



PR 2003/14 - Income tax: tax consequences for employees under the Toyota Financial Services Vehicle Leasing and Novation Arrangement

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 This document has changed over time. This is a consolidated version of the ruling which was published on *16 April 2003*

Product Ruling

Income tax: tax consequences for employees under the Toyota Financial Services Vehicle Leasing and Novation Arrangement

Contents	Para
What this Product ruling is about	1
Date of effect	8
Withdrawal	10
Arrangement	11
Ruling	16
Explanations	18
Detailed contents list	31

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Preamble

*The number, subject heading, and the **What this Product Ruling is about** (including **Tax law(s)**, **Class of persons** and **Qualifications** sections), **Date of effect**, **Withdrawal**, **Arrangement** and **Ruling** parts of this document are a 'public ruling' in terms of Part IVAAA of the **Taxation Administration Act 1953**. Product Ruling PR 1999/95 explains Product Rulings and Taxation Rulings TR 92/1 and TR 97/16 together explain when a Ruling is a public ruling and how it is binding on the Commissioner.*

No guarantee of commercial success

The Australian Taxation Office (ATO) does not sanction or guarantee this product. Further, we give no assurance that the product is commercially viable, that charges are reasonable, appropriate or represent industry norms, or that projected returns will be achieved or are reasonably based.

Participants must form their own view about the commercial and financial viability of the product. This will involve a consideration of important issues such as whether projected returns are realistic, the 'track record' of the management, the level of fees in comparison to similar products, how the investment fits an existing portfolio, etc. We recommend a financial (or other) adviser be consulted for such information.

This Product Ruling provides certainty for participants by confirming that the tax benefits set out below in the Ruling part of this document are available, provided that the arrangement is carried out in accordance with the information we have been given, and have described below in the Arrangement part of this document.

If the arrangement is not carried out as described below, participants lose the protection of this Product Ruling. Participants may wish to seek assurances from the promoter that the arrangement will be carried out as described in this Product Ruling.

Participants should be aware that the ATO will be undertaking review activities to confirm the arrangement has been implemented as described below and to ensure that the participants in the arrangement include in their income tax returns income derived in those future years.

Terms of use of this Product Ruling

This Product Ruling has been given on the basis that the person(s) who applied for the Ruling, and their associates, will abide by strict terms of use. Any failure to comply with the terms of use may lead to the withdrawal of this Ruling.

What this Product Ruling is about

1. This Ruling sets out the Commissioner's opinion on the way in which the 'tax laws' identified below apply to the defined class of person who takes part in the arrangement to which this Ruling relates. In this Ruling the arrangement is:

- the entering into of a lease (referred to in this Ruling as the 'Lease') of a motor vehicle by way of either Toyota Financial Services' Novated Finance Lease (referred to in this Ruling as the 'Finance Lease') or Toyota Financial Services' Novated Operating Lease (referred to in this Ruling as the 'Operating Lease'); and
- a novation agreement, named the 'Toyota Financial Services' Novation Agreement' (referred to in this Ruling as the 'TFS Novation Agreement').

2. This Ruling only addresses the tax consequences for the defined class of person where:

- the date of commencement of the TFS Novation Agreement is on or after the date of commencement of the Lease; and
- the Novation Period under the TFS Novation Agreement ends because of the expiry or termination of the Lease.

3. This Ruling does *not* address the tax consequences for the defined class of person:

- of any Indemnity Obligations under the Lease;
- in respect of any period of time between the commencement of the Lease and commencement of the TFS Novation Agreement; or
- in respect of the final day of the Lease where the Novation Period ends the day before the expiry of the Lease.

Tax law(s)

4. The tax laws dealt with in this Ruling are:

- section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997');
- section 6-10 (ITAA 1997);
- paragraph 23L(1)(a) of the *Income Tax Assessment Act 1936* ('ITAA 1936');

- Subdivisions 42A-A, 42A-B and 42A-C of Schedule 2E (ITAA 1936);
- section 42A-115 of Schedule 2E (ITAA 1936);
- section 42A-120 of Schedule 2E (ITAA 1936);
- section 7 of the *Fringe Benefits Tax Assessment Act 1986* ('FBTAA'); and
- section 136 (FBTAA).

