is subsequently financed is not reduced by the amount of the ***manufacturer's credit***. In these circumstances, the ***manufacturer's credit*** is not received by the third party or financier. The ***manufacturer's credit*** received in such cases is not directed at reducing the purchase or order price of the particular ***aircraft*** as a matter of substance and form. Rather, the ***manufacturer's credit*** is directed at conferring a positive benefit on the ***purchaser*** and gives the ***purchaser*** the right to use the benefit as it chooses.

34. The arrangement for the provision of a ***manufacturer's credit*** is related to the business activities of the ***purchaser*** and arises as a product of the income producing activities of the ***purchaser*** (see the comments of Northrop J in *FC of T v. Co-operative Motors Pty Ltd* 95 ATC 4411 at 4416; 31 ATR 88 at 93). In our view, the

arrangement for the provision of a ***manufacturer's credit*** will give rise to assessable income under subsection 25(1).

35. We consider that a ***manufacturer's credit*** gives rise to assessable income under subsection 25(1) because it arises in the ordinary course of carrying on the ***purchaser's*** business. The continual re-equipment and financing of ***aircraft*** is a normal incidence of business in the aircraft industry, just as much as the trading activities. A ***manufacturer's credit*** arises as part of this process. Such receipts are not typically intended to reduce the purchase or order price of the ***aircraft***, but constitute profits made from facilitating a transaction between other parties, which are an incidental activity of business (*A L Hamblin Equipment Pty Ltd v. FC of T and A L Hamblin Construction Pty Ltd v. FC of T* (1974) 159 CLR 131; 74 ATC 4310; 5 ATR 16 (*Hamblin's* case)).

36. The Full High Court of Australia in *Hamblin's* case considered the character of a credit of $5,000 (referred to as a 'no trade discount') received by a construction company for inducing another company to order new plant from a supplier. The construction company would subsequently take that new plant on lease. In that case, the majority of the High Court agreed that such a receipt was an incidental activity in the carrying on of the taxpayer's business. Mason J, with whom Barwick CJ agreed, said (CLR at 584-585; ATC at 4320; ATR at 26):

> 'The receipt was therefore an incident of the contracting company's business. That it was considered by the parties to be a substitute for an allowance on the trade-in of equipment disposes of the notion that it was a gift and emphasises its true character as a trade receipt arising out of the business relationship between Hastings Deering as a supplier of earth-moving equipment and the Construction company as the purchaser of such equipment in the course of carrying on its business as a contractor.'

37. If a ***manufacturer's credit*** has its source in the conduct of a business, it does not matter if the receipt of that ***manufacturer's credit*** is irregular, as distinct from an everyday occurrence (see, e.g., the comments of Hill J in *Cooling's* case, ATC at 4484; ATR at 26).

38. Even if a ***manufacturer's credit*** does not arise in the ordinary course of the ***purchaser's*** business, but as an isolated transaction, we consider that it gives rise to assessable income under subsection 25(1). This is because, in our view, the transaction giving rise to the ***manufacturer's credit*** is a commercial transaction. It forms part of the ***purchaser's*** business activity, a significant purpose of which is the obtaining of a commercial profit by way of the ***manufacturer's credit***.

39. We consider that the views, expressed in paragraph 38 above, are supported by the reasoning of the High Court of Australia in *FC of*

T v. Myer Emporium Ltd (1987) 163 CLR 199; 87 ATC 4363; (1987) 18 ATR 693 and that of *Cooling's* case (see Hill J's comments at ATC at 4484; ATR at 26-27).

Cash benefits

40. A ***manufacturer's credit*** provided to the ***purchaser*** in the form of a cash benefit, will give rise to assessable income under subsection 25(1) where the intention and conduct of the parties to the purchase agreement is not directed at reducing the purchase or order price of the particular ***aircraft*** (see paragraphs 29 to 39 of this Ruling).

Non-cash benefits

41. If a ***manufacturer's credit*** received in the form of a non-cash benefit is not directed at reducing the purchase or order price of that particular ***aircraft***, it will give rise to assessable income under subsection 25(1) provided that it is convertible to cash, either as a matter of fact or through the operation of section 21A.

