

# ***IT 2496 - Income tax : deductibility of the cost of lease receivables***

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TAXATION RULING NO. IT 2496

INCOME TAX : DEDUCTIBILITY OF THE COST OF LEASE  
RECEIVABLES

F.O.I. EMBARGO: May be released

REF N.O. REF: 87/5235-4 DATE OF EFFECT: Immediate  
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F.O.I. INDEX DETAIL

| REFERENCE NO: | SUBJECT REFS:                             | LEGISLAT. REFS:          |
|---------------|-------------------------------------------|--------------------------|
| I 1010875     | LEASE RECEIVABLES<br>LIMITED PARTNERSHIPS | 51(1), 92(2)<br>Part IVA |

PREAMBLE This Ruling deals with the deductibility of expenditure incurred by a limited partnership to acquire income receivables. An example of such an acquisition is the assignment for consideration of rights to rental income under an existing lease of property.

2. The legal principles that govern the transfer of rights apply to proprietary rights, including choses in action. A presently existing right to future income from property, such as rent under an existing lease, is a chose in action which is assignable in law or in equity. Where the agreement involves an equitable assignment then the assignor becomes trustee for the assignee (per Mason J. in Booth v FC of T 87 ATC 5100 at 5102; 19 ATR 514 at 517).

3. Consideration was recently given to highly geared arrangements whereby taxpayers who become partners in a limited partnership claim deductions for partnership losses arising from the purchase or assignment for consideration of lease receivables. One such arrangement is outlined below:

- (i) Investors are invited by way of a publicly available prospectus to become partners in a limited partnership which will continue for 15 years. The partnership comprises limited partners, being the members of the public who invest, and a general partner representing the promoter who manages the partnership affairs. It is intended that the partnership will acquire lease receivables at a discounted rate - usually from a finance company - and will receive the rental income payable under the relevant leases over the period of the leases. The lease receivables are not purchased for resale.
- (ii) Each partner is required to make an initial minimum contribution of \$5,000. Approximately one third of this amount is payable as a once-only management fee. Assuming a \$5,000 investment this leaves a

balance of \$3,334 as the limited partner's equity.

- (iii) The general partner arranges for a loan of up to four times the partnership capital. (Partnership capital excludes management fees.)
- (iv) The total funds available to the partnership are then used to acquire lease receivables at a discounted rate.
- (v) In the first year of operation the partnership claims a deduction under section 51 for the full cost of the lease receivables. As little or no income is generated, the partnership is in a loss position and the partners claim a deduction under subsection 92(2) for their respective shares of the loss. The partnership also claims a deduction for the management fees paid to the general partner.
- (vi) In the second year of operation the loan and the interest in respect of the loan are repaid from the lease receipts. The net earnings are supplemented with a further loan and used to acquire more lease receivables. This procedure is repeated in subsequent years resulting in neither profits nor losses during the life of the partnership.
- (vii) At the end of 15 years the partnership is to be terminated and each partner is to receive a taxable distribution. These funds are to be used in part to repay outstanding loans and interest due.
- (viii) The liability of a limited partner is restricted by law to the amount originally invested.
- (ix) A limited partner can, subject to certain conditions, call upon the general partner at any time to acquire the limited partner's share in the partnership.

4. A partner is not guaranteed a return at the end of the 15 year period when the partnership is terminated. This will be dependent upon the rate of interest on the loans and the rate of discount obtained on the purchases of the lease receivables. Unless a partner exercises the option of requiring the general partner to repurchase his or her partnership interest, the partner will not obtain any tangible benefit from the partnership for a considerable period.

RULING

5. The limited partnership in acquiring lease receivables is purchasing income producing property, being choses in action which generate future income when the rentals become due and payable in accordance with the lease agreements. The choses in action are the partnership assets that generate the income. Accordingly, it is considered they represent the "sources of income" or "the profit-yielding subject" in the sense in which Dixon J. (as he was then) used those descriptions in Sun

Newspapers Ltd and Associated Newspapers Ltd v FCT (1938) 61 CLR 337 at pp.359-360. The assets acquired produce a benefit which endures for the period of the leases to which the assignments relate. It follows that the cost of acquiring the lease receivables is not deductible under subsection 51(1), being expenditure of a capital nature.

6. The management fee is a part of a larger amount paid as a capital contribution to the partnership by each limited partner. Where it is paid out of partnership capital the management fee is not a deductible expense to the partnership as it represents the payment of remuneration to the general partner (see Taxation Ruling No. IT 2218). Where it is paid by each limited partner, it represents a cost of entry to the partnership and is accordingly of a capital nature. Furthermore, it is not considered that the management fee is incurred in or for the purpose of gaining or producing assessable income and is not a deductible expense under subsection 51(1).

7. Having regard to the tax advantages sought in the arrangements outlined in paragraph 3 no assurance can be given that Part IVA will not apply.

COMMISSIONER OF TAXATION  
29 September 1988