Class of persons

5. The class of persons to whom this Ruling applies is those employees who enter into the arrangement described below after the date this ruling is made. In this ruling these persons are referred to as 'Employees'.

Qualifications

6. The Commissioner rules on the precise arrangement identified in the Ruling. If the arrangement described in the Ruling is materially different from the arrangement that is actually carried out, the Ruling has no binding effect on the Commissioner. The Ruling will be withdrawn or modified.

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Date of effect

8. This Ruling applies prospectively from 16 April 2003, the date this Ruling is made. However, the Ruling does not apply to taxpayers to the extent that it conflicts with the terms of settlement of a dispute agreed to before the date of issue of the Ruling (see paragraphs 21 and 22 of Taxation Ruling TR 92/20).

9. If a taxpayer has a more favourable private ruling (which is legally binding), the taxpayer can rely on the private ruling if the income year to which the private ruling relates has ended, or has commenced but not yet ended. However, if the arrangement covered by the private ruling has not begun to be carried out, and the income year to which it relates has not yet commenced, this Product Ruling applies to the taxpayer to the extent of the inconsistency only (see Taxation Determination TD 93/34).

Withdrawal

10. This Product Ruling is withdrawn and ceases to have effect after 30 June 2006. The Ruling continues to apply, in respect of the tax laws ruled upon, to all persons within the specified class who enter into the specified arrangement during the term of the Ruling. Thus, the Ruling continues to apply to those persons, even following its withdrawal, who entered into the specified arrangement prior to withdrawal of the Ruling. This is subject to there being no material difference in the arrangement or in the persons' involvement in the arrangement.

Arrangement

11. The arrangement that is subject to this Ruling is described below. This arrangement incorporates the following documents:

- Application for Product Ruling received from Corrs Chambers Westgarth on behalf of Toyota Finance Australia Limited dated 17 February 2003;
- Draft TFS Novation Agreement, received 17 February 2003;
- Draft TFS Novated Finance Lease Agreement, received 3 March 2003;
- Draft TFS Novated Operating Lease Agreement, received 3 March 2003; and

- Additional information provided by the Applicant on 20 February 2003 and 3 March 2003.

12. Toyota Financial Services (referred to in this Ruling as 'TFS') is a division of Toyota Finance Australia Limited (referred to in this Ruling as 'TFAL'). Under the TFS Novation Agreement, all of the obligations of a member of the defined class of person under the Lease, apart from those obligations known as the 'Indemnity Obligations', are assumed by a third party, being the employer of that member, for the duration of the Agreement. In this Ruling, the assumed obligations are referred to as the 'Novated Obligations', the period of duration of the TFS Novation Agreement is referred to as the 'Novation Period' and the third parties are referred to as 'Employers'.

13. The details of the aspects of the arrangement subject to this ruling are summarised as follows:

- (a) An Employee will:
- enter into either a Finance Lease or an Operating Lease over a motor vehicle with TFAL; and
 - will novate their obligations under the Lease, apart from the Indemnity Obligations, to their Employer by then entering into the TFS Novation Agreement.

The Lease

- (b) The Finance Lease and the Operating Lease are both standard form leases used by TFAL where the Novated Obligations will ultimately be assumed by an Employer under the terms of the TFS Novation Agreement;
- (c) The key features of the Finance Lease, as provided by the Terms and Conditions of that Lease, are as follows:
- The motor vehicle may be a luxury car;
 - The motor vehicle remains the property of TFAL;
 - The lessee is responsible for regular rental payments and the registration, repair, maintenance and insurance of the motor vehicle;
 - TFAL must offer to sell the motor vehicle at a public auction or attempt to re-lease the motor vehicle as soon as practicable after it is returned; and