42. For a ***manufacturer's credit*** to be convertible to cash, the benefit must be convertible to money or something which could be employed in the acquisition of some other right or commodity (*FC of T v. Cooke & Sherden* 80 ATC 4140; 10 ATR 696).

43. In most cases, a ***manufacturer's credit*** provided in the form of a non-cash benefit will be readily convertible to cash. For example, in cases where benefits such as engines, spare parts, simulators, other forms of aeronautical equipment, certain buyer furnished equipment and goods and services are provided, the benefit can be readily converted to money and the arm's length value can be readily determined.

Non-cash non-convertible benefits

44. If a ***manufacturer's credit*** is provided in the form of a non-cash benefit after 31 August 1988, subsection 21A(1) will treat the ***manufacturer's credit***, which is not convertible to cash, as if it were convertible to cash. Subsection 21A(2) brings to account as assessable income, both convertible and non-convertible ***manufacturers' credits*** provided after 31 August 1988, at their arm's length value less any amounts paid as consideration for the benefits (see Taxation Ruling IT 2631).

45. A ***manufacturer's credit*** provided in the form of a non-cash benefit will, in some cases, not be readily convertible to cash (e.g., benefits provided in the form of specific pilot training). In such cases,

subsection 21A(1) will treat the benefit, which is not convertible to cash, as if it were convertible to cash. The assessable income amount of such benefits will be the arm's length value less any amount paid as consideration for the benefit (see Taxation Ruling IT 2631).

Otherwise deductible rule

46. If a ***manufacturer's credit*** provided in the form of a non-cash benefit after 31 August 1988 is income derived from the business activities of the ***purchaser***, the assessable income amount of that benefit may be reduced by the operation of the 'otherwise deductible rule' under subsection 21A(3). To determine if the 'otherwise deductible rule' applies, it is necessary to consider if the ***purchaser*** would have been entitled to deduct the amount of that benefit. Accordingly, if at the time the benefit was derived by the ***purchaser***, the ***purchaser*** had provided, incurred and paid an unreimbursed amount for the benefit equal to its arm's length value, the assessable income amount is reduced by that amount.

47. The 'otherwise deductible rule' will not apply to ***manufacturers' credits*** provided to the ***purchaser*** to the extent that they consist of plant or articles of the ***purchaser*** within the meaning of section 54 of the Act. To the extent that the ***manufacturer's credit*** provided to the ***purchaser*** in the form of plant or articles is used to produce assessable income of the ***purchaser***, deductions for depreciation would be available based on the arm's length value of the benefit.

48. If a ***manufacturer's credit*** provided in the form of a non-cash benefit that consists of plant or articles of the ***purchaser*** within the meaning of section 54 is subsequently disposed of by the ***purchaser***, the market value consideration, for capital gains tax purposes, is deemed to have been given by the ***purchaser*** for the acquisition of that benefit in accordance with subsection 160ZH(9).

Timing of derivation

49. The question of when the ***purchaser*** derives a ***manufacturer's credit*** as assessable income under subsection 25(1) needs to be determined by reference to the facts of each case, the terms of the purchase agreements and letter and supplementary agreements entered into between the ***purchaser*** and the ***manufacturer***.

50. Generally, ***manufacturers' credits*** are made available by the ***manufacturer*** to the ***purchaser***:

(i) on delivery of the ***aircraft***; or

(ii) when the ***purchaser*** places or confirms an order; or

(iii) when the ***purchaser*** agrees to sell and sells the used ***aircraft*** rather than using the aircraft manufacturer as a selling agent.

51. In cases (i) and (iii) in paragraph 50 above, the income arising from the ***manufacturer's credit*** is derived at that time as no further steps or action need be taken by the ***purchaser*** to become entitled to the benefit. At that time, the ***purchaser*** has the right to receive the ***manufacturer's credit*** and no element of contingency exists to affect that right (see *Gasparin v. FC of T* 94 ATC 4280; (1994) 28 ATR 130).

52. In case (ii) in paragraph 50 above, the ***purchaser*** may have an obligation to refund the ***manufacturer's credit*** relating to that particular ***aircraft***, if that order or confirmation for that particular ***aircraft*** is cancelled. In such cases, derivation of the income arising from the ***manufacturer's credit*** will arise when delivery of the ***aircraft*** occurs (see *Arthur Murray (NSW) Pty Ltd v. FC of T* (1965) 114 CLR 314; (1965) 14 ATD 98).

