# *TD 93/D94 - Income tax: are lease payments allowable as a deduction under subsection 51(1) of the Income Tax Assessment Act 1936 where a previously owned asset is traded-in on the newly leased asset?*

**Draft Taxation Determinations (TDs) represent the preliminary, though considered, views of the ATO. Draft TDs may not be relied on; only final TDs are authoritative statements of the ATO.**

# Draft Taxation Determination

## Income tax: are lease payments allowable as a deduction under subsection 51(1) of the *Income Tax Assessment Act 1936* where a previously owned asset is traded-in on the newly leased asset?

1. Yes, where the lease agreement is for the full cost of the asset and the trade-in represents a lump sum rental payment or is used to reduce the monthly lease payments over the period of the lease.

2. This trade-in amount is subject to the provisions of Subdivision H of Division 3 of Part III. These provisions apply to spread the deductibility of pre-paid expenses over the period to which the payment relates, which is generally taken to be the term of the agreement. The trade-in value will be deductible over the term of the lease and the subsequent monthly lease payments will be deductible in the year they are incurred.

3. Where the lease agreement is for the reduced amount (after trade-in) and the transaction has the effect of creating a low residual value and the lessee or an associated entity has an option to purchase the property, the arrangement would be treated as a deferred purchase contract. A low residual value is usually regarded as being inconsistent with the provisions of a normal commercial lease. The trade-in would be treated as part of the purchase price and depreciation allowed to the extent of business use, provided the lessor is not claiming depreciation on the asset. The interest portion of the monthly payments would also be allowed, according to that business use.

4. A reasonable residual value for tax purposes is one that accurately reflects the true market value of the leased asset at the completion of the lease. Income Tax Ruling IT 28 sets out the basic test and provides general guidelines to assist in determining residual value. Compliance with IT 28 guidelines is not insisted on if an independent valuation of the market value is provided.

*Example 1*

*Maxine M owns a motor vehicle which she uses 100% for business purposes. On the 1 July she decides to upgrade her vehicle and decides to lease the new one over 4 years. As part of the lease agreement she receives a trade-in on the old vehicle of $10,000 which reduces the monthly lease payment from $365 to $215.*

*The amount received on trade-in is deductible over the term of the lease i.e. $2500 per year and the monthly lease payments made ($2580 p.a.) are deductible in the year they are incurred. The annual deduction is therefore $5080.*

*Example 2*

*Kevin C uses his vehicle in the course of carrying on his business. He decides to acquire a new vehicle under a lease agreement and trade-in his existing vehicle. As the result of this trade-in the residual value is reduced by $10,000 leaving a value well below the expected market value of the vehicle at the end of the lease. Under the agreement entered into he, or an associated entity of his, has an option to purchase the vehicle at the end of the 'lease'. There is no effect on the monthly payments as the result of the trade-in.*

*The agreement would be regarded as a deferred purchase agreement and the monthly lease payments treated as part of the capital cost of the vehicle. Provided the lessor is not claiming depreciation on the vehicle, depreciation to the extent of business use would be allowed annually and any interest component of the monthly payments allowed, according to that business use, in the year it is incurred.*

**Commissioner of Taxation**
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