- The lessee indemnifies TFAL against losses, claims, liabilities or expenses arising as a result of certain events, including where the Lease is terminated before the end of the term or where the Lease expires. The lessee must indemnify TFAL if the net sale or re-leasing proceeds received by TFAL after the return of the motor vehicle is less than the residual value or termination amount provided for under the Lease.
- (d) The key features of the Operating Lease, as provided by the Terms and Conditions of that Lease, are as follows:
- The motor vehicle cannot be a luxury car;
 - The motor vehicle remains the property of TFAL;
 - The lessee makes regular rental payments to TFAL in accordance with the terms set out in the Schedule to the Lease;
 - The lessee is responsible for the registration, repair, maintenance and insurance of the motor vehicle unless it is specified in the Details to the Lease that TFAL is to register and obtain third party insurance for the motor vehicle and/or the lessee elects that the amounts financed by the lease payments include certain vehicle maintenance services and insurance arrangements;
 - On the return of the motor vehicle at the expiry or termination of the Lease, the lessee is required to pay an amount to TFAL if the 'actual kilometre usage' during the Lease exceeded the 'maximum kilometre usage' specified in the Details to the Lease; and
 - The lessee indemnifies TFAL against losses, claims, liabilities or expenses arising as a result of certain events, including where the Lease is terminated before the end of the term.

The TFS Novation Agreement

- (e) The TFS Novation Agreement is a tripartite agreement entered into between TFAL, the Employee and the Employer in respect of the Lease; and
- (f) The key features of the TFS Novation Agreement, as provided for under the Terms and Conditions of that Agreement, are as follows:
 - The original Lease continues in full force during the Novation Period in accordance with its original terms as novated by the TFS Novation Agreement;
 - All of the obligations owed by the Employee under the Lease apart from the Indemnity Obligations are assumed by the Employer for the Novation Period;
 - The Employer must perform the Novated Obligations in favour of TFAL as if it was an original party to the Lease and is entitled to all the rights to which the lessee is entitled in relation to the Novated Obligations under the Lease;
 - The Employee will continue to be bound by the Indemnity Obligations for the period of the Lease, including the Novation Period. The Indemnity Obligations are those under the Lease to indemnify the Lessor as a result of the early termination or expiry of the Lease; and
 - In the context of a Finance Lease that has expired, the Indemnity Obligations ensure that the residual value of the vehicle, as calculated in accordance with the terms of the Lease, is realised on the sale or re-lease of the vehicle by TFAL.
 - The TFS Novation Period ends at the earliest of the following:
 - the day before the Lease expires;
 - the early termination of the Lease;
 - the expiry of one month's written notice given by the Employer to TFS of its wish to terminate the TFS Novation Agreement;

- the expiry of one month's written notice given by the Employer to TFS of the termination of the Employee's employment with the Employer; and
- the Employer commencing insolvency.
- At the expiry of the Novation Period, the Novated Obligations are novated back to the Employee. The Employee then resumes all of the rights and obligations under the Lease that were originally novated to the Employer; and
- The Employee will indemnify the Employer from any liability the Employer accrued in connection with the Lease and the TFS Novation Agreement for any period occurring after the Novation Period.

The Participants

14. TFAL originally provides a motor vehicle under a Lease to an Employee. TFAL and that Employee then enter into the TFS Novation Agreement with the Employer of that Employee.

15. Employees can only be individuals.

Ruling

16. Subject to the assumptions listed in paragraph 18 of this Ruling:

- (a) An Employee will not derive assessable income under sections 6-5 or 6-10 of the ITAA 1997 as a result of novating their lease payment obligations under the Lease by entering into the TFS Novation Agreement;
- (b) The income derived by the Employee through the provision of a car benefit is exempt income under paragraph 23L(1)(a) of the ITAA 1936; and
- (c) There are no income tax consequences for an Employee under Subdivisions 42A-A, 42A-B or 42A-C of Schedule 2E to the ITAA 1936 during the Novation Period under the TFS Novation Agreement in respect of a luxury car.