53. Section 19 of the Act will deem the ***purchaser*** to have derived the income when a ***purchaser*** has to take no further steps or action to become entitled to the ***manufacturer's credit***, notwithstanding that there is no actual receipt of that benefit (see the comments of Rich J in *Permanent Trustee Co of NSW Ltd v. FC of T* 6 ATD 5 at 12; (1940) 2 AITR 109 at 110). If a ***manufacturer's credit*** is transferred to (or applied for the benefit of) an associated entity or another person, carried to any reserve, or otherwise dealt with on the ***purchaser's*** behalf or as the ***purchaser*** directs, section 19 deems the ***purchaser*** to have derived the income arising from the ***manufacturer's credit***.

Reduction in purchase price

54. In our view, a ***manufacturer's credit*** reduces the purchase or order price (rather than giving rise to assessable income under subsection 25(1)), if the intention and conduct of the parties is directed at reducing the purchase or order price of the particular ***aircraft***.

55. We consider that in order for a ***manufacturer's credit*** to reduce the purchase or order price, it must effect a reduction of the sale price of the particular ***aircraft***. In *EMI Australia Ltd v. FC of T* 71 ATC 4112 at 4118; 2 ATR 325 at 332, Windeyer J said:

> '..."the amount" for which a thing is sold means I consider the sum total of all moneys the buyer promises, expressly or tacitly, to pay to, or for, the seller in order that he, the buyer, may get good title to goods that he has agreed to buy.'

56. It cannot be said the ***manufacturer's credit*** affects the amount for which that particular ***aircraft*** (i.e., that ***aircraft*** the subject of that particular sale) is sold, unless a ***manufacturer's credit*** provided by a ***manufacturer*** can be allocated to that particular ***aircraft*** or sale.

57. In a contract for the acquisition of goods, it is the transfer of property in the goods in return for money consideration which constitutes full satisfaction of the contract. However, this will not be the case if the parties agree to reduce the amounts payable under a contract by refunding an amount or certain amounts subsequent to the sale, and as a matter of commercial reality the amounts refunded are directed to that end (*Queensland Independent Wholesalers Ltd v. FCT* 91 ATC 4492; (1991-92) 22 ATR 45).

58. In *Queensland Independent Wholesalers Ltd*, the taxpayer company carried on a business as a wholesaler and distributor of groceries and other goods to small, independently owned stores. It acted as a co-operative buyer for its customers in order to obtain volume discounts available to larger stores. The taxpayer company passed the volume discounts onto its customers by way of rebates in the year prior to the company's restructure. The rebates were payable to the customers who were signatories to a rebate agreement and shareholders in the taxpayer's company. In that particular year, the rebates were paid partly in cash and partly by a credit paid to the customers' revolving credit account. The rebate agreement provided that the company had established the rebate scheme for the purpose of granting its customers, subject to certain conditions, a rebate on goods, merchandise and commodities purchased. As part of that agreement, the customers agreed to lend part of the rebate to the company.

59. Hill J, with whom Davis and Lee JJ agreed, in his judgment said (ATC at 4500; ATR at 54):

> 'While in my view it is not necessary that the amount of a rebate be given contractually to reduce the amount at which the goods are sold, it is clear that the factual circumstances must be such that it is apparent that the rebate does effect a reduction in the sale price as a matter of commercial reality and that it is not directed at some other end. The cash component of the 1985 rebate clearly enough satisfies such a test. However, I think that other considerations arise when one considers that part of the rebate, which was credited and provided a mechanism for ensuring an additional capital injection for RSDF [Retail Stores Development Finance Limited], should it be needed. The rebate, while it could be said in one sense to reduce the sale price of the goods, went far beyond that. It was not a mere rebate against the price of the goods, but rather was directed at another end. In those circumstances the non-cash component

did not operate to reduce the amount for which the goods were sold to customers.'