Assumptions

17. This Ruling is made on the basis of the following necessary assumptions:

- (a) the Employee receives, or is entitled to receive, salary and wages, as defined for the purposes of the FBTA, from their Employer;
- (b) the motor vehicle that is the subject of the Arrangement is not trading stock of the Employee or the Employer;
- (c) after the TFS Novation Agreement is entered into, the Employer, in respect of the employment of the Employee, will provide or make available the motor vehicle for the private use of the Employee or an associate of the Employee;
- (d) where a luxury car is the subject of the Arrangement:
 - the motor vehicle is one that would have its cost reduced under section 40-230 of the ITAA 1997 had the vehicle been bought by the Employee from TFAL when the Finance Lease was entered into for a price equal to the value of the vehicle for the purposes of the Lease; and
 - the terms 'lease', 'lessor' and 'lessee' have meanings as defined in section 42A-115 of Schedule 2E to the ITAA 1936.
- (e) the arrangement will be executed in the manner described in the 'Arrangement' section of this Ruling; and
- (f) all dealings by Employees, Employers and TFAL will be at arm's length.

Explanations

Sections 6-5 and 6-10 of the ITAA 1997: Novation of the Lease Payment Obligations

18. Under Division 6 of the ITAA 1997, assessable income consists of both ordinary income and statutory income. Section 6-5 of the ITAA 1997 sets out the rules for ordinary income and section 6-10 of the ITAA 1997 sets out the rules for statutory income.

19. Subsection 6-5(4) of the ITAA 1997 provides that an amount of ordinary income will be taken to be received as soon as it has been applied or dealt with in any way on behalf of or as directed by the taxpayer. Subsection 6-10(3) of the ITAA 1997 provides that an amount that would otherwise be statutory income of a taxpayer but for the fact that it is not received becomes statutory income of the taxpayer as soon as it is applied or dealt with in any way on behalf of or as directed by the taxpayer.

20. As a result of the TFS Novation Agreement, an Employer will make rental payments under the Lease to TFS. These payments are not amounts being paid on behalf of an Employee by the Employer. The payments are being made in respect of the rights and obligations that have been assumed by the Employer under the TFS Novation Agreement. Specifically, the payments are made in respect of the rights novated to the Employer set out in the Lease, such as the right of the Employer to obtain possession of the vehicle subject to the Lease for the duration of the Novation Period.

21. Accordingly, payments made under the Lease by the Employer as a result of entering into the TFS Novation Agreement will not constitute ordinary income derived by the Employee under section 6-5 of the ITAA 1997. Subsection 6-5(4) has no application because the amounts are not applied or dealt with on behalf of the Employee or as the Employee directs.

22. These payments will not constitute statutory income of the Employee under section 6-10 of the ITAA 1997. Subsection 6-10(3) has no application because the amounts are not applied or dealt with on behalf of the Employee or as the Employee directs.

23. Possession of the motor vehicle and all other obligations of the Lease are novated to the Employer, while the Indemnity Obligations remain with the Employee. There is not an actual transfer of the relevant rights and obligations, but rather an assumption by the Employer of those specific rights and obligations. The absence of a sub-lease under the TFS Novation Agreement means that an assessable benefit will not arise for an Employee in respect of the making of the lease payments under sections 6-5 or 6-10 of the ITAA 1997.

Paragraph 23L(1)(a) of the ITAA 1936: Provision of the Vehicle by the Employer for the Private Use of the Employee or an Associate of the Employee

24. Under the TFS Novation Agreement, the Employer will have possession of the motor vehicle for the duration of the Novation Period, as the Employer assumes all of the rights and obligations in respect of the Lease apart from the Indemnity Obligations.

25. Section 136 of the FBTAA defines a fringe benefit to mean a benefit provided to an employee or to an associate of the employee by an employer (or associate) in respect of the employment of the employee. Section 7 of the FBTAA provides that a car benefit will arise where a car is applied or is taken to be available for the private use of an employee or an associate of the employee and the benefit is provided by an employer or an associate of the employer in respect of the employee's employment. Where the Employer makes the vehicle available for the private use of the Employee or an associate of the Employee, a car fringe benefit will therefore arise under the definition of that term in section 136 of the FBTAA.

26. Under paragraph 23L(1)(a) of the ITAA 1936, where the Employee derives income by way of the provision of a car benefit, the income is exempt income.

Division 42A in Schedule 2E to the ITAA 1936: Leases over Luxury Motor Vehicles

27. Under Division 42A in Schedule 2E to the ITAA 1936 ('Schedule 2E'), the lease of a luxury car is treated as the sale of the motor vehicle by the lessor to the lessee, with the lessor providing a notional loan to the lessee to finance this notional acquisition of the vehicle. The requirements in section 42A-10 of Schedule 2E will be satisfied in respect of this arrangement.

28. At the time the TFS Novation Agreement is entered into, a lease has previously been entered into for the purposes of Schedule 2E. The relevant arrangement is the original Lease entered into between TFAL and the Employee. Prior to entering into the TFS Novation Agreement, TFAL is the lessor and the Employee is the lessee for the purposes of Schedule 2E. This means that the Employee is deemed to be the owner of the vehicle under subsection 42A-15(2) of Schedule 2E immediately prior to the TFS Novation Agreement being entered into.

29. The TFS Novation Agreement constitutes a new lease for the purposes of Schedule 2E. Subsection 42A-15(3) of Schedule 2E provides that the Employee ceases to be taken to be the owner of the car because the TFS Novation Agreement is an arrangement of a kind described in paragraph (b) of the definition of lease in section 42A-115 of Schedule 2E. TFAL remains the entity which is granting the right to use the car and therefore remains the lessor for the purposes of Schedule 2E. The Employer, as the entity to whom the right to use is granted, becomes the lessee for the purposes of Schedule 2E.

PR 2003/14

30. As the Employee is neither the lessor nor the lessee for the purposes of Schedule 2E during the Novation Period, there are no income tax consequences during this period for the Employee under Subdivisions 42A-A, 42A-B and 42A-C of Schedule 2E.

Detailed contents list

31. Below is a detailed contents list for this Product Ruling

	Paragraph
What this Product Ruling is about	1
Tax law(s)	4
Class of persons	5
Qualifications	6
Date of effect	8
Withdrawal	10
Arrangement	11
<i>The Lease</i>	13
<i>The TFS Novation Agreement</i>	13
The Participants	14
Ruling	16
Assumptions	17
Explanations	18
Sections 6-5 and 6-10 of the ITAA 1997: Novation of the Lease Payment Obligations	18
Paragraph 23L(1)(a) of the ITAA 1936: Provision of the Vehicle by the Employer for the Private Use of the Employee or an Associate of the Employee	24
Division 42A in Schedule 2E to the ITAA 1936: Leases over Luxury Motor Vehicles	27
Detailed contents list	31

Commissioner of Taxation

16 April 2003

Previous draft:

Not previously issued in draft form

Related Rulings/Determinations

TR 92/1; TR 92/20; TD 93/34;
TR 97/16; PR 1999/95

Subject references

- leasing
- vehicle leasing & hire
- luxury car lease
- car fringe benefits
- novation
- product rulings
- public rulings
- taxation administration

Legislative references

- Copyright Act 1968
- TAA 1953 Part IVAAA
- ITAA 1936 23L(1)(a)

- ITAA 1936 42A-A Sch 2E
- ITAA 1936 42A-10 Sch 2E
- ITAA 1936 42A-15(2) Sch 2E
- ITAA 1936 42A-15(3) Sch 2E
- ITAA 1936 42A-115 Sch 2E
- ITAA 1936 42A-B Sch 2E
- ITAA 1936 42A-C Sch 2E
- ITAA 1936 42A-115 Sch 2E
- ITAA 1936 42A-120 Sch 2E
- ITAA 1997 6-5
- ITAA 1997 6-5(4)
- ITAA 1997 6-10
- ITAA 1997 6-10(3)
- ITAA 1997 40-230
- FBTAA 1986 7
- FBTAA 1986 136

ATO references

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