60. In the typical contractual arrangements for the purchase or order of new ***aircraft***, there is provision for the assignment of the contractual rights by the ***purchaser*** to third parties or financiers prior to delivery. The amounts paid by the third parties or financiers to acquire ownership of the ***aircraft*** and the subsequent financing arrangements are not reduced by the amount of the ***manufacturers' credits***. As a matter of substance and form, a ***manufacturer's credit*** in such circumstances is not directed at reducing the legal and practical obligations in relation to the purchase or order price of the particular ***aircraft***. The arrangements for the purchase or order of ***aircraft*** and the provision of ***manufacturers' credits*** in such circumstances are directed to conferring a positive benefit on the ***purchaser***.

Examples

61. The following examples demonstrate how cash and non-cash benefits (including those convertible and/or non-convertible to cash) should be treated for income tax purposes:

Example 1

A *manufacturer's credit* which is taken in cash or applied against the cost of other goods and services

62. Airframe Co and X Co enter into a purchase agreement and a letter agreement to acquire 5 aircraft for their list price. The list price of each aircraft is specified as follows:

Airframes	USD 30M
Two Engines	USD 5M
List Price	USD 35M

63. The letter agreement provides that, in consideration of entering into the purchase agreement, X Co will receive a ***manufacturer's credit*** of USD 5M per aircraft from Airframe Co (airframe credits) on delivery of each aircraft.

64. X Co also enters into a purchase agreement and a letter agreement with Engine Co, for the acquisition of engines at a list price of USD 2.5M per engine. The letter agreement, which imposes obligations in addition to the purchase agreement, allows for a ***manufacturer's credit*** of USD 0.5M per aircraft (engine credits)to be made available to X Co by Engine Co on delivery of each aircraft.

65. All 5 aircraft are delivered at the same time. The ***manufacturer's credits*** of USD 27.5M become available at that time (i.e., USD 5M per aircraft from Airframe Co and USD 0.5M per aircraft from Engine Co).

66. The ***manufacturer's credits*** of USD 27.5M can be used in various ways and are utilised as follows:

(i) USD 10M airframe credits and USD 2.5M engine credits taken in cash;

(ii) USD 5M airframe credits applied towards the purchase of spare parts; and

(iii) USD 10M airframe credits taken as reimbursement for costs associated with the purchase of other goods and services provided by an unrelated ***manufacturer***.

67. The rights to purchase the aircraft are assigned prior to delivery to a financier for USD 35M. X Co becomes the end user of each aircraft through lease agreements and the value of each aircraft under the lease agreements amounts to USD 35M.

68. The AUD equivalent of USD 27.5M ***manufacturer's credits*** would be assessable income under subsection 25(1), as the ***manufacturer's credits*** have not been directed at reducing the purchase price of the aircraft.

Example 2

A *manufacturer's credit* which is applied against the cost of goods and services which give rise to that credit

69. X Co enters into a purchase agreement and a number of letter agreements with Airframe Co, whereby X Co agrees to acquire 10 new aircraft (designated as aircraft A to J) at a list price of USD 40M per aircraft. The list price of each aircraft is specified as follows:

Airframes	USD 35M
Two Engines	USD 5M
List Price	USD 40M

70. The letter agreements provide that in consideration of entering into the purchase agreement, X Co will receive ***manufacturer's credits*** of USD 5M per aircraft from Airframe Co, on delivery of each aircraft.

71. X Co also enters into a purchase and a letter agreement with Engine Co for the acquisition of engines at a list price of USD 5M per engine. The letter agreement, which imposes obligations in addition to the purchase agreement, allows for a ***manufacturer's credit*** of USD

0.5M per aircraft to be made available by Engine Co to X Co on delivery of each aircraft.

72. The letter agreement provides that the ***manufacturer's credits*** can be taken in cash, applied against spare parts, or applied against the cost of the aircraft acquired.

73. Aircraft A to J are delivered at the same time. The ***manufacturers' credits*** of USD 55M become available at that time (i.e., USD 5M per aircraft from Airframe Co and USD 0.5M per aircraft from Engine Co).

74. Aircraft (A-C) are assigned prior to delivery to a financier for USD 38M per aircraft. X Co becomes the end user of each aircraft through lease agreements and the value of each aircraft under the lease agreements amounts to USD 38M.

75. Aircraft (D-J) are assigned prior to delivery to a financier for USD 40M per aircraft. X Co becomes the end user of each aircraft through lease agreements and the value of each aircraft under the lease agreements amounts to USD 40M.

76. The ***manufacturer's credits*** of USD 6M are applied against the purchase price of aircraft (A-C) (i.e., USD 2M per aircraft) and the balance of the ***manufacturer's credits*** (USD 49M) is taken in cash.

77. The ***manufacturer's credit*** amounts that would be recognised as reducing the purchase price of aircraft (A-C) would be USD 6M (USD 2M per aircraft in respect of aircraft (A-C) as the ***manufacturer's credits*** have been directed to that end.

78. The AUD equivalent of the balance of the ***manufacturer's credits*** received, USD 49M, would be assessable income pursuant to subsection 25(1), given that they are not directed at reducing the purchase price of the aircraft.

Example 3

A *manufacturer's credit* which is provided in the form of a non-cash benefit which is convertible to cash

79. X Co and Airframe Co enter into a purchase agreement and a number of letter agreements, whereby X Co agrees to acquire 10 aircraft at a list price of USD 40M per aircraft. The list price of each aircraft is specified as follows:

Airframes	USD 32M
Two Engines	USD 8M
List Price	USD 40M

80. The letter agreements provide that in consideration of entering into the purchase agreement, X Co will be entitled to ***manufacturer's credits*** in the form of aeronautical equipment to the value of USD 4M per aircraft, for each aircraft delivered. The aeronautical equipment to the value of USD 40M is, pursuant to the terms of the letter agreements, made available by Airframe Co to X Co on delivery of the first aircraft.

81. X Co also enters into a purchase agreement and a letter agreement with Engine Co for the acquisition of engines at a list price of USD 8M per engine. The letter agreement, imposes obligations in addition to the purchase agreement, and allows for 2 engines, at no cost, to be made available to the ***purchaser*** on delivery of the first aircraft, on the condition that the ***purchaser*** accepts delivery of the 10 aircraft. The arm's length value of the no cost engines amounts to USD 8M per engine.

82. Each aircraft is assigned prior to delivery to a financier for USD 40M. X Co becomes the end user of each aircraft through lease agreements and the value of each aircraft under each lease agreements amounts to USD 40M.

83. The aeronautical equipment is considered to be a benefit that is readily convertible to cash and is considered as income according to ordinary concepts under subsection 25(1). The income from the provision of the aeronautical equipment is derived on a pro-rata basis of USD 4M (AUD equivalent) per aircraft, on delivery of each aircraft.

84. The engines are considered to be benefits that are readily convertible to cash and are considered as income according to ordinary concepts under subsection 25(1). The income from the provision of the engines is derived on delivery of the tenth aircraft and the income amount will be determined by the arm's length value of the engines (i.e., the AUD equivalent of USD 16M).

85. The engines and aeronautical equipment, to the extent that they would qualify as plant within the meaning of section 54, would entitle X Co to claim depreciation deductions based on the AUD equivalent of USD 40M for the aeronautical equipment and the AUD equivalent of USD 8M for each of the engines.

Example 4

A *manufacturer's credit* which is provided in the form of a non-cash benefit and which is not convertible to cash

86. X Co and Airframe Co enter into a purchase and a letter agreement whereby X Co agrees to acquire an aircraft at a list price of USD 40M (includes airframes and engines).

87. X Co and Airframe Co also enter into a letter agreement which provides that in consideration for entering into the purchase agreement, X Co will receive a manufacturer's credit in the form of specific pilot training valued at USD 2M.

88. The aircraft is assigned prior to delivery to a financier for USD 40M. X Co becomes the end user of the aircraft through a lease agreement and the value of the aircraft under the lease amounts to USD 40M.

89. The pilot training is made available, pursuant to the terms of the letter agreement, on delivery of the aircraft.

90. The pilot training is not convertible to cash. However, subsection 21A(1) will treat the pilot training as convertible to cash and it will be an assessable benefit under subsection 25(1). The assessable income amount, in this case, may be reduced by the operation of the otherwise deductible rule under subsection 21A(3), to the extent that if X Co had incurred the expense on pilot training it would have given rise to a revenue expense and a deduction under subsection 51(1). Accordingly, the assessable income amount will be reduced to nil